PhilanthropyRoundtable

Transparency in Philanthropy

An Analysis of Accountability, Fallacy, and Volunteerism

John Tyler

PRINCIPLES OF PHILANTHROPY

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If people could be enticed to relinquish their privacy rights in exchange for financial or other incentives, and if governments or corporations could form their own surveillance and behavior monitoring networks at will, the citizenry would, over time, be relinquishing its autonomy and democratic powers to the government and other entities.

—John Henry Clippinger

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Preface

Engaging in philanthropy, as a donor or manager, involves hard work and hard choices. But recent years have seen new difficulties for philanthropists, in the form of challenges to the legitimacy of private philanthropy itself. Philanthropy and philanthropists are said to ignore the poor, abuse the privileges that our tax system accords to charity and donors, and deny the American public its proper authority in allocating philanthropic funds. For individuals who have chosen to incur the costs of engaging in philanthropy, these charges are extremely disturbing.

The Philanthropy Roundtable, because of its commitment to private philanthropy in America, has given a high priority to examining these charges.

Whether called attacks, threats, defenses, discussions, debates, dialogue, conversations, recommendations, or suggestions, public discourse about philanthropy over the last decade and more may be characterized in part as a search for definition of how philanthropy serves and should serve, and in some cases ultimately express, America's social, economic, and political systems. That discourse has, at times, been impaired by ambiguity of language and terminology and lack of discipline concerning principles.

In America, disagreements about values, strategies, priorities, and their relative importance are to be expected and even encouraged. It is through such disagreements that we often "search." It is to protect these disagreements and the progress they produce that our nation was and is grounded in principles and processes that foster checks and balances, federalism, separation of powers, self-determination, and liberty. Philanthropy should not be immune from such disagreements, but neither should it be a mere pawn subject to public winds and whims. Phil-

anthropy's relevance to our nation is too important, and its potential contributions to our future too valuable, to allow it to be relegated to marionette status. Therefore, the current disagreements about American philanthropy deserve greater clarity about guiding principles, more disciplined respect for roles and contributions, and less ambiguity about terminology.

It was with these objectives in mind that my colleague Evelyn Brody and I accepted The Philanthropy Roundtable's 2008 invitation to write about the legal foundations of an important part of the current debate—the question of whether foundation and charity assets may properly be characterized as "public money." The question was, in one sense, merely a matter of terminology, but the words had too often begun to be applied literally, arguing these assets were public money in the strictest sense and, thus, should be subject to government or quasi-government control. What was a seemingly innocuous semantic matter had been elevated to one of material consequence.[1] The Roundtable's invitation resulted in a monograph (now available in a second edition), a supplemental law review article, and various essays and presentations that debunked the "public money" myth and, we

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1. For instance, the "public money" concept—or simply the fact of the charitable tax exemption and deduction—has been used to advocate the imposition of mandatory ratios on the allocation of philanthropic funds and racial or gender quotas for board composition. For example, at a panel discussion in 2008, the then-head of Greenlining Institute, John Gamboa, remarked, "[W]e should have a partial share of those tax dollars that are going to subsidize those foundations to give back to our community." John Gamboa, "Mandating Multicultural Munificence?" (transcript, Washington: Hudson Institute, 2008). The "public money" concept has also been used to justify imposing various requirements on foundation boards—including public representation, open meetings and decision-making, public input on decisions about grants and strategies, or even outright deference to and implementation of such input. See Leslie Lenkowsky, "'Sunshine' Laws Also Produce Some Shadows," *Chronicle of Philanthropy*, April 23, 1998. These types of demands are not new. David A. Lipton, "Significant Private Foundations and the Need for Public Selection of Their Trustees," *Virginia Law Review* 64 (1978): 779; and Lawrence M. Stone, "The Charitable Foundation: Its Governance," *Law and Contemporary Problems* 39, no. 1 (1975): 57. Fortunately, these intrusions have generally been resisted by policymakers, but the need for ongoing vigilance and demonstrated value remains.

hope, contributed to the dialogue about the philanthropic and charitable sectors.[2]

Another, related, charge in the debate over the legitimacy of private philanthropy is the contention that philanthropic organizations are insufficiently "transparent" to public view. The present monograph examines this charge.

A major topic of contention in the current discourse has been the question of how much and what kind of transparency, openness, or disclosure should be required of philanthropic enterprises. Discussion of this question has been particularly confused and hampered by the absence of linguistic, theoretical, and even practical clarity. The goals of this monograph are similar to those of the "not public money" monograph: to consider ways in which the concept of "transparency" has been used in discussions about philanthropy and to propose an analytical framework for the term and the concepts it denotes. The hope is that this monograph can contribute to optimizing the potential of philanthropy by facilitating better understanding of how the term "transparency" and its underlying concepts have been generally applied to philanthropy,[3] including ways that both threaten and confuse. An-

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2. See Evelyn Brody and John Tyler, *How Public is Private Philanthropy? Separating Reality from Myth,* 2nd ed. (Washington: The Philanthropy Roundtable, 2012), available at http://www.philanthropyroundtable.org/files/Public_Private%20Monograph_high%20res_Final.pdf; and Evelyn Brody and John Tyler, "Respecting Foundation and Charity Autonomy: How Public is Private Philanthropy?" *Chicago-Kent Law Review* 85, no. 2 (June 2010), available at http://www.cklawreview.com/wp-content/uploads/vol85no2/Brody.pdf.
3. Throughout this monograph, "philanthropy" is generally used to refer to grantmakers, including individuals who make charitable gifts deductible under Internal Revenue Code (the "Code" or "I.R.C.") section 170 and private and community foundations that operate as nonprofit corporations under state law and are tax exempt under Code section 501(c)(3), whether grantmaking or operating. This monograph does not treat philanthropic efforts grounded in strategies outside this regimen—strategies that are becoming more common, as evidenced by the innovations of the various Milken enterprises, the Omidyar Network, Open Society Foundations, and others who choose to use the American foundation structure as one form among several within a broader strategy for pursuing philanthropic objectives. George McCully advocates a definition of "philanthropy" that does not limit itself to funders but implements the classical definition of the word, to encompass a broader range of exempt,

other goal is to increase appreciation for the complex nature of the topic, the need to respect and balance competing principles, the usefulness of relative degrees of transparency, and the benefits of disciplined decision-making that takes into account financial, opportunity, and other costs.

Ultimately, it is my hope that this monograph and discussions of it can help lead to a clearer definition of and appreciation for the role of philanthropy in America's social, economic, and political systems, particularly as transparency can facilitate or impede those roles and strengthen philanthropy's contributions to those systems.

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charitable, and voluntary associations. George McCully, *Philanthropy Reconsidered: Private Initiatives, Public Good, Quality of Life* (Bloomington, Ind.: AuthorHouse, 2008), 1–3. The narrower definition used here is merely a matter of convenience and a knowing compromise of the disciplined use of terms and rhetoric that both he and I support.

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Introduction

Discussions about transparency in philanthropy have been going on since the days of Julius Rosenwald, Andrew Carnegie, John D. Rockefeller, and J. Howard Pew. On one hand, Rosenwald and Carnegie seemed to embrace degrees of openness if for no other reason than the fact that their *modus operandi* required communities to raise money to supplement funds which they committed for building schools and libraries. Julius Rosenwald wrote about and encouraged the giving away of wealth during one's lifetime. Carnegie did the same, although some suggest that Carnegie wanted "publicity" rather than openness in order to rehabilitate the harm to his reputation attributable to decisions made while building the railroad and steel industries. Rockefeller and Pew, on the other hand, seemed to desire less or no visibility for their philanthropy during their lives because of religious convictions and a desire for privacy. In each case, the discussions and decisions were essentially private, even though both Carnegie and Rosenwald publicly sought to influence how their peers and legacies approached philanthropy.

More recent discussions about transparency in philanthropy have expanded well beyond donors and their advisors. Now, the conversation occurs across a much broader spectrum that includes, and is even dominated by, policymakers and regulators at both the state and federal levels along with academics, grantees, journalists, bloggers, commentators, associations, watchdog groups, data miners, tweeters, Facebookers, and others. While such an observation suggests a pervasiveness of dialogue, it may be that donors, boards, and managers of many philanthropic enterprises have not engaged enough in the discussions, whether those that affect the field broadly or even with regard to their specific organizations.

Each of these sets of conversations—among the great industrial-age philanthropists, policymakers, media, the public, foundations, etc.—

has much in common, particularly in that they all involve notions of transparency, openness, or disclosure. However, involving "notions" of transparency is not the same as those "notions" having commonality or being the same. The failure to recognize and address that distinction can be a significant problem for the field, for individual entities and their donors, leaders, and managers, and even for those who want to inspire transparency.

More specifically, it is likely that nearly all or at least most people would agree that there is value to be gained from degrees of transparency in philanthropy. However, that broad agreement collapses when confronted by the all-important details and realities of implementation in practice. Among these details are questions about what is expected to be open (e.g., board meetings, decision-making meetings, individual grant assessments, etc.), as determined by whom (e.g., government or private persons or entities), to what degrees or with what limitations, to what ends (e.g., compliance with tax treatment, resource redistribution, better understanding the charitable sector, etc.), and with what consequences (e.g., intended or not, financial and other costs to foundations, grantees, and society, etc.). Of course, even that list of questions is nowhere near exhaustive.

The topic of transparency is complicated, deserves further analysis, and should not be engaged without clarity about presumptions being made by participants in the dialogue. For instance, it should not be presumed that those who advocate generally for transparency in philanthropy have vetted whether the consequences and costs of their positions are generally acceptable. It also should not be presumed that those who appear to oppose the concept of transparency are not instead alarmed about the details of implementation and various consequences and costs of doing so, particularly if those details, consequences and costs have been neglected in the first place. In other words, what might seem wholesome on the surface may not be in practice and what might

seem obstructionist might be striving for solutions to the practical impediments to greater transparency. The opponents might be looking for ways in which transparency can work within various limits and boundaries without otherwise unacceptable costs and consequences to the capacity of philanthropy to fulfill its responsibilities in our social, economic, and political systems.

As a result of the lack of clarity and the too-frequent misjudgments, misunderstandings, or mischaracterizations, what seems to have emerged is more of an unfortunate cacophony than harmonic dissonance—much less perfect harmony.

There have been few, if any, thorough attempts to truly analyze and focus on issues relating to calls for greater transparency in philanthropy. The issues are important enough to philanthropy and the corresponding role of government that we need more study of the legal bases for and limits to such calls, the legitimacy and deficiencies of various other efforts to justify greater transparency in philanthropy, and reasons why philanthropic enterprises should voluntarily pursue degrees of transparency more aggressively than is required by law. The presumptions that have been filling that void are becoming increasingly troublesome, particularly as legislators and regulators at federal and state levels have been viewing philanthropy with certain (sometimes mistaken) preconceptions and are increasingly acting on those views. Also contributing to the concern are calls for greater openness from within the charitable sector that too frequently are based on presumptions that are unstated or that have not been appropriately or thoroughly vetted for their grounding or consequences. Such calls, if allowed to permeate discussions and thinking without challenge or disciplined assessment, then shape public opinion and policy, with attendant consequences and costs.

This monograph is an attempt to begin filling that vacancy. The monograph asserts that it is appropriate for the government to require

certain degrees and types of transparency to achieve specified legitimate objectives. It also advocates that foundations should do more to voluntarily pursue openness in ways that exceed current legal mandates and that are consistent with and of benefit to each foundation's particular mission and operations. This monograph also critically scrutinizes calls for increased transparency more generally, including the common (and sometimes intentional) lack of clarity about whether the pleas are merely encouraging voluntary private decision-making or are demanding government-imposed standards. The monograph challenges those latter calls for government intervention, including those that seem to presume the legitimacy of transparency as a fundamental principle in itself instead of a dependent value in service to other objectives that must themselves be legitimate. Along the same lines, the monograph dissects the most frequently asserted objectives for government mandates and reveals deeply rooted, potentially insurmountable problems with the practical pursuit of those objectives.

As such, this monograph is an effort to encourage advocates of greater transparency in philanthropy to be more disciplined and clear in their assertions. It is an attempt to embolden opponents—or even those who just want to avoid unintended and damaging consequences to philanthropy in America—to be wary, to ask questions, and to challenge stated positions about philanthropic transparency. In these ways, both can help ensure that the sector is treated with the discipline and clarity that it deserves and that is required for it to fulfill its responsibilities to our social, economic, and political systems. Ultimately, the intent of this monograph is to allow the conversation to proceed in meaningful ways that strengthen philanthropy and its service to our nation and culture. There are degrees to which more transparency in philanthropy can be pursued, promoted, and actually achieved if we remove the threats that are inherent in too many of the presumptions and if consequences of various courses of action are more completely

understood so we can embrace those approaches that are beneficial and minimize or eliminate those that are likely to cause damage.

It is one thing for Andrew Carnegie to communicate his views on philanthropy, including his expectations of transparency, and to try to persuade John D. Rockefeller to be more open or J. P. Morgan to enter the field with greater vigor. It is quite another thing to suggest that Carnegie should have been permitted to actually dictate and determine either peer's approach to philanthropy or transparency. I doubt that he would have tolerated such a view any more than he would have permitted his peers to dictate and determine his approaches to philanthropy or transparency. All these individuals decided such things for themselves based on the processes and guidance they chose to deploy. In formalizing the structure of their philanthropic enterprises as they did, they also chose to depend on their successor boards, managers, and leaders to do likewise for their respective legacy institutions. As with the original benefactors, successive institutions, other philanthropies, and the field itself are responsible for making those decisions they believe best serve donor intent, programmatic missions, and the law—including the law as it relates to degrees of transparency and openness.

Chapter I
Philanthropic Transparency and Accountability to Government

American philanthropy became an integral part of the nation's fabric long before the founding of the American republic in 1776.[1] But organized philanthropy as we know it today, made up of enterprises created specifically to pursue identifiable charitable objectives through grantmaking, is a much more recent phenomenon. Over the past century, philanthropy has evolved, particularly philanthropy by tax-exempt foundations. Among the key factors driving this evolution have been an unparalleled generosity of human spirit, visionary donors, changing social needs, an increasingly interconnected world, and, of course, changes in the tax code.

There is debate about whether the most recent steps in that evolution have made foundations more homogenous and marginalized or whether they have helped make them more effective and efficient contributors to society. There is agreement, though, that many foundations have become increasingly formal and, at least among foundations with larger staffs, professionalized.[2] Whether or not these have been universally good developments is a subject for another time.

1. See Paul Arnsberger et al., "A History of the Tax Exempt Sector: An SOI Perspective," *Statistics of Income Bulletin* (Winter 2008): 105; and Chauncey Belknap, "The Federal Income Tax Exemption of Charitable Organizations: Its History and Underlying Policy," *Commission on Private Philanthropy and Public Needs: Research Papers* 4 (Washington: U.S. Department of the Treasury, 1977): 2025, 2027–30.
2. There is a danger of over-generalizing the description of the management and operations of exempt foundations and neglecting their many permutations. Most foundations are not professionally managed. But the larger foundations have increasingly become staffed and managed by "professionals," and there has been correspondingly increased attention to the influence of this change on philanthropy and its role in American society.

There seems to be general agreement that among the factors shaping modern exempt foundations have been changes in the tax treatment of their operations and their donors' contributions. Although the federal income tax was instituted in the early 20th century, the late 1960s began formalizing a view of the tax code not just as a way to address tax treatment of private philanthropy but also as a means of interjecting other types of accountability and government presence (at least for some) into philanthropic operations and outcomes—an effort that has only increased in more recent years.

Since the tax code excludes or subtracts foundation income and donations from taxable income, it is arguably reasonable as a matter of public policy to require foundations and their donors, like other recipients of tax benefits, to substantiate their claims to these benefits and their compliance with applicable conditions. Such is the nature of the tax treatment compact, which thus provides the most compelling basis for any requisite legal accountability and for which non-compliance can carry concrete consequences.

Noticeably missing from the compact is the vesting of affirmative rights in or other empowerment of the public or government to govern and manage the participating enterprises. To the contrary, these standards, when properly applied, set barriers to such interference, except and only when necessary and appropriate to enforce the conditions of the tax treatment compact. However, tax treatment has given rise to increasingly regular demands for more transparency as a way to force the pace and direction of further change unrelated to tax policy so as to redefine philanthropy and its relationship to our social, economic, and political systems. Some of these demands are based on *quid pro*

quo and "stakeholder" theories, neither of which withstands scrutiny (as discussed below), to support more expansive approaches to accountability and transparency.

In addition to being accountable for tax treatment, foundations and charities also may be accountable for complying with conditions that donors legally attach to their contributions. Operationally, this accountability to donors most commonly manifests itself in responding to the state Attorney General or other chief charity official of the state charged with enforcing donor intent, but also can involve engaging with the courts.

