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## Disruptive Philanthropy: Chan-Zuckerberg, the Limited Liability Company, and the Millionaire Next Door

Dana Brakman Reiser

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DISRUPTIVE PHILANTHROPY: CHAN-ZUCKERBERG, THE LIMITED LIABILITY COMPANY, AND THE MILLIONAIRE NEXT DOOR

*Dana Brakman Reiser\**

Facebook founder Mark Zuckerberg and his wife, Dr. Priscilla Chan, have pledged to give 99% of their net worth to—in their words—“advance[e] human potential and promot[e] equal opportunity.” To make good on this promise, however, they did not set up a traditional nonprofit, tax-exempt organization. Instead, they founded the Chan-Zuckerberg Initiative, a limited liability company (LLC). The bulk of this Article provides the definitive explanation for this seemingly bizarre choice. Importantly, the philanthropy LLC structure offers donors the flexibility to bolster charitable grantmaking with impact investment and political advocacy, free of the restrictions, penalties, and transparency requirements applied to tax-exempt vehicles. The LLC form also provides donors complete control over the organizations they found, including an ability to reclaim donated assets that is absolutely prohibited in traditional forms. With careful planning, all of these advantages can be gained at relatively little tax cost—especially in a post-2017 tax environment. The philanthropy LLC is poised to spread beyond Silicon Valley to the millionaire next door, a development with the potential to do both good and harm. In its concluding section, the Article explores how a turn to such disruptive philanthropic vehicles can both unleash tremendous capital for solving society’s most challenging problems and magnify the influence of its most powerful elites.

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INTRODUCTION

On the occasion of the birth of their first child, Facebook founder and billionaire Mark Zuckerberg and his wife, pediatrician Dr. Priscilla Chan, announced they would give 99% of their net worth to “advance human potential and promote equality for all children in the next generation.”<sup>1</sup> They published a long letter to their new daughter, Max, committing to this massive gift and identifying their “initial areas of focus [as] personalized learning, curing disease, connecting people and building strong communities.”<sup>2</sup> The letter connected their efforts to their career experiences as a social media entrepreneur and doctor/educator, and underscored their sense of responsibility to use their success to improve the lives of Max’s generation.<sup>3</sup> But they did not create a charity to helm their philanthropic efforts—they formed a limited liability company.

The moment was tender and the letter was heartfelt, yet reactions were mixed. Many lauded the generosity of Chan and Zuckerberg, linking their generosity to that of generations of America’s magnates-turned-

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1. Mark Zuckerberg, *A Letter to Our Daughter*, FACEBOOK (Dec. 1, 2015), <https://www.facebook.com/notes/mark-zuckerberg/a-letter-to-our-daughter/10153375081581634/>.

2. *Id.*

3. *See id.*

philanthropists from Carnegie and Rockefeller to Gates and Buffet's Giving Pledge.<sup>4</sup> Others were skeptical.<sup>5</sup>

Chan and Zuckerberg were relative novices in the philanthropy world. Chan had experience working with education and healthcare charities running back to her college days at least.<sup>6</sup> Her latest efforts created The Primary School, a nonprofit providing free preschool and primary education integrated with health care services for students in underserved Bay Area communities.<sup>7</sup> This ambitious project, however, was launched just two months before the couple's big announcement.<sup>8</sup> Zuckerberg had made his first foray into philanthropy with a huge and much ballyhooed donation to the Newark public schools in 2010.<sup>9</sup> That effort did nothing to establish his reputation for wisdom and efficacy as a philanthropist—

4. See, e.g., Fred Barbash, *Zuckerberg, Gates, Buffett and the Triumph of Competitive Philanthropy*, WASH. POST (Dec. 2, 2015), [https://www.washingtonpost.com/news/morning-mix/wp/2015/12/02/mark-zuckerberg-bill-gates-warren-buffett-and-triumph-of-competitive-philanthropy/?utm\\_term=.7b510479418e](https://www.washingtonpost.com/news/morning-mix/wp/2015/12/02/mark-zuckerberg-bill-gates-warren-buffett-and-triumph-of-competitive-philanthropy/?utm_term=.7b510479418e) (discussing how Gates and Buffett have created a philanthropic competition); Bill George, *America is in the Midst of a Philanthropic Revolution*, FORTUNE (Jan. 17, 2016), <http://fortune.com/2016/01/17/philanthropy-america-zuckerberg-gates/> (noting that American philanthropists are following a long line of benefactors); Bloomberg News, *Zuckerberg Philanthropy Pledge Sets New Giving Standard*, PRIVATE WEALTH (Dec. 2, 2015), <https://www.fa-mag.com/news/zuckerberg-philanthropy-pledge-sets-new-giving-standard-24088.html> (discussing how Zuckerberg's pledge is in the same league with other billionaires).

5. See, e.g., Leslie Lenkowsky, *Ending Philanthropy as We Know It*, WALL ST. J., Dec. 3, 2015, at A15 (noting the risks of the LLC structure, and for-profit efforts to solve social problems more generally, and opining that if CZI "succeeds, it may bring an end to philanthropy as we have known it"); Jesse Eisinger, *How Mark Zuckerberg's Altruism Helps Himself*, PROPUBLICA (Dec. 3, 2015), <https://www.propublica.org/article/how-mark-zuckerbergs-altruism-helps-himself> ("Mark Zuckerberg did not donate \$45 billion to charity. You may have heard that, but that was wrong."); David Olive, *Zuckerberg's \$46B Charitable Gift Not What it Seems*, TORONTO STAR (Dec. 11, 2015), <https://www.thestar.com/business/2015/12/11/zuckerbergs-46b-charitable-gift-not-what-it-seems.html> ("Writ large, these mega-donations by the super-wealthy amount to a creeping privatization of social-service provision. Or, put another way, they are the removal of democratic principles from the provision of essential societal needs. This 'black-box charity' is no solution.").

6. See Queenie Wong, *Priscilla Chan, In Rare Interview, Tells How Her Goals with Mark Zuckerberg Are Shaped by Personal Story*, SAN JOSE MERCURY NEWS (Apr. 1, 2016), <http://www.mercurynews.com/2016/04/01/priscilla-chan-in-rare-interview-tells-how-her-goals-with-mark-zuckerberg-are-shaped-by-personal-story/>.

7. See *Overview*, PRIMARY SCH., <https://www.theprimaryschool.org/overview/>.

8. See Wong, *supra* note 6.

9. The announcement of his donation was made on The Oprah Winfrey Show, to much fanfare. See *Mark Zuckerberg Announces \$100 Million Grant*, OPRAH.COM (Sept. 24, 2010), <http://www.oprah.com/own-oprahshow/mark-zuckerbergs-big-announcement-video> (providing a video clip of the broadcast); see also Richard Perez-Pena, *Facebook Founder to Donate \$100 Million to Help Remake Newark's Schools*, N.Y. TIMES (Sept. 22, 2010), <https://www.nytimes.com/2010/09/23/education/23newark.html> (detailing the gift).

it was widely regarded as a spectacular failure.<sup>10</sup> None of their efforts, of course, was on anything like the scale of the massive project the couple dubbed the Chan Zuckerberg Initiative (CZI).

CZI raises questions not only about competence, but also about power. This is not new. Big philanthropy has long raised concerns about the power it affords already potent elites. Andrew Carnegie's announcement that he planned to give away his fortune over a century ago was met with concerns about the provenance of his wealth—made on the backs of workers—and his apparent belief that he was better able to determine how to improve their lives than they would be.<sup>11</sup> When the ranks of industrialist do-gooders swelled in the early twentieth century, alarm over greed and paternalism was joined by charges that the foundations they established were antidemocratic.<sup>12</sup> Mid-century, these concerns culminated in tax reforms intended to prevent the wealthy from abusing philanthropic tax benefits and further concentrating their economic and political power through their charitable entities.<sup>13</sup> Critiques of elite philanthropy resurfaced around the expansion of the Gates Foundation, initiation of the Giving Pledge, and again with CZI. The arguments that charitable endeavors allow the wealthiest to sanitize their tremendous advantage and further increase their influence over society are persistent.

By organizing as a limited liability company, the Chan Zuckerberg Initiative avoids one particularly trenchant strain of this criticism. Donating funds to CZI does not create an immediate tax write-off for its founders.<sup>14</sup> Chan and Zuckerberg must pay federal and state tax on income they receive from CZI. They must pay state and local property taxes on any real estate it owns and sales taxes on any purchases it makes. If they die owning interests in it, these interests will be part of their taxable estates. CZI is simply not a tax-exempt institution, and cannot access the array of subsidies such entities receive.

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10. An exhaustive account of the donation and its aftermath can be found in DALE RUSSAKOFF, *THE PRIZE: WHO'S IN CHARGE OF AMERICA'S SCHOOLS* (2015).

11. See David Nasaw, *Looking the Carnegie Gift Horse in the Mouth: The 19th-Century Critique of Big Philanthropy*, SLATE (Nov. 10, 2006), [http://www.slate.com/articles/news\\_and\\_politics/history\\_lesson/2006/11/looking\\_the\\_carnegie\\_gift\\_horse\\_in\\_the\\_mouth.html](http://www.slate.com/articles/news_and_politics/history_lesson/2006/11/looking_the_carnegie_gift_horse_in_the_mouth.html).

12. See Rob Reich, *On the Role of Foundations in Democracies*, in PHILANTHROPY IN DEMOCRATIC SOCIETIES 64–65 (Rob Reich et al. eds., 2016) (describing the “fierce criticism” John D. Rockefeller received for his efforts in the early 1900s to create a philanthropic foundation perceived as antidemocratic).

13. See MARION R. FREMONT-SMITH, *GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION* 76–80 (2004); John G. Simon, *The Regulation of American Foundations: Looking Backward at the Tax Reform Act of 1969*, 6 VOLUNTAS 243, 243–46 (1995).

14. See Mark Zuckerberg, FACEBOOK (Dec. 3, 2015), <https://www.facebook.com/zuck/posts/10102507695055801?pnref=story>.

Still, to some, structuring CZI as an LLC raised alarm bells. Skeptics were anxious that there must be some nefarious reason for this nongift gift, prompting Zuckerberg to mount a defense of his unusual philanthropic vehicle.<sup>15</sup> But CZI is not the first philanthropic institution to adopt a for-profit form,<sup>16</sup> and there are numerous benign explanations for this organizational design.

For-profit vehicles for philanthropy, and particularly the philanthropy LLC model, provide founders substantial operational flexibility. Unlike nonprofit, tax-exempt entities, an LLC is free to combine traditional grantmaking with strategic investments and political advocacy. This freedom of approach, especially when combined with the far greater privacy and control an LLC provides, can understandably be worth trading for foregone tax benefits. The unusual nature of this philanthropic structure also fits the disruptive mantra that has driven so much of Silicon Valley's success.

The remainder of this Article will explore the future of this innovative structure and its consequences. Part I will describe philanthropy LLCs in action, first by chronicling the Chan Zuckerberg Initiative's first years, and then by connecting it with its predecessors and the broader Silicon Valley context in which it arose. The next two Parts consider the tradeoffs inherent in this particular kind of disruptive philanthropy. Part II traces the advantages philanthropy LLCs offer in operational flexibility, privacy, and control for founders, as compared with traditional nonprofit philanthropic vehicles. Part III evaluates the tax benefits a philanthropy LLC sacrifices, which are not as substantial as might be expected, and how changes affected by the 2017 tax legislation may further reduce those benefits. Part IV then asks whether the philanthropy LLC will remain an exclusive plaything of the ultra-rich, or will be attractive to other (merely) high-net-worth individuals. It also contemplates the impact widespread adoption of such structures would have on American philanthropy and society. Part V briefly concludes.

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15. See Zuckerberg, *supra* note 14 (“By using an LLC instead of a traditional foundation, we receive no tax benefit from transferring our shares to the Chan Zuckerberg Initiative, but we gain flexibility to execute our mission more effectively. In fact, if we transferred our shares to a traditional foundation, then we would have received an immediate tax benefit, but by using an LLC we do not. And just like everyone else, we will pay capital gains taxes when our shares are sold by the LLC.”).

16. Although LLC laws typically permit formation for “any lawful purpose,” see Robert Keatinge, *LLCs and Nonprofit Organizations—For-Profits, Nonprofits, and Hybrids*, 42 SUFFOLK U. L. REV. 553, 570–72 (2009) (describing these and other limitations), the form and its widespread use is associated with the for-profit sector.

## I. CZI AND THE PHILANTHROPY LLC MODEL

The Chan Zuckerberg Initiative is a very new organization, but it has already made some big bets. Its most significant charitable commitment came about a year after its inception, when CZI announced it would spend \$3 billion on medical research over the next ten years.<sup>17</sup> Twenty percent of this sum funded Biohub, a nonprofit research institution dedicated “to develop new technologies that will enable doctors to cure, prevent or manage all diseases during our children’s lifetime.”<sup>18</sup> Biohub partnered with Berkeley, Stanford, and the University of California San Francisco and inaugurated initiatives to map every type of human cell and to develop better diagnostic and treatment options for infectious diseases.<sup>19</sup>

CZI jumped into impact investing too—making investments designed to achieve a combination of financial and social returns. It made a \$24 million investment in Andela, a company that trains engineers in Africa for placement at top global technology firms, leading its Series B round.<sup>20</sup> It also acquired Meta—a Canadian startup that developed artificial intelligence technology to analyze and assimilate medical research data, making it more usable by scientists.<sup>21</sup> CZI plans to offer the research community free and open access to Meta’s tools,<sup>22</sup> and has announced a \$5.5 million grant to University of Massachusetts researchers to help develop them.<sup>23</sup>

The Initiative is also developing its advocacy program. It tapped David Plouffe, a former senior advisor to President Barack Obama, to lead its policy and advocacy efforts in early 2017.<sup>24</sup> Demonstrating political savvy right out of the gate, Plouffe’s hiring was announced alongside the appointment of Kenneth Mehlman, who managed President

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17. See Katie Benner, *Not Thinking Small for \$3 Billion Investment*, N.Y. TIMES, Sept. 22, 2016, at B6.

18. CHAN ZUCKERBERG BIOHUB, <https://czbiohub.org> (last visited Apr. 9, 2018).

19. See *id.*

20. See Nathan McAlone, *Mark Zuckerberg Just Made a Big Investment in a Startup That Pays Young People in Africa to Learn Code*, BUS. INSIDER (June 16, 2016, 7:00 AM), <http://www.businessinsider.com/chan-zuckerberg-initiative-leads-24-million-round-in-andela-2016-6>.

21. See Liat Clark, *Why the Chan Zuckerberg Initiative is Buying AI Search Tool Meta*, WIRED (Jan. 24, 2017), <http://www.wired.co.uk/article/chan-zuckerberg-initiative-buys-ai-scientific-search-tool-meta>.

22. See *id.*

23. See Katherine Conti, *UMass Gets Grant Funds from Chan Zuckerberg; Charity Will Back AI Research Tool Project*, BOSTON GLOBE (Jan. 16, 2018), <https://www.boston.com/news/education/2018/01/21/umass-is-getting-a-5-5-million-grant-from-the-chan-zuckerberg-initiative>.

24. See Mike Isaac, *Chan Zuckerberg Initiative Builds Political Muscle for Philanthropic Work*, N.Y. TIMES (Jan. 10, 2017), <https://www.nytimes.com/2017/01/10/technology/chan-zuckerberg-initiative-builds-political-muscle-for-philanthropic-work.html>.

George W. Bush's 2004 re-election, to lead CZI's policy advisory board.<sup>25</sup>

These early efforts take advantage of the flexible structure CZI's founders adopted. As an LLC, it can make both grants to nonprofit entities like a traditional foundation and equity investments and acquisitions like a venture capital or private equity fund.<sup>26</sup> Its policy efforts have not been as transparent—discretion being another boon of organization as an LLC—but they are unimpeded by the stringent regulatory limits that would apply to a tax-exempt nonprofit.

### A. *Disruptive Philanthropy Pioneers*

As deftly as CZI has employed disruptive philanthropy, it cannot claim to have invented it. Other Silicon Valley philanthropists pioneered the philanthropy LLC and for-profit philanthropy vehicles more generally. They too have used these creative structures to achieve operational flexibility, privacy, and control.

