Doing Well By Doing Good ©

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Many of us have a passion to help specific non-profit organizations. These organizations can be health, education, veterans, music, art, environmental and community-related. The common denominator is a likely need for increasing amounts of support, as the need for the services provided increases, in both operational cost and the need and number of beneficiaries.

Royalties, an agreed percentage of a company's revenues, paid for an agreed period, are a logical means of supporting the organizations of choice. Royalties are more naturally sold by business owners of privately owned companies than managers of publicly traded companies due to the inherent advantages of the royalty and the business owner not wanting to share ownership. Indeed, investors should be very cautious of business owners offering to sell shares of ownership at a fraction of predicted future valuation, if there are available alternative non-equity dilutive means of financing the business.

Royalty payments are structured to increase as the revenues of the company grow. Therefore, investors seek to buy royalties from companies likely to experience increased revenues, irrespective of the level of reported profits, and, of course, believed to be sustainable.

Rather than simply buying a royalty from a company and contributing the royalty to the non-profit entity, the donor could contribute the necessary funds to the non-profit, specifically so that the non-profit can invest in the royalty offered by the donor-selected company.

It is also possible for the donor to make the purchase in his own name, and then donate the royalty payment to the non-profit after receiving royalty payments equal to the cost of the royalty, typically in less than 5 years. The recapture of cost of investment is, for Americans, federal tax-free. Of course, the non-profit would not be burdened by federal taxation as the owner of the royalty. It is likely

that the revenues of the company issuing the royalty will be larger after the non-profit becomes the owner of the royalty due to the increased revenues resulting from the use of the additional capital over the course of time.

The above is reasonable but not generally practical, as investing in royalties is an art and not a science. Experience is required as each transaction is different in both the characteristics of the royalty issuer and the terms negotiated for the royalty. One size does not fit all. Royalties can be issued by established companies and also by high potential pre-revenue companies. Royalties can be issued by companies that are specifically targeted to be socially constructive, as well as by companies not concerned with impact on the society.

Therefore, the logical development is to design special royalty income funds, dedicated to both investing only in royalties purchased from companies with defined characteristics. Investment professionals would manage these royalty income funds and the funds would provide administrative services. The administrative services would include registrar, transfer agency, royalty issuer monitoring, royalty collection and distribution. Investors in royalties also negotiate the form, amount, timing and breadth of distribution of information regarding royalty issuer.

Investor groups, institutions and family offices could create royalty income funds. Professional investment managers could also be the creators and managers of royalty income funds that the needs of investors who directly intend social impact. Finally, certain non-profits might see it as being in their best interest to initiate and assist in the formation of royalty income funds specifically for their future benefit.

Using royalties, investors have the ability to make valuable cost-free donations to charities. Royalties are cost-free because issuer payments of royalties to the owner are initially a return of capital. Therefore, if the royalty is contributed to a non-profit entity after the initial investment has been recaptured, there is no tax liability for the donor. The revenue projections and terms of many royalties anticipate a return of capital within five years.

As the donor would naturally want a tax deduction benefit for the contribution of the royalty, an appraisal of the value of the royalty will be required. We have created the website calculator REX-PV.com which can be useful to those making the appraisal determining the present value of the donated royalty. Clearly, the right to receive the agreed percentage of revenues for X number of additional years has a calculable value, of course, dependent on the achievement of issuer's projected revenues.

We are able to assist the appraiser in using REX-PV.com to value the asset.

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