A. Accountability to Law and the Tax Code: The Four Conditions that Underlie the Tax Treatment Compact

As a matter of tax and public policy, foundation income is generally exempt from federal income tax.[3] Foundations also are usually exempt from sales, property, income, and other taxes imposed by states and localities. In addition, federal and state tax policies allow donors to take charitable deductions from their income, gift, and estate taxes for contributions to foundations, subject to restrictions.[4] In return, donors and those who govern and manage foundations accept conditions for which there is accountability and reasonable degrees of transparency. There are questions, however, about how much transparency or intrusion the compact can justify. For instance, does it support reaching beyond the explicit

3. I.R.C. § 501(c)(3). However, Code section 512 requires these organizations to pay tax on their unrelated business income. In addition, unless they fall within one of the exceptions in Code section 509(a), section 501(c)(3) organizations are treated as "private foundations." As such, they are required under Code section 4940 to pay an annual excise tax on their net investment income. Thus, private foundations, strictly speaking, are not wholly tax-exempt. The "tax-exempt" label is an example of the general lack of discipline in the language applied to the philanthropic sector. Still, "tax-exempt" is a commonly understood label used to describe these organizations, so this monograph will use it as well.
4. In general, under Code section 170, donors may deduct charitable contributions to private foundations in amounts up to 30 percent of their adjusted gross incomes. The corresponding figure for contributions to public charities is 50 percent.

conditions of the compact itself, whose conditions are discussed next? Or should the analysis be re-positioned as one of *quid pro quo* and, thus, be used to rationalize government assessments of effectiveness?

Long before the institution of the federal income tax, the American social, economic, and political systems seeded countless efforts to raise and distribute money for charitable purposes. These activities became more complicated about a hundred years ago when Congress imposed a federal income tax, then had to figure out how to address charitable organizations and contributions within the context of the new tax.

Without declaring—or even hinting at—whether it was excluding charitable income and donations from the tax base altogether or whether it was including them in the tax base but reducing or eliminating the amount of tax due, Congress dealt with the situation by introducing charitable exemptions and deductions for donors who have truly given up the right to use the funds for their unilaterally directed consumption. For purposes of both the exemption and deductibility, the recipient organizations must satisfy the four core conditions that are the heart of the tax treatment compact:[5]

1. **Foundations must be organized and operated for charitable purposes.** The first condition has two parts: The entities must be both organized and operated for certain purposes. First, 501(c)(3) entities must be explicitly organized to further purposes

5. Peter Frumkin, *Trouble in Foundationland: Looking Back, Looking Ahead* (Washington: Hudson Institute, 2004), 14. Foundation accountability arises from the tax deduction. Foundations are accountable to act "within the law and ethics of good grantmaking." Richard Marker, "Public Role in Foundation Decision Making," *Wise Philanthropy*, September 16, 2007 . The explicitness of these conditions should not be overstated, however. As Belknap observed, to treat the compact as the result of a *quid pro quo* transaction "is to state the terms of a bargain which we have not before us. There is no direct evidence that such a bargain was ever made. The process of exempting these private institutions developed imperceptibly, subtly. It was a spontaneous process, leaving no trace of its origins or immediate development." Belknap, "Federal Income Tax Exemption," 2030.

that the Internal Revenue Code identifies as charitable, religious, educational, directed to the pursuit of scientific research or literacy, or otherwise exempt.[6] Note that these purposes are distinct from government's responsibilities for the "public good" writ large, although there is certainly some overlap. The distinction is explored further in chapter II. The second part of the first condition requires that relevant entities actually operate in furtherance of such purposes.[7] That is, foundations and public charities must conduct their activities and use their assets for charitable purposes. Together, these dual pieces of the first condition ensure that both organizational form and operational substance are united towards charitable ends.

2. **Foundations must not use funds for private benefit.** The second core condition is that foundations and public charities may not use their assets to further private purposes.[8] Logically, requiring that these entities be organized and operated exclusively for charitable purposes might necessarily exclude providing benefits to private interests, but stating the "no private benefit" condition separately serves independent objectives. For instance, a foundation would satisfy the first condition—being organized and operated exclusively for exempt purposes—if it supported only the religious activities or evangelizing efforts of the donor's family members, earmarked educational scholarships for the donor's relatives, or en-

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6. I.R.C. § 501(c)(3). Among indicia of being so organized, the governing documents must describe the exempt purposes that it will pursue and state that, upon its liquidation, its assets will be distributed to another charitable exempt organization or the government.
7. Ibid.
8. The prohibition on private benefit is not absolute. For instance, there is direct and implicit statutory authority for providing reasonable compensation to personnel (I.R.C. § 4941) and making other reasonable payments for goods and services that are incidental to the foundation's pursuing its exempt purposes. In this monograph, the term "private benefit" and the legal concept it denotes should be understood as permitting such compensation and payments. A foundation is also permitted—even expected—to invest its corpus so as to maintain or increase its size.

gaged in other types of exempt activities narrowly tailored to benefit the donor or another private interest. Such focused uses, even though charitable and meeting the first condition, would further private purposes in violation of this second condition.

Thus, this second condition does not merely restate the first; it broadens and complements it. But the second condition has limits. It is properly understood in the negative; that is, "no private benefit." It should not be misconstrued as requiring philanthropies to undertake the affirmative pursuit of something called "public benefit." The Code and the tax compact require charities and foundations to pursue charitable, exempt purposes, not "public benefit." As discussed in chapter II, section B, such purposes are a discrete subset of "public benefit" and "social good" that further particular roles in our American systems rather than being synonymous with the same concepts. The degrees of accountability and transparency that may properly be required of foundations should connect directly to this specific role. When government exceeds or is inconsistent with a proper understanding of the second condition, it impermissibly crosses boundaries that are crucial in order for philanthropy to fulfill its roles in our society, economy, and politics.[9]

3. **Foundations must not engage in impermissible lobbying or political activity.** The third core condition of the tax treatment compact is that philanthropic or charitable organizations and their funds must not be used for impermissible lobbying or to intervene, directly or indirectly, in a political campaign for or against any candidate for public office. This condition limits the direct influence of charities and nearly eliminates that of foundations on our nation's legislative processes. It also prohibits their engagement in our elec-

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9. See Brody and Tyler, *How Public Is Private Philanthropy?* 73–76; and Brody and Tyler, "Respecting Foundation and Charity Autonomy," 614.

toral processes. These restrictions arose for a variety of policy reasons, which are beyond the scope of this monograph. It should be added that these reasons may soon be challenged in light of recent Supreme Court decisions.[10] For our purposes, it suffices to say that this restriction supports certain degrees of government-mandated openness and disclosures to ensure compliance with its provisions (although it is difficult to prove a negative). As with the first two conditions, this third core condition does not vest power or authority in government or the public to do anything but impose consequences for non-compliance.

4. **Foundations must following reporting rules.** A fourth core condition of the compact requires foundations and charities to file information returns with the IRS—Forms 990PF and 990, respectively, and Form 990T for business income that is unrelated to charitable purposes.[11] Federal law also directs foundations and charities to provide copies of their information returns to anyone who asks and to state Attorneys General.[12] The law further mandates that these enterprises make available to the public on request their applications for exemption and the IRS letters acknowledging the same. Several states have similar filing and openness requirements.

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10. See *Citizens United v. Federal Election Commission*, 558 U.S. 310 (2010). Under the First Amendment, government may not suppress political speech on the basis of the speaker's corporate identity. In order to extend the holding of *Citizens United* to exempt corporations such as private foundations or public charities, the Court would have to overturn or distinguish *Regan v. Taxation with Representation of Washington*, 461 U.S. 540 (1983). The staff of Sen. Charles E. Grassley (R-Iowa), a member of the Senate Committee on Finance, has released a paper proposing a study of this issue. See Theresa Pattara and Sean Barnett, "Memo to Senator Grassley: Review of Media-Based Ministries," January 6, 2011.
11. In addition to general financial information, private foundations must provide specific items of information including the following: each grant made during the preceding year, separately reported details of grants or activities conducted under the "expenditure responsibility" rules, investment transactions, and compensation of officers, directors, highest-compensated employees, and parties with contracts totaling more than $5,000.
12. I.R.C. §§ 6033, 6104.

> This last condition uses openness and disclosure as a means of requiring philanthropies to demonstrate compliance with the other conditions of the tax treatment compact. Such disclosure is an unusual approach to tax policy; that is, no other taxpaying persons who receive tax-favored treatment are subject to similar requirements. Businesses and individuals that declare any number of deductions and credits are not thereby required to make their tax returns public; instead, the law requires only that they maintain documents adequate to substantiate their claims. The law requires that foundations and charities go further. Congress has essentially enlisted the media and the general public as collaborators in ensuring that exempt foundations and charities satisfy the other core conditions of the compact. It is a unique way to achieve tax policy objectives but, for the most part, it seems to have some benefits.

The above four core conditions apply to all organizations exempt under section 501(c)(3). Foundations, however, must also comply with the more specific regimen that is set out in Code sections 4940 through 4946. Congress originally imposed this regimen in the Tax Reform Act of 1969. Most of its elements elaborate on the first two core conditions of the compact—the use of assets exclusively for charitable purposes and the prohibition on private benefit.[13] For example, the first condition is reinforced by requiring that foundations pay out certain minimum amounts for charitable purposes each year and that they not make investments that jeopardize their ability to carry out their charitable purposes. Both of the first two conditions are buttressed by specific rules against self-dealing, excess business holdings, and taxable expenditures.

13. The rules include a five percent payout requirement and prohibitions on self-dealing, "taxable expenditures," "jeopardy investments," and "excess business holdings." The only rule not clearly tied to this rationale is the maximum two percent excise tax on net investment income, which was originally expected to fund greater oversight of the charitable sector by the Internal Revenue Service but was quickly diverted by Congress to the general treasury.

The 1969 act also supplemented the previously exclusive remedy of terminating exempt status for non-compliance by specifying excise taxes as lesser but still significant consequences for failure to meet the four core conditions or the act's more detailed requirements.[14]

The 1969 legislation, then, was in many ways more procedural than substantive.[15] It enacted more detailed legal standards and new penalties to ensure compliance with the already-existing core conditions applicable to all section 501(c)(3) entities. The act essentially reinforced the pre-existing compact, including degrees of openness and disclosure obligations that were consistent with it. Other than authority to enforce provisions by imposing excise taxes, the relevant parts of the act did not vest in government any new affirmative power or authority.

These core conditions are the basis for legally mandated accountability, including some that overlap with accountability for satisfying fiduciary duties at the state level. These conditions, then, should be the standard against which to measure the utility of any compelled openness and disclosures. In that sense, they are both a floor and a ceiling. The floor is that requiring certain disclosures is necessary and appropriate to ensure compliance with the tax treatment compact as embodied in the law. The ceiling exists in the sense that these conditions help protect against intrusiveness, voyeurism, and hijacking of foundation purposes,[16] any of which can fundamentally damage the roles of philanthropy, particularly as complements and counterweights to the gov-

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14. I.R.C. §§ 4940–4946.
15. Legislation was concerned with "detecting abuse but not about detecting poor performance." Kenneth Prewitt, "American Foundations: What Justifies Their Unique Privileges and Powers," in *The Legitimacy of Philanthropic Foundations: United States and European Perspectives*, ed. Kenneth Prewitt et al. (New York: Russell Sage, 2006), 45.
16. These concerns raise questions about how far government may go in requiring that foundations organized under current law meet quotas for board or staff composition, ratios for grants to organizations that serve particular causes or efforts, or other such formulas or imposing other requirements and prohibitions without violating First Amendment freedoms of speech and association and Fifth and Fourteenth Amendment due process and possibly even equal protection rights.

ernment and business sectors. Nothing in the compact or its more specific application to foundations authorizes government to interject itself in the management or day-to-day operations of a foundation or charity, absent evidence of substantial noncompliance, fraud, or abuse. Nor does government have authority, on this basis, to require greater openness, disclosure, or transparency than is necessary to enforce the tax treatment compact and its corollaries. Accordingly, arguments to expand transparency obligations by law beyond accountability to these conditions are not grounded in the tax treatment compact or its underlying policies, should not be permitted to masquerade as such, and should survive only if legitimately grounded on independent justification.

B. The *Quid Pro Quo* Fallacy: "What Are We Getting in Return?"

> Some critics say we need more transparency than the law currently requires so that the public can see whether it is getting enough benefits in return for the favorable tax treatment accorded to philanthropies and their donors.

In recent years, people have increasingly asked what society and the public are getting in return for the tax treatment compact, apparently focusing on whether foundations and charities make economic contributions to society that equal or exceed the monetary value of their exemptions and deductible contributions.[17] This is money, proponents

17. Policymakers should "scrutinize the costly subsidies" to exempt entities "and weigh that with the benefit they provide to the public." Dean Zerbe, "Should Some Charities Be More Equal Than Others?" *Chronicle of Philanthropy*, April 13, 2010. For reporting on similar arguments by Sen. Grassley and Rep. Xavier Becerra (D-Calif.), see Suzanne Perry, "Paying It Forward—and Back," *Chronicle of Philanthropy*, September 4, 2008; Makani

say, that would otherwise have been available for government to spend as part of the public treasury. Therefore, they seem to contend that every section 501(c)(3) entity must show that it affirmatively adds at least one dollar in value to society or saves government at least one dollar in value for every dollar exempted or deducted from taxation. Building on that premise, the argument continues that government must impose "transparency" so that assessments can be made about the effectiveness of this proposed value exchange. The natural next step is to impose consequences if the exchange is deemed unequal.

Setting aside the debate about whether government is taking money or letting taxpayers keep money, it can be tempting to find appeal in *quid pro quo* inquiries, particularly in the face of bad economic times, budget deficits at all levels of government, and isolated reports of charitable fraud and abuse. In addition, such inquiries on the surface seem to be what a responsible person might ask in any area of public policy, particularly tax policy. After all, public, social, and tax policy should consider outcomes, costs, and benefits, both economic and non-economic.

Themba-Nixon, "Can Counting Really Make a Difference?" *Philanthropic Initiative for Racial Equity Critical Issues Forum: Measuring What We Value* 1 (2008): 14–15; Arturo Vargas, "Data Collection Is an Important Tool for Building a More Vibrant Nonprofit Sector," in *Philanthropic Initiative for Racial Equity Critical Issues Forum: Measuring What We Value* 1 (2008): 16–17; John Gamboa and Pablo Eisenberg, "Mandating Multicultural Munificence?"; Joel Fleishman, *The Foundation: A Great American Secret—How Private Wealth is Changing the World* (New York: PublicAffairs, 2007), 52; and National Committee for Responsive Philanthropy (NCRP), *Criteria for Philanthropy at Its Best: Benchmarks to Assess and Enhance Grantmaker Impact* (2009). For charitable deductions "based on the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare," see Laurens Williams and Donald V. Moorehead, *An Analysis of the Reasons Prompting Current Statutory Distinctions Between Public and Private Charitable Organizations* (Washington: Commission on Private Philanthropy and Public Needs, 1977), 2112; and Peter Frumkin, "Accountability and Legitimacy in American Foundation Philanthropy," in *The Legitimacy of Philanthropic Foundations*, ed. Prewitt et al., 99, 100. To some, accepting tax breaks creates responsibilities.

> The "quid pro quo" rationale has no basis in law. In fact, it is contrary to the principles of our nonprofit tax law, which give private citizens, rather than the public as a whole, authority to choose the charitable purposes for which philanthropic dollars should be spent. Moreover, letting government decide whether philanthropies provide sufficient benefit means vesting this power where it is not likely to be exercised well.

Thus, the problem is not necessarily with the inquiry itself but with certain of its assumptions, inferences, and applications. For instance, the tax treatment of an exempt organization is generally not determined by savings to the government or costs government would incur if it were responsible for delivering the services (or even by the costs incurred by the organization itself).[18] After all, for over 200 years there has been recognition that the charitable sector is not a mere proxy for government, as the *quid pro quo* theory would posit.[19] In addition, if saving government money were the justifying criterion, exemptions would be available to individuals and to organizations without regard to their status as exempt or for-profit.[20] Also, many exempt organizations provide services that are not the responsibility of government in the first place—indeed, in many instances, they provide services that government is constitutionally prohibited from providing, which defeats any ability to undertake a *quid pro quo* analysis in these areas.[21]

Problems continue in that *quid pro quo* accountability and transparency

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18. See John D. Colombo, "Why Is Harvard Tax-Exempt? (And Other Mysteries of Tax Exemption for Private Educational Institutions)," *Arizona Law Review* 35 (Winter 1993): 862–64.
19. Chief Justice John Marshall: "Eleemosynary institutions do not fill the place which would otherwise be occupied by government, that would otherwise remain vacant." *Dartmouth College v. Woodward*, 17 U.S. 518, 647 (1819).
20. See Colombo, "Why is Harvard Tax Exempt," 862–64.
21. Ibid.

to support it would impose a new financial condition on the compact and put government in the position of assessing relative value, merit, and effectiveness of all entities in the sector. Such an imposition either ignores or unilaterally changes the existing compact, which could then be used to expand government intrusions beyond concepts of accountability and transparency.