One of the earliest examples of the LLC structure is the Emerson Collective, founded by Laurene Powell Jobs in 2004.<sup>27</sup> Powell Jobs, the widow of Apple founder Steve Jobs, has a reported net worth of nearly \$20 billion.<sup>28</sup> She uses Emerson as a coordinated hub for her grantmaking, investment activity (particularly investment in social enterprises), and political action.<sup>29</sup> Emerson funds a number of nonprofits in the education space, including College Track, a nonprofit education and mentoring organization Powell Jobs founded prior to Emerson's creation,<sup>30</sup> and XQ: The Super School Project, a \$50 million project

25. *See id.*

26. *See About*, CHAN ZUCKERBERG INITIATIVE, <https://chanzuckerberg.com/about/> (last visited June 6, 2018) (“We look for bold ideas — regardless of structure and stage — and help them scale . . . . We make long-term investments because important breakthroughs often take decades, or even centuries.”). Previously, the CZI website was even more explicit about this issue. The prior version of the “About” page explained, “We invest in the best ideas regardless of organizational structure. That includes nonprofit and for profit entities, as well as non-governmental research institutions.” *See* Kate Bramson and Linda Borg, *Facebook founder Mark Zuckerberg visits Providence school, meets with governor*, PROVIDENCE J. (May 22, 2017, 9:08 PM); *Facebook founder Mark Zuckerberg visits Del Sesto Middle School*, ABC6 NEWS (Jun. 5, 2017, 5:39 PM) (quoting this language).

27. *See Company Overview of The Emerson Collective LLC*, BLOOMBERG, <https://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=263956917>.

28. *See Laurene Powell Jobs & Family: Real Time Net Worth*, FORBES, <https://www.forbes.com/profile/laurene-powell-jobs/>.

29. *See Our Mission*, EMERSON COLLECTIVE, <http://www.emersoncollective.com/about-us>.

30. *See Our History*, C. TRACK, <https://collegetrack.org/who-we-are/our-history/> (last visited June 9, 2018) (describing its founding, by Ms. Powell Jobs and Carlos Watson, in the 1990s).



initiated in 2015 to rethink public high schools.<sup>31</sup> Emerson's investments have been eclectic, in recent years ranging from providing seed funding to education and health technology startups; to leading a Series A round for Neighborly, an online broker for municipal bonds;<sup>32</sup> to buying a majority stake in *The Atlantic*.<sup>33</sup> Emerson also cites immigration reform among its priorities,<sup>34</sup> and can use advocacy and political contributions to pursue it. The Emerson Collective's long tenure and deep pockets suggest these publicized efforts may only scratch the surface of its activities. Ms. Powell Jobs is famously private,<sup>35</sup> preferring anonymous gifts and the retreat from the spotlight that Emerson's LLC structure facilitates.

In 1995, eBay founder Pierre Omidyar and his wife, Pam, began their organized philanthropic efforts by creating a traditional nonprofit foundation. In 2004, however, they established an LLC to broaden the types of strategies they could use to achieve their philanthropic goals.<sup>36</sup> Operating together and now known as The Omidyar Network, the nonprofit private foundation continues to make grants primarily to operating charities while the LLC arm makes impact investments intended to drive social change.<sup>37</sup> Both types of efforts stretch across a range of issue areas, from education to financial inclusion.<sup>38</sup> The Omidyar Network has also become an advocate for the value of impact investing. It warns that “[I]eaving the markets out of our efforts to tackle society's most intractable problems ignores a powerful force for identifying viable

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31. See *Who We Are*, XQ, <https://xqsuperschool.org/whoweare> (last visited June 9, 2018) (noting that Laurene Powell Jobs chairs the XQ board).

32. Jase Wilson, *Neighborly Raised a Series A*, NEIGHBORLY (May 16, 2017), <https://neighborly.com/learn/neighborly-raised-series>.

33. See Gillian B. White, *Emerson Collective Acquires Majority Stake in the Atlantic*, ATLANTIC (July 28, 2017), <https://www.theatlantic.com/business/archive/2017/07/emerson-collective-atlantic-coalition/535215/>.

34. See *Immigration*, EMERSON COLLECTIVE, <http://www.emersoncollective.com/immigration/>.

35. See Peter Lattman & Claire Cain Miller, *A Modest Billionaire Makes Her Way Onto the Philanthropic Stage*, N.Y. TIMES, May 17, 2013, at B1 (“Famous because of her last name and fortune, she has always been private and publicity-averse.”).

36. See *Why a Hybrid Structure?*, OMIDYAR NETWORK (June 26, 2017), <https://www.omidyar.com/spotlight/why-hybrid-structure#content>.

37. See *id.*

38. See *Investees*, OMIDYAR NETWORK, <https://www.omidyar.com/investees>; see also Kevin Johnson, *A Peek Inside Omidyar Network's Methodology for Making Grants and Investments*, NONPROFIT Q. (Nov. 30, 2016), <https://nonprofitquarterly.org/2016/11/30/peek-inside-omidyar-networks-methodology-making-grants-investments/> (describing, for example, investments in insurance for the developing world).

solutions that can scale to help millions.”<sup>39</sup> Its tandem approach gives it access to the best of both worlds—nonprofit and for-profit philanthropy—and it tailors the capital it provides to the needs of particular issues, organizations, and geographies.<sup>40</sup>

While not the project of an individual philanthropist, the creation of Google.org in 2008 is another important antecedent. Google, Inc. had a traditional corporate foundation,<sup>41</sup> but it changed course when it established an in-house division dedicated to philanthropy. Google.org has evolved and shifted its approach over time, and now describes its mission as “accelerat[ing] the progress of innovative nonprofits by connecting them to the best of Google.”<sup>42</sup> Initially, though, Google.org had much in common with the philanthropy LLC structures of Emerson and Omidyar. It made investments in for-profits alongside charitable grants in its climate change, public health, and antipoverty areas of focus, and its efforts all leveraged its deep technology expertise.<sup>43</sup> Launching these initiatives within a traditional nonprofit foundation would have risked violating a number of tax regulations.<sup>44</sup> In contrast, the for-profit philanthropy strategy gave Google’s leaders operational flexibility, along with valuable privacy and ultimate control.<sup>45</sup>

Corporate experimentation with for-profit philanthropy has even spread beyond Silicon Valley. General Motors (GM) announced last year that as part of “overhauling its \$30-million-a-year philanthropy efforts to focus on high-tech education, safety and economic sustainability,” it would shutter its longstanding General Motors Foundation.<sup>46</sup> Going forward, GM’s philanthropy would be coordinated by its internal Global Corporate Giving department and grants would be made directly by the corporation.<sup>47</sup> Like Google, GM made the move to enhance operational flexibility and improve the coordination of its business and philanthropic strategies.<sup>48</sup>

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39. *Impact Investing*, OMIDYAR NETWORK, <https://www.omidyar.com/our-work/impact-investing>.

40. *See id.*

41. Google Inc., Registration Statement (Form S-1), at vi (Aug. 18, 2004), <https://www.sec.gov/Archives/edgar/data/1288776/000119312504073639/ds1.htm> (noting the establishment of the Google Foundation).

42. *Our Work*, GOOGLE.ORG, <https://www.google.org/our-work/>.

43. *See* Dana Brakman Reiser, *For-Profit Philanthropy*, 77 *FORDHAM L. REV.* 2437, 2440–42 (2009).

44. *See id.* at 2452–62.

45. *Id.*

46. Melissa Burden, *GM to End Foundation, Redirect its Charitable Giving*, *DETROIT NEWS* (June 12, 2017), <https://www.detroitnews.com/story/business/autos/general-motors/2017/06/12/gm-giving/102764328/>.

47. *Id.*

48. *See id.*

### B. *A Silicon Valley Development*

The GM development aside, for-profit philanthropy is very much associated with wealth generated by technology entrepreneurs in Silicon Valley. It is no accident that CZI and its predecessor philanthropy LLCs are all funded with tech wealth germinated there. Tech companies in Silicon Valley are certainly not the first to seize the mantle of corporate social responsibility. But they do make some of the boldest claims about the power of their businesses to solve social problems. Just last summer, Facebook announced a revision of its mission statement to “Give people the power to build community and bring the world closer together.”<sup>49</sup> Using for-profit structures for philanthropy aligns with this ethic of blurring the boundary between generating profit and social good. Others might find the premise of for-profit philanthropy oxymoronic, if not unnerving. Entrepreneurs who view their behemoth for-profit businesses as catalysts for saving the world are instead drawn to it.

The idea of using a for-profit entity to pursue social good also fits seamlessly with the ethos of disruption that marks Silicon Valley culture. Fortunes are not built in the Valley by building a better mousetrap, but by reimagining an old industry or creating a new one from whole cloth. Disruption is not just a catchword for those who find ultimate success there. As David Callahan explains in his 2017 book on elite philanthropists, this “disruptor” group’s ability to see how to disrupt an industry is the key reason for their success and becomes an important part of its members’ self-concepts.<sup>50</sup> Along the way, the top echelons of Silicon Valley billionaires develop a deep belief in the value of experimentation, of skepticism, and even of failure.

When they turn to philanthropic pursuits, they take these values with them. Using a typically for-profit structure to house a philanthropic institution is just the kind of off-the-wall idea that is prized in Silicon Valley: what they might call disruptive philanthropy. For a billionaire in a hoodie out to “move fast and break things,”<sup>51</sup> shaking up the fusty private foundation “suits” is an attractive end in itself. If disruptive philanthropy will also give a founder flexibility, avoid regulatory complications, and enhance privacy—all without much foregone tax benefit—so much the better.

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49. *About*, FACEBOOK, <https://www.facebook.com/pg/facebook/about/>; see also Josh Constine, *Facebook Changes Mission Statement to ‘Bring the World Closer Together,’* TECH CRUNCH (June 22, 2017), <https://techcrunch.com/2017/06/22/bring-the-world-closer-together/> (describing the change).

50. See DAVID CALLAHAN, *THE GIVERS: WEALTH, POWER, AND PHILANTHROPY IN A NEW GILDED AGE* 112–35 (2017).

51. Nick Statt, *Zuckerberg: ‘Move Fast and Break Things’ Isn’t how Facebook Operates Anymore*, CNET (Apr. 30, 2017, 10:30 AM), <https://www.cnet.com/news/zuckerberg-move-fast-and-break-things-isnt-how-we-operate-anymore/>.

## II. BENEFITS OF THE TRADEOFF

Make no mistake: The LLC structure offers philanthropists very significant benefits. First among these is flexibility—an LLC can make grants to nonprofits, but it can also make investments in for-profits, participate deeply in politics and advocacy, and work synergistically with its employees, owners, and their other business interests. Its nimbleness means a founder can establish an LLC as a one-stop shop capable of doing everything she might want to achieve philanthropically within a single entity. Alternatively, the LLC’s almost endlessly flexible nature also allows it to serve as the coordinating vehicle for a philanthropic program that includes a variety of strategies, some of which can be pursued through other entities the LLC controls. The examples above show both models already in use.

But operational flexibility is far from the LLC’s only advantage. An LLC also affords its founders abundant privacy, especially as compared to a tax-exempt nonprofit vehicle. For wealthy individuals keenly aware that information is power, the ability to disclose selectively is valuable indeed. Finally, an LLC structure empowers philanthropists who adopt it with virtually absolute control. LLC law imposes few mandates, and allows founders to design governance as they wish. They even hold the ultimate power to exit. If their generosity or their fortunes wane, philanthropy LLC founders can change their minds and reclaim their assets.

### A. *Operational Flexibility*

An LLC’s malleability would be a desirable feature all on its own, but this advantage is enhanced by an LLC’s ability to engage in so many and varied activities with very little regulation. In contrast, federal tax rules and state organizational law impose myriad limits on a nonprofit philanthropy’s investments and business relationships, harshly penalizing those who exceed them. Moreover, to retain tax exemption and avoid penalties, nonprofit philanthropic vehicles can engage in very limited political activity—some none at all. As Part IV will discuss, the lack of regulation of philanthropy LLCs does raise concerns for society. For their philanthropist founders, though, it is indisputably a selling point.

Much of the comparative advantage of an LLC structure with respect to regulation lies in avoiding the federal tax code’s strictures for “private foundations,” a subcategory of § 501(c)(3) tax-exempt organizations. The statutory and regulatory tests for designation as a private foundation are lengthy and complex.<sup>52</sup> To summarize: A private foundation is (1) a

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52. See JAMES J. FISHMAN ET AL., *NONPROFIT ORGANIZATIONS: CASES AND MATERIALS* 679–704 (5th ed. 2015) (explaining the details of the tests over twenty-five densely packed pages); see also I.R.C. §§ 170, 509 (2018) (the statutes from which the tests arise).

nonprofit, § 501(c)(3) tax-exempt organization; (2) that is funded predominantly by a single or small set of donors; and (3) that pursues its mission primarily by enabling the efforts of other organizations rather than running its own charitable programs.<sup>53</sup>

Individuals or families desiring to establish a tax-exempt philanthropic vehicle of their own will almost always fall within this definition, rather than qualifying as less regulated and more tax-advantaged “public charities.” The resulting organizations will therefore be subject to the restrictive private foundation rules.<sup>54</sup> The limitations these rules impose span many topics, including investment practices, political activity, and relationships between the foundation and its leaders and donors. Had Chan and Zuckerberg formed a tax-exempt entity to distribute their wealth, it would have been deemed a private foundation and forced to contend with this army of restrictions.<sup>55</sup> An LLC structure neatly avoids them.

### 1. Investment Choices

Chan, Zuckerberg, and their precursors believe in the power of business as a force for good. They see the value their technology businesses have brought to society and believe many social problems can be solved by entrepreneurs. To that end, they see investment in social enterprises as an important component of their philanthropic programs. They are not alone. In a 2016 survey of wealthy donors, thirty-three percent of these high-net-worth individuals reported that they “participate

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53. See FISHMAN ET AL., *supra* note 52, at 679–704 (5th ed. 2015); I.R.C. §§ 170, 509 (2018). An LLC can seek tax-exempt status, but only if its members are § 501(c)(3) exempt organizations or governmental entities, a hurdle CZI and the other philanthropist-owned LLCs discussed here could not clear. See Keatinge, *supra* note 16, at 574 (describing these and other limitations).

54. Donors who establish a “donor-advised fund” account within a public charity, discussed *infra* at notes 196–201 and accompanying text, can escape some of the private foundation restrictions.

55. Chan and Zuckerberg do have a private foundation, but it is not the coordinating vehicle for their philanthropic efforts. In 2016, the most recent year for which disclosures are available, it was used to make charitable contributions funded by transfers from CZI. See Chan Zuckerberg Foundation, Form 990-PF (2016), <https://www.guidestar.org/FinDocuments/2016/455/002/2016-455002209-0e86d20b-F.pdf> (showing the Foundation was the recipient of over \$1 billion in Facebook stock from the Initiative and granted approximately \$21 million to two public charities); see also *supra* notes 7–8 and 18–19 and accompanying text (describing the Primary School and the Biohub project). Filings for prior years show minimal contributions and grants. See Chan Zuckerberg Foundation Form 990-PF (2015), <https://www.guidestar.org/FinDocuments/2015/455/002/2015-455002209-0d500d0b-F.pdf>; Chan Zuckerberg Foundation Form 990-PF (2014); <https://www.guidestar.org/FinDocuments/2014/455/002/2014-455002209-0c175ef6-F.pdf> (showing the Guidestar report of this form, in the name of The Openness Trust, as the 2014 disclosure of the Chan Zuckerberg Foundation).

in impact investing.”<sup>56</sup> Where an LLC offers philanthropists a wide berth to engage in this kind of blended investment activity, private foundations are subject to a raft of burdensome—sometimes even prohibitive—regulatory restrictions.

Federal tax law most forcefully constrains private foundations’ investments by imposing serious, and potentially confiscatory, excise taxes on foundations that hold too large a stake in any business enterprise.<sup>57</sup> The baseline rule allows foundations to hold up to twenty percent of a corporation’s voting stock.<sup>58</sup> This ceiling can vary in either direction, depending on the circumstances. The permissible limit is reduced by the holdings of the foundation’s leaders or substantial contributors;<sup>59</sup> it is increased to thirty-five percent if unrelated persons have “effective control” of the corporation in which the foundation invests.<sup>60</sup> Private foundations that receive such excess business holdings by gift or bequest need not disclaim the assets or sell them in an immediate fire sale, but they must dispose of them within five years.<sup>61</sup> If they do not, the excess holdings will be subject to a whopping 200% tax.<sup>62</sup>

This excess-business-holdings regime creates two different sorts of problems for entrepreneurs turned philanthropists. First, it can impose a timeline for relinquishing control over their companies. For those like Pierre Omidyar, who no longer owns anything close to twenty percent of eBay and stepped away from active control of the company years ago, relinquishing control is a nonissue.<sup>63</sup> But founders in the Zuckerberg mold will fiercely resist divestiture. Zuckerberg is thirty-four years old and has no intention of giving up control of Facebook’s voting stock or daily business operations anytime soon.<sup>64</sup> Yet much of his wealth is tied up in the company.<sup>65</sup> He would need to donate his controlling interest to

56. U.S. TR. & THE LILLY FAMILY SCH. OF PHILANTHROPY, THE 2016 U.S. TRUST STUDY OF HIGH NET WORTH PHILANTHROPY: CHARITABLE PRACTICES AND PREFERENCES OF WEALTHY HOUSEHOLDS 77, [http://www.ustrust.com/publish/content/application/pdf/GWMOL/USTp\\_ARMCGDN7\\_oct\\_2017.pdf](http://www.ustrust.com/publish/content/application/pdf/GWMOL/USTp_ARMCGDN7_oct_2017.pdf).