Even if it could somehow be argued that the compact can be ignored or changed, the *quid pro quo* position is laden with ambiguity, monovision, and suggestions of consequences for failure. Sometimes the devil really is in the details, particularly with a deceptively simple and otherwise alluring policy. Like problems with effectiveness generally as an objective for transparency, which is discussed in section D of chapter II, the *quid pro quo* position often neglects the needs to identify and adopt standards, to empower someone to assess compliance, and to determine consequences in the event of noncompliance. Taken to an extreme, section 501(c)(3) entities could lose their exempt status if they are deemed deficient in providing adequate monetary value, and organizations would be denied exempt status if they cannot commit to doing so. Other suggested or implied consequences for failure might include government-imposed quotas or ratios for grantmaking or personnel, fewer decisions (if any) left to the discretion of board or management, or other, still more expansive and intrusive excursions into autonomy.[22]

Two additional problems for the *quid pro quo* approach that deserve more attention are the absence of a sound economic basis and its disregard for the intangible, invaluable contributions of philanthropy.

The Unclear Economics of the *Quid Pro Quo* Rationale. The *quid pro quo* position lacks clarity or discipline in the value it is demanding. For example, while the literal words suggest an intent to as-

22. Paradoxically, many of the recent proposals that encourage quotas or ratios in activities and personnel do not seem to concern themselves with the actual effectiveness of the subject organizations.

sess the "cost" only in terms of revenue that government forgoes by allowing exemptions and deductions, the rhetoric and messaging demand more broadly that the "cost" consist of all funds under the management or control of exempt organizations, even money that was not "diverted" from the public treasury. Which is it? Consider a donor who contributes $100 to a charity at a time when the total tax rate on the donor's income is 35 percent. A *quid pro quo* proponent would say that 35 percent, or $35, is "forgone" by the government: It has gone to the charity instead of to the public treasury. In contrast, the "all funds" approach also asserts dominion over the remaining $65 that is in no sense revenue lost by government. The distinction between these approaches is neither subtle nor nuanced, and the lack of discipline or clarity suggests a desire for the broadest application. However, even accepting the argument at face value, there is no justification in the compact for government to demand economic value from funds that would never have been paid in taxes.

There are at least three more practical reasons why the economics of the *quid pro quo* rationale does not work.

First, the *quid pro quo* argument seems to assume that eliminating a charitable exemption or deduction will generate at least an equivalent amount of financial gain to the public treasury. Among the serious problems with this assumption is that the donor who no longer has the charitable deduction available may find other tax-deductible uses for his or her money. Moreover, with regard to foundations, their annual payouts as required by law likely exceed what the government would probably receive by taxing their income in any event. Consider a foundation with assets of $100 million that generates net income of $10 million. If the foundation were not exempt, that $10 million would be taxable: Assuming a rate of 15 percent and no deductions against the income, the tax due would be $1.5 million. But because the foundation is exempt, it is required by law to spend five percent of its net asset

value on distributions that serve its charitable purposes—in other words, $5 million. That is, the foundation's qualifying distributions are more than three times the amount it would pay if it were taxable. In addition, the "exempt" foundation must pay tax on its net investment income—generally two percent, or $200,000 in this case—as well as paying taxes at regular business rates on any unrelated business income. Applicable tax rates would need to exceed 52 percent—not counting the expenses that the foundation would incur in generating its income and could claim as deductions—before government could "break even." Therefore, any assumption that changing the tax compact will automatically grow government coffers is fallacious.

Second, although the public treasury may gain initially from eliminating the exemption or deduction, it could find itself drained later by the need to provide services that foundations and charities stopped providing when contributions fell. Additionally, it cannot be reliably presumed that government will provide those services at the same or lesser cost or at the same or better efficiency or quality. If not, government could ultimately pay more to deliver the services, which might result in a financial loss to government over time instead of a gain.

Finally, there is evidence that the economic return from the charitable sector may actually exceed, dollar for dollar, the standard required by a *quid pro quo* theory, whichever accounting approach its proponents adopt. Although establishing definitive causal relationships is not possible, a 2008 study by economists Robert Shapiro and Aparna Mathur for the Philanthropic Collaborative found that economic activity across all subdivisions of the charitable sector yielded an average eight-to-one return.[23] That is, every dollar made available to the sector through grants and donations appears to generate $8 in economic benefits. That ratio would be substantially higher if applied only to

23. Robert J. Shapiro and Aparna Mathur, *The Social and Economic Value of Private and Community Foundations* (Washington: Philanthropic Collaborative, 2008), 2.

amounts actually forgone by government—which, as demonstrated above, represent only a fraction of all philanthropic funds.

Beyond Economics. Congress regularly uses taxation and other financial incentives and preferences for purposes other than generating revenue to pay for government operations. It commonly uses tax policy to promote certain behaviors and practices and discourage others. In the area of philanthropy, tax policy was and is designed to respect and encourage the critical non-monetary roles and contributions of charities and foundations. After all, the "underlying motivation of the tax exemptions was not restricted to fiscal advantages to the granting government, nor even restricted to the welfare of its own people" but instead embraced "ideals of humanitarianism and piety."[24] The philanthropic and charitable sectors are replete with examples of value to society, often in terms of activities but also through their very existence as fundamental expressions of principles and values that cannot be appraised. As such, the "tax exemption privilege has much deeper roots than *quid pro quo* theory would admit."[25]

In other words, it isn't only, or even necessarily, about the money. A literal application of the *quid pro quo* position, in which the "quid" and the "quo" are commonly understood in financial terms, would make it about the money and abandon those ideals and all else that cannot be objectified in monetary terms.

That danger exists, however, only to the extent that the *quid pro quo* analysis is applied consistently. One of the problems with some *quid pro quo* positions is the occasional selectivity with which the position sometimes seems to be advanced. Some applications of the theory purport to impose the theory generally but forgive it for those charities and philanthropies that support the causes, issues, purposes, or organ-

24. Belknap, "Federal Income Tax Exemption," 2033.
25. Ibid., 2032.

izations they favor. Such inconsistency weakens the value of any principles that might otherwise have supported the argument and leaves the position vulnerable to challenge. Consistently applied, however, the *quid pro quo* analysis runs the risk of demeaning essential non-economic contributions that are a hallmark of the sector and epitomize the features that distinguish philanthropy from government and business.

For instance, there is inherent value in the sector being independent of government[26] and having the flexibility to respond quickly to unexpected needs and opportunities. There is value in not being beholden to politicized policies, pressures, or demands and in not being unduly influenced by what may be popular or the latest fad.[27]

There is also value in the sector's being programmatically separated from the commercial market. Such a distinction permits foundations and charities to pursue strategies with a long time horizon and long-term vision of the future, to sponsor efforts that advance human wel-

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26. "[W]hen you team up with the government, you compromise your ability to be critical of the government and sometimes you compromise your ability to do controversial and maybe unpopular things with your money." Chester E. Finn Jr, "Quick Question Survey: What's the Right Relationship between Philanthropy and Government?" Grantcraft, 2010, available at www.grantcraft.org/index.cfm?fuseaction=page.viewPage&pageID=1532. For the role of private philanthropy in challenging democratic majority and conventional wisdom, see Lawrence M. Stone, "The Charitable Foundation: Its Governance," *Law and Contemporary Problems* 39, no. 1 (1975): 66; Subcommittee on Foundations, 93rd Cong., 2nd sess., *Congressional Record* (October 4, 1974): 33,952, 33,954. Foundations offer an alternative to dependence on government.
27. Society should "value institutions with an ambition for longevity and be wary of simplistic generalizations that trivialize one or another part of the philanthropic world." Susan Berresford and Lorie Slutsky, "Foundations' Longevity Should Be Valued," *Chronicle of Philanthropy*, September 2, 2008. "Whatever someone elects to support, others will question or challenge." Internal Revenue Service, Advisory Committee on Tax Exempt and Government Entities, *Report of Recommendations* (Washington, June 11, 2008), ii; and Curtis W. Meadows Jr., *Philanthropic Choice and Donor Intent: Freedom, Responsibility and Public Interest* (Washington: Center for Public and Nonprofit Leadership, Georgetown University, 2002), 2. However, common good can be characterized by "collective causality," or actions traceable to "the community (rather than individual members or parts)." Cf. Mark Rosenman, *Foundations for the Common Good* (Washington: Caring to Change Project, 2010).

fare in the absence of an expected commercial rate of return, and to fund initiatives that might prove useful to society in ways that are presently controversial, unacknowledged, or remote.[28]

Among the many examples are foundations whose funding supported organizations and activities that eradicated various diseases in parts of the world; established libraries for the public; founded schools for African-American children in a time of pervasive segregation and violent Jim Crow; helped propel the American civil rights movement; revolutionized medical schools; got lane lines on highways and roadways; and contributed to the development of commercial flight, telecommunications, and biotechnology. Often, foundations undertook such steps in the face of severe criticism and threats and despite unpopularity and low likelihood of success, commercial or otherwise. It is possible that none of these advances would have occurred without the autonomy, independence, and privacy that the philanthropic sector enjoyed and continues to enjoy. They certainly would have occurred differently.

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28. For a source citing benefits of "the kind of independence that allows foundations to be innovative, take risks, and work on long-term solutions to some of the world's most vexing problems," see Bradford Smith, "Foundations Need to Be More Transparent," *Philantopic*, January 29, 2010. Foundations are meant to be the "venture capital of the nonprofit sector." See Vartan Gregorian, *Transparency and Accomplishment: A Legacy of Glass Pockets* (New York: Carnegie Corporation, 2003), 9; The private foundations' "independence from . . . popular support" makes them "less likely to be subject to public passions and prejudices of the moment than almost any other institution in our society." Stone, "The Charitable Foundation," 58, 60–61, 65. As stated by the Cox Commission, foundations' "most significant function has been displayed in supplying the risk and venture capital expended in advancing the frontiers of knowledge." Laurens Williams and Donald V. Moorehead, *An Analysis of the Federal Tax Distinctions*, 2104. Some lament the danger of philanthropic professionalization producing a level of "agreement and complacency" that is "hardly a recipe for achieving philanthropic breakthroughs" and call for a use of philanthropic funds "to enact new and compelling visions of the common good." Frumkin, *Trouble in Foundationland*, 36, 70.

> There are circumstances in which government can and should uniformly require more transparency from the sector. Those circumstances generally involve pervasive fraud and abuse not remediable by enforcing current law. While there are instances of both, there is not evidence of a widespread infestation of either, nor is there evidence that current laws are inadequate to address the fraud and abuse that do occur.

Of course, realizing the promise of this independence requires courage, steadfastness, and discipline. It involves society and donors placing considerable trust in the structure of philanthropy and those who oversee, manage, and operate its enterprises. Such trust, properly understood, is not blind or thoughtless but instead is part of a network that seeks to balance regulation, openness, and accountability with autonomy, independence, and effectiveness. Thus, some circumstances might warrant more intrusive government scrutiny or enhanced regulation requiring more openness.

One such circumstance might be an infestation of fraud and abuse that could not be countered by current laws, regulations, and enforcement. Unfortunately, there is a small segment of people who exploit philanthropy for their own private purposes, just as there are people who do the same in government and business. Given the frailties of human nature, such individuals will always exist despite the best efforts of the overwhelming majority of people in philanthropy who act with good faith and benevolence. Existing laws must be enforced, and more resources and better coordination should be devoted to federal and state enforcement efforts.

Thus, as a matter of imposing accountability under the tax code or mandating greater transparency in philanthropy, the *quid pro quo* position is woefully inadequate and, rather than generating clarity, instead contributes massively to the confusion.

C. The Misnomer of Philanthropic "Stakeholders"

In addition to being accountable under the law and the tax compact, some assert that foundations have a duty of accountability to a broad group of "stakeholders" and that fulfilling this duty justifies demands for greater transparency. Like *quid pro quo* thinking, an expansive view of who constitutes a legitimate stakeholder might have an intuitive appeal on the surface, but the most commonly asserted arguments for more expansive accountability and corresponding transparency mandates quickly fall apart when challenged.

For instance, as with other aspects of the charitable sector, discussions about foundation stakeholders often suffer from lack of clarity in word choice, definition, and discipline. For example, the term can be applied without distinguishing between legally vested rights and responsibilities and various social interests. Stakeholder theory is essentially a theory of management.[29] Some advocates, however, seek to vest such management theories and practices with fiduciary levels of responsibility and governance. The resulting confusion, if left unchecked, could threaten the ability of foundations to fulfill their roles and responsibilities in our system.

This is not to suggest that foundations do not have legitimate stakeholders or that foundations should not be appropriately accountable

29. "Stakeholder theory is really a theory of management." Norman Bowie, "Forward," in *Stakeholder Theory: Essential Readings in Ethical Leadership and Management*, ed. Abe J. Zakhem et al. (Amherst, NY: Prometheus, 2008), 10–11; R. Edward Freeman *et al.*, *Stakeholder Theory: The State of the Art* (Cambridge, U.K.: Cambridge University Press, 2010): 9, 12, 64, 87, 224; Robert Phillips, *Stakeholder Theory and Organizational Ethics* (San Francisco: Berrett-Koehler, 2003), 15, 32; Thomas Donaldson and Lee E. Preston, "The Stakeholder Theory of the Corporation," *Academy of Management Review* 20, no. 1 (January 1995): 68; R. Edward Freeman, "Managing for Stakeholders," in *Stakeholder Theory*, 78–79; and Ronald K. Mitchell et al., "Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts," *The Academy of Management Review* 22, no. 4 (October 1997): 167.

and transparent, legally and socially, to those stakeholders. Nor should they ignore or neglect the very people and institutions that are affected by their decisions. But there are critical differences between legal and social accountability and the degree of transparency applicable to each. The former is grounded in law and all the hallmarks of law in civil society in terms of resorting to courts, imposing consequences for violations, and raising expectations of order, consistency, and predictability. The latter is derived from the possible impact that decisions by foundation personnel might have on others. Discussions about philanthropic transparency and accountability would benefit from understanding and maintaining this distinction.

Rights Holders and Guardians. Within the first category of stakeholders are those who have legally enforceable rights and the ability to demand corresponding remedies and consequences for a foundation or person's failure to respect those rights. These rights may be grounded in statutes, regulations, contracts, or fiduciary duties. In some instances, such rights may be broadly applied to the entirety of the foundation as an enterprise, including governance, management, and programs. In other instances those rights may be narrowly confined to a particular obligation undertaken as a matter of contract. In both cases, a foundation has a duty of accountability and relative degrees of transparency to such stakeholders. Indeed, the persons described by this category are perhaps more appropriately deemed "rights holders" rather than being lumped indiscriminately into the more generic category of "stakeholders."

Examples of such rights holders include members of the boards of directors or trustees, members of management, and other significant decision makers. As is discussed in part A, directors, trustees, and management have responsibilities for ensuring charitable organization and operation, protecting against impermissible private benefit, ensuring that there is not improper lobbying and political intervention, and ef-

fecting required disclosures and reporting. They are rights holders because they have legal authority, can legally be held to account personally and collectively, and can legally hold others to account. As long as they serve in these positions, they have no subsequent right to abrogate or neglect their duties and responsibilities with impunity. Additionally, they also have at least a moral and, in some cases, legal responsibility to the donor and his or her instructions and intentions.

The chief charity official of a state, usually the Attorney General or Secretary of State, and the Internal Revenue Service are often portrayed as rights holders. Certainly, foundations have legal responsibilities to account to charity officials and the IRS, particularly with regard to matters such as compliance with donor intent, charitable organization and operation, and the absence of impermissible private benefit. Moreover, charity officials and the IRS have the legal power and duty to hold foundations and their personnel accountable for failing to fulfill those and other responsibilities. However, neither charity officials nor the IRS have the legal authority or legitimate right to substitute their personal opinions, preferences, or judgment for that of the donor or of foundation personnel, if such judgment is exercised reasonably and in good faith and otherwise satisfies donor intent and complies with the law.

Consequently, it may be more accurate to characterize charity officials and the IRS as “rights guardians” rather than direct rights holders. In essence, these guardians protect donor intent and ensure compliance with the law. In both instances, charity officials and the IRS also protect society’s interest in preserving and promoting private foundations and the roles they fulfill in our systems. Foundations are appropriately accountable to rights guardians and have transparency obligations that further such accountability.

Interest Holders. The second category of alleged foundation “stakeholders” includes those who are affected by decisions of foundations

and their personnel and, as such, have interests in those decisions. In contrast with holders of legal rights and responsibilities, persons in this second category might better be called “interest holders.” Despite their interests in particular results, they do not have an intrinsic legal claim to particular outcomes, nor can they be held to account for the manner in which they exercise or pursue their interests. They also lack an inherent ability to pursue or impose legal consequences for decisions with which they disagree, even if such decisions cause them harm. Instead, their influence is social rather than legal.

In the case of private foundations, interest holders might include grant recipients, unsuccessful applicants, and potential recipients of grants; the people, causes, and missions served by grant recipients, unsuccessful applicants, and potential applicants; employees of the foundation, grant recipients, unsuccessful applicants, and potential applicants; others who work in and fund the same charitable missions, including other foundations, individuals, corporate funders, charities, and governments; vendors, suppliers, and creditors; researchers, academics, and theoreticians; various communities; and many others. Given the longevity of most foundations, another set of interest holders might even be future generations of the above who are affected by current decisions. The degree and weight of these interests among these holders are likely to change over time and circumstances.

It would be impossible to prioritize each of these interests equally or even to a rational degree of proportion. Choices must be made. At a minimum, limited resources prevent funding every grant request and require making hard choices from among equally deserving applicants. Moreover, these interests often will irreconcilably conflict with each other, so that there is no way a material decision can fully (or in many cases even partially) satisfy all of the possible interests. Stated differently, someone will almost always be disappointed or worse. For instance, current grantees might contend that they have an abiding

interest in continuing or even increasing their grants; this interest necessarily clashes with the interests of other current grantees and of unsuccessful applicants and potential grantees who would like to change the status quo to favor their own interests. Legally prioritizing the interests of current grantees would likely inhibit innovation and change, while forcing foundations to prefer other claimants to foundation funds would interfere with the benefits of consistency, success, and a long time horizon.

That is part of the reason why rights holders exist in America—to evaluate competing claims and make decisions using their best judgment so as to implement donor intent, ensure compliance with the law, and achieve desirable charitable outcomes. To help foundation personnel make the decisions they must make in an informed manner, it often would be appropriate, and even encouraged as a management practice, for them to engage with—that is, listen to and provide relevant information to—some of those who have affected interests. Thus, management considerations, rather than legal obligations, provide the proper framework within which to consider the ways in which "stakeholder" theory might translate from the for-profit sector to foundations, despite the clearly divergent contexts.

For instance, for-profit companies need buyers to whom to sell their goods and services; they want suppliers, creditors and others to give them better terms; they want to attract and retain employees and potential employees; and they often want to be appreciated within their communities. The ways in which these non-shareholder stakeholders perceive businesses can fundamentally affect the businesses' ultimate legal objectives—that is, their profitability. Therefore, as a theory of for-profit management, choosing to engage non-shareholder stakeholders can be meaningful, because failing to do so can have direct consequences on the company's bottom line and ultimate legal objectives. The relationship is reciprocal: All of these non-shareholder stakeholders have a direct inter-

est in the companies' profitability, because the lack of profitability can directly threaten the ability to pursue their respective interests. The reciprocity generates some material degree of substantive alignment.

Herein lies one of the key differences between a for-profit company's non-shareholder stakeholders and a foundation's interest holders. A foundation's ultimate legal objective (and the responsibility of its rights holders and guardians) is to pursue charitable purposes consistent with donor intent and the law. It cannot be presumed that interest holders share that same objective for the foundation, nor is there a degree of alignment comparable to the alignment of goals among the array of for profit stakeholders. In fact, some interest holders may have objectives that undermine a foundation's charitable status. Thus, vesting accountability and transparency rights in foundation interest holders as if they were stakeholders of for-profit companies would be fallacious. They are not the same.

Not only are they not the same, but under our American system, non-shareholder stakeholders of for-profit companies lack legal status that would permit them to file claims, pursue remedies, or assert legal consequences for failure to respect their position as stakeholders. Constituency statutes enacted in most states during and since the 1980s never changed that dynamic; instead, such statutes merely protect directors from liability for considering certain non-shareholder interests in certain unique situations.[30] Even the more recently created flexible-purpose corporations and benefit corporations do not vest standing or authority in non-shareholder stakeholders to hold directors or management accountable if they neglect such stakeholders.[31] As a result, stakeholder theory and practice in the for-profit context in the United

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30. See John Tyler, "Negating the Legal Problem of Having 'Two Masters': A Framework for L3C Fiduciary Duties and Accountability," *Vermont Law Review* 35 (Fall 2010): 117, 131–38.
31. Ibid., 136 n.88; and John Tyler, "Regulating Charitable Hybrid Forms and the Effect of Various Approaches on Financial Capital," *NYU Journal of Law and Business* (forthcoming, Spring 2013).

States remain, at best, a focus of management or business ethics, not of governance and fiduciary duties.

Therefore, to the extent that there is reliance on appeals to "stakeholder" theories and practices to justify holding foundations accountable to interest holders and to demand greater transparency as a result, such reliance is misplaced for at least two independent reasons. First, such appeals misapply management and business ethics theories and practices to matters of governance and fiduciary duty. The principles that characterize these spheres are not the same, and confusion and harm result from conflating them. Second, these appeals actually seek to vest more rights in interest holders than is enjoyed by non-legal stakeholders of for-profit companies.

Although foundations may have the legal right to ignore or neglect interest holders, there are numerous reasons why doing so would be generally counterproductive and maybe even unwise. Many of these reasons are presented in chapter III, which discusses why voluntarily and strategically undertaking degrees of transparency beyond the minimums required by law can serve foundations generally and any given foundation more specifically. Among the benefits are enhanced reputation and credibility, stronger and more informed programs and grantmaking, potentially more efficient processes, and greater opportunities for collaboration, scaling and replicating successes, and avoiding mistakes.

Particularly in this age of social media and instant communication of unfiltered opinions, interest holders do have a voice that can exert social pressure on foundations and their personnel, and they can have a very meaningful influence. This can be a negative factor for a foundation or can be very beneficial, depending on the way in which foundations engage before and during such situations. More than just paying attention to rights holders and guardians, foundations also should consider how best to engage their relevant interest holders affirmatively, as a management tool, in order to pursue their charitable purposes most

effectively and efficiently consistent with donor intent and the law. Such an effort, however, should not be confused with or deviate towards legal accountability and misapplied stakeholder theories and practices.

D. Accountability to Donor Intent

> Philanthropies have a degree of accountability to their donors under state law. But this accountability varies widely by state, and trying to expand state law accountability is likely to harm philanthropy at least as much as it helps.

Donors who create or contribute to philanthropic organizations rightly have implicit if not legally enforceable expectations that their charitable intent will be honored—including, in some cases, an intent to defer to the decisions of others. Such philanthropists make their intent known through combinations of various informal methods and formal documentation, such as trust agreements, articles of incorporation, bylaws, and applications that ask the IRS to recognize their organizations as exempt.[32] Philanthropists, then, should be able to reasonably expect that the trustees, directors, and managers of the charitable enterprises they create or support will abide by their stated intentions—not the retrospective interpretations of that intent but, as much as possible, the actual, objective intent of the donor.

Living donors may or may not have authority to enforce that intent directly in the courts. Much depends on the specifics of state laws and

32. For more information about how donors might consider communicating their intent for posterity, see Jeffrey Cain, *Protecting Donor Intent: How to Define and Safeguard Your Philanthropic Principles* (Washington: The Philanthropy Roundtable, 2012); Thomas J. Tierney and Joel Fleishman, *Give Smart: Philanthropy That Gets Results* (New York: PublicAffairs, 2011); and Thomas J. Tierney, "To Succeed, Philanthropy Needs to Be Rooted in Deep Personal Beliefs," *Chronicle of Philanthropy*, February 20, 2011.

the content of the donative documents, including the clarity with which intent is stated and the degree of discretion granted to trustees, directors, and managers. The donor's heirs are even more limited in their ability to enforce donor intent directly, though the donative documents and less formal statements of intent can be helpful if the heirs serve as directors or employees or wish to appeal to a state Attorney General.

Ultimately, society has an abiding interest in respecting and protecting essential degrees of donor intent, if for no other reason than to encourage the continuing formation of and donations to philanthropic enterprises. If potential philanthropists cannot securely expect their legitimate charitable intent will be honored and enforced, they will not create such entities or contribute to them. Philanthropists gain their confidence based in part on how Attorneys General and public treat the donors who have preceded them. If that record is not meaningfully reliable, they will deploy their wealth in other ways that may or may not serve society as broadly or productively.[33]

Responsibility for fulfilling this obligation to society and the philanthropist, particularly one who is deceased, is normally vested by statute or common law in the state Attorney General or other chief charity official. As discussed earlier, that investiture does not permit these persons to substitute their judgment or charitable—or political—intent for that of the donor, nor is it their prerogative to pursue their versions of donor intent. State charity officials best fulfill their duty by

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33. Potential donors also gain comfort from the record with regard to how well or poorly subsequent trustees, directors, and managers abide by or neglect donor intent. For discussions of how donor intent has been perceived with regard to particular aspects of the Ford Foundation, the Pew Trusts, the Barnes Collection, the Marin County Community Foundation, and others, see Waldemar Nielsen, *The Golden Donors: A New Anatomy of the Great Foundations* (New York: E. P. Dutton, 1989); and Martin Morse Wooster, *The Great Philanthropists and the Problem of "Donor Intent,"* 3rd ed. (Washington: Capital Research Center, 2007). With regard to the Robertson donation to Princeton University, see Neal Freeman et al., *The Robertson v. Princeton Case: Too Important to Be Left to the Lawyers* (Washington: Hudson Institute, 2009).

seeking, as much as possible, to enforce the donor's intent to the extent that it can be discerned. The courts also can have an important role, for matters brought before them, in overseeing how charity officials carry out their duties and countering efforts to distort donor intent or exceed boundaries of authority.

Just as Congress has enlisted the public and the media to facilitate accountability to the tax treatment compact, donors can rely on various disclosures to encourage fidelity to their intent. At a minimum, articles of incorporation, exemption applications, recognition letters from the IRS, and annual tax information returns are required by law to be made available to the public, including the media. Members of the public and the media can examine and compare these documents and from them gain some degree of understanding of donor intent and possible deviations from that intent, which they can then publicize or provide to a state's chief charity official. To the extent a donor wants to expand the role of the public and the media in this regard and further deploy social accountability, she or he can make other documents and information more broadly available to them.

However, providing for such expansive transparency ultimately can be of limited usefulness and can actually be detrimental. The usefulness is limited because the public and the media have no enforcement authority. At best, they exercise persuasive authority by putting pressure on trustees, directors, and managers or the Attorney General. Moreover, the public and the media are likely to have only bits and pieces of relevant information; they are not likely to have most, much less all, of it. Thus, their conclusions can be faulty. If so, their subsequent actions can disrupt the enterprise's valid pursuit of mission and divert funds and other resources from legitimate programs and operations. Such actions also can distract trustees, directors, and managers from fulfilling their primary obligations to the donor, the law, and society.

Of course, a donor could choose to communicate her or his intent

publicly while living. For instance, Andrew Carnegie was very public about his philanthropic intentions, activities, and philosophy. He also was clear about vesting ultimate decision-making authority in his foundation's trustees, including authority to deviate from his precedents and words in order to pursue those charitable objectives they believed best under the circumstances. Melinda and Bill Gates have chosen to be similarly open about their philanthropic goals and how they intend to pursue them through their foundation. In addition to some of the benefits of openness discussed in chapter III, part A, such openness invites the public and the media into an informal—but still limited—relationship with a foundation's trustees, directors, and managers after a donor can no longer be active. The possible dangers of such an invitation can be mitigated if, in addition, a donor either communicates, with similar publicity, an intent to empower trustees to use their discretion as Andrew Carnegie did or is explicit and public about her or his programmatic and operational intent.

Donors who are very public about these aspects of their philanthropy also set expectations concerning the way they expect their foundation to operate subsequently. With a donor for whom anonymity or privacy is a priority, or who chooses to be more open about certain things than others, such expectations can sometimes be inferred from the donor's patterns of action. Care should be taken, however, to distinguish between a donor experimenting with possible fads and providing informed, thoughtful guidance. Care should also be exercised to avoid unintentionally vesting in the public or media or some vague subset of either a pretense of authority or influence that does not exist in law and can be detrimental in practice to clear decision-making and achieving charitable goals.

Chapter II
Philanthropic Transparency In Context: Fallacies of the Four Most Common Arguments

The disclosure currently required of foundations—their legally mandated degree of transparency—serves substantive public policy objectives of accountability that are clearly linked to tax policy and limited accountability to donors. Today, however, many would require considerably more from foundations. These arguments for further transparency generally fall into four major categories:

1. Transparency as an end in itself
2. Transparency to ensure that foundations serve "public" purposes
3. Transparency to re-balance a purported power asymmetry between foundations and grantees
4. Transparency to enable assessments of foundation effectiveness

Although these positions could have merit in certain contexts and applications, including some storefront appeal, further analysis shows that they are inherently unsound as stand-alone objectives. As such, these objectives as generally alleged contribute to the quagmire instead of to the desired clarity and coherence, particularly if trying to justify legally expanding intrusions.

A. Transparency for Its Own Sake

Those who make this argument treat transparency as an independent value like democracy, liberty, justice, or moral virtue. They claim that philanthropies should be transparent in the same way that government and business are. But liberal democracies do not treat transparency as an end in itself: We impose different degrees of transparency on different institutions, based on the purposes they serve in our larger political, economic, and social systems.

We require the most transparency from government; we require the least transparency from individual citizens, who even exercise their most sacred public responsibility—voting—in secret. In between, we require extensive transparency from public corporations because of their obligations to their shareholders and their role in the public markets; we require less transparency when businesses are private.

Philanthropy is neither government nor a series of public corporations. As with each, the degree of transparency imposed on philanthropy should be based on an analysis of what is needed to ensure that it fulfills its role in our system without imposing unacceptable costs in terms of expense, opportunity, or principle.

Proponents commonly point to the transparency of government and business to justify mandating greater openness in philanthropy.[1] These

1. For the need to "demand clear, detailed information about the results of efforts and hold charities to the same standard of transparency and accountability that we ask of government and public corporations see, e.g., Sally Beatty, "How Charities Can Make Themselves More Open," *Wall Street Journal*, December 10, 2007. John Gamboa justified California legislation on foundation transparency by explaining that it requires reporting "like you see in government and private industry." Bradley Center, *Mandating Multicultural Munificence*? (transcript, Washington: Hudson Institute, 2008).

appeals usually treat transparency with simplicity and as if it were an end unto itself—as if the mandated openness of and disclosures by government and business were not imposed to further other objectives. The assertions also seem to imply that government, business, and philanthropy are equivalent, or at least that transparency being required in one sector is reason to export it to other sectors without regard to their differences and respective roles and responsibilities. The reality is otherwise.

Enterprises in each of the three sectors have unique objectives that support different types and degrees of transparency. Efforts to shoehorn any one sector into either of the others miss the all-important point that transparency is not an end unto itself. Transparency is not an independent good like democracy, freedom, liberty, justice, or moral virtue. Achieving transparency does not satisfy some inherent goal, destiny, or purpose. Instead, transparency is a tool—a vehicle or strategy for pursuing other, higher objectives, values, and principles.

For example, transparency in the government of a representative democracy is intended to allow those who govern to be held accountable to those who have granted them authority to govern—that is, to the people. Transparency of publicly traded companies, as distinct from business more broadly, is generally intended to serve at least two purposes: accountability to shareholder-owners and improved distribution of information to support credible financial markets. In neither case is transparency an end in itself, nor is it related to exemptions, deductions, credits, or other tax benefits.

These points are further emphasized by the additional differences between what the law expects with regard to openness of publicly traded versus privately owned companies. These differences do not depend on factors such as number of employees, sales volume, industry position, etc., and they certainly have nothing to do with beneficial tax treatment. Instead, the different requirements for transparency reflect

the different relationships that the two types of firms have to the financial markets and the different ways in which information about the underlying companies affects the broader economy. Because the objectives of transparency are different in each case, the expectations are different. We expect more openness from publicly traded companies because the effects of less openness are more significant.

Likewise, the objectives and roles of philanthropy differ from those of other sectors. Philanthropic objectives differ from those of government if for no other reason than that philanthropy does not and should not exercise powers of taxation, enact legislation or impose regulations that govern citizen behavior, adjudicate violations of law, exercise eminent domain, or exhibit other indicia of sovereign authority. Nor does philanthropy have the responsibilities of government or function as a proxy for government.[2] Though some philanthropic enterprises choose to fund activities that would otherwise fall to government, among the defining characteristics of philanthropy is its ability and responsibility to do certain things and take certain risks that government cannot and should not.

Neither does philanthropy compare closely in this regard with public companies. Among the many differences are their respective orientations toward profit versus charitable purpose, time horizons for results, and capacity to take various risks. There also are material differences with regard to the effects of failure, fraud, and corruption.

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2. Chief Justice Marshall distinguished sharply between the role of charities and that of government, saying that "eleemosynary institutions do not fill the place which would otherwise be occupied by government, that which would otherwise remain vacant." *Dartmouth College v. Woodward*, 17 U.S. at 647. Williams and Moorehead state that foundations operate in "areas into which government cannot and should not advance." Laurens Williams and Donald V. Moorehead, *An Analysis of the Reasons Prompting Current Statutory Distinctions Between Public and Private Charitable Organizations* (Washington: Commission on Private Philanthropy and Public Needs, 1977); and Chauncey Belknap, "The Federal Income Tax Exemption of Charitable Organizations: Its History and Underlying Policy," *Commission on Private Philanthropy and Public Needs: Research Papers* 4 (Washington: U.S. Department of the Treasury, 1977): 2016 and 2039.

Such behavior in public companies can influence the almost-immediate movement of trillions of dollars and jeopardize the ability of millions of people to earn livelihoods, pay for educations, and enjoy retirements.

This is not to suggest that failure, fraud, and corruption in philanthropy are without meaningful impact. It is just that the effects are different, should be understood as distinct, and should not be equated with those of other sectors. Philanthropies are more like private companies than they are like government, but they are generally distinct from private companies in their exclusive dedication to charitable, exempt purposes and in the wide gulf created by the absence of a profit motive.