57. I.R.C. § 4943(a)(1).

58. *Id.* § 4943(c)(2)(A).

59. *Id.*

60. *Id.* § 4943(c)(2)(B).

61. *Id.* § 4943(c)(6). Under certain circumstances, a private foundation may obtain an additional five-year extension from the Secretary of the Treasury. *Id.* § 4943(c)(7).

62. *Id.* § 4943(b).

63. See Ed Lin, *Pierre Omidyar Trims Stakes in eBay, PayPal*, BARRON’S (Feb. 14, 2018), <https://www.barrons.com/articles/pierre-omidyar-trims-stakes-in-ebay-paypal-1518632718>.

64. See, e.g., Kathleen Chaykowski, *How Facebook is Making Sure Zuckerberg Stays in Control Forever*, FORBES (Apr. 27, 2016), <https://www.forbes.com/sites/kathleenchaykowski/2016/04/27/how-facebook-is-making-sure-zuckerberg-stays-in-control-forever/#2b4d3ac4e97c>.

65. Lisa Marie Segarra, *Mark Zuckerberg Just Became the World’s Fifth Richest Person*, MONEY (July 27, 2017), <http://time.com/money/4877281/mark-zuckerberg-facebook-worlds->

his philanthropy to make good on his ninety-nine percent pledge.<sup>66</sup> If the philanthropy was structured as a private foundation, in just a few years, the excess business holdings rules would require the foundation to sell this large stake in Facebook to investors over which Zuckerberg has no sway.

Congress intended the rules to function this way—to combat concerns “that some foundation managers were investing foundation assets in enterprises in which their donors also had a personal interest and were operating them in a manner that provided more benefit to the donors than to the public.”<sup>67</sup> Despite some strong criticism, the excess business holdings rules remain on the books.<sup>68</sup>

This regime would understandably sour philanthropists like Zuckerberg on private foundations.<sup>69</sup> Zuckerberg is set on remaining in control of Facebook.<sup>70</sup> In fact, he was originally unwilling even to transfer his voting control over Facebook to the Initiative he and his wife fully control.<sup>71</sup> (This is not so surprising considering that the LLC would eventually need to divest its shares to fund its charitable, investment, and political activities.) Soon after CZI’s founding, Zuckerberg proposed that the Facebook board reorganize the company’s capital structure.<sup>72</sup> The

richest-person/.

66. See Zuckerberg, *supra* note 1 (discussing the ninety-nine percent pledge).

67. FREMONT-SMITH, *supra* note 13, at 276; see also Richard Schmalbeck, *Reconsidering Private Foundation Investment Limitations*, 58 TAX L. REV. 59, 68–93 (2004) (comprehensively reviewing and critiquing the rationales behind the excess business holdings rules).

68. Newman’s Own Foundation, a frequent critic of the excess-business-holdings regime, narrowly failed to obtain an exemption from the excess-business-holdings regime for itself and other foundations like it as part of the 2017 tax legislation. See Ana Radelat, *Tax Bill Glitch Endangers Future of Newman’s Own and Actor’s Foundation*, CONN. MIRROR (Dec. 21, 2017), <https://ctmirror.org/2017/12/21/tax-bill-glitch-endangers-future-of-newmans-own-and-actors-foundation/>. It did not, however, have to wait long for another bite at the apple. This time was more successful, and the February 2018 Bipartisan Budget Act contains an exemption to the rules for foundations that: (1) own 100% of the business; (2) receive their holdings other than by purchase; (3) operate independently from the business enterprise; and (4) donate all of their profits to charity. See I.R.C. § 4943(g) (2018); see also Ana Radelat, *Budget Deal has Plenty for Connecticut*, CONN. MIRROR (Feb. 9, 2018), <https://ctmirror.org/2018/02/09/senate-stumbles-on-way-to-vote-on-budget-bill-with-plenty-for-ct/> (explaining that the exemption allowed Newman’s Own to avoid the 200% excess business holdings tax). The contributions planned by donors addressed here, however, would not fit within this new exemption.

69. Richard Schmalbeck predicted just such discomfort among self-made multimillionaires more than a decade ago. See Schmalbeck, *supra* note 67, at 105–06. He also expected such individuals to search for private foundation alternatives, *see id.* at 105–08, but he did not anticipate their use of philanthropy LLCs.

70. See Chaykowski, *supra* note 64.

71. See Erin Griffith, *Mark Zuckerberg Controls Facebook and He Intends to Keep it That Way*, FORTUNE (Apr. 27, 2016), <http://fortune.com/2016/04/27/zuckerberg-facebook-control/>.

72. *See id.*

new structure would have allowed him to donate large numbers of economically valuable but nonvoting shares to the Initiative while maintaining voting control of the company.<sup>73</sup>

Here's how it worked. Facebook already had dual-class stock, with Class B shares owned by Zuckerberg and other executives enjoying a ten-to-one voting advantage over publicly-traded Class A shares.<sup>74</sup> The plan, which the board approved but delayed executing due to shareholder litigation,<sup>75</sup> would have issued a dividend of two shares of a new Class C stock to each holder of either Class A or B shares.<sup>76</sup> The Class C shares would have had the same economic rights as Class A and B shares, but no voting rights.<sup>77</sup> After the dividend, Zuckerberg would have been able to donate his new Class C shares to CZI while maintaining control through his super-voting Class B holdings.<sup>78</sup> The LLC could sell those Class C shares to institutional investors, mom and pop, or my Aunt Mary—it still wouldn't undermine Zuckerberg's control of Facebook.

Not all entrepreneurs can use this particular dodge. Creating a dual-class structure midstream is difficult.<sup>79</sup> Some philanthropists will not helm companies that conveniently already have one in place—though the number of companies adopting them is large and growing, particularly in the tech field.<sup>80</sup> Even philanthropists with a dual-class structure at their

73. *See id.*

74. *See* Kurt Wagner, *How Can Zuckerberg Give Away All That Stock and Still Control Facebook?*, RECODE (Dec. 14, 2015), <https://www.recode.net/2015/12/14/11621416/how-can-mark-zuckerberg-give-away-stock-and-while-still-controlling>.

75. *See* Second Stipulation and Order Governing Case Schedule at 3, *In re Facebook, Inc. Class C Reclassification Litig.*, No. 122286-VCL (Del. Ch. Ct. Mar. 21, 2017) (“Facebook, Inc. shall not effect the amendment of its certificate of incorporation and stock reclassification that is the subject of this litigation during the pendency of proceedings in this Court.”). As explained below, events overtook the case, and it never went to trial. *See* Stipulation and Order Dismissing Action as Moot and Retaining Jurisdiction to Determine Plaintiffs’ Counsel’s Application for an Award of Attorneys’ Fees and Reimbursement of Expenses at 4, *In re Facebook, Inc. Class C Reclassification Litig.*, No. 122286-VCL (Del. Ch. Ct. Sept. 26, 2017) [hereinafter Order Dismissing Action].

76. *See* Colin Stretch, *Preserving Founder-Led Structure to Focus on the Long Term*, FACEBOOK (Apr. 27, 2016), <https://newsroom.fb.com/news/2016/04/q1-earnings-note/> (announcing the plan to shareholders).

77. *See id.*

78. *See id.*

79. For example, while companies newly going public can adopt a dual-class structure, the NYSE restricts its listed companies from undertaking a midstream reclassification to create a dual-class structure. *See* NYSE, LISTED COMPANY MANUAL §§ 313.00(A), 313.10 (2018), [http://wallstreet.cch.com/LCMTTools/PlatformViewer.asp?selectednode=chp\\_1\\_4&manual=%2Flcm%2Fsections%2Flcm-sections%2F](http://wallstreet.cch.com/LCMTTools/PlatformViewer.asp?selectednode=chp_1_4&manual=%2Flcm%2Fsections%2Flcm-sections%2F).

80. *See* Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585, 594 (2017) (“[T]here has been an upward trend in the adoption of dual-class stock since Google went public with a dual-class structure in 2004 and was followed



disposal may be unable convince their boards to adopt a plan like Zuckerberg's. It also remains to be seen if courts will balk at such moves, and the challenge to Facebook's plan will not provide any answers. On the eve of trial in late September 2017, with his company under fire due to the Russian election meddling scandal, Zuckerberg asked the Facebook board to abandon it.<sup>81</sup> It complied, and the court dismissed the case as moot.<sup>82</sup>

However the corporate law question is resolved, the nonvoting share gambit will not evade the excess-business-holdings regime. Section 4943 treats nonvoting shares held by a private foundation as permitted holdings only so long its leaders and substantial contributors own no more than twenty percent of the voting stock.<sup>83</sup> Zuckerberg and CZI could not have taken refuge in this safe harbor. The plan to develop and donate Class C shares was intended specifically to ensure Zuckerberg would remain in control of far more than twenty percent of Facebook's voting shares. Had he created a private foundation, the excess business holdings rules would have required it to divest on the government's timeline or turn over billions to the federal treasury.

The excess-business-holdings regime also creates a second problem: impeding particular investment strategies. Consider Powell Jobs' Emerson Initiative. Venture-capital-like investment is a major part of its activities, participating in over a dozen rounds of funding for social enterprise startups over the last five years—often as the lead investor.<sup>84</sup> Emerson has also invested in more established firms that it believes will make an impact in its areas of interest. For example, in 2016 it acquired “a significant minority stake in Anonymous Content, the production and management company behind the Oscar-winning film *Spotlight*” to harness “the power of storytelling to shape our culture and improve lives.”<sup>85</sup> Last year it bought majority control in *The Atlantic*.<sup>86</sup> The

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by well-known tech companies, such as Facebook, Groupon, LinkedIn, Snap, Trip Advisor, and Zynga.”).

81. See Mark Zuckerberg, FACEBOOK (Sept. 22, 2017), [https://www.facebook.com/search/top/?q=mark%20zuckerberg%20stock%20reclassification&filters\\_rp\\_author=%7B%22name%22%3A%22author%22%2C%22args%22%3A%224%22%7D](https://www.facebook.com/search/top/?q=mark%20zuckerberg%20stock%20reclassification&filters_rp_author=%7B%22name%22%3A%22author%22%2C%22args%22%3A%224%22%7D) (“I've asked our board to withdraw the proposal to reclassify our stock – and the board has agreed.”).

82. See Order Dismissing Action, *supra* note 75.

83. See I.R.C. § 4943 (2018); Treas. Reg. § 53.4943-3(b)(2) (1977).

84. See *Emerson Collective: Investments*, CRUNCHBASE, [https://www.crunchbase.com/organization/emerson-collective/investments/investments\\_list#section-investments](https://www.crunchbase.com/organization/emerson-collective/investments/investments_list#section-investments) (last visited June 9, 2018).

85. Matthew Belloni, *Laurene Powell Jobs Goes Hollywood, Buys Minority Stake in “Spotlight” Producer Anonymous Content*, HOLLYWOOD REP. (Sept. 30, 2016, 7:37 AM), <http://www.hollywoodreporter.com/news/laurene-powell-jobs-takes-minority-934139>.

86. See White, *supra* note 33.

precise stakes involved in these deals are often undisclosed, but when Emerson acts as lead investor, stakes over the excess business holdings limits will not be unusual.<sup>87</sup> As an LLC, though, Emerson need not concern itself with these restrictions.

A philanthropy LLC means no regulatory regime will set the schedule for disposing of a founder's stock in his or her company.<sup>88</sup> Owners can contribute whatever assets they wish to their philanthropic ventures, and they may impose any time horizon they choose for divestiture. They can likewise opt to purchase positions of any size they desire in the investee companies they select. They can structure their investments based on the business and impact value of each deal, with no externally imposed regulatory ceilings. They sit, happily and unimpeded by regulation, in the driver's seat.

But the headaches for private foundations seeking flexibility for their investment operations do not end with the excess business holdings rules. State law duties of care and prudence require their charitable fiduciaries to make investment decisions as would a prudent person, and often prize diversification.<sup>89</sup> Section 4944 of the federal tax code doubles down on this idea. "If a private foundation invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes," excise taxes apply to both the entity and its management.<sup>90</sup> Treasury regulations impose a standard of ordinary business care and prudence to avoid these penalties, which is applied investment-by-investment, as of the time the investment was made, and in relation to the foundation's complete investment portfolio.<sup>91</sup> These standards, and their heavy reliance on diversification, create serious risks for philanthropists planning to allocate much or all of their portfolios to impact investments—which can carry high risk, generate below-market financial return, or both.

A number of factors considerably reduce these apparent hazards. The first is a statutory exception: "[I]nvestments, the primary purpose of which is to accomplish one or more [charitable purposes], and no significant purpose of which is the production of income or the appreciation of property, shall not be considered as investments which

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87. Investments that qualify as program-related under I.R.C. § 4944, discussed *infra* notes 92-96 and accompanying text, can escape the excess business holdings rules. As noted there, however, such investments must lack a financial motive and many investments philanthropy LLC adopters would like to make will not so qualify.

88. See Treas. Reg. § 53.4944-1(a)(1) (1972) (stating the general requirements for discharge of excess business holdings, which apply only to private foundations and donor-advised funds).

89. See FREMONT-SMITH, *supra* note 13, at 189-95, 211-15.

90. I.R.C. § 4944 (b)(2) (2018) (imposing penalties ranging from five to twenty-five percent of the amount of the jeopardizing investment).

91. See Treas. Reg. § 53.4944-1(a)(2).

jeopardize the carrying out of exempt purposes.”<sup>92</sup> Falling within this program-related investment (PRI) exception not only eliminates potential excise tax liability under Section 4944, but also allows a private foundation to count the excepted investment towards its required annual payout of five percent of its assets.<sup>93</sup> Second, the addition of new regulatory examples in 2016, specifically blessed nineteen different types of transactions as qualifying PRIs.<sup>94</sup> These examples clarify that PRIs may be made to for-profit entities, that they may be structured as debt or equity investments, and that a potentially high rate of return is not a disqualifier.<sup>95</sup> The revised regulations also reinforce the requirement that all PRIs must be made with a primary purpose of accomplishing a charitable purpose, and frequently cite qualifying investments’ lack of appeal to other investors.<sup>96</sup>

Today’s PRI regulations offer comfort to private foundations considering certain types of impact investments. Yet the requirements that PRIs serve a primarily charitable purpose, not have a significant purpose to generate income, and not be investments a commercial investor would undertake remain stumbling blocks. It would be hard to defend an investment like Emerson’s in Anonymous Content as primarily charitable and without a financial motivation. The round of Neighborly Series A that it led was joined by social investors and pure venture capital funds.<sup>97</sup> The PRI exception will not so easily accommodate investments like these.

Of course, if an investment will not qualify as a PRI because it is too lucrative, the jeopardy investment regime may not present a problem. But impact investing for blended value can have a partially financial motivation that would disqualify it as a PRI while still presenting a risk profile or lack of diversification that could render it jeopardizing under § 4944. The IRS provided reassuring guidance in 2015, stating:

When exercising ordinary business care and prudence in deciding whether to make an investment, foundation managers may consider all relevant facts and circumstances,

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92. I.R.C. § 4944(c). Another statutory exception, which exempts donated investments from the diversification rules, would shield donated stock (but not investments chosen as part of a foundation’s own investment program) from scrutiny under Section 4944. *See* 26 C.F.R. § 53.4944-1(a)(2)(ii)(a).

93. The foundation payout requirement is discussed in more detail *infra* notes 103–05 and accompanying text.

94. *See* Treas. Reg. § 54.4944-3(b).

95. *See id.*

96. *See id.*

97. *See* Jase Wilson, *Neighborly Raised a Series A*, NEIGHBORLY (May 16, 2017), <https://learn.neighborly.com/news/neighborly-raised-series/>.

including the relationship between a particular investment and the foundation's charitable purposes. Foundation managers are not required to select only investments that offer the highest rates of return, the lowest risks, or the greatest liquidity so long as the foundation managers exercise the requisite ordinary business care and prudence under the facts and circumstances prevailing at the time of the investment in making investment decisions that support, and do not jeopardize, the furtherance of the private foundation's charitable purposes.<sup>98</sup>

Language in the Uniform Prudent Management of Institutional Funds Act permitting fiduciaries making investment decisions to "consider the charitable purposes of the institution" in making their selections suggests the trend under state law will be similar.<sup>99</sup>

Private foundations are increasingly making impact investments a part of their endowment strategy. In one of the biggest commitments to date, the Ford Foundation announced last year it would devote up to one billion of its twelve-billion-dollar endowment to mission-related investments over the next ten years.<sup>100</sup> In doing so, it explicitly credited the 2015 IRS guidance in resolving the "legal uncertainty" that had until its issue been a "barrier" to adopting such an approach.<sup>101</sup> The Nathan Cummings Foundation has only about half a billion in endowment, but pledged in 2018 that it would align all of its investments with its mission.<sup>102</sup> These important developments should eliminate private foundation concerns that investing that trades financial for social returns will *per se* violate federal tax law or state fiduciary obligations.

The philanthropy LLC still affords its creators far greater flexibility and comfort. This model frees philanthropists to pursue whatever type and range of investments they wish. A philanthropy LLC can act like a venture capital fund, a private equity firm, or free-wheeling speculator. Moreover, it can do so with neither the anxiety nor the burden of proving these investments fit the PRI model or any other legal standard.

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98. I.R.S. Notice 15-62, IRB 2015-39 (Sept. 28, 2015), <https://www.irs.gov/pub/irs-drop/n-15-62.pdf>.

99. UNIF. PRUDENT MGMT. OF INSTITUTIONAL FUNDS ACT § 3(a), (e)(1)(H) (Nat'l Conference of Comm'rs on Unif. State Laws 2006).

100. Darren Walker, *Unleashing the Power of Endowments: The Next Great Challenge for Philanthropy*, FORD FOUND.: EQUALS CHANGE BLOG (Apr. 5, 2017), <https://www.fordfoundation.org/ideas/equals-change-blog/posts/unleashing-the-power-of-endowments-the-next-great-challenge-for-philanthropy/>.

101. *Id.*

102. See Nathan Cummings Foundation, *Nathan Cummings Foundation Announces Move to 100 Percent Mission-Aligned Investing*, <http://www.nathancummings.org/ncf-commits-100-percent>.

Finally, using a philanthropy LLC structure gives a donor more freedom to determine how quickly her philanthropy will spend its assets. Tax rules require private foundations to distribute five percent of their assets annually to qualifying recipients (generally tax-exempt public charities),<sup>103</sup> in an effort to prevent donors from using them to warehouse assets tax-free.<sup>104</sup> Foundations who fail to meet this minimum distribution requirement again are subject to penalty taxes.<sup>105</sup> Like the excess business holding rules, jeopardy investment prohibition, and nonprofit fiduciary law, these demands simply do not apply to a philanthropy LLC. Their founders are masters not only of how their philanthropies invest their assets, but of how and when they spend them.

## 2. Political Activity

The philanthropy LLC will also outperform the private foundation for philanthropists who see political action as pivotal to achieving their goals. Federal law<sup>106</sup> checks the political activities of all tax-exempt charitable entities, and it most severely limits private foundations.<sup>107</sup> Private foundations risk loss of exemption if they engage in substantial lobbying or any political campaign activity, and such activities also subject the foundation and its management to two-tiered penalty taxes.<sup>108</sup> A twenty percent tax will be levied on any private foundation expenditures on lobbying or campaign activity,<sup>109</sup> and willful and unreasonable expenditures expose foundation managers to an additional five percent tax.<sup>110</sup> If the amount expended on prohibited activities is not returned to the foundation, further penalties of 100% for the foundation and fifty percent for foundation managers apply.<sup>111</sup> Even voter registration drives

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103. See I.R.C. § 4942 (2018).

104. See FREMONT-SMITH, *supra* note 13, at 272.

105. See I.R.C. § 4942 (a)–(b) (imposing first tier taxes of 30% of the undistributed amounts and second tier taxes of 100%).

106. State nonprofit corporation and charitable trust law rarely include explicit prohibitions on political activity, though such activity can preclude state property tax exemption. See Dana Brakman Reiser, *Charity Law's Essentials*, 86 NOTRE DAME L. REV. 1, 28 (2011). As the sweeping prohibitions under federal tax law eclipse any state law in this area, the remainder of the Article will leave aside state law constraints on political activity.

107. Private foundations are not the only exempt category available to structure a philanthropic vehicle, but as noted earlier, they are the most likely classification of a § 501(c)(3) tax-exempt philanthropic vehicle formed by the donors considered here.

108. See I.R.C. § 501(c)(3) (“[N]o part of the net earnings of” a tax-exempt charitable entity may be used to “participate in, or intervene in . . . any political campaign on behalf of (or in opposition to) any candidate for public office.”); see also *id.* § 4945(d) (subjecting any lobbying or campaign expenditure by a private foundation to prohibitive penalty taxes).

109. *Id.* § 4945(a), (d), (e).

110. *Id.* § 4945(a)(2).

111. *Id.* § 4945(b).

will trigger these hefty penalties, unless they are carefully constructed to avoid the appearance of partisanship.<sup>112</sup> While foundation donors can conduct political activities on their own or through other entities they control, the foundation itself must stay far clear of them.

These political restrictions would clearly frustrate donors like Powell Jobs, Chan, and Zuckerberg. The Emerson Collective touts its dedication to immigration and education reform.<sup>113</sup> Powell Jobs even met personally with President Trump to advocate that immigration reform be done in a “thoughtful way.”<sup>114</sup> From its inception, the Chan Zuckerberg Initiative has emphasized the importance of advocacy work to its objectives. Chan and Zuckerberg’s letter to Max articulated that “[w]e must participate in policy and advocacy to shape debates. Many institutions are unwilling to do this, but progress must be supported by movements to be sustainable.”<sup>115</sup> It would be impossible to meet commitments like these using a tax-exempt private foundation alone, and running multiple organizations adds risk and expense.

Of course, tax-exempt organizations other than private foundations can accommodate a substantial amount of political activity,<sup>116</sup> and politically oriented donors frequently use them for such purposes. Both social welfare organizations exempt under § 501(c)(4) and business leagues exempt under § 501(c)(6) can engage in unlimited lobbying, so long as it is relevant to their exempt purposes.<sup>117</sup> These organizations can

112. *Id.* § 4945(d)(2), (f).

113. *See Priorities*, EMERSON COLLECTIVE, <http://www.emersoncollective.com/about-us>.

114. *See* Tony Romm, *Laurene Powell Jobs and Senator Kamala Harris Are Worried About Trump and Immigration*, RECODE (June 1, 2017), <https://www.recode.net/2017/6/1/15694146/laurene-powell-jobs-kamala-harris-california-senator-donald-trump-dreamers-code-2017>.

115. Zuckerberg, *supra* note 1.

116. The baseline political restrictions allowing only insubstantial lobbying and no political campaign activity appear in I.R.C. § 501(c)(3) and apply only to private foundations and public charities organized under this section.

117. Treas. Reg. § 501(c)(4)-1(a)(2)(ii) (as amended in 1990) (providing that an organization “may qualify [for exemption] under section 501(c)(4) even though it is an action organization,” meaning it engages in lobbying); Rev. Rul. 61-177, 1961-2 C.B. 117 (stating that an organization may be exempt under section 501(c)(6) “even though its sole activity is directed to the influencing of legislation which is germane to such common business interest”). For comprehensive treatment of the tax consequences of political activity by social welfare organizations and business leagues, see JOHN FRANCIS REILLY & BARBARA A. BRAIG ALLEN, IRS, POLITICAL CAMPAIGN AND LOBBYING ACTIVITIES OF IRC 501(c)(4), (c)(5), AND (c)(6) ORGANIZATIONS (2003), <https://www.irs.gov/pub/irs-tege/eotopicl03.pdf>. For a discussion of the 501(c)(4) scandal that embroiled the IRS in 2013, see Evelyn Brody & Marcus Owens, *Exile to Main Street: The I.R.S.’s Diminished Role in Overseeing Tax-Exempt Organizations*, 91 CHI.-KENT. L. REV. 859 (2016).

also engage in political campaign activity so long as it does not become “primary.”<sup>118</sup>

But donors like Powell Jobs, Chan, and Zuckerberg would have little to gain from structuring their entities as social welfare organizations or business leagues. Social welfare entities are not eligible to receive tax-deductible contributions. Contributions to business leagues are deductible only if they qualify as business expenses, which donations for lobbying or political campaign activity do not.<sup>119</sup> These organizations can engage in political activity without imperiling their tax-exempt status, but doing so can reduce the value of the exemption. Both are taxed on the lesser of their political expenditures or their investment income.<sup>120</sup> For founders who plan for their organization to conduct both social welfare or business league and political activities (carefully preventing political ones from becoming primary) and to have little or no investment income, this reduction in value will be small. For donors like those contemplated here, who will expect significant investment income to maintain their philanthropic venture’s real assets, the reduction is potentially substantial. These alternatives are useful structures for many types of political organizations, but they are not well-suited for donors seeking an organization devoted to combining charitable, investment, and significant political pursuits.<sup>121</sup>

Where exempt entities run into walls, LLCs open doors. A philanthropy LLC can do as much lobbying and political campaign activity its owners desire, so long as it complies with any relevant disclosure and campaign finance regulations. After *Citizens United v. Federal Election Commission*,<sup>122</sup> even these limitations have been reduced. The LLC model is an elegant solution for donors who see political action as intertwined with their social goals. Combining this political capacity with the versatility to conduct and coordinate both charitable grants and impact investments further enhances the operational flexibility of the philanthropy LLC.

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118. See Rev. Rul. 81-95 (addressing 501(c)(4) social welfare organizations); I.R.S. Gen. Couns. Mem. 34,233 (Dec. 3, 1969) (addressing 501(c)(6) business leagues).

119. *Tax treatment of donations – 501(c)(6) organizations*, I.R.S., <https://www.irs.gov/charities-non-profits/other-non-profits/tax-treatment-of-donations-501c6-organizations> (last updated Apr. 2, 2018).

120. See I.R.C. § 527(f) (2018).

121. For a discussion considering a range of such structures, as well as donor-advised funds and supporting organizations, see Dana Brakman Reiser, Sharon Lincoln & Ingrid Mittermeier, *Using Non-501(c)(3) Vehicles to Accomplish Philanthropic Objectives*, 95 TAXES: TAX MAG. 41 (2017).

122. 558 U.S. 310 (2010).

### 3. Coordination Across Entities

Nonprofit structures not only limit investment choices and political activity, but also regulate the relationships a philanthropic venture may have with its fiduciaries, its donors, and other entities either of them controls. Some of these restrictions derive from state law, others result from the private foundation rules of the federal tax code.

Nonprofit fiduciary concepts drawn from state nonprofit corporate and charitable trust law—here the duty of loyalty rather than that of care or prudence—limit compensation and other self-dealing transactions.<sup>123</sup> A private foundation organized as a charitable trust must avoid being ensnared by trust law’s strict prohibitions on self-interested transactions.<sup>124</sup> By contrast, an incorporated private foundation can generally prevent fiduciary liability by ensuring its compensation and other self-dealing transactions are fair, but independent review and documentation is advisable.<sup>125</sup> Besting both, an LLC structure imposes hardly any limits on compensation or sharing of resources. Delaware LLCs can even waive fiduciary obligations.<sup>126</sup>

Federal tax law is stricter, especially so for private foundations. Allowing a foundation’s net earnings to inure to its insiders or bestowing a substantial private benefit on a third party risks loss of exemption.<sup>127</sup> The private foundation excise taxes go even further. For example, they characterize any “sale or exchange, or leasing, of property” between a foundation and its directors, officers, substantial contributors, or entities they control as self-dealing.<sup>128</sup> The self-dealing label, and its associated penalties, sticks even to transactions in which the foundation receives a fair-market deal—or better.<sup>129</sup> Like in the other private foundation excise

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123. See Thomas Lee Hazen & Lisa Love Hazen, *Duties of Nonprofit Corporate Directors—Emphasizing Oversight Responsibilities*, 90 N.C. L. REV. 1845, 1861–62 (2012).

124. See FREMONT-SMITH, *supra* note 13, at 195–97 (describing these prohibitions and the limited extent to which they can be eased).

125. See *id.* at 215–25 (explaining the common law and statutory approaches to fair dealing in nonprofit corporations).

126. See, e.g., DEL. CODE ANN. tit. 6, § 18-1101(c) (2018) (“To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company . . . , [these] duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement; provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.”). LLC laws in other jurisdictions are not always as accommodating as Delaware law, but still generally offer more flexibility than charitable forms. Ellen Aprill, *Section 501(c)(3) Organizations, Single Member Limited Liability Companies, and Fiduciary Duties*, 52 REAL PROPERTY, TRUST & ESTATE L. J. 153, 161–81 (2017) (comparing LLC fiduciary law and fiduciary obligations in charitable entities).

127. See I.R.C. § 501(c)(3) (2018).

128. See *id.* § 4941(d)(1)(A).

129. See *id.*



tax regimes described above, these penalties charge foundations and their managers, and the transactions must be unwound to avoid second-order confiscatory taxes.<sup>130</sup> Only deals in which a foundation receives property or services free of charge are safe.<sup>131</sup>

These rules will obviously hamper collaboration between a private foundation and its donor's business ventures. The original plans for Google.org effectively demonstrate this lack of fit. The company saw great value in using its technology and personnel to achieve philanthropic goals. It announced it would use Google tools to track data from its demonstration fleet of rechargeable cars and to provide real-time disease warnings as part of its public health initiative.<sup>132</sup> It also created a group within its engineering division to research renewable energy.<sup>133</sup> But selling or leasing these resources to its private foundation for as little as one dollar would trigger self-dealing penalty taxes. Even sharing office space would be fraught. Perhaps Google might have been willing to provide all of these assets to its foundation gratis. Still, the deep connections between the company's business and its foundation could risk exemption on grounds of private inurement or private benefit. Like establishing Google.org as an internal division of the for-profit Google, Inc., a philanthropy LLC avoids all of these concerns.

Compensation, too, becomes simpler. Since the philanthropies explored here have taken the LLC route, the details of their compensation arrangements are not publicly available. We do know, though, that CZI plucked its early leadership from the highest levels of business, academia, and government. Plouffe, who left Uber to lead CZI's policy efforts,<sup>134</sup> is not the only example. CZI's Chief Technology Officer came from Amazon, the president of its science organization hails from Rockefeller University, and the president of its education organization was a former U.S. Deputy Secretary of Education.<sup>135</sup> Perhaps some or all of these individuals were persuaded to join the Initiative by its grand and disruptive mission. Their talent and experience, however, would give them access to many lucrative opportunities, and some (if not all) surely had significant compensation requirements.

Even without knowing the particulars of their compensation, the comparatively higher administrative hurdles a nonprofit vehicle would have to clear to hire them are evident. State fiduciary law permits only

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130. *See id.* § 4941(a)–(b).

131. *See, e.g.*, Treas. Reg. §§ 53.4941(d)–2(b)(2), 53.4941(d)–2(d)(3).

132. *See* Brakman Reiser, *supra* note 43, at 2443.

133. *See id.*

134. *See* Isaac, *supra* note 24.

135. *See* CHAN ZUCKERBERG INITIATIVE, *supra* note 26.

reasonable compensation of a nonprofit director, trustee, or officer.<sup>136</sup> The private foundation rules align to this standard, permitting compensation for fiduciaries, substantial contributors, and their related persons and entities only when it is “reasonable and necessary to carrying out the exempt purpose of the private foundation” and “not excessive.”<sup>137</sup> Foundations can most easily prove compensation fits within these limits through careful consideration of comparability data and documentation.<sup>138</sup> The 2017 tax legislation also adds a new twenty-one percent excise tax on compensation over \$1 million paid by tax-exempt organizations.<sup>139</sup>

Had CZI been structured as a tax-exempt foundation, its top-flight hires would be subject to these restrictive compensation regimes. At the very least, to devise reasonable and nonexcessive compensation for them, a foundation’s board would need to obtain and examine comparability data and thoroughly document their decisions. In doing so, they would need to consider whether any salaries over the \$1 million level would be worth triggering the excise tax. Once this process is complete, the foundation would also need to disclose the compensation it awards to its officers—as well as that paid to nonofficers among its five most highly compensated employees—to the IRS and to the public.<sup>140</sup> The philanthropy LLC frees Chan and Zuckerberg from all these regulatory burdens and many prying eyes.