Thus, the value and utility of transparency depend on the presence of independent and legitimate objectives to justify its existence, scope, and extent, and both the purposes for transparency and methods for achieving it are particular to the situation's objectives. For both government and publicly traded companies, transparency is imposed in degrees, rather than in absolutes. Even when holding governors accountable to the governed, we rarely expect "full" or "complete" transparency. Not everyone has access to everything: certain meetings are closed; certain documents are protected; there are gradations. Even that most elemental action at the heart of a representative democracy—citizen voting—is not transparent. Limits exist. Likewise, publicly traded companies are not expected to be fully or completely transparent. Board and management meetings continue to be held in private, and considerations of such things as competitive advantage, sustainability, and profitability justify respecting boundaries and limits on legally coerced transparency.

Unfortunately, some conversations about transparency in philanthropy have tended towards hyperbole in seeming to embrace or command "full," "absolute," or "complete" transparency and in speaking

of transparency as an end in itself.[3] At one time, it may have been reasonable to understand this language as merely appealing to higher (or the highest) ethical standards and not applying literally. After all, the thinking went, everyone "knows" what such adjectives as modifiers really mean and that objecting to their use is overly sensitive.[4] Regrettably, there has been a growing trend toward treating transparency as if synonymous with truthfulness and integrity, such that foundations not perceived as fully, absolutely, or completely transparent can be unfairly and inaccurately portrayed or considered suspect, deceitful, or even corrupt. When that happens, transparency increasingly threatens to become, whether genuinely or disingenuously, an independent measure of philanthropic virtue.

It does not seem unfair to wonder why that has happened and whether it is appropriate to allow it to continue. Some may be striving for a utopian vision or idyllic state of affairs. Others may not have fully thought through the implications. Some may simply want to better understand the sector more broadly, and there can be merit in transparency that furthers data collection and analysis in order to facilitate a deeper, more comprehensive understanding of the sector's presence in society. More ominously, however, others may be arguing for transparency as a

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3. "The larger [a foundation] is, the more energetically it should disseminate *full* information on its activities." Vartan Gregorian, *Transparency and Accomplishment: A Legacy of Glass Pockets* (New York: Carnegie Corporation, 2003), 1. Andrew Carnegie also called for "*full* publicity," "openness, honesty and transparency" in "*all aspects* of our work and finances" and "*absolute* transparency in communicating progress toward our goals." Ibid., 6–7 (emphases added). Professionalization and bureaucratization make foundations "profoundly public institutions" that should be "open and accountable to all." Peter Frumkin, *Trouble in Foundationland: Looking Back, Looking Ahead* (Washington: Hudson Institute, 2004), 32. Stone recommends "*full* disclosure of foundation operations." Lawrence M. Stone, "Charitable Foundation: Its Governance," *Law and Contemporary Problems* 39. no. 1 (1975) 63 (emphasis added).
4. Evelyn Brody and John Tyler, *How Public Is Private Philanthropy?: Separating Reality from Myth*, 2nd ed. (Washington: The Philanthropy Roundtable, 2012), 17; Evelyn Brody and John Tyler, "Respecting Foundation and Charity Autonomy: How Public is Private Philanthropy? *Chicago-Kent Law Review* 85, no. 2 (June 2010), 573. Similar arguments are made in the debate over "public money," a term that continues to be applied literally but without a concern for the precise legal and historical nuances of the term.

vehicle for redistribution, litigation, or something else entirely. In other words, motives can matter, particularly if clandestine or surreptitious.

In evaluating motives, the nature of the philanthropic enterprise should be kept in mind. More specifically, turning down requests for funds is not just an inescapable part of philanthropy but a core function of operating, managing, and overseeing a foundation. It is not uncommon for a foundation to reject substantially more requests than it funds. This is one feature that distinguishes grantmakers from government, business, and other 501(c)(3) organizations, none of which has the affirmative job of rejecting people as such a regular, omnipresent experience. Nearly every rejection strikes at a program, need, or cause in which the applicant has vested personal passion and fervor. Thus, an inherent part of foundation activities is upsetting people or making them angry.

Similarly, for just about any programmatic or strategic decision a foundation makes, there are likely to be some who oppose or are even actively hostile to the underlying activity, cause, purpose, or organization. This, too, can be upsetting or even maddening.

None of this is intended to evoke the playing of violins but merely serves as a reminder of this reality of foundation operations—a reality derived precisely from being a plurality of independent, private, autonomous entities. These characteristics are essential to philanthropy's ability to serve our various systems and they are too important to risk losing. Society and philanthropy act at their peril, and to the detriment of philanthropy's ability to fulfill its roles and responsibilities, if they presume—and allow others to presume—that transparency is an end in itself; that philanthropy is too much like government and not enough like privately held companies; that purpose, context, scope, and degree are not relevant; or that some who would impose expansive transparency are not harboring other intentions.

B. Transparency for the Sake of Public Benefit and Social Good

> Those who make this argument note that foundations are not purely private organizations: They seek to promote a vision of public good. Because it involves a "public" good, the argument goes, the public must have a role in determining this vision. But, in fact, there is no single definition of "public good"; and, if there were such a definition, no private foundation could possibly meet it. Instead, what foundations provide, and what the tax code makes possible, is a pluralistic array of private visions that together contribute to making up the public good.

Some argue that government must impose greater transparency on philanthropy, foundations in particular, because law and principle require that they serve the "public good" and provide "social benefit."[5] More specifically, they continue, philanthropy "by its nature intrudes into the public sphere," or "is public in its intention," or "seeks to enact a private vision of the common good," or "projects private values and commitments into the public sphere."[6] More aggressive positions characterize

5. See Gregorian, *Transparency and Accomplishment*, 1, 4; Frumkin writes that philanthropy has moved from satisfying donors to producing "public and community benefits." Additionally, foundations have recast themselves as "public trusts to be governed by public purposes . . . open and accountable to all," Frumkin, *Trouble in Foundationland*, 15, 33, 35, 40, 53. See also Evelyn Brody, "Sunshine and Shadows on Charity Governance: Public Disclosure as a Regulatory Tool," *Proceedings of the 2011 IRS-Tax Policy Center Research Conference* (forthcoming) (draft, August 23, 2011, on file with the author and cited with permission), 26. She notes Independent Sector's emphasis on exempt organization disclosure obligations generally, without distinguishing between legal and voluntary disclosures. "[A]pplication of [foundation] resources to public purposes should make foundations accountable to the public." Terry Odendahl, *Over Two Decades of Philanthropic Reform*, (Washington: Center for Public and Nonprofit Leadership, Georgetown University, 2003), 3.
6. See Peter Frumkin, "Accountability and Legitimacy," in *The Legitimacy of Philanthropic Foundations*, ed. Kenneth Prewitt et al. (New York: Russell Sage, 2006), 100. Williams and Moorehead write that the "concept of tax exemption as a public trust . . . carries with it the obligation of affirmative public accountability." Williams and Moorehead, *An Analysis of the Federal Tax Distinctions*, 2127.

"donors, taxpayers, and nonprofits" as "partners in pursuit of the common good," such that all of them have "certain rights and responsibilities in this partnership."[7] As "partners," the argument goes, "we need to share power" by ensuring that donors "democratize their work," presumably including their decision-making.[8]

Certain of these arguments may have theoretical attractiveness in a vacuum. But as a matter of practical policy, they do not justify expanding the tax code compact by imposing new standards of accountability or openness, nor do they provide the requisite clarity for adopting "public benefit" or "social good" as unassailable objectives for philanthropic transparency.

One general problem with these arguments is that they neglect the irreducibly private character of many of philanthropy's core decisions. Among these are decisions to donate private funds in the first place and how much to donate, the selection of the particular charitable purposes to which the funds will be dedicated, the choice of the organizational form through which to implement these choices, and sometimes even the selection of directors and managers with fiduciary responsibility for the funds and their deployment.[9] Decisions of this sort are fundamental ex-

7. See Aaron Dorfman, "The Giving Pledge: Dangerous Implications for Democratic Decision-Making," *Huffington Post*, December 21, 2010.

8. Ibid.

9. "Each philanthropic gift, or new foundation established, was highly motivated by the donor's free right to individually select their own charitable interest, as well as set the time and conditions of the gift. The fundamental right of every citizen to engage in his or her own individual philanthropic selection and action is the foundation of the giving spirit of our voluntary system. As a free people we want the right to live our lives with as much freedom and individual choice as possible, including the making and selection of philanthropic and charitable choices. [Moreover,] the opportunity to individually choose is central to the donor's voluntary decision to give." Curtis W. Meadows Jr., *Philanthropic Choice and Donor Intent: Freedom, Responsibility and Public Interest,* (Washington: Center for Public and Nonprofit Leadership, Georgetown University, 2002), 2. Belknap writes that the "essential brilliance of tax exemption is that it is automatic in that government does not control the flow of funds . . . ; the receipts of each organization are determined by the values and choices of private givers [and] the beneficiary organizations receive their governmental aid without having to petition for it"; Belknap, "Federal Income Tax Exemption," 2039. "[E]ffective philanthropy is fundamentally personal. Philanthropists accomplish far more when they pursue results driven explicitly by who they are and what they care about most." Thomas J. Tierney, "To Succeed, Philanthropy Needs to Be Rooted in Deep Personal Beliefs," *Chronicle of Philanthropy*, February 20, 2011."

pressions of distinctively American values: freedom of speech, association, and even religion.[10] They also arguably and uniquely manifest both the "pursuit of happiness" and the "blessings of liberty" embraced in the Declaration of Independence and the preamble to the Constitution.

In addition, the state laws under which foundations operate recognize that donors, founders, trustees, and subsequent directors and managers—not government or the public—have authority and responsibility in this sphere, subject to their compliance with the law. Merrimon Cuninggim, a former president of the Danforth Foundation, gave voice to the "immensely important distinction" between the charitable purposes that foundations serve and the private nature of foundation decision-making, which is beyond the "hands of the general public or Government."[11]

There is no legal requirement that any foundation serve the "public," at least as that term is broadly defined to encompass all members of the population.[12] Indeed, it is hard to see how there could be such a requirement. No foundation has the resources to meaningfully serve all members of the public. A still more basic problem is that there is no consensus about what "public benefit" and "social good" mean for

10. U.S. tax exemption is "probably" rooted in widely shared philosophy of classical liberalism, with "dominant tenets" of "distrust of government and faith that the progress and well-being of mankind could best be achieved by natural forces harmonizing the individual actions of men who were left untrammeled." Belknap, "Federal Income Tax Exemption," 2031. Private foundations are viewed by the U.S. public as "solidly in the American tradition of using private resources for public benefits—and solidly in the pluralistic tradition of encouraging multiple, contending versions of the public interest." Kenneth Prewitt, "American Foundations: What Justifies Their Unique Privileges and Powers," in *The Legitimacy of Philanthropic Foundations: United States and European Perspectives*, ed. Prewitt et al., 41.
11. Cuninggim recognized at the same time that such private decisions must direct philanthropic assets to exempt purposes associated with "the general welfare or some chosen segment of it." Merrimon Cuninggim, *Private Money and Public Service* (New York: McGraw-Hill, 1972), 4–5.
12. Congress or individual states could, of course, change the laws concerning exemptions or deductions to specify further what purposes qualify for such treatment. But their authority to make material changes retroactively could be subject to constitutional challenges based, among other things, on the freedom to contract and the First, Fifth, and Fourteenth Amendments.

philanthropy, beyond what is provided in the tax code. On one hand, a narrowly based consensus about these terms is likely to give rise to ill-conceived susceptibility to the most popular ideas, fads, fashions, and the short term.[13] On the other hand, these terms could be defined so broadly as to render philanthropy indistinguishable from government and the "public" it is responsible for serving.

These definitional problems developed over time—in much the same way that definitional problems with the modifiers of "transparency" shifted over time, from expressive to increasingly literal and absolute. Recently, however, the terms have been used in ways that overstate those served by philanthropy and mistakenly equate the "public" served by philanthropy with the "public" to which government is responsible. But the degrees of transparency required of government reflect its specific duties to the public, which are different duties and different "publics" from philanthropy's. The distinctive features of government and philanthropy are the source of many of philanthropy's most meaningful contributions to the nation,[14] including an unencumbered ability to criticize government and its policies and

13. Richard Marker, "Public Role in Foundation Decision-Making," *Wise Philanthropy,* September 16, 2007.
14. States remain better positioned than the IRS to regulate with sensitivity to "diversity of and experimentation in the sector." Internal Revenue Service, Advisory Committee on Tax Exempt and Government Entities, *Report of Recommendations* (Washington, June 11, 2008), 21. The virtue of the private foundation is the "capacity to experiment" because it is "controlled by trustees answerable primarily to their own sense of responsibility. Williams and Moorehead, *An Analysis of the Federal Tax Distinctions*, 2121. Additionally, private foundations "can be uniquely qualified" to "experiment with new and untried ventures, dissent from prevailing attitudes, and act quickly and flexibly." Ibid., 2106. Foundations "operate best when they work at the 'growing' edge of knowledge, when they uncover and support talent interested in finding new ways of dealing with old problems." Homer C. Wadsworth, "Private Foundations and the Tax Reform Act of 1969, *Law and Contemporary Problems* 39, no. 1 (Winter 1975): 255, 259 . See generally Christopher Levenick et al., "What is the Most Audacious, Daring, and Successful Grant of the Past 100 Years?" *Philanthropy*, Winter 2011; Joel L. Fleishman, *The Foundation: A Great American Secret—How Private Wealth is Changing the World* (New York: PublicAffairs, 2007); and Claire Gaudiani, *The Greater Good: How Philanthropy Drives the American Economy and Can Save Capitalism* (New York: Holt and Company, 2003).

strategies.[15] Equating philanthropy with government and migrating governmental standards of openness to philanthropy risk undermining characteristics that contribute to philanthropy's unique value.

Conversely, with regard to business, rather than actively conflating the various "publics," critics many times ignore the "public" and "social" purposes served by for-profit enterprises even as they preserve the primacy of profit. For instance, it has been argued that foundations and their donors must be more transparent because "philanthropy has as its intentions and seeks to enact a private vision of the common good." In this view, such a goal "raises accountability issues precisely because the act of giving projects private values and commitments into the public sphere."[16] This contention contrasts the public-directed intentions of philanthropy with the sale and use of goods or services in the market, which "rarely has as its goal generating direct consequences for others."[17] The argument is that public policy can justify more intrusive philanthropic transparency than what is expected of business because philanthropy is intended to serve the public good, provide social benefit, and be of direct consequence for others, while business is not meant to do these things. There are at least three reasons why this contrast is not as simple or useful as it may seem.

First, non-business sectors of society—that is, government and philanthropy—depend on the revenue and profitability of the business sector. Government, whose whole purpose is to further the public good, cannot operate without the tax revenues derived from taxpayers with taxable income. Similarly, the philanthropic sector—whose focus is on charitable, exempt purposes as a subset of public purposes—depends on contributions that are not possible without successful business enterprises

15. See Chester E. Finn Jr, "Quick Question Survey: What's the Right Relationship between Philanthropy and Government?" Grantcraft, 2010, available at www.grantcraft.org/index.cfm?fuseaction=page.viewPage&pageID=1532. For the role of private philanthropy in challenging democratic majority and conventional wisdom, see Stone, "The Charitable Foundation," 66.

16. Frumkin, *Trouble in Foundationland*, 18.

17. Ibid.

to generate wealth and employ the people who contribute to charities. Thus, as the primary source of funding for government and philanthropy, business in many ways serves their respective public purposes.

Second, many for-profit businesses have among their founding intentions the aim of directly affecting the lives of others. Even businesses without such intentions often can't help doing so. Think of Microsoft, Apple, Disney, General Motors, Ford, Merck, AOL, Time Warner, Google, Yahoo, IBM, General Electric, Kellogg, and many, many more. Even small, local businesses implement a private vision of their inventors, entrepreneurs, founders, directors, and managers seeking to be of "direct consequence for others." Not only that, but many businesses are born or grow precisely because of a private intention—a vision—not only to affect lives and advance human welfare but to change the trajectory of industries or give rise to whole new industries of direct consequence to others. Think of aeronautics, biomedicine, pharmacology, nanotechnology, computer hardware and software, the internet, search engines, communications, mobile devices, energy, automobiles, entertainment, and many, many more. These advances and their benefits arose because the business sector researches, develops, and distributes innovative products, services, systems, and processes that stimulate economic growth and advance human welfare. More than merely being of direct consequence, these undertakings frequently end up serving the public good and providing social benefits.

Third, among the outcomes of most businesses in the American marketplace is providing jobs. Sometimes business owners and managers might measure success and progress, in part, by the number of people they productively employ. They may even set employment targets and specify time frames in which to meet them. As we are painfully aware today, the presence or absence of jobs has "direct consequences for others" and for the "public sphere."

Thus, business is the primary driver of the innovation, jobs, and even revenue on which government and philanthropy depend. Amer-

ica's economic, social, and governmental systems all depend fundamentally on a business sector that is of "direct consequence to others" and whose contributions serve the public good and provide social benefits. Without it, the future of all of our systems would be imperiled. The definition of the "public sphere" must necessarily contemplate these enterprises.

Yet, no one rationally uses the "public" nature of business as a justification for legally expanding the transparency requirements on the business sector as a whole, and no one uses (or should use) this argument to justify treating private companies in the same way we treat public ones or government.