### B. *Privacy*

Nonprofit philanthropic institutions must operate with a considerable amount of transparency. Private foundations and other tax-exempt entities must submit annual informational returns to the IRS, on its various Forms 990.<sup>141</sup> These informational returns detail the organization’s operations and governance, including spending and the

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136. See JACK B. SIEGEL, A DESKTOP GUIDE FOR NONPROFIT DIRECTORS, OFFICERS, AND ADVISORS: AVOIDING TROUBLE WHILE DOING GOOD § 4.4(a) (2006).

137. I.R.C. § 4941(d)(2)(E) (2018).

138. See *id.*

139. See *id.* § 4960(c)(2)(a) (applying the tax only to such compensation to an entity’s five highest compensated employees).

140. See I.R.S., INSTRUCTIONS FOR FORM 990-PF 27 (2017), <https://www.irs.gov/pub/irs-pdf/i990pf.pdf> (describing the requirements for listing “Information About Officers, Directors, Trustees, Foundation Managers, Highly Paid Employees, and Contractors” on private foundations’ annual disclosures).

141. See *Which Forms Do Exempt Organizations File*, IRS, <https://www.irs.gov/charities-non-profits/form-990-series-which-forms-do-exempt-organizations-file-filing-phase-in> (last updated Aug. 4, 2017).

names of various fiduciaries and employees.<sup>142</sup> This and most of the other content of the Form 990 is available to the public. Some of the most sensitive information of all, the names and addresses of contributors, is kept confidential by the IRS—except in the case of private foundations and political organizations. Their donor lists are open to public inspection.<sup>143</sup> States also often require registration and annual reporting by charitable entities operating within their borders, though many allow organizations to file federal Forms 990 with in lieu of state-specific forms.<sup>144</sup> Disclosure requirements impose administrative costs, but more importantly, transparency intrudes on donors' privacy.

In stark contrast, for-profit philanthropic vehicles are screened from public scrutiny. If founders opt for a philanthropy LLC, the entity may not file any return whatsoever. The member of a single member LLC must simply report income from it on her own (confidential) return.<sup>145</sup> LLCs consisting of multiple members will file partnership returns,<sup>146</sup> but founders can again rely on tax confidentiality to protect the contents of these filings. For donors like the famously private Powell Jobs, as well as those who seek to shield some or all of their philanthropic activities from public scrutiny, the privacy benefits an LLC structure provides may outstrip any of its disadvantages.

### C. Control

The final, powerful pull toward for-profit philanthropy is control. A philanthropy LLC or other for-profit structure will give donors something no nonprofit organizational form can offer—the ability to exit. The funds the Omidyars contribute to their charitable nonprofit are locked into the charitable stream.<sup>147</sup> Even if they decide there is a better use for those

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142. See, e.g., I.R.S., FORM 990: RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX 7 (2017), <https://www.irs.gov/pub/irs-pdf/f990.pdf>; I.R.S., FORM 990-PF: RETURN OF PRIVATE FOUNDATION 6 (2017), <https://www.irs.gov/pub/irs-pdf/f990pf.pdf>.

143. See I.R.S., SCHEDULE B: SCHEDULE OF CONTRIBUTORS 5 (2017), <https://www.irs.gov/pub/irs-pdf/f990ezb.pdf>. In July 2018, the IRS announced it would no longer require many non-charitable types of tax-exempt entities to provide it with information about their donors, but private foundations remain subject to donor disclosure to both regulators and the public. See Rev. Proc. 2018-38, <https://www.irs.gov/pub/irs-drop/rp-18-38.pdf>.

144. See FREMONT-SMITH, *supra* note 13, at 315–17.

145. See I.R.S., PUBLICATION 3402: TAXATION OF LIMITED LIABILITY COMPANIES 2 (2016), <https://www.irs.gov/pub/irs-pdf/p3402.pdf>.

146. See *id.*

147. This lock-in, sometimes called the “nondistribution constraint” is the defining characteristic of nonprofit organizations. See Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 501 (1981) (coining the term).

funds, the gift is irrevocable and both state organizational law and federal tax law bars returning those funds to the donors' private use.<sup>148</sup>

Not so their LLC. To be clear, the Omidyars—and other philanthropy LLC adopters—have made no suggestion they ever plan to seek the return of their donated assets. All of their public statements depict the transfers to their LLCs as permanent and immutable, and they have given us no reason to doubt their intentions. Still, there is no legal constraint forcing their hands. LLC structures allow donors to change their minds and take back their toys.

The control advantages of for-profit philanthropy also extend beyond the ability to exit. Governance arrangements are more flexible in a for-profit, particularly in an LLC structure where a founder can be the sole member and wield complete control over the entity's affairs and assets. A nonprofit can be structured to maximize founder control using a charitable trust form with the founder as its sole trustee.<sup>149</sup> This sole trustee will remain subject to fiduciary standards, however, and charitable fiduciary standards are more rigorous than those applicable to LLCs.<sup>150</sup> As noted above, in some states LLC founders are even empowered to waive fiduciary obligations if they so choose.<sup>151</sup> Donors keen to maximize their control over the philanthropic vehicles they create could not do better than an LLC.

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Perhaps counterintuitively, for-profit vehicles offer very attractive benefits to aspiring philanthropists. Many of these advantages arise by avoiding the multiple legal restrictions imposed on tax-exempt nonprofit organizations, particularly on private foundations. Without these limitations, a philanthropy LLC can choose among unfettered investment options, engage deeply in politics, and structure its operations to take

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148. See, e.g., I.R.C. § 501(c)(3) (2018) (defining tax-exempt charitable entities as those in which “no part of the net earnings . . . inures to the benefit of any private shareholder or individual”); REVISED MODEL NONPROFIT CORP. ACT §§ 13.01–.02 (AM. BAR ASS'N 2008) (prohibiting distributions in a popular uniform statute).

149. Although most jurisdictions, (and best practice) require multiple directors of a nonprofit corporation, single-trustee charitable trusts are widely permissible. See Evelyn Brody, *Charity Governance: What's Trust Law Got to Do with It?*, 80 CHI.-KENT L. REV. 641, 645 (2005) (noting this disparity). The IRS also appears to disfavor tax-exemption for entities with few directors, although it does not have any specific authority to require particular governance practices for exempt entities. See Terri Lynn Helge, *Rejecting Charity: Why the IRS Denies Tax Exemption to 501(C)(3) Applicants*, 14 PITT. TAX. REV. 1, 52–56 (2016) (reporting a study showing denials of exemption frequently cite a small number of directors as a concern).

150. See FREMONT-SMITH, *supra* note 13, at 187–88 (describing the fiduciary standards for charitable trustees and noting, their “strict” interpretation by courts).

151. See, e.g., DEL. CODE ANN. tit. 6, § 18-1101(e) (2018).

advantage of shared resources. It also can help donors safeguard their privacy and avoid public scrutiny, all while maintaining unparalleled control. These valuable benefits, however, do not come without costs—either for individual donors or for society. The next Part will address the tax burdens a donor must bear when organizing a philanthropic endeavor as an LLC. After fully exploring the tradeoffs for donors, Part IV will consider the likelihood that these disruptive philanthropy structures will become more common, and examine the costs of this trend for the philanthropic sector and society at large.

### III. THE (LIMITED) DOWNSIDE

To obtain the philanthropy LLC's benefits of flexibility, privacy, and control, one might think donors must be willing to accept a very significant downside: higher taxes. Shouldn't eschewing nonprofit, tax-exempt alternatives also mean leaving behind the substantial income, gift, and estate tax benefits that come with them? If so, the sacrifice inherent in a philanthropy LLC structure might well prove too great for many to adopt. It turns out, however, that the real tax cost of adopting this disruptive philanthropy structure is surprisingly limited.

#### A. *Income Tax Advantages*

Nonprofit, tax-exempt philanthropies receive two distinct types of income tax advantages. The first is self-evident: The income these entities generate is largely, if not entirely, invulnerable to taxation.<sup>152</sup> Public charities receive the most extensive tax-exemption; only their unrelated business income is subject to taxation.<sup>153</sup> Even when tax exemption is not absolute, exempt entities pay tax on small slices or segments of their income compared with taxable alternatives.<sup>154</sup>

The second type of advantage accrues not to tax-exempt entities themselves, but to their donors. Qualifying charitable donations can reduce a taxpayer's overall income tax bill. This effect proceeds most directly through the charitable contribution deduction. In just the same fashion as other deductions, an itemizing taxpayer may subtract her charitable contributions from her adjusted gross income in determining her taxable income.<sup>155</sup> By reducing the income figure to which the

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152. See I.R.C. § 501(c) (describing various types of tax-exempt entities).

153. See *id.* § 501(c)(3) (setting forth income tax exemption for charitable entities); *id.* § 511 (imposing tax on unrelated business income of charitable organizations).

154. See, e.g., *id.* § 4940 (imposing a two percent excise tax on private foundations' net investment income); *id.* § 527(f) (imposing tax on the lesser of social welfare organization's political campaign expenditures or investment income).

155. See *id.* § 170(b). As many discussions of the 2017 tax legislation addressed, the benefits of the charitable contribution deduction are only available to taxpayers who itemize. See Megan

taxpayer's tax rate is applied, charitable deductions decrease the total amount of tax to be paid. Also, like any tax benefit structured as a deduction, the deduction for charitable contributions increases in value with the marginal tax rate of the taxpayer.<sup>156</sup> The higher one's income, the more tax will be avoided for a contribution of the same amount.

Charitable contributors of appreciated property receive an additional benefit. Typically, when a taxpayer owns appreciated property and sells it, realizing a return, she must pay tax on the appreciation over her tax basis in the asset.<sup>157</sup> Yet donors of appreciated property to qualifying charitable recipients need not recognize, and pay tax upon, their capital gains.<sup>158</sup> Neither will the recipient.<sup>159</sup> The charity can sell the appreciated asset for a profit, and its tax-exempt status will protect the return on this transaction from taxation.

A philanthropy LLC itself qualifies for neither tax-exemption nor deductibility.<sup>160</sup> Consider CZI. If the Institute earns income on its investments in Andela or Meta and that income is passed through to CZI's owners, Zuckerberg, and Chan, it will be taxable to them.<sup>161</sup> Likewise,

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O'Neil & Dan Parks, *Tax Law Eliminates Giving Incentive for 21 Million Americans, Study Says*, CHRON. PHILANTHROPY (Jan. 12, 2018), <https://www.philanthropy.com/article/Tax-Law-Wipes-Out-Giving/242227>. For those who take the standard deduction instead—a group which is expected to expand significantly when the standard deduction nearly doubles in 2018—the tax code's incentive for charitable contributions are irrelevant. *See id.* This impact has many in the charitable sector worried, as some researchers have estimated the increased standard deduction will lead to a significant drop in charitable giving. *See id.*

156. *See* William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 345 (1972) (explaining this “unusual” facet of the charitable contribution deduction).

157. *See* I.R.C. § 1001(a).

158. *Id.* § 170(e). The Trump administration's plan to allow taxpayers to increase their basis for inflation when calculating capital gains to be taxed would reduce, but not eliminate this benefit. *See* Alex Daniels, *Nonprofits Fear Impact of Trump Administration Plan to Cut Capital-Gains Tax*, CHRON. PHILANTHROPY (Aug. 2, 2017).

159. *Id.*

160. *See id.* §§ 170(c), 501(c).

161. Although philanthropy LLC owners like Chan and Zuckerberg may benefit from the reduced tax rates on their individual incomes that apply starting in 2018, they are unlikely to qualify for the new twenty-percent deduction on pass-through income. *See* I.R.C. § 199A. The shape of this provision is quite murky as yet, but philanthropy LLC owners will have at least two strikes against them in attempting to claim it. *See* Ken Berry, *2018 Tax Reform: Pass-Through Income Deduction More Complex Than Thought*, CPA PRAC. ADVISOR (Jan. 8, 2018), <http://www.cpapracticadvisor.com/news/12389903/2018-tax-reform-pass-through-income-deduction-more-complex-than-thought>. First, the business of a philanthropy LLC may well be deemed a “specified service business”; eligibility for the deduction based on income from these businesses phases out entirely at \$415,000 for joint filers. *See id.* (explaining that above this threshold, “you get no deduction—period”). Second, even if income falls below this rate, the deduction is further limited for high earners based on the size of the company's payrolls or its depreciable business property—neither of which may be large for a philanthropy LLC with a small staff and no depreciable assets. *See id.* (providing the details on these restrictions). More

when the couple donates funds or assets to CZI, they will not be able to take a deduction for this contribution in computing their annual income taxes.

These sacrifices are not as great as it might first appear, however. On the tax-exemption side, it is important to remember that exemption is only of value to the extent that there is income to tax. CZI and its owners do not purport to have income-generating goals. Quite the opposite. They plan to make often risky impact investments and give money away to charities and political causes. If the losses CZI generates are roughly on pace with the returns on its investments, there will be little income to be allocated to Chan and Zuckerberg, and on which they will have to pay tax.

The pass-through nature of a philanthropy LLC also mutes the initial loss of the deductibility advantage. When CZI makes grants to donees qualified to receive tax-deductible contributions, these deductions will flow through to its member-owners. As such, whatever portion of the \$3 billion it ultimately grants to § 501(c)(3) tax-exempt charities in its medical research program will generate potential tax deductions for Zuckerberg and Chan.<sup>162</sup>

These deductions will only be potential tax deductions because all charitable contribution deductions are subject to percentage limitations. Donors to tax-exempt public charities can deduct only up to sixty percent of their annual income based on their cash charitable contributions and only up to thirty percent of their contributions of appreciated property.<sup>163</sup> Somewhat lower percentage limits apply to contributions to private foundations: thirty percent for cash contributions and twenty percent for appreciated property.<sup>164</sup> Even more importantly, the value of the deduction for appreciated property also varies by the type of gift and type of tax-exempt recipient. Gifts of appreciated property (except gifts of

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clarity will come when the IRS issues guidance and regulations on the new deduction provision, but at this point, access to the new pass-through deduction does not appear to be a significant reason to elect the philanthropy LLC structure.

162. Unless it could qualify as an S corporation, *see* I.R.C. § 1361, a philanthropy organized as a business corporation would be less tax efficient than an LLC. Corporate tax treatment always raises the specter of double taxation, whereby the entity's income is taxed once through the corporate income tax as earned and again through the individual income tax when distributed to owners. *See* JAMES D. COX & THOMAS L. HAZEN, *BUSINESS ORGANIZATIONS LAW* § 1.10 (3d ed. 2011). Charitable contributions by the philanthropic entity also would generate corporate deductions only up to a ten-percent ceiling and would not pass through for use by individual owners at all. *See* I.R.C. § 170(b)(2). Although the 2017 tax legislation reduced corporate rates, for entities dedicated to philanthropy, these differences will likely swamp the potential value of rate reduction.

163. *See* I.R.C. § 170(b)-(d).

164. *See id.*

over ten percent of the stock of a single corporation) to public charities generate deductions for the full fair market value of the asset; the same gift to a private foundation will often generate a stepped down deduction reduced for the donor's unrecognized capital gains.<sup>165</sup>

Philanthropy LLC donors can preserve much of the value of the tax treatment of charitable contributions of appreciated property. This is hugely important for founders like Chan and Zuckerberg, who plan to fund their LLC with stock.<sup>166</sup> When Zuckerberg contributes his vastly appreciated Facebook stock to CZI in exchange for membership interests, the transaction will not wipe out his gains as would the same contribution to a tax-exempt public charity. But the transaction also will not be a taxable event.<sup>167</sup> The stock will continue be Zuckerberg's asset until the LLC disposes of it.

If the LLC sells the stock, realizing a return, the gains (and associated tax burden) would flow through to the owners. CZI, though, will often have a much better option. When the funds it would generate through sale of Facebook stock would be used to make grants to tax-exempt public charities, it can simply grant them the Facebook stock instead. The charitable recipients can then sell the stock tax-free. The donors (Chan and Zuckerberg through CZI) avoid the tax on appreciated value and obtain any available deduction. In theory, the percentage limits and lack of a full market value deduction for donations to private foundations could enable a transfer of appreciated assets to a philanthropy LLC followed by a speedy donation to a public charity to yield a greater tax benefit than the same transfer to a private foundation. Even outside of this scenario, an LLC offers donors the ability to stage donations to take maximum advantage of deductibility.

Comparing the philanthropy LLC strategy with conventional alternatives yields less of a contrast than the initial categories of taxable and tax-exempt would suggest. The income of a philanthropy LLC will be taxable to its owners, but those owners have significant control over how much will be earned and distributed. Contributions to found or fund a philanthropy LLC will not be tax-deductible, but the grants the LLC makes can generate deductions for its founder-owners. Prudent planning will even allow them to take considerable advantage of the preferential tax treatment of charitable gifts of appreciated property. In addition, with the subset of donors under consideration here, income tax deductions like these may simply not figure into their decision-making at all. Many will

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165. Compare I.R.C. § 170(b)(1)(C), with § 170(e)(1)(A), (e)(1)(B)(ii), (e)(5). Note that § 170(e)(5) does allow a full market value deduction for donations of "qualified appreciated stock" to private foundations. See I.R.C. § 170(e)(5).

166. Zuckerberg, *supra* note 1.

167. See I.R.C. § 1001(a).



have made prior charitable contributions that have maxed out their percentage limitations for the foreseeable future, especially if they are engaged in tax planning to keep their incomes relatively low.

Tax preferences for charities are also not set in stone.<sup>168</sup> The 2017 tax legislation did not directly target the charitable deduction, but the increase in the standard deduction will shift many taxpayers from itemizers to nonitemizers, the latter of whom gain no benefit from the charitable deduction, thereby significantly undermining the tax benefits of donating to nonprofit entities.<sup>169</sup> The legislation's reduction of tax rates simultaneously reduces the value of charitable deductions for those donors who continue to itemize and take them. In the past, some reformers have even advocated narrowing the types of organizations that qualify for tax-exemption.<sup>170</sup> Donors considering disruptive philanthropy face a dynamic income tax environment, and are wise to discount the benefits of the current system in light of possible future changes.

### B. Gift Tax Advantages

Income tax implications are not the only ones relevant to traditional philanthropy, and that philanthropy LLC adopters would seem destined to lose. The gift tax applies to any "transfer of property by gift,"<sup>171</sup> for less than full consideration. It subjects these transfers to tax rates as high as forty percent.<sup>172</sup> Gifts to tax-exempt charitable entities like private foundations, however, avoid this potentially significant tax bite.<sup>173</sup> Donors can deduct these contributions from the total amount of their gifts upon which the annual tax is levied, and this deduction is subject to no percentage or other limitations.<sup>174</sup> Essentially, gifts to charity are tax-exempt. But a gift to one of the philanthropy LLCs discussed here cannot qualify for this exemption, and thus seems to portend sizable gift tax bill for donors.

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168. See generally CONG. BUDGET OFFICE, OPTIONS FOR CHANGING THE TAX TREATMENT OF CHARITABLE GIVING (2011) (analyzing various alternatives for charitable tax reform).

169. See Ann Carns, *Charities Fear Tax Bill Will Cut Giving*, N.Y. TIMES (Dec. 15, 2017) at B5 ("A higher standard deduction means fewer taxpayers will itemize their deductions on their tax returns, reducing the incentive to give to charities"); O'Neil & Parks, *supra* note 155 ("Nonprofit advocates are deeply worried about the impact of the tax law, especially the doubling of the standard deduction for individual taxpayers. As a result of that provision, many Americans will stop itemizing their taxes and will no longer get any tax benefit for charitable giving.").

170. See, e.g., John D. Colombo & Mark A. Hall, *The Future of Tax-Exemption for NonProfit Hospitals and Other Health Care Providers*, 2 HEALTH MATRIX 1, 2-9 (1992) (describing early 1990s debate over imposing charity care requirements for hospitals to retain tax exemption).

171. I.R.C. § 2501.

172. See *id.* § 2001(c) (imposing graduated rates up to forty percent).

173. See *id.* § 2522(a)(2).

174. See *id.* Contributions to § 501(c)(4) and § 501(c)(6) entities are also exempt from gift taxation. See *id.* § 2501(a)(6).

A transfer of assets to a philanthropy LLC, though, should actually be irrelevant for gift tax purposes. Such a transaction is no gift at all. In return for transfers of assets to their philanthropy LLCs, philanthropists like Chan, Zuckerberg, Omidyar, and Powell Jobs receive memberships, which vest in them ownership of the entity. In other words, these are transfers for consideration. As such, philanthropy LLC founders should avoid gift taxation just as founders of a small business do not pay gift tax on their transfers of assets to the LLC or corporation organized to operate their ventures. Of course, a philanthropic institution is a very odd type of business—one which professes its desire to give away all or most of its assets over time. The IRS might question whether the economic substance of transfers to these unusual entities is properly understood to provide consideration. The cards appear heavily stacked in philanthropy LLC owners' favor, though. They obtain control rights in return for the assets they transfer to the entities they create, and these control rights include the right to take back the assets should they decide to do so. It is hard to see such a quid pro quo as a gift.

In the unlikely event the non-gift argument is unavailing, philanthropy LLC founders could also use other arguments to avoid gift taxation. One applies only to single-member LLCs, which are disregarded entities under tax law;<sup>175</sup> an LLC with two or more members is instead treated as a pass-through.<sup>176</sup> When an individual gives assets to her own single-member LLC, there is no gift taxable event at all. The recipient entity is disregarded, and tax law responds as if the donor made no transfer, and thus, no gift.<sup>177</sup> A single-member philanthropy LLC founder can handily adopt this argument to backstop the earlier one about transfers for consideration.

Of course, many donors—even among our small group of case studies—do not act alone. If a donor transfers assets to an LLC with two or more members and the transfer is deemed gratuitous, it would be recognized for gift tax purposes just as if the transfer were made to a partnership or corporation, unless the two members are spouses. The unlimited marital deduction shelters all transfers between spouses from the gift tax.<sup>178</sup> Moreover, under a 2006 Revenue Procedure, those spouses

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175. See I.R.S., *supra* note 145, at 2.

176. See *id.*

177. Note, however, that the disregarded nature of a single-member LLC cannot be used to defeat the gift tax if an LLC owner gifts her interests in an LLC to a taxable individual or entity. See *Pierre v. Comm'r*, 133 T.C. 24, 35–36 (2009).

178. I.R.C. § 2523(a).

in a community property state (like California) can create single member (and thereby disregarded entity) LLCs.<sup>179</sup>

The potential for tax reform is less relevant here, as even the sweeping changes in the 2017 tax legislation largely neglected specific gift tax reforms.<sup>180</sup> If the gift tax were swept away by another tax housecleaning effort, any lingering concerns that founding a philanthropy LLC could trigger it would disappear as well. But that seems unlikely. Even without any changes, however, philanthropy LLC founders have little to fear from the gift tax. Its apparent dangers for donors who take this route vanish on closer inspection. As transfers in return for consideration, asset transfers to philanthropy LLCs should entirely avoid characterization as gifts. Failing that, the marital deduction and LLCs' ability to operate as disregarded entities offer additional routes to defer or avoid gift taxation.

### C. Estate Tax Advantages

Nobody, of course, can avoid death. Of the tax burdens that choosing a for-profit vehicle for one's philanthropy will inflict, one might presume the estate tax would be the most tenacious. The federal regime taxes "the transfer of the taxable estate of every decedent who is a citizen or resident of the United States," with top rates again at forty percent.<sup>181</sup> A credit doubled by the 2017 tax legislation fully shields over \$11 million in assets, but (absent truly shocking reversals) the donors contemplated here will die with assets that vastly exceed that threshold.<sup>182</sup> As for gift taxation, deathtime transfers to private foundations and public charities

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179. See *Revenue Procedure 2002-69*, FIRST AM. EXCHANGE CO., <https://firstexchange.com/revenue-procedure-2002-69/> (last visited June 9, 2018).

180. The two changes worked by the 2017 legislation were to increase from \$14,000 to \$15,000 the amounts that may be excluded from determining gifts subject to taxation annually and essentially doubling the lifetime credit for gift, estate and generation-skipping taxes. See generally Allyson Versprille, *Gift Tax Tweaks Could Lead to Unsavory Avoidance Tactics*, BLOOMBERG (Apr. 10, 2017), <https://www.bna.com/gift-tax-tweaks-n57982086495/> (discussing changes to the tax code). The latter change, to the unified credits for both inter vivos and deathtime gratuitous transfers, will be discussed in the next section on the estate tax.

181. See I.R.C. § 2001(a), (c).

182. The credit is actually a unified one, that includes both death and lifetime gratuitous transfers. For 2017, it was \$5,490,000. See *Estate Tax*, IRS, <https://www.irs.gov/businesses/small-businesses-self-employed/estate-tax/> (last updated May 9, 2018). Changes under the 2017 tax legislation raised it to over \$11 million for 2018. *Id.* Spouses can combine their credits to double these amounts. Ashlea Ebeling, *IRS Announces 2018 Estate and Gift Tax Limits: \$11.2 Million*, FORBES (Oct. 19, 2017, 1:54 PM), <https://www.forbes.com/sites/ashleaebeling/2017/10/19/irs-announces-2018-estate-and-gift-tax-limits-11-2-million-per-couple/#6bb999ca4a4b>. It is always worth noting that this credit means very few estates pay any estate tax whatsoever, but the potential founders of philanthropy LLCs are among the lucky few who will likely die with estates large enough to surpass the available credits and remain subject to the tax.

are fully deductible, with no percentage or other limitations.<sup>183</sup> Assets transferred to traditional nonprofit philanthropic organizations will not count as part of the estate on which the tax is levied.<sup>184</sup>

A donor's interest in a philanthropy LLC receives no such immunity and will be a part of her taxable estate. But again, preparation offers a way out. To avoid taxation, a philanthropy LLC founder need only create an estate plan that transfers the assets remaining in her LLC at her death in a way that qualifies for an available deduction. There are at least two ready options. Any assets a taxpayer transfers to his or her surviving spouse on death qualify for the unlimited marital deduction.<sup>185</sup> Assets transferred on death to a tax-exempt public charity or private foundation also qualify for an unlimited charitable deduction.<sup>186</sup> Married philanthropy LLC founders will likely find it useful to deploy these tools seriatim, providing for those assets they wish to remove from their taxable estates to transfer to the surviving spouse on the death of the first to die, and on the death of the survivor to a tax-exempt entity. An estate plan including one's philanthropy LLC holdings in transfers like these elegantly defangs estate tax concerns.

Deathtime transfers do still expose one of the philanthropy LLC's unavoidable limitations. A private foundation can hold a family's assets through generations without any application of the estate tax. A philanthropy LLC cannot function as such a perpetual tax-free vehicle, which might transmit a family's philanthropic values over time and future generations. To avoid the estate tax, those with assets over the credit amounts will need to transfer their LLC stakes to exempt entities on death, or pay Uncle Sam his share.

Forsaking perpetuity will not matter much to the growing group of philanthropists who have proclaimed their intention to spend down their assets prior to death.<sup>187</sup> This view of depleting one's philanthropic assets as a key goal contrasts with the vision of creating a perpetual endowment

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183. See I.R.C. § 2055; see also RICHARD B. STEPHENS ET AL., *FEDERAL ESTATE AND GIFT TAXATION* 5–59 (9th ed. 2013) (“The estate tax charitable deduction . . . is unlimited in the sense that it is not subject to percentage restrictions such as those applicable to the income tax deduction for contributions to charity.”).

184. See I.R.C. § 2055.

185. See *id.* § 2056(a).

186. See *id.* § 2055.

187. See FRANCIE OSTROWER, *LIMITED LIFE FOUNDATIONS: MOTIVATIONS, EXPERIENCES, AND STRATEGIES* 9–12 (2009), <http://www.urban.org/sites/default/files/publication/30121/411836-Limited-Life-Foundations-Motivations-Experiences-and-Strategies.PDF>; see also Veronica Dagher, *The Rise of Spend-Down Philanthropy*, WALL ST. J. (Apr. 13, 2014), <https://www.wsj.com/articles/the-rise-of-spend-down-philanthropy-1397242743> (reporting findings from Bridgespan Group study). *But see generally* JOEL L. FLEISCHMAN, *PUTTING WEALTH TO WORK: PHILANTHROPY FOR TODAY OR INVESTING FOR TOMORROW?* (2017) (mounting a forceful critique of the spend-down philosophy).

typical of earlier generations of donors. The modern cachet of spending down also makes the philanthropy LLC's inability to promise a perpetual estate-tax-sheltered home for assets less problematic.

It is worth noting that estate planning makes sense even for donors who strongly believe in spending down. The future is always uncertain. At the moment, Powell Jobs, the Omidyars, Chan, and Zuckerberg are alive and well, but life is unpredictable. And they will not be the first to learn that it can be surprisingly difficult to spend large amounts of money. Tax-avoiding transfers can be planned later if it becomes clear that a spend-down goal will be unattainable during a founder's lifetime, or as the founders of a philanthropy LLC age or see their health falter. But better safe than sorry. Founders should execute an estate plan directing their LLCs' holdings to a spouse, a tax-exempt charity, or both, just in case.

Of course, a gambler might bet on a total repeal of the estate tax. Although the cost of funding other tax cuts made eliminating the estate tax impossible in 2017, there is no reason to believe this concession has changed conservatives' devotion estate tax repeal.<sup>188</sup> Savvy donors must at least account for the possibility that repeal eventually will render the estate tax charitable contribution deduction superfluous, regardless of the forms their philanthropic ventures take.

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The philanthropy LLC sounds at first like a very expensive—if not foolish—strategy. Close review, however, reveals that with careful planning a philanthropy LLC is a very attractive alternative to the heavily regulated, public, and permanent version of philanthropy tax-exempt structures present. The real tax costs a philanthropy LLC imposes are simply not as large as one might suppose. The very high-profile and sophisticated donors profiled here are willing to tolerate these costs in exchange for enhanced flexibility, privacy, and control. If tax regimes continue to shift in ways that reduce the benefits of adopting a traditional nonprofit vehicle, the appeal of this kind of disruptive philanthropy will only increase.

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188. See Speaker Paul Ryan, First Major Speech on Tax Reform at the National Association of Manufacturers 2017 Manufacturing Summit (June 20, 2017), <https://www.speaker.gov/press-release/full-text-speaker-ryans-first-major-speech-tax-reform> (claiming that as part of its tax reform agenda, Congress “will eliminate harmful, burdensome taxes including the death tax”); then-Presidential candidate Donald Trump, An America First Economic Plan: Winning the Global Competition, Remarks on Repealing the Death Tax at the Detroit Economic Club (Aug. 8, 2016), <http://fortune.com/2016/08/08/trump-economic-speech-detroit/> (promising, while on the campaign trail, that “no family will have to pay the death tax”).

#### IV. THE MILLIONAIRE NEXT DOOR

There are only so many Silicon Valley tech fortunes. If the philanthropy LLC can only appeal to this extremely select group, it would be hard to call it a trend. But there are good reasons to believe this innovation will spread to potential donors further down the high net worth chain. Although these very wealthy individuals will not necessarily share the penchant for disruption of West Coast tech startup founders, many of the characteristics that make the philanthropy LLC attractive to the Zuckerbergs of the world will also entice the millionaire next door.<sup>189</sup>

##### A. *The Likelihood of Adoption*

There are more extremely wealthy individuals and families than the average Jane struggling to save for retirement might imagine. A 2017 global report found over 225,000 “ultra high-net-worth individuals:”<sup>190</sup> those with over \$30 million in investable assets.<sup>191</sup> The total number grew 3.5% from the prior year’s tally, and more than 73,000 of these individuals reside in the United States.<sup>192</sup> Looking to those (only) “high-net-worth individuals”—with a (measly) one million dollars or more in investable assets—yields a bumper crop of potential philanthropy LLC adopters. A 2017 report estimates this group to be over 16.5 million strong globally, with nearly 5.2 million in the U.S. alone.<sup>193</sup>

Together, these wealthy individuals and families control trillions of dollars of assets, and large portions of this wealth will predictably be dedicated to philanthropic pursuits. For example, the annual Giving USA Report found donors contributed roughly \$40 billion to private foundations in 2016.<sup>194</sup> If the attraction of the philanthropy LLC is its relative advantages compared with a private foundation, there is considerable market share for it to gain.

Whether the many millionaires next door will be swayed to adopt a philanthropy LLC structure will depend primarily on their assessment of

189. This term was popularized by Thomas J. Stanley in his book of the same name. See generally THOMAS J. STANLEY, *THE MILLIONAIRE NEXT DOOR* (1996) (repeatedly using the term “millionaire next door”).