True, there are laws and regulations that apply equally to publicly held and privately held companies. Among the areas affected are advertising, debt collection, discriminatory practices, monopolistic behavior, taxes, worker safety, environmental practices, and more. (In fact, many of these rules also apply to foundations and other tax-exempt organizations as well.) But these legal intrusions are not based on some vague notion of the "public" nature of business—or on any feature of business as a whole. Instead, these legal intrusions seek to achieve more narrowly defined objectives that operate at the points at which these enterprises intersect with the broader society, economy, and politics. Furthermore, in seeking these objectives, Congress, legislatures, regulatory agencies, and courts have attempted, albeit imperfectly, to recognize and preserve the autonomous, independent, and private nature of the for-profit companies on which they impose mandates. Thus, debates about the optimal level of transparency in the business sector are usually more respectful of nuance and degree than is normal in discussions of philanthropic transparency.

Both the for-profit and the philanthropic sectors aim to project a private vision into the public sphere. While the for-profit sector expects—even demands—"private benefit," philanthropy does not and

cannot.[18] But this distinction seems a wholly inadequate reason to neglect the similarities between these sectors, to deny autonomy or privacy to philanthropic organizations, or to hold philanthropy to standards of transparency applicable to government.

C. Transparency to Correct Purported "Power Asymmetry"

This argument contends that the relationship between foundations and grantees is unfair—that foundations make potential grantees ask for money, that foundations can "de-fund" grantees, and that foundation staffers can abuse their discretion. Still, although there is no excuse for a lack of respect by foundation staff, the discretion foundations have is necessary if they are to fulfill their intended role in our system.

Foundations have money that grantees want. Foundations demand information from prospective and actual grant recipients. Foundations have agendas, networks, and other resources that can substantially influence grantees.[19] It is no surprise then that some people see grantees as systematically subordinate to foundations and treat this "power asymmetry"[20] as inherently suspect or intrinsically abusive. However, there is more to the relationship than that.

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18. There are other differences. For instance, philanthropy can and should take risks and pursue ventures within its purview that businesses cannot and should not, even if such risks and ventures may ultimately lead to new businesses or even industries.
19. Frumkin, "Accountability and Legitimacy," 101. Many who make this argument view the issue "in the context of a society in which power and resources are grossly misallocated" and "in which misallocations of power and discriminating patterns have created wide-spread mistrust" Independent Sector Donee Group, *Private Philanthropy: Vital and Innovative? Or Passive and Irrelevant?* (Washington: Independent Sector, 2008).
20. See Frumkin, *Trouble in Foundationland*, 8–9, 18; Frumkin, "Accountability and Legitimacy," 101.

For instance, the above factors that give rise to the "power asymmetry" label are not unique to the foundation-grantee relationship. These characterizations can also describe grantee relationships with government agencies that make grants and charitable giving by businesses, community foundations, and even individual donors.

Admittedly, there are instances, even too many instances, in which a specific relationship between a grantor and a grantee reflects an extreme imbalance of power favoring the grantor. This situation can arise when people who oversee and manage grantors succumb to temptations of arrogance, condescension, and egotism.[21] Sometimes, grantors can lose sight of the fact that they need grantees to fulfill their legal obligations and programmatic missions.

Such distortions can result in grantors' over-emphasizing form and process over substantive progress and achievement. They can forget or neglect the fact that their actions and inactions have real consequences for those who seek and receive funding and for the people and causes that they serve. Unduly burdensome application processes, vague or overly broad missions and strategies, and reporting obligations that are disproportionate to the amounts of money or purposes at issue—these are but three unfortunately too common examples.

I am not an apologist for disrespectfulness, arrogance, or abusive behavior. Grantors should treat grant-seekers and recipients with respect. As entities, grantors should ensure that their processes and practices incorporate these values. As individuals, the people who staff and represent grantors should do likewise.

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21. Foundations are "not always efficient, may be elitist, sometimes tempted by self-dealing." Prewitt, "American Foundations," 41. See also 1980 speech by Irving Kristol to Council on Foundations, warning philanthropy about "the sin of pride" and "temptation . . . to believe it has the obligation and ability to make more far-reaching changes than it really does," quoted in Leslie Lenkowsky, "Irving Kristol's Legacy for Philanthropy," *Chronicle of Philanthropy*, September 21, 2009.

Grantees, for their part, can also take steps to foster respectful relationships and avoid placing themselves in the role of supplicant. They can—and do—decide not to apply for grants from certain grantors.[22] They can and do refuse grants when conditions are unacceptable, and they return money if a grantor's demands become excessive. Although it can be a hard temptation to resist on the front end, grantees should try to avoid becoming dependent on funding from just one or a few sources and should be suspicious when a donor—including the government—offers to provide a large part of their financial support over a long period of time. At a minimum, they should know that by accepting money under such circumstances, they substantially increase the chances that a real "power asymmetry" will result, such as government-imposed caps, limits, and prohibitions that are emerging in various states on compensation and otherwise.

Then again, these same cautions apply to many relationships. In philanthropy as elsewhere, there are people who abuse their positions, and corrective action by government is sometimes called for. However, grantees are not in the situation of child and industrial workers at the end of the 19th and beginning of the 20th centuries, or like women and minorities who were regularly denied the liberty of work or engaging fully in society and the marketplace. Imbalance and "power asymmetry" do not by themselves require corrective legal action in the absence of pervasive abuse evaluated in light of legitimate needs, processes, and behavior. There are differences between the relative positions of foundations and grantees, and tension inevitably results. These tensions can be exacerbated for some grant seekers because the information requested, the time taken by foundations to make their decisions, and the resulting decisions themselves may make grant-seekers upset, hurt,

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22. "We don't go after foundation money because we don't want foundations to tell us and limit us to what issues we can go after, like going after foundations." John Gamboa, Bradley Center, *Mandating Multicultural Munificence?*

or angry. Those reactions are understandable, but that does not mean that grant seekers must be victims of "power asymmetry." Instead, these reactions are better understood, absent actual evidence to the contrary, as manifestations of that natural disappointment that inevitably accompanies choices about allocating limited philanthropic resources within a bounded set of purposes about which reasonable people can disagree.

Tension can also arise or grow as those who manage foundations seek information from grantees in order to fulfill their responsibilities for ensuring compliance with the law, fealty to donor intent, and furthering philanthropy's proper roles in society. In light of these obligations, foundation demands for information and for time to make decisions are often unavoidable. There is nothing inherently disrespectful or arrogant about asking for the information needed to differentiate potential recipients from one another, to calculate the opportunity costs associated with choosing one course of action over another, or to assess potential and actual outcomes. Nor is it inherently disrespectful or arrogant to take appropriate amounts of time to conduct these analyses and make the corresponding decisions.

Ironically, some of the behaviors that grantees and their advocates consider abuses of power are in fact efforts by foundations to be more transparent. Foundations need information and documentation during the application, reporting, and concluding stages of a grant award or rejection in order to complete publicly available tax returns. They use information, much of it from grant recipients, in order to provide informative annual reports, maintain useful high-quality websites, and use social networking tools effectively. Information from grantees is also critical to enable foundations to assess the effectiveness of their systems and progress towards fulfilling their programmatic missions.

Thus, declarations of "power asymmetry" can put foundations in an untenable, no-win situation. Some criticize foundations for being

ineffective or not being more open, yet label them as arrogant abusers of power when they try to get the information they need to assess effectiveness or provide more disclosures.[23]

As a practical matter, foundations can help their situation if they try to minimize misperceptions by communicating and informing as much as is strategically and reasonably possible. As discussed in chapter III, voluntary disclosure of certain relevant information about processes, strategies, and programs can help mitigate hurt and anger and contribute to the successful management of grantor-grantee relationships. But even the best of efforts will never eliminate all misperceptions. The only way to avoid causing hurt to grantees and potential grantees is to give them everything they want, which is neither possible nor wise. The discipline of making and implementing choices—which should be strategic, thoughtful, and informed—is among the ways in which philanthropy fulfills its obligations to the nation. Unfortunately, downsides will inevitably accompany those choices.

Thus, the "power asymmetry" argument cannot survive as a legitimate basis for legal mandates to increase philanthropic openness.

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23. In the same way, some of those who call for more regulation, greater compliance, and increased reporting also complain about the high administrative costs of meeting these obligations. Some critics also complain about foundation ineffectiveness but demand that their personnel work for below-market compensation. Many of these observers fail to note costs of compliance with transparency measures and the need to balance competing interests. See IRS Advisory Committee, *Report of Recommendations*, 27–28; After the 1969 legislation and regulations thereunder, foundations "increased their overhead . . . precisely because they were charged with being insufficiently accountable and ineffectively managed. Now . . . some in Congress are asking the foundation field to exclude from their qualifying distributions expenses that are the product of that very regulation." Frumkin, *Trouble in Foundationland*, 54, 67. Those critics either do not see the inconsistency of their position or choose to ignore it. Another disconnect can be found in calls for foundations to publicly report "failures" while simultaneously demanding that they be held accountable if they do not succeed.

D. Transparency as a Tool for Measuring Effectiveness

This argument claims that the public has a legitimate interest in assessing philanthropic effectiveness and that we cannot assess this effectiveness without more transparency than the law currently requires. The argument sounds benign, but it suffers from several practical defects: How would it work in practice? What organization would define effectiveness? How would we prevent the organization from becoming a tool of special interests? What would the legal consequences be for a deficiency in effectiveness? Would we really want foundations to insert themselves more deeply into the affairs of the grantees on whose performance foundations depend for their effectiveness?

One of the most frequently heard arguments for requiring greater transparency is that openness fosters effectiveness. This argument is particularly mired in semantic confusion and lack of definitional clarity. For instance, proponents sometimes use "effectiveness" when they mean "accountability" and vice versa.[24] They might be advocating that individual foundations expand their internal knowledge and understanding of themselves or that society know more about and better understand the sector. Alternatively, they might be using the language of "effectiveness" as a way to give external parties the power or authority to assess effectiveness, express judgments, and perhaps even impose consequences for deemed failure.

The term "effectiveness" should be used to measure how well or poorly a person or enterprise operates, whether it has accomplished its

24. Frumkin describes this view as, "[a]ccountability and effectiveness . . . locked in a strange relationship of mutual dependence." See Frumkin, *Trouble in Foundationland*, 16.

objectives, or the extent to which it has constructively affected a situation or made a desired change.[25] In general, "effectiveness" is not a legal concept that carries punitive legal consequences for failure. In theory, assessing effectiveness can be a perfectly reasonable objective and can be aided by increased openness, particularly if such openness is voluntarily provided individually or as part of a group. But the theory looks less benign when government, claiming the authority of the tax treatment compact or "public" purpose arguments requires or sets standards of effectiveness, assesses whether they have been achieved, deems certain information necessary or relevant for such an assessment, and punishes failure or rewards success. If that happens, an otherwise innocuous or potentially useful inquiry into "effectiveness" morphs into a demand for "accountability" and government meddling.

The term "accountability," in contrast, should be used to measure whether the parties to a transaction or compact have abided by its terms, performed their respective obligations, or delivered agreed-upon outcomes. Legal accountability, unlike effectiveness, innately carries an element of consequences and exposure to penalties for failing to adhere, perform, or deliver as required, regardless of whether one is "effective" in performing or delivering by some other standard. Thus, an enterprise can be effective without being accountable and accountable without being effective. However, to complicate matters still further, if a transaction or agreement makes "effectiveness" a requirement, the relevant party is accountable for its effectiveness and is subject to applicable consequences for failing to be effective.

As part of the tax treatment compact discussed previously, exempt foundations and their managers are, and should be, held accountable for ensuring that assets are used for charitable purposes and not for private benefit, impermissible lobbying, or intervention in political

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25. Ibid., 13. There is a need for a "meaningful causal link" and "a certain proximity" in analyzing effectiveness.

campaigns. The scope, type, and degrees of disclosure required and the corresponding consequences for non-compliance should be (and currently seem to be) specifically designed to ensure such accountability. "Effectiveness," however, is not and should not be part of this compact.

Some proponents of more philanthropic transparency are trying to change this by injecting "effectiveness" into the compact. The IRS inserted (though it eventually withdrew) mandated disclosures targeting effectiveness into early drafts of proposed revisions to the 990 information return filed by public charities—an almost certain precursor of future efforts, including with regard to foundations. Although these efforts implicitly or explicitly require more openness from foundations, there are several problems with legally mandated transparency for these purposes. Even if effectiveness seems to occupy a relative high ground theoretically, as an objective for transparency it is inextricably bound to the strategies and details of how it would be pursued. When evaluated in theory and practice, effectiveness does not withstand scrutiny as a legitimate objective for expanding philanthropic transparency, particularly if imposed by government. Among the problems are difficulties with identifying relevant, uniform standards to apply consistently across the sector, lack of clarity about who is an appropriate judge of compliance on behalf of government, and ambiguity about consequences for failure.[26]

What Standards for Effectiveness? There are no standards in the law against which to assess the effectiveness of philanthropy. Of course, such laws or regulations could be drafted, but this course would present its own problems. First, there is the threshold matter of whether setting such standards is a proper role for government. Even if it is deemed proper, there is the question of how far government can go before destabilizing philanthropy's roles and responsibilities in our various systems, including the roles arguably protected by the Constitution.

26. Ibid., 8, 65.

Even if those thresholds are met, there is the more practical problem of designing legal standards that can apply consistently across a diverse and complex sector.

Foundations are anything but uniform. They vary in the amounts of their assets and the size and volume of their grants. They pursue a multitude of missions that traverse the entire spectrum of permissible exempt activities: social services, medical care, humanitarian relief, revitalizing economically disadvantaged communities, reversing the effects of discrimination, relieving the burdens of government, and more. A few foundations operate through employees; many more rely heavily on volunteers. Many focus giving on their local communities, while some operate globally. Foundations also differ in their ambitions and the degree to which they innovate, pursue their visions creatively, and are willing to experiment and take programmatic risks. Most focus on giving grants, but some operate their own programs and conduct their own research.

In many ways, such diversity embodies the advantages of pluralism and operates as a fundamental expression of essentially American values, principles, and ideals.[27]

Legally mandated standards of effectiveness that could be relevant and consistent across such disparate organizations would tend, almost necessarily, either to cover only the least common denominators, which would be of limited or no value, or to plunge regulators and philan-

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27. See Susan Berresford and Lorie Slutsky, "Foundations' Longevity Should Be Valued," *Chronicle of Philanthropy*, September 2, 2008. The private foundation, "an institution of democratic capitalism, exists to strengthen and facilitate the mutually supporting American systems of democratic pluralism and a free-market economy." Carl Schramm, "Law Outside the Market: The Social Utility of the Private Foundation," *Harvard Journal of Law and Public Policy* 30, no. 1 (2006): 355. See also Prewitt, "American Foundations," 41. "Not only our freedom but our continued progress toward a better life depend in part upon maintaining . . . diversity of values and abilities and the powerful motive force of individual initiative and insight"; when "centralization of decision-making passes beyond a certain point, these prerequisites of freedom and progress are sacrificed." Belknap, "Federal Income Tax Exemption," 2037. Private foundations "enrich the pluralism of our social order." Williams and Moorehead, *An Analysis of the Federal Tax Distinctions*, 2106.

thropy into a profusion of tailored, customized standards with a high likelihood of arbitrariness. Before undertaking such a task, it would be appropriate to ask:

1. Whether the effort required is the best use of limited resources when compared with other legislative and regulatory priorities
2. Whether the effort and its implementation justify the significant financial and other costs
3. Perhaps most important, whether the standards themselves are likely to be effective

A particular problem with imposing legal standards of effectiveness in philanthropy is an absence of precedent or authority. For instance, tax policy generally concerns itself with accountability, not effectiveness. The government does not ask whether businesses using tax credits for research on clean energy alternatives are effective in doing so. Government does not request grades from individuals who take education expense deductions in order to ascertain whether these people are performing up to their potential.[28] Government holds businesses and individuals accountable only for having actually incurred the expenses for which the beneficial tax treatment is asserted and documenting this fact.

Similarly, in philanthropy, regulatory oversight appropriately focuses less on "detecting poor performance" or effectiveness than on deterring and correcting abuses.[29] Indeed, public criticisms, hearings, commissions, and committees on philanthropy have virtually never crossed the boundary that would have "led . . . except very marginally, to any attempt at restricting what a foundation selects as its mission and how it pursues that mission."[30]

28. "Substantive accountability . . . is nowhere to be seen in American law or practice. American politics is not designed to judge that one 'good cause' is better than another." Prewitt, "American Foundations," 42
29. See, for example, ibid., 45.
30. Ibid., 44–45.

Another, practical problem in setting government-mandated standards of effectiveness is the danger that such efforts would deprive philanthropy of flexibility to change direction or even terminate certain efforts for fear that doing so could be deemed a failure of the original strategy and, thus, "ineffective." Foundation boards, managers, and personnel might remain so focused on original plans that they forgo new opportunities or neglect new needs because deviations might be considered ineffective and, therefore, "failure" relative to original plans, even though the deviations are otherwise successful when measured against alternative standards. It may be possible to design standards that address these objections by permitting the needed flexibility to change, but the exceptions would likely swallow the rule, a strong indicator that the rule should not have existed in the first place.