190. See WEALTH X, *WORLD ULTRA WEALTH REPORT 2017*, 1, <https://www.wealthx.com/report/exclusive-uhnwi-analysis-the-world-ultra-wealth-report-2017/#downloadform>.

191. See *id.*; see also *Ultra High Net Worth Individual (UHNWI)*, INVESTOPEDIA, <http://www.investopedia.com/terms/u/ultra-high-net-worth-individuals-uhnwi.asp> (last visited June 9, 2018) (“Ultra high-net-worth individuals (UHNWI) are people with investable assets of at least \$30 million . . .”).

192. See WEALTH X, *supra* note 190, at 22.

193. See CAPGEMINI, *WORLD WEALTH REPORT 2017*, 7, [https://www.capgemini.com/wp-content/uploads/2017/09/worldwealthreport\\_2017\\_final.pdf](https://www.capgemini.com/wp-content/uploads/2017/09/worldwealthreport_2017_final.pdf).

194. See *See the Numbers – Giving USA 2017 Infographic*, GIVING USA (June 12, 2017), <https://givingusa.org/wp-content/uploads/2017/06/Giving-USA-2017-Infographic.jpg>.

the tradeoff discussed above. For high-net-worth individuals with a lower profile than the Silicon Valley tech elite, privacy may not be so critical. Part of the mystique of unmasking the “millionaire next door” was that nobody knew about them.<sup>195</sup> Their anonymity may make transparency a nonissue. Alternatively, it could make privacy ever more valuable. It is fair to assume that millionaires’ tastes for privacy will vary. Some of these potential philanthropists will care little about the privacy the LLC structure offers, others will value being spared the spotlight; still others will want to showcase some of their philanthropic efforts and keep others to themselves. Whatever one’s personal preferences around privacy, the appeal of flexibility and control are universal.

The tremendous growth of donor-advised funds bolsters this intuition.<sup>196</sup> Unlike a private foundation, a donor-advised fund is not a standalone philanthropic institution, but rather a separate account within a preexisting public charity.<sup>197</sup> When a donor contributes assets to her account, the public charity receives and holds them, and the donor may take a current deduction for her contribution.<sup>198</sup> She may also provide nonbinding advice on both how the fund’s assets should be invested and to whom grants from it should ultimately be made.<sup>199</sup>

Donor-advised funds preserve donors’ deductibility benefits while being less expensive to establish and maintain than private foundations.<sup>200</sup> They avoid many, though not all, of the private foundation rules’ restrictions.<sup>201</sup> They are also more private. Although the public charity of which a donor-advised fund is a part remains within federal and state regulators’ purview, individual donor-advised funds are subject to no such oversight. On the down side, a donor-advised fund does

195. See STANLEY, *supra* note 189, at 30 (explaining that the typical American millionaire appear to their neighbors as “nondescript, middle class folks”).

196. See Roger Colinvaux, *Donor Advised Funds: Charitable Spending Vehicles for 21st Century Philanthropy*, 92 WASH. L. REV. 39, 40 (2017) (reporting various indicators of this growth, including the fact that “an astonishing five of the top eleven recipients for charitable gifts in the United States are sponsoring organizations of donor advised funds”).

197. See I.R.C. § 4966(d)(2) (2018) (providing the tax definition of “donor-advised fund”); see also Colinvaux, *supra* note 196, at 43–44 (describing donor-advised funds in an article analyzing the major policy questions they raise).

198. See Colinvaux, *supra* note 196, at 43–44.

199. See I.R.C. § 4966(d)(2)(A)(iii) (2018) (defining a donor-advised fund to include “a fund or account . . . with respect to which a donor . . . has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in such fund or account by reason of the donor’s status as a donor”).

200. In fact, because donor-advised fund contributions are treated as made to public charities, they typically offer greater deductibility benefits than would a private foundation. See Colinvaux, *supra* note 196, at 52–53.

201. For example, under reforms included in the Pension Protection Act of 2006, donor-advised funds are subject to the private foundation excess-business-holdings regime. See I.R.C. § 4943(e).

not allow a donor to create her own institution, staff it, and set its priorities, and she must relinquish ultimate control over the assets it holds. That said, donor advice tends to be powerful and rarely ignored. A donor-advised fund can be seen as a private foundation “lite” or a kind of (not very) poor man’s private foundation. Although the pros and cons of donor-advised funds and philanthropy LLCs differ, those who opt for donor-advised funds make their decisions using the same kind of cost-benefit analysis that predicts wider adoption of the philanthropy LLC.

Perhaps the freedom from regulation the philanthropy LLC offers will also be particularly attractive to individuals with only somewhat smaller fortunes to devote to philanthropy. After all, a mere multimillionaire should think more carefully about the extra costs of compliance a private foundation entails than should Priscilla Chan. The same is true, though, when considering the forgone tax benefits attendant to these philanthropic vehicles. The philanthropy LLC structure can trim these costs considerably, but not entirely eliminate them. The somewhat less staggeringly wealthy will have a smaller cushion to cover the relatively higher tax burden of a philanthropy LLC. Those millionaires anxious to avoid sending any extra dollars to the IRS also will not easily be converted to disruptive philanthropy. For those high-net-worth individuals willing to tolerate somewhat higher tax bills, though, the philanthropy LLC’s extensive freedom to invest, manage and advocate as they choose will be a draw.

Some high-net-worth donors have already demonstrated their willingness to sacrifice tax benefits in order to pursue their social goals. Warren Buffet’s 2011 New York Times op-ed calling for Congress to “raise rates immediately on taxable income in excess of \$1 million” comes quickly to mind.<sup>202</sup> But less public and more relevant examples are also available. Social welfare organizations organized under § 501(c)(4) are a common tool for donors interested in political activities from which § 501(c)(3) organizations are restricted or barred, despite their inability to receive tax-deductible contributions.<sup>203</sup> Practitioners also report an uptick in donor interest in using both these § 501(c)(4) entities and business leagues organized under § 501(c)(6) to coordinate their philanthropic activities, although neither structure offers donors deductibility under the income or estate tax.<sup>204</sup> By utilizing these vehicles, wealthy individuals and families are already leaving potential tax benefits on the table.

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202. See Warren E. Buffett, *Stop Coddling the Super-Rich*, N.Y. TIMES (Aug. 14, 2011), <https://www.nytimes.com/2011/08/15/opinion/stop-coddling-the-super-rich.html>.

203. See Brody & Owens, *supra* note 117, at 864–65.

204. See Brakman Reiser, Lincoln & Mittermeier, *supra* note 121.



Donors adopt these alternatives despite foregone tax benefits because of the other advantages they provide. Social welfare organizations and business leagues are by definition not subject to the private foundation rules; they are free to engage in more political activity than their § 501(c)(3) counterparts,<sup>205</sup> and they can provide donors with greater privacy.<sup>206</sup> Unlike a philanthropy LLC, these forms generally retain tax exemption for organizational income.<sup>207</sup> As social welfare organizations and business leagues are formed as state law nonprofits, though, they do not offer donors the kind of extensive control found in for-profit philanthropic alternatives. Founders of a § 501(c)(4) or § 501(c)(6) entity will not be able to change their minds and reclaim their donated assets down the line. Attorneys advising high-net-worth clients about these alternatives will certainly add the philanthropy LLC to the mix of options they detail—if they have not already.

The growth in “family offices” also bodes well for wider adoption of the philanthropy LLC model. A family office is “a private investment firm that exclusively manages [a] family’s wealth, often with a long-term, multi-generational perspective.”<sup>208</sup> A 2016 report estimated that “there are at least 10,000 single family offices in existence globally and at least half of these were set up in the last 15 years.”<sup>209</sup> In addition to coordinating investments, family offices frequently manage a family’s philanthropic pursuits, often by coordinating transfers of wealth to the family’s private foundation or donor-advised funds. Philanthropy LLC structures would allow donors to bring these efforts entirely in-house,

205. See *supra* notes 116–18 and accompanying text.

206. See Brody & Owens, *supra* note 117, at 864–65 (explaining that the major benefit of utilizing a § 501(c)(4) entity, rather than an explicitly politically exempt entity organized under Code § 527, is privacy). Section 527 organizations must publicly disclose every donor of more than \$200 but donors to § 501(c)(4) organizations until recently remained confidential within the IRS. See *id.* The Trump administration’s recent removal of requirements that social welfare organizations and other non-charitable exempt entities disclose donor information to the IRS will only make these forms more attractive. See Rev. Proc. 2018-38, <https://www.irs.gov/pub/irs-drop/rp-18-38.pdf> (announcing removal of donor disclosure requirements for (c)(4) and other non-charitable exempt entities, but not 527 organizations). Numerous helpful articles on the use and regulation of § 501(c)(4) social welfare organizations can be found in the symposium issue at 21 N.Y.U. J. LEG. & PUB. POL’Y (forthcoming 2018).

207. See I.R.C. § 501(c)(4) (2018). But see *supra* note 117 and accompanying text. (explaining the potential limitations on (c)(4) entities’ exemptions when they make political expenditures).

208. Nathan Crow & Gregory S. Crespi, *The Family Office Exclusion Under the Investment Advisers Act of 1940*, 69 SMU L. REV. 97, 99 (2016).

209. EY, EY FAMILY OFFICE GUIDE 5 (2016), <https://familybusiness.ey-vx.com/pdfs/1003023-family-office-guide-v3-lr.pdf>. A “single” family office manages the wealth of a single family, as compared with “multifamily offices” that service two or more families. Crow & Crespi, *supra* note 208, at 102.

within existing family offices or new ones formed to include such purposes. The transition would be particularly seamless for the many family offices already structured as LLCs or groups of LLCs. Indeed, at least one of the marquis examples described here has already been recognized to function this way; investment industry sources often refer to the Emerson Collective as a family office.<sup>210</sup>

Family offices share not only structural elements with the philanthropy LLC, but also many of its most appealing characteristics. After reviewing the existing research on single family offices (SFOs), one commentator concluded, “[w]hat is evident from the literature is why the very affluent are increasingly using SFOs – they value factors such as privacy, control, flexibility and individualized service.”<sup>211</sup> These wealthy families have spent millions to create bespoke family offices to maximize their flexibility, protect the family from scrutiny, and ensure the family’s control. Organizing a philanthropy LLC, or incorporating one into an existing family office structure, is a natural next step.

For-profit philanthropy’s appeal is likely to spread beyond the rarefied circles of Silicon Valley’s technology magnates. Today’s swelling inequality means the rich continue to get richer, making more assets available for philanthropic pursuits. As their ranks increase, both domestically and globally, so does their sophistication in wealth management. At least some in this wealthy and powerful group are willing to tolerate relatively higher tax burdens in order to achieve their social goals. Innovative advisors and high-profile examples like CZI ensure they will soon discover the philanthropy LLC’s advantages in flexibility, privacy and control—and many will adopt it.

### B. *The Stakes for Society*

Growth of philanthropy LLCs will impact the philanthropic sector and influence society at large. Some of these effects should be cause for celebration; others are causes for concern. Although current law offers few tools to impede the growth of philanthropy LLCs, it remains important to identify the trend’s benefits and drawbacks. Greater clarity will enable adopters and their counsel to understand the import of

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210. See e.g., *Emerson Collective*, CRUNCHBASE, <https://www.crunchbase.com/organization/emerson-collective> (last visited June 7, 2018); *Emerson Collective*, VENTUREDEAL, <http://www.venturedeal.com/VentureCapitalFirmProfiles/Emerson%20Collective.aspx> (last visited June 7, 2018).

211. Heinrich Liechtenstein et al., *Single Family Offices: The Art of Effective Wealth Management*, in FAMILY VALUES AND VALUE CREATION: THE FOSTERING OF ENDURING VALUES WITHIN FAMILY-OWNED BUSINESSES 171 (Joseph Tapias & John L. Ward eds., 2008). A single family office serves only one family, while multifamily offices count several families among their clients. See *id.* at 170.

individual decisions to utilize philanthropy LLCs more fully, and can guide policy makers as they develop responses.

### 1. A Capital Infusion for Social Good

The most important advantage of an increase in philanthropy LLC structures is its potential to draw more capital into efforts to tackle serious societal issues. As detailed above, a philanthropy LLC's assets can be used in ways far beyond those permitted for assets contributed to traditional, nonprofit charity. To the extent this is money that would otherwise not be spent on achieving social good, society benefits. If as many high-net-worth individuals as possible give less of their wealth to their children, buy fewer yachts and vacation homes, and instead try to improve the lives of those less fortunate and save the planet, it is hard to be ungrateful. Even if they decide to take the assets back later, renting those assets is a potentially huge societal win.

The soft underbelly of this argument, of course, lies in considering where this capital would be deployed if it were not devoted to for-profit philanthropic vehicles. If philanthropy LLCs displace asset-hoarding or rapacious consumption, they are surely a positive force. If these structures instead crowd out donations to more traditional nonprofit institutions, more caution is advisable. A knee-jerk reaction against philanthropy LLCs out of unfounded fears of crowding out is unwarranted, but this is an important empirical problem for further study.<sup>212</sup>

If evidence ultimately demonstrates that funding for philanthropy LLCs and other for-profit philanthropic vehicles does crowd out donations to conventional charities, concern is appropriate. The traditional, nonprofit philanthropic sector has been an important positive force in American society for over a century. Private foundations in particular supported early civil rights litigation,<sup>213</sup> developed the 911 system,<sup>214</sup> and have financed countless scientific breakthroughs and artistic masterworks.<sup>215</sup> Since 1969, they have done so while complying with regulations that channel them toward steady, annual spending on

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212. An early study of impact investing shows it has displaced only a small amount of charitable giving, but the researchers did not specifically study the philanthropy LLC. *See* U.S. TR. & THE LILLY FAMILY SCH. OF PHILANTHROPY, *supra* note 56.

213. *See* Lynn Walker, *The Role of Foundations in Helping to Reach the Civil Rights Goals of the 1980s*, 37 RUTGERS L. REV. 1055, 1058–62 (1985) (describing the Ford Foundation's deep involvement in funding the NAACP during the Civil Rights Movement of the 1960s as well as other civil rights litigation efforts).

214. *See* JOEL L. FLEISCHMAN, *THE FOUNDATION: A GREAT AMERICAN SECRET; HOW PRIVATE WEALTH IS CHANGING THE WORLD* 61 (2007) (describing the Robert Wood Johnson Foundation's leadership in developing the 911 emergency response system).

215. *See generally id.* (providing one hundred case studies of the impact and outcome of foundations' grantmaking programs).

grants to public charities, careful stewardship, and considerable transparency. Upsetting this apple cart could risk weakening the philanthropic sector and its public bent.

These risks of disruptive philanthropy, however, counsel caution rather than condemnation. Traditional nonprofit philanthropies are not without flaws. Nonprofit production can be highly inefficient. The considerable regulation imposed on nonprofit philanthropies can stifle innovation. The lobbying and campaign restrictions imposed on tax-exempt entities can muzzle political involvement by those who would speak on behalf of the powerless.<sup>216</sup> If the restrictions on traditional philanthropic institutions are viewed in this vein, the philanthropy LLC's ability to bolster charitable donations with impact investments and direct political advocacy becomes a welcome salve.

Even if the legal strictures placed on traditional nonprofit philanthropies were ideal and perfect, nonprofit law in action is also a far cry from the way it appears on the books. Regulators in this sphere are chronically underfunded.<sup>217</sup> This lack of enforcement resources considerably undermines any advantages the nonprofit regulatory architecture can be expected to provide. To be rigorous, assessments of the comparative value philanthropy LLCs create should look honestly at more traditional philanthropic vehicles and their regulatory environment, warts and all.

Another important benefit of the rise of philanthropy LLCs is its impact on the wider for-profit sector. Disruptive philanthropy is tied to other trends blurring the boundary between traditionally charitable and business endeavors. Corporate philanthropy is a longstanding phenomenon,<sup>218</sup> but in recent decades it has become far more strategic. Though few corporations have taken Google and GM's extreme course of bringing their philanthropic programs inside the walls of their for-profit businesses, today's corporations are widely aligning their philanthropic programs more tightly with their business concerns.<sup>219</sup>

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216. See Brakman Reiser, *supra* note 106, at 61–62 (arguing for the removal of many of these restrictions).

217. See Brody & Owens, *supra* note 117, at 865–66 (describing the lack of resources at the IRS, particularly in the aftermath of the (c)(4) scandal); Thomas Lee Hazen & Lisa Love Hazen, *Duties of Nonprofit Corporate Directors-Emphasizing Oversight Responsibilities*, 90 N.C. L. REV. 1845, 1879 n.163 (2012) (reviewing the literature describing state nonprofit regulators' lack of resources).

218. See MARION R. FREMONT-SMITH, PHILANTHROPY AND THE BUSINESS CORPORATION 31–78 (1972) (describing the state of corporate philanthropy 45 years ago).

219. See, e.g., Caroline Preston, *Rethinking Corporate Giving: Western Union's CEO Offers Her Philosophy*, CHRON. PHILANTHROPY (June 3, 2010), <https://www.philanthropy.com/article/Rethinking-Corporate-Giving/160569> (“When I first started out in business, corporate philanthropy meant presenting an oversized check and going home. For the most part, those days

Today's programs address supply chain management by contributing to environmental remediation efforts where their key imports are located or labor continuity through training efforts that increase the supply of qualified employees, rather than simply making feel-good grants to the Red Cross or cultural organizations.

Similarly, corporate social responsibility (CSR) has become *de rigueur*. Corporate philanthropy programs make direct grants to charitable entities. CSR instead involves permeating business decisions with social and environmental considerations in order to take better account of a business' comprehensive impact.<sup>220</sup> It is now difficult to find a major company without a CSR agenda. Critics can easily challenge the authenticity and effectiveness of these programs, but one cannot ignore their ubiquity.<sup>221</sup> Social enterprises—businesses that pursue a dual mission of earning profits for owners and generating social good—are likewise on the rise,<sup>222</sup> as are the impact investments that help fund them.<sup>223</sup>

These developments all share a foundational belief that business can be a force for good. Disruptive philanthropy is of a piece with them. As philanthropy LLCs grow in prominence and popularity, they broadcast the capacity of for-profit entities to be part of the project of innovating for social good—and encourage businesses to continue to follow suit.<sup>224</sup>

are over.”). The work of Michael Porter and Mark Kramer has been influential in this shift. See Michael E. Porter & Mark R. Kramer, *The Competitive Advantage of Corporate Philanthropy*, HARV. BUS. REV., Dec. 2002, 1, 1, [https://sharedvalue.org/sites/default/files/resource-files/Competitive\\_Advantage.pdf](https://sharedvalue.org/sites/default/files/resource-files/Competitive_Advantage.pdf).

220. See *Definition of Corporate Social Responsibility*, FT.COM/LEXICON, [http://lexicon.ft.com/Term?term=corporate-social-responsibility--\(CSR\)](http://lexicon.ft.com/Term?term=corporate-social-responsibility--(CSR)) (describing the CSR concept and movement and offering the approach of Unilever as one representative example).

221. See DAVID VOGEL, *THE MARKET FOR VIRTUE: THE POTENTIAL AND LIMITS OF CORPORATE SOCIAL RESPONSIBILITY* 6–12 (2005) (describing the pervasiveness of CSR).

222. See Ofer Eldar, *The Role of Social Enterprise and Hybrid Organizations*, 2017 COLUM. BUS. L. REV. 92, 95 (“In recent years, there has been a remarkable increase in the number of organizations that combine profit-seeking with an altruistic or social mission.”).

223. See generally ANTONY BUGG-LEVINE & JED EMERSON, *IMPACT INVESTING: TRANSFORMING HOW WE MAKE MONEY WHILE MAKING A DIFFERENCE* (2011) (describing impact investment, its growth, and its adopters); *NEW FRONTIERS OF PHILANTHROPY: A GUIDE TO THE NEW TOOLS AND ACTORS RESHAPING GLOBAL PHILANTHROPY AND SOCIAL INVESTING* (Lester M. Salamon ed., 2014) (discussing social investment and its philanthropic impact).

224. Matthew Bishop and Michael Green present a strong argument for the value of blending the business and nonprofit spheres in *PHILANTHROCAPITALISM: HOW THE RICH CAN SAVE THE WORLD* (2008) (discussing how “philanthrocapitalism” could have an impact on social problems throughout the world). Still, these trends are not without their detractors. Michael Edwards, longtime foundation manager and Director of Governance and Civil Society at the Ford Foundation, has cautioned that the turn toward for-profit solutions more broadly may be a fad with dangerous risks. See MICHAEL EDWARDS, *JUST ANOTHER EMPEROR?* 82–91 (2008).

## 2. Magnifying Elite Influence

Despite the philanthropy LLC trend's potential benefits, it is not without costs. The potential for crowding out has already been addressed. In addition, philanthropy LLCs tend to magnify the most negative aspect of traditional nonprofit giving: essentially, that it is elitist. For all of the good that wealthy individuals can do by devoting their fortunes to worthy causes, it means these wealthy individuals are the ones who decide which causes are the worthy ones, and what kinds of solutions to try. The rich already possess outsized power in our society. From Carnegie and Vanderbilt in the Gilded Age to Gates and Buffet in our own, amassing a mega fortune has earned the successful both civic admiration and public suspicion.

In his new and much-discussed book, David Callahan paints an unnerving picture of the power of elite philanthropy.<sup>225</sup> In his words,

“[p]rivate funders have been pushing more energetically into public life even as many ordinary people have been withdrawing—and even as a key means by which citizens do things together, government, is foundering.”<sup>226</sup>

He is not alone in worrying about the dark side of elite philanthropy. Legal scholars have identified the paternalism and even colonialism on display in traditional nonprofit organizations.<sup>227</sup> Political scientist Rob Reich recounts the “many antidemocratic features” of private foundations, including their lack of accountability, limited transparency, and empowerment of the dead hand.<sup>228</sup> In her extensive research inside four of America's most elite foundations, Megan Tompkins-Stange found that even grant makers themselves are disquieted by their industry's lack of accountability and transparency.<sup>229</sup> Although these scholars ultimately

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225. See generally CALLAHAN, *supra* note 50; see also, e.g., Pablo Eisenberg, *Time for a New Movement: Clamp Down on “The Givers” Who are Taking Too Much from Average Americans*, CHRON. PHILANTHROPY (July 6, 2017), <https://www.philanthropy.com/article/Opinion-The-Givers-Are/240543> (reviewing CALLAHAN, *supra* note 50, and expanding on its themes); Alana Semuels, *The Problem with Modern Philanthropy*, ATLANTIC (Mar. 28, 2017), <https://www.theatlantic.com/business/archive/2017/03/the-problem-with-philanthropy/520989/> (discussing CALLAHAN, *supra* note 50, and other critiques of elite philanthropy).

226. See CALLAHAN, *supra* note 50, at 285.

227. See Garry W. Jenkins, *Nongovernmental Organizations and the Forces Against Them: Lessons of the Anti-NGO Movement*, 37 BROOK. J. INT'L L. 459, 479–92 (2012) (collecting legal and other critiques of NGOs, including private foundations, from the left and right); Eric Franklin Amarante, *The Perils of Philanthrocapitalism* 29–35 (Feb. 27, 2018) (unpublished research paper), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2885550](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2885550).

228. See Reich, *supra* note 12, at 67–70.

229. See MEGAN E. TOMPKINS-STANGE, *POLICY PATRONS: PHILANTHROPY, EDUCATION REFORM, AND THE POLITICS OF INFLUENCE* 131–41 (2016).

find these deficits do not make private foundations fundamentally incompatible with democracy, these attributes make it a close call.<sup>230</sup> If democracy needs to fear private foundations' potential for plutocracy, philanthropy LLCs represent yet greater peril.<sup>231</sup> They seriously underperform private foundations on the dimensions of accountability and transparency—and do so by design.

By maximizing founder control, philanthropy LLCs insulate their founders not only from public scrutiny, but also from outside input. Callahan's work collects the stories of a number of philanthropists who have been overconfident in their ability to port their success in business over to the philanthropic context.<sup>232</sup> Some of them point this out for themselves; others have yet to learn this valuable lesson.<sup>233</sup> Critics also chastise some elite philanthropists' failures to attend to the interests and ideas of the very beneficiaries they purport to help.<sup>234</sup> Elite philanthropists operating traditional nonprofit structures can easily act alone, with input from a few family members, or as part of a managing group drawn from socioeconomic and educational backgrounds similar to their own. Their governance arrangements can make it difficult to obtain ideas and feedback from beneficiaries, and the philanthropy LLC does nothing to remedy this structural flaw. Philanthropy LLC founders can make a point of seeking beneficiary input, as some foundations and grant makers do,<sup>235</sup> but nothing in the form encourages such efforts.

Much of the regulatory apparatus restricting private foundations was enacted to prevent wealthy elites from using their philanthropic vehicles to amplify their already considerable influence on society. The political restrictions are the most obvious example, but even seemingly more technical rules are addressed in part to this concern. The five percent payout requirement<sup>236</sup> prevents the affluent from stockpiling all of their funds indefinitely and forces them to spend it on current societal needs, at least as determined by the tax code's definition of qualifying charitable recipients. The excess-business-holdings regime<sup>237</sup> prevents a business

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230. See, e.g., Reich, *supra* note 12, at 80–81.

231. See Amarante, *supra* note 227, at 60–62.

232. See CALLAHAN, *supra* note 50, at 118 (“Making a bundle in software or short trading doesn't mean you'll know the first thing about, say, K-12 education, and it's easy for misguided philanthropists to do a lot of damage . . .”); see also Amarante, *supra* note 227, at 60–62 (characterizing this as the problem of “amateurism”).

233. See CALLAHAN, *supra* note 50, at 119.

234. See, e.g., Jenkins, *supra* note 227, at 489.

235. See, e.g., TOMPKINS-STANGE, *supra* note 229, at 55–56 (describing some foundations' embrace of “field-oriented” philanthropy, which “value[s] the democratic engagement of broad populations in decision-making processes as opposed to focusing on efficient and effective outcomes”).

236. See I.R.C. § 4942 (2018).

237. See generally *id.* § 4943 (describing the taxes on excess business holdings).

owner from ostensibly stepping away from control of a business while maintaining her hold from the comfort of a private foundation. The transparency required by tax-exempt entities not only enables enforcement but also forces the efforts of these potential power-brokers into the light, where the media and the public may scrutinize them.

All of this regulation comes by way of a very particular bargain. The government makes available tax-favored vehicles like private foundations, but allows philanthropists to use them only if they comply with the web of regulations intended to channel their efforts and curb their influence. The bargain falls apart if donors are willing to give up the tax advantages on offer, as do adopters of the philanthropy LLC. Philanthropy LLC founders need not concern themselves with complying with the private foundation rules. They can invest and donate as they please, on the schedule they desire, including to lobbying efforts and political campaigns, and all without surrendering the protection of tax confidentiality.

Not only do these individual bargains go by the wayside, but the advent of disruptive philanthropy threatens to undercut private foundation law generally as an important lever for disciplining and curtailing elite power. Philanthropy LLC pioneers like Powell Jobs, Omidyar, Chan, and Zuckerberg shine a light on the path away from social control over the good they wish to see in the world. Their examples demonstrate how donors can reject the philanthropic deal on offer for the past five decades and instead embrace flexibility, privacy, and control. All it costs is a few more tax dollars, maybe not even so many more tax dollars as would initially appear. As more high-net-worth individuals adopt this tactic, tax regulation diminishes as a mechanism for observing and channeling our most powerful elites.<sup>238</sup>

### 3. Prospects for Reform

It is hard to tote up the benefits and detriments of greater use of disruptive philanthropy. On the one hand, the empirical question of how much more capital it unleashes for valuable prosocial activities is essentially irresolvable. On the other, its costs to democracy and equality are impossible to value. The difficulty in calculating the difference between these unknowables only increases the challenge of evaluating policy responses.

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238. It also may divide the world of philanthropy into those merely wealthy who can afford only the more public and heavily regulated private foundation or donor-advised fund route that comes with tax concessions, and the truly carefree rich, who can foot the somewhat higher tax bill associated with the more flexible and private philanthropy LLC. I thank Kerry Ryan for this insight.



The philanthropy LLC is not an avenue law can easily foreclose with a targeted fix.<sup>239</sup> Tax law could rejigger the tradeoff that philanthropists face when considering their options by increasing tax benefits attendant to private foundations or reducing the regulatory costs they impose. Neither approach seems particularly feasible or attractive. In light of widespread concerns over the pro-wealthy cast of the 2017 tax legislation,<sup>240</sup> new proposals to reduce tax revenue by transparently increasing giveaways to the rich would seem to have dim political prospects. Reducing regulation might be more politically palatable, but dismantling the private foundation rules would counterproductively increase the very risks of elite influence that a response to the philanthropy LLC should combat.

Envisioning reforms to discourage philanthropy LLCs by increasing their costs or reducing their benefits is equally challenging. Tax law might penalize or prohibit charitable deductions for donations run through an LLC, but LLCs are an incredibly popular business form.<sup>241</sup> It will be difficult to limit such an anti-abuse rule to philanthropy LLCs alone without explicitly targeting the rich in a highly unusual manner. It is likewise hard to see how investment, political, and operational restrictions and transparency requirements could legitimately be imposed only on philanthropy LLCs, especially without some tie to tax or other government benefits sought by their owners.

Policymakers could reject such surgical solutions to tame the philanthropy LLC in favor of broader responses to tackle societal inequality, of which this structure is only one small manifestation. Reformers could overhaul tax, business, and election law to limit elite influence and democratize our society. The philanthropy LLC would be easy to cabin or eliminate as part of such a radical reform effort.

Realistically, though, this kind of reckoning is quite far off. If recent experience is any guide, our tax law is not going to become considerably more progressive in the near term, and limited liability companies and their preferential tax treatment are here to stay. Election law has been

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239. *But see* Amarante, *supra* note 227, at 64–66 (arguing it would be possible, albeit very unlikely, to create and enforce a licensing requirement for philanthropic activity).

240. In a CNN poll in December 2017, shortly before final passage of the tax package, sixty-six percent of respondents answered that they thought “the tax reform proposals made by the Republicans in Congress will do more . . . to benefit the wealthy” than the middle class. *See* SSRS, CNN DECEMBER 2017 POLL 6 (2017), <http://cdn.cnn.com/cnn/2017/images/12/18/rel12a.-trump.and.taxes.pdf>.

241. *See* Rodney D. Chrisman, *LLCs Are the New King of the Hill: An Empirical Study of the Number of New LLCs, Corporations, and LPs Formed in the United States Between 2004-2007 and How LLCs Were Taxed for Tax Years 2002-2006*, 15 *FORDHAM J. CORP. & FIN. L.* 459, 464 (2010) (describing the ascent of the LLC business form and reporting results of a study showing “that the LLC is now undeniably the most popular form of new business entity in America”).

loosening restrictions rather than tightening them of late. The idea that individuals can use their own assets more or less as they wish will likewise be hard to dislodge, and rightly so. Private property is the bedrock of our legal system. Donors who do not seek any kind of tax or other public benefit in return for their largesse will most likely continue to be able to invest as they wish, donate to causes and candidates, and maintain their privacy as they do so.

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In the absence of targeted or large-scale policy responses to the philanthropy LLC, donors and their advisors can still be sensitized to the societal risks attendant to this model. They can be exhorted to weigh them in their calculus as they decide among philanthropic alternatives. Scholars and the media can attempt to tarnish the halo of philanthropy LLC founders by dispelling any false sense that their public pledges establish a transparent or permanent charitable endowment. Commentators can also expose philanthropy LLC founders who ultimately renege on their promises and take back or redirect resources they pledged to pursue social good—if and when they do so. But many donors will still find the tradeoff the philanthropy LLC offers compelling. Even a more educated public may not care very much, or for very long. And they may be right. The potentially enormous societal return on philanthropy LLC funders' investments could be worth the risks they entail.

#### CONCLUSION

Chan and Zuckerberg are not the first to see the value in the philanthropy LLC, and they are very unlikely to be the last. Ultra high-net-worth individuals, the high-net-worth cohort just below them, and even the millionaire next door will soon be considering this newly publicized philanthropic alternative. Many will like what they find. An LLC structure can raise the tax burden of philanthropy somewhat, but in return it offers an enticing blend of flexibility, privacy, and control. While these are attractive attributes for donors, they do raise concerns for society more broadly. The regulatory burden imposed on tax-exempt, nonprofit vehicles channels elite philanthropy, and subjects it to some degree of transparency. Sidestepping this regime will make philanthropy—and its already privileged and influential purveyors—more powerful and less public. Fortunately, this kind of disruptive philanthropy also has the exciting potential to draw new and greater assets to the cause of social good.