Assuming that the substantial hurdles posed by these problems can be addressed, effectiveness as an objective for transparency still requires decisions about who legitimately should have authority to adopt standards, assess compliance, and impose sanctions for violations.

Who Establishes Standards, Judges Effectiveness, and Imposes Consequences? Government certainly has the authority and even the responsibility to assess the effectiveness of organizations with which it contracts or to which it makes grants. It should hold those organizations accountable for delivering on the promised outcomes. This monograph does not address the direct contracting relationship, nor does it address the question of whether government has the power, prospectively, to narrow the purposes and activities that qualify as tax-exempt, the contributions that may be deducted as charitable, or the expenditures that foundations may count as "qualifying distributions." In any event, each of these issues is more a matter of accountability to tax policy than of effectiveness.

The question considered here is not whether government has these powers but, more specifically, whether government should use the pow-

ers that it does have to establish standards for philanthropic effectiveness, assess progress and achievements under these standards, or require disclosure of information that the government deems relevant for purposes of allowing third parties to judge philanthropic effectiveness.

One reason often given for government doing these things lies in the misconception that foundation money is really "public money." This argument has been rebutted elsewhere.[31]

A second reason given is that foundations do not operate under market discipline or other oversight in the way that for-profit business or government does. In this view, owners, managers, directors, competitors, creditors, suppliers, employees, communities, the media, and government deploy various means and techniques of holding business accountable for effectiveness. If a business is not effective, it risks losing customers, market share, financing, suppliers, employees, and more. Although not necessarily accountable to them in a legal sense, a business jeopardizes its survival if it chooses to ignore them.

Likewise, voters, campaign contributors, constituents, and the media hold elected officials accountable for their effectiveness; elected officials, in turn, hold each other and career government employees accountable. If government is not effective, politicians are not re-elected and officials can lose their jobs.

In contrast, exempt foundations are legally accountable to the IRS and the chief charity officials in the states where they operate for compliance with applicable statutes, regulations, and donor intent but not for whether they are effective in achieving their charitable purposes. As discussed in chapter I, they have no other external legal "stakeholders" to satisfy and no non-legal constituencies to serve. If foundations are not effective, there are no direct consequences imposed by third parties for the lack of effectiveness. There might be social accountability in the

31. See Brody and Tyler, *How Public Is Private Philanthropy?*; and Brody and Tyler, "Respecting Foundation and Charity Autonomy."

form of public pressure, adverse opinions from advocacy groups or media coverage, and repercussions from watchdog organizations, trade associations, and peer foundations. There may also be uncomfortable social situations, including, in the extreme, ostracism of donors and those who serve as foundation directors, managers, and employees. But foundations do not act at any externally imposed peril of their existence for neglecting or ignoring popularity signals or outside groups or, more positively stated, for taking programmatic risks in order to pursue visionary and innovative approaches to social problems.[32]

These opportunities for steadfastness in the face of public opposition and contrary popular opinion are among the most important constructive characteristics of philanthropy and its unique roles in this country, but calls for broadly increased transparency to enhance philanthropic effectiveness risk undermining this virtue.[33] Changing the current dynamic will require fabricating an artificial and unnatural "market" where none exists. It will involve devising "stakeholders" or "constituents" and bestowing powers on them—with attendant risks and consequences, including the not-unlikely deterioration of the essential character of American philanthropy.

Even if legislators or regulators decide that the risks and consequences are worth it, there remains the issue of who should be charged with responsibility for the effort and its implementation. It would be

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32 See Caroline Preston, "Some 70% of Grant Makers Say Foundations Have Few Measures to Test Effectiveness," *Chronicle of Philanthropy*, June 14, 2010. Tellado urges the provision of more information to "grantees and others who have a big stake in our work." Marta L. Tellado, "How Can Foundations Demystify Their Work?" *Chronicle of Philanthropy*, June 15, 2010. In contrast, Marker distinguishes the presence of stakeholders in public charities and foundations from the absence of such stakeholders in private foundations. Marker, "Public Role in Foundation Decision-Making."

33. Depending on the extent and degree of the changes imposed, such efforts could also risk undermining the First Amendment and violating Fifth and Fourteenth Amendment protections. Moreover, to the extent that foundations are an extension of fundamental principles of property rights, such efforts could have broader and more significant consequences for the country's political and economic system as a whole.

another in a line of ironies to make government the judge of organizational effectiveness. Even so, Congress could establish general standards but would not likely have the time or inclination to make rules in meaningful detail given other priorities. Congress could authorize the IRS to undertake the job, but the IRS is already falling short in various aspects of its operations. Alternatively, Congress could create a new federal agency, but funding for such an agency would be only one of several potential problems. Congress could vest regulatory power in private associations or watchdog groups but, if history is a guide, it is almost inevitable that vested, empowered, and entrenched interests will favor self-preservation and the status quo over sound policy. Even if regulatory posts were initially populated by people everyone would agree are reasonable, it is unlikely that the posts would always (or even usually) be filled by such reasonable people. Basing long-term policy on the virtuousness of current personalities is never a good idea.

Furthermore, each of these approaches poses substantial dangers. One such danger is the prospect of politicizing specific foundations and philanthropy generally—an already-existing threat, given current attacks from each side of the political spectrum on charities perceived as sympathetic to the other side. To be useful and long-lasting, any standards of philanthropic effectiveness and their implementation would need to apply without regard to affiliations, messages, or mission-fit along the political spectrum, and they must survive changes in political power. Regularly changing or inconsistently applied standards will themselves cause foundations and the sector to be ineffective—an ironic result, given that the stated objective of the effort is ultimately to improve philanthropic effectiveness.

Other dangers could include diminishing or destroying the ability to criticize government and business, subjugating missions and donor intent to popular pressures and fads, and threatening the capacity to innovate, take risks, and operate with flexibility and long-term time

horizons.[34] These are likely outcomes and losses if government asserts unchallenged authority to assess effectiveness of philanthropy broadly, and the likelihood turns to certainty with the introduction of consequences for failure.

What are the Consequences for Failing to be Effective, and Who Imposes Them? The problems associated with government meddling in philanthropic effectiveness are exacerbated when "effectiveness" is transformed into "accountability" by adding an expectation of actual, implied, or merely threatened consequences for "ineffectiveness." A system of legal accountability and government-imposed consequences gives rise to problems of identifying appropriate punishments for failing to operate effectively (whatever that means) and considering the potential effects of such punishments, narrowly on philanthropy and more broadly on our social, economic, and political systems.[35]

Among the outcomes for imposing such consequences could be increased deference to tax lawyers and accountants, "safer" grantmaking, a tendency to pursue only those programs that are currently popular or at least noncontroversial, and an absence of support for innovation and programmatic risk-taking.[36] Deference to risk-averse pro-

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34. The government is "neither politically nor legally equipped to do more than ask if the mission is in the public good and then hope that the mission is more or less realized"; "[n]either is the government likely to ask the efficiency question. . . . There is simply no conceptual or empirical base on which to do so. If political agreement on what constitutes good works is elusive, even more so would be the metric for measuring its realization. The government is not even able to measure its own performance." Prewitt, "American Foundations," 42, 43.
35. "Transparency is only the first step in a longer journey to accountability" in which a foundation must 'answer for what it does (or doesn't) do.'" Kevin Laskowski, "Please Tap the Glass (Pockets)," National Committee on Responsive Philanthropy blog, May 6, 2010. See also Brody, "Sunshine and Shadows," 40. Some members of the Independent Sector Panel on the Nonprofit Sector "were disappointed that the [Report's] principles were precatory only" and were lacking the force of law.
36. Since tax lawyers and accountants encouraged only the "most obviously safe" grants, a tendency arose for foundations to let lawyers and accountants "make their charitable judgments for them." Frumkin, *Trouble in Foundationland*, 39.

fessionals and moves to safety became more common following the changes in private foundation rules made by the Tax Reform Act of 1969. Similar changes could be expected to arise if legal consequences were to be imposed for "ineffectiveness." Of course, there are those who would welcome such an outcome: They would be happy to see foundations making more conventional grants for more traditionally charitable purposes instead of more adventurous, innovative grantmaking. As a matter of donor intent, making such choices is to be encouraged. As a matter of government coercion, however, it is a problem, whether undertaken directly by force of law or the result of a less direct, government-inspired race to safety.

The mere fact that a legislative committee or federal oversight agency asks or suggests something, even without acting formally, may be persuasive by itself.[37] Ambiguity about what consequences, if any, may flow from a violation can also be influential. For instance, public charities are required to file an annual Form 990 information return. In recent years, the IRS has substantially modified the form to add questions about governance, with predictable results. As the Form 990 and its instructions state, the governance matters about which the IRS inquires are not items required by federal law.[38] Indeed, a former director of the exempt organizations division of the IRS, Marcus Owens, has pointed out that it is, at best, unclear whether these inquiries are even within the authority of the IRS.[39] Moreover, the questions may encroach on principles of federalism and the responsibilities of the states. But by merely asking the governance questions, the IRS sends a pow-

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37. The IRS can "drive behavior merely by asking about specific governance practices." IRS Advisory Committee, *Report of Recommendations*, 52, 56. "[S]imply by asking questions . . . the Service sends a strong signal of their desirability." Brody, "Sunshine and Shadows," 2.
38. Brody, "Sunshine and Shadows," 46; see also Internal Revenue Service Form 990 (2008). Sections A, B, and C of Part VI of the Form entitled "Governance, Management, and Disclosure" seek "information about policies not required by the Internal Revenue Code."
39. See Marcus S. Owens, "Charities and Governance: Is the IRS Subject to Challenge?" *Tax Analysts*, November 12, 2008.

erful message about its expectations, especially with those questions that are framed to make clear what the "right" answer is.

The charitable sector has obliged by answering these questions, even though (or maybe because), with one exception, the consequences for failing to answer are not clear. The exception is significant: The IRS has stated that it intends to use these answers to help it determine what charities to audit. Thus, negative answers or blank spaces increase the chances of an IRS encounter—a powerful incentive for an organization to make sure it can answer the questions in ways that meet the IRS' expectations, whether or not they are in the best interests of the entity.

Aside from using ambiguity to change behavior, any number of punishments can be contemplated for a foundation that is deemed "ineffective" even though it has otherwise complied with the letter and spirit of the law. Should there be fines? Excise taxes? Should they be assessed against the organization, thus reducing the amounts available to spend for charitable purposes? Or should they be assessed against the individuals responsible for ensuring "effectiveness," thus discouraging participation? Should there be public reprimands from government? Should government be able to replace directors, officers, or managers? Should exemptions be revoked? What role, if any, is there for the courts? How far is too far in punishing failure to meet government-designed or adopted standards of "effectiveness"?

The last question—how far is too far—is particularly important when considered in light of the fact that, for a grantmaking foundation, programmatic effectiveness is usually beyond its control.[40] The effectiveness of philanthropy depends substantially on the performance of grant recipients. Thus, in any evaluation of effectiveness, foundations and their personnel risk being punished for the performance of others.

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40. See Frumkin, *Trouble in Foundationland*, 30, 65. Frumkin outlines the reliance of foundations on the work of others and the difficulty of attributing foundation effectiveness of actions of its staff. In focusing on outcomes, many a critic "holds nonprofits responsible for factors beyond their control." Brody, "Sunshine and Shadows," 8.

The possibility of this kind of vicarious liability might prompt foundations to become more involved in the day-to-day operations of their grant recipients. Grantees who object to foundation involvement at current levels would certainly consider this an especially undesirable outcome. Alternatively, more foundations might begin operating their own programs and giving fewer grants to others.

Other possibilities are equally unappealing. If compliance burdens turned foundations to increasingly safe, short-term, measurable activities, society could be denied untold benefits and advances in human welfare.[41] In addition, foundations and donors could find it more difficult to attract competent, much less extraordinary, people to serve as directors, officers, and key employees. Potential donors could find it considerably less attractive to endow philanthropic enterprises in the United States in the future, a prospect with its own significant consequences.

Each of these asserted rationales—transparency as an end in itself, transparency to ensure so called public good and social benefit, transparency to rectify purported power asymmetry, and transparency to enable assessments of "effectiveness"—is rife with fatal difficulties as an objective for mandating greater transparency in philanthropy beyond what is necessary to demonstrate compliance with the tax treatment compact. Scratching the surface of each assertion reveals too many unanswered questions, too much confusion, and too many substantial problems, among them a lack of discipline in terminology, lack of respect for degrees, and lack of adequate consideration of the impact on roles and responsibilities. Thus, adopting any of these as an objective justifying a demand for more expansive transparency in philanthropy would not be good.

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41. See Frumkin, *Trouble in Foundationland*, 281.

Chapter III
Voluntary Philanthropic Transparency: Telling Your Story and Keeping Public Trust

Today, calculations about the degree of transparency in which a foundation should engage are more than a matter of law. We live in a world of instant communications, and of direct democracy via the internet and social media. Every foundation that wants to be effective must take the power of communications into account—to define itself positively and to avoid allowing others to do the defining. Foundations should provide information about the good they do, should build a reputation that can withstand attacks and, when it is appropriate, should use communications to increase their effectiveness.

However inappropriate it may be for more laws and regulations to impose greater openness on and disclosures from philanthropy, there are legitimate, valuable reasons for individual foundations to make strategic and thoughtful decisions, as appropriate to their circumstances, to be more open and to disclose more information than the law requires. Some of the reasons are constructive and advance the relevance of philanthropy, while others are more defensive and counter criticisms and attacks on philanthropy.

Some critics and opponents target philanthropy broadly, while oth-

ers focus on specific foundations or types of entities, such as foundations that are large or are controlled by the donor's family members or operate internationally.[1] Some critics question the contributions of philanthropy, financial and non-financial, to our society. Others recognize the potential value of those contributions and even acknowledge their historic usefulness but assert that foundations are failing to live up to legitimate expectations. Still other critics favor more immediate spending of foundation funds to address short-term needs.

Some critics and detractors decry concentrations of wealth and seek its redistribution[2]—often according to their own preferred priorities, which may or may not be self-serving. Some believe that foundations should be "democratic" and that their lack of representativeness in terms of programs and personnel is contrary to the nation's political

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1. There is a difference between constructive critics and detractors. Both may be found inside and outside the philanthropic sector. Critics generally value foundations and philanthropy and seek to help them improve the ways in which they function and fulfill their responsibilities, with appropriate respect for their autonomy and independence. Detractors, on the other hand (particularly at the extreme), strive to re-fashion philanthropy and foundations to serve their particular agendas and preferences. Sometimes critics are misperceived as detractors; sometimes detractors disguise themselves as critics. The confusion has sometimes caused potentially valuable ideas to be misunderstood as dangerous. A distinction between critics and detractors could often be a matter of apparent motives. Some may be motivated by principled convictions about how society should function or by a conviction that fraud pervades human nature. Others may simply have had bad experiences with foundations, such as the rejection of a grant request or the termination of a grant, or may be moved by the prospect of consulting or business fees. This list does not purport to be exhaustive or even authoritative, and the likely reality is that a variety of experiences and philosophies motivate critics and detractors just as a combination of venerable and nefarious factors move defenders and advocates of foundations and philanthropy. An appreciation of these various motives may help to distinguish between critics and detractors and give proper weight to the positions they expound.
2. See National Committee for Responsive Philanthropy (NCRP), *Criteria for Philanthropy at Its Best: Benchmarks to Assess and Enhance Grantmaker Impact* (2009); Pablo Eisenberg, "Making a Difference," *Chronicle of Philanthropy*, May 27, 2010; and Mark Rosenman, *Foundations for the Common Good* (Washington: Caring to Change, 2010). Whether they are relying on their own persuasive abilities or calling for government imposition of quotas, ratios, and other mandatory distributions is often unclear. Foundations should not be immune to the former, but the latter requires active counter-measures to preserve the character and roles of American philanthropy.

principles. Still others want foundations to focus solely on alleviating poverty and remedying social injustice as they conceive it.

None of the lists above is exhaustive, and not all of the reasons will appeal to or motivate every foundation—nor should they. Foundations operate in numerous unique and varied incarnations. Each foundation's decision to evaluate the question of expanding openness and disclosure should be made in light of the factors most relevant to the specific circumstances that define its character, serve its purposes, and most influence its operations. Foundations' chosen methods for pursuing greater openness and disclosures should be similarly customized.

Among the factors to be considered are the following:

- Donor intent, mission, and prioritized strategies
- Willingness to engage in policy research, advocacy, and education
- Geographic scope of operations
- Nature of relationships with grantees and other collaborators
- Capacities and competencies of staff and whether it is paid or volunteer, full-time or part-time
- Size of endowment
- Investment policies and practices
- Time horizon for existence, whether in perpetuity or limited-term
- Time horizons for grant and operational commitments, whether single-year or multi-year, and how far into the future
- Willingness to incur expenses for planning and evaluation
- Commitment to internal discipline and consistency of practices

There are other considerations as well, including effects on donors and their families, grant recipients, and those who contract with a foundation. There also are the inevitable unknown and unknowable consequences. Ideally, choosing more openness and disclosure will contemplate all of these factors and their relative priorities. In theory if not in practice, these various factors and relationships should be con-

sidered both as they currently exist and as aspirations of the donor and the foundation's board members, officers and managers.

How a foundation considers and addresses the above factors, individually and in the aggregate, will define that foundation's philosophy and culture, not just with regard to openness and disclosure but also more broadly. Whether done intentionally and strategically or by accident and happenstance, a philosophy and culture will be created and perpetuated. The approach to openness and disclosure will be an integral part of both.

As with most decisions, balances must be struck and benefits and costs weighed. Also, these types of decisions are not usually made for all time but should be revisited periodically in light of changed circumstances. In that way, the currency, accuracy, and relevance of previously presumed values, benefits, and costs can be affirmed or modified in light of new potential opportunities and threats.

A. Benefits of More Expansive Voluntary Disclosure

There are at least three reasons why foundations may wish to decide voluntarily to share more information. First, and crucially, such a decision gives foundations the opportunity to exercise more control over the information available to the public, including control over the accuracy of the information, its presentation, and its context. Second, it can contribute to building, maintaining, and enhancing reputation and credibility. Third, it can increase administrative efficiency and opportunities for collaboration, which can help leverage foundation assets and outcomes.

Information is ubiquitous, and its omnipresence can be insidious. It used to be that the most likely sources of broadly disseminated misinformation were print media, television, radio, and word of mouth. Today, the sources have expanded to include webpages, blogs and com-

ments, tweets, Facebook posts, open-source media, email, cable television channels, talk radio, and more. The ethical and professional standards that historically applied in credible journalism do not generally apply in these broader media of expression, and the convergence of journalism with entertainment has made it harder to tell where such standards apply at all.

Foundations and philanthropy are not immune from the damage that can now be caused by anyone with an opinion who is willing to state it widely and repeatedly and without regard to whether the opinion is informed or credible.[3] When such opinions are expressed, if foundations and philanthropy have not already acted affirmatively to populate the technological ether with relevant, reliable information appropriate to their circumstances, they may find themselves in the untenable position of trying to undo damage that has already been done to reputations, programs, and more.

This is not to suggest that every foundation should disclose everything—or even anything. Instead, it is to encourage foundations to consider the risk of others' disseminating misinformation and the benefits of strategies to ensure that accurate, appropriate information has already educated those who matter most. The aim is for the foundation to build a reputation capable of withstanding attacks, whether inadvertent or malicious.

The tools and vehicles that can be used to attack can also be combined with other strategies to circulate accurate information in proper context. Such information can better inform policymakers, grantees, and the public about how individual foundations and philanthropists pursue

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3. "[A]s information becomes more ubiquitous in the age of web 2.0, it becomes important to tell your own story." Foundation Center, "Too Small to Have a Website," *Philantopic*, May 12, 2010. "No sector—government, church, business, or charitable—gets a free pass in the world of 24/7 media blogs, YouTube, Twitter, crowd sourcing, and digital everything." Aaron Dorfman, "A New Portal for Philanthropic Transparency," *Huffington Post*, February 9, 2010.

their charitable purposes and, by doing so, fulfill their social, economic, and political roles and responsibilities. Expanding this type of knowledge can also decrease the mystery that sometimes shrouds these enterprises.

In addition, greater disclosure about grantmaking processes can contribute to a more efficient allocation of a foundation's resources, including money and personnel.[4] Communicating a foundation's mission and strategy can reduce the volume of requests that do not "fit," particularly if the mission and strategy are clear and disciplined in the first place. Foundation personnel will be able to focus their time and energy on making the more important and already hard decisions about selecting from among qualified organizations and activities that complement the foundation's own goals.

The same purpose can be served by promulgating application processes, including details about the information, data, and materials that are required. The foundation should first ensure that it is requiring applicants to submit only what is relevant and necessary for its legitimate purposes. Disseminating its information requirements can save large amounts of time and grief for grant-seekers and foundation personnel.

Disseminating information about grants that have already been made can be equally useful. A foundation's grant history can provide examples for prospective grantees who are trying to focus their own time and energy on placing their requests where they are most likely to be funded.

Greater degrees of openness and disclosure also can help militate against grantee dependency and feelings of entitlement. When a foundation decides to change the ways in which it allocates resources, what once seemed like a mutually beneficial and cordial relationship can quickly deteriorate into a clash between the foundation and "constituencies" or "stakeholders" whose interest is in preserving the status quo and who can believe they have

4. Thomas J. Tierney, "To Succeed, Philanthropy Needs to Be Rooted in Deep Personal Beliefs," *Chronicle of Philanthropy*, February 20, 2011.

been empowered in some fashion. Such clashes and the situations that give rise to them can damage autonomy, credibility, and reputations.

How a foundation approaches public engagement and disclosure can either foster or prevent such problems, depending on how the activities are conducted and their timing. Not even the best-executed strategies for openness and engagement under such circumstances can guarantee that there will not be problems, but openness and disclosure can help avert problems if the foundation is consistently disciplined in its processes and communications and clear about its mission, strategies, application and assessment processes, and individual authority or lack of authority to make and communicate decisions. The likelihood of problems can also be minimized with information on the extent to which the foundation does or does not intend to be a long-term funder of particular grantees.

However, attempts at openness can contribute to problems rather than avert them if such attempts are inconsistent or undertaken too late and only defensively to undo prior silence or ineffective communications. Openness and engagement done badly can also be perceived as undue deference, an abdication of authority, or an apparent vesting of authority that does not actually exist. Examples of engagement that might give rise to notions of abdication or vesting could include creating *ex officio* positions on a foundation board for grantees or public officials or having board members represent the general community or specific interests or constituencies rather than the foundation as a whole.[5] Grantmaking by crowd can also leave these unfortunate impressions when done too broadly or too often.

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5. Any given donor may want such a board. But for several decades, donors have had the option of putting their contributions in donor-advised funds or other community foundation vehicles overseen by such boards. If a donor has instead chosen a private foundation, it may be reasonably presumed from the donor's selection of the foundation form that he or she wants a board that serves the interests of the foundation, not of the "community" or fictitious "stakeholders" or "constituents." Cf. Aaron Dorfman, "The Giving Pledge: Dangerous Implications for Democratic Decision-Making," *Huffington Post*, December 21, 2010. "[S]ome forward-thinking foundations share power with communities by including grantees or the constituent perspective on their boards."

Thoughtfully communicating information about strategic outcomes and results can also help manage these problems and contribute to more efficient operations. A foundation might provide information about lessons learned from the success or failure of initiatives, programs, or specific grants.[6] Doing so can be helpful in numerous ways. Among these are identifying opportunities for collaboration, coordinated efforts, leverage, and access to networks.[7] Disclosing successes can help other foundations, public charities, government, and even business better target similar efforts. Disclosure of failures, as has been advocated, can provide insight and guidance to others about what to avoid and what variables they might try to change. Such disclosures also can reduce redundancy and, thus, help allocate resources more effectively.

In undertaking these efforts, foundations also should try to understand and predict the ways in which their information is likely to be used and conduct their analysis and develop their strategies accordingly. For instance, a foundation might want to consider with special care the consequences of disclosing failures in a context of demands that foundations and their personnel be held "accountable" for their "effectiveness."

These are among the benefits that foundations might weigh when voluntarily undertaking openness not required by law. These benefits are not absolute or unqualified, and foundation personnel should exercise prudence when accepting the risks of disclosure, including an awareness of undesirable or unintended outcomes.

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6. See Vartan Gregorian, *Transparency and Accomplishment: A Legacy of Glass Pockets* (New York: Carnegie Corporation, 2003), 7.
7. For an argument advocating for the coordination of efforts with government, see Vartan Gregorian in "Quick Question Survey: What's the Right Relationship between Philanthropy and Government?" Grantcraft, 2010. For an essay arguing for the importance of information to solve problems and coordinate services, see Cinthia Schuman Ottinger, "Information, Please! A Dearth of Data Hides Nonprofit World's Impact," *Chronicle of Philanthropy*, February 7, 2010.

B. Cautions Regarding Expansive Voluntary Disclosure

> A foundation that has decided to undertake more voluntary disclosure must be mindful of several things: information about not-so-successful outcomes may give ammunition to those who want to brand the foundation as ineffective; information provided in an indiscriminate way may harm grantees, contractors, and donors and their families; and voluntary disclosure is not without costs in terms of finances, administration, and opportunities.

Every decision about openness and disclosures, even a decision to maintain the status quo, has consequences. Some are predictable, others are unintended, and still more are unknowable. In addition to affecting the foundation and philanthropy in general, increased openness and disclosures can affect foundation employees, donors and their families; grant recipients, contracting parties, and their respective employees and beneficiaries; and possibly even those who are served by such parties. How a foundation thinks about potential consequences can help shape the way in which it approaches openness and disclosure and the consequences with which it must then deal.

One wholly foreseeable and likely unavoidable consequence of greater openness and disclosure, whether voluntary or mandatory, is that it will increase the amount of money and time spent on administration, management, and non-program activities. Such costs are real and can be material. Thus, they should be incurred only in pursuit of corresponding strategic value for the foundation and its purposes and not merely as exercises in self-indulgence or to satisfy some mythical notion of accountability or some imagined, artificial constituency. These and other costs should be part of any calculation of the benefits and risks of voluntary openness beyond legal requirements.

Donors and Their Families. The law requires that foundations report and disclose certain information about substantial contributors, and donors themselves often publicly reveal information about their donations. But in making a donation and thereby relinquishing discretion and control over the donated assets, donors have not thereby also automatically given up their rights or expectations of privacy or personal safety for themselves and their families.[8] At a very practical level, they may want to preserve at least some degree of privacy so they are not bombarded by others who want contributions from them.[9] They may also need to protect themselves and their families from threats to their physical health and safety.

Anonymity may be important to donors for other reasons as well.[10] Religious tenets or principles of faith and spirituality may be among the motivations for donor generosity. Anonymity is frequently integral to these tenets and principles and, thus, may legitimately constrain certain public disclosures. A donor may forgo publicity and recognition in order to avoid the attendant temptation to pride and egotism. Donors also sometimes avoid publicity or ask that their foundations do so in order to emphasize the work and results of their grant recipients.[11] Such modesty has the additional benefit of dampening the sense of self-importance to which foundation personnel can sometimes be prone. Even so, it might be wise to consider explaining the reasons for quiet or silent grant making so that ulterior motives are not as easily ascribed to fill the void.

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8. See Bradford Smith, "Transparency: One Size Does Not Fit All," *Philantopic*, February 9, 2010; and Joe Mont, "What's in a Name? Debate for Philanthropists," *The Street*, February 24, 2011.
9. See Stephen Greene, "A Donor's Obsession with Secrecy," *Chronicle of Philanthropy*, February 6, 1997. A donor demanded anonymity after a "flood of solicitations from numerous organizations" following publicity about a substantial contribution.
10. Ibid.; and Stephen Greene, "For Anonymous Donors, Offshore Philanthropy Can Be Appealing," *Chronicle of Philanthropy*, February 6, 1997. Foundations outside United States have advantages, including privacy, for those willing to forgo tax exemptions and deductions.
11. See Smith, "Transparency: One Size Does Not Fit All."

Ulterior motives can exist for wanting anonymity just as such motives can drive certain rationales for wanting more information about foundations and their donors. Among such less-than-pure motives are greed, retaliation for rejected proposals or terminated grants, opposition to a foundation's missions, strategies, or grantees, or the desire to raise funds through litigation.[12] Although such motivations can sometimes produce useful outcomes, they should not normally be tolerated, especially if they pose risks to donors and their families, foundations and their employees, or philanthropy in general.[13]

Anonymity is increasingly difficult in our age of omnipresent, undisciplined, and often unreliable information. There are benefits in choosing to compromise anonymity voluntarily and by degrees with public disclosures beyond those required by law. Those benefits, though, must be balanced with the potential for negative consequences for donors and their families.

Grant Recipients and Contracting Parties. In some cases, disclosure can have undesirable consequences for organizations that accept grants from or contract with a foundation.[14] As with donors and their families, consequences for grant recipients and contracting parties and their employees can include concerns about privacy and security, particularly for senior management and board members. We saw an example of this danger in California in 2010, when a heavily armed

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12. John Gamboa, the head of the Greenlining Institute in 2008, stated that the Institute does not pursue foundation grants "because we don't want foundations to . . . limit us to what issues we can go after, like going after foundations. Most of our money comes from the lawsuits we take on." Bradley Center, *Mandating Multicultural Munificence?* (transcript, Washington: Hudson Institute, 2008).
13. Another motive not to be tolerated is the desire to use foundations to pursue private benefit (including unreasonable compensation for directors, employees, or contractors) or otherwise undermine foundations' roles and responsibilities.
14. NCRP's agenda seeks "benchmarks" for the "common good" and advocates for "open approaches to grantmaking." Aaron Dorfman, "Foundations Need to Think Hard About Their Blind Spots," *Chronicle of Philanthropy*, April 23, 2009.

person was stopped by police reportedly on his way to foundations and charities whose work he found distasteful.[15] In the United States, this is an extreme and, hopefully, isolated case; but the potential for such threats and harm may be greater in certain other parts of the world where foundations and grantees operate. In 2011, in response to an IRS invitation for comments on its proposal to require more identifying information on Form 990 about foreign grantees, the Evangelical Lutheran Church in America sent a letter pointing to precisely these types of threats. The degree of personal risk should obviously be considered when making decisions about greater disclosure.

In less hazardous but still damaging ways, releasing information about grantees and contractors—including proposals or reports from them, decisions about them, or assessments of their performance—could affect their reputations and programs and even beneficiaries of their services. Limited resources regularly force foundations to decide not to fund a substantial number of high-quality, worthwhile proposals from well-run, successful organizations, even when the proposals are consistent with foundation missions and strategies.[16] Even though the reasons for not funding a proposal may be valid by any measure, publicizing the rejection could inadvertently inspire others to make similar refusals by relying solely or too heavily on the particular foundation's decision not to fund.[17]

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15. See Naimah Jabali-Nash, "California Highway Gunman Byron Williams Aimed for 'Revolution,' Say Cops," CBS News, July 21, 2010.
16. "[A] foundation that must deny ninety requests for every one that is accepted . . . has severe limits on its ability to 'win friends and influence people." Homer C. Wadsworth, "Private Foundations and the Tax Reform Act of 1969, *Law and Contemporary Problems* 39, no. 1 (Winter 1975): 259.
17. This phenomenon is the flip side of the desire of many grantees to acknowledge their contributors—including foundations—publicly, so that the donor names, individually or in the aggregate, will influence others to give. This is particularly true with formal fundraising campaigns and early efforts to attract funders whom the community is likely to perceive as diligent and credible. Such credibility, grantees hope, will make other potential contributors more likely to give.

Making the reasons for the rejection public could mitigate the problems; but there are many valid reasons for rejection, some of which can be highly critical of an applicant. Rejection may not be based on the foundation's limited resources alone or its internal assessment of programmatic risk. It may also be based on information about or perceptions of the applicant's past performance, capacity, fiscal controls, efficiency, or personnel. Disclosing this information or perceptions, which may not be based on complete information, could unfairly harm an organization's reputation and ability to raise funds and provide services. It could also unduly tarnish the organization's directors and personnel. Depending on the nature of the information disclosed, a foundation and its personnel could even find themselves spending time, energy, and resources to defend against causes of action for defamation. It seems that there is very little to be gained and a lot of harm risked in pursuing these types of disclosures.

Similar problems can arise from publicizing assessments of grants programs, initiatives, and strategies.[18] However, these concerns diminish to the extent that the information is increasingly anonymous and generalized or the number of recipients of the information is limited. Assessments of how a foundation strategy might have achieved better outcomes in general are less likely to cause problems than are assessments of specific grantees or contractors (though such assessments may, as discussed above, affect evaluations of the effectiveness and accountability of the grantors themselves). Widely distributed critiques of specific grantees or contractors and their personnel or activities are more likely to be problematic than are targeted, discrete conversations with a few select people, though even private conversations are not wholly without risk.

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18. "Whatever someone elects to support, others will question or challenge that choice or allocation." Curtis W. Meadows Jr., *Philanthropic Choice and Donor Intent: Freedom, Responsibility and Public Interest,* (Washington: Center for Public and Nonprofit Leadership, Georgetown University, 2002), 7.

Thus, inviting the public into a private foundation's decision-making and evaluation, whether the disclosure is mandatory or voluntary, can have undesirable repercussions for grantees, applicants, contractors, and their respective programs and personnel. Even if unintended, certain consequences are reasonably predictable, and a foundation should consider them when voluntarily pursuing greater openness and disclosure.

Conclusion

Transparency in philanthropy is complicated. It can be deployed appropriately and thereby strengthen philanthropy's unique functionality, or it can be used to weaken or even destroy it and its contributions to our various systems. Consequently, it is an important enough subject so that its complexity deserves acknowledgement and respect. Unless there is greater discipline and clarity as discussions continue about transparency in philanthropy, we may see an emergence of policies and practices that fundamentally change the ways philanthropy fulfills its roles in our social, economic, and political systems to the detriment of those systems. Some may intentionally seek that outcome, and they should be clear about their cause.

What should be more clear now is that, in the current tax environment, there are reasonable degrees of transparency that are appropriate for ensuring accountability to the conditions for tax exemptions and charitable deductions. There may be disputes about some of the details, but it is not inappropriate to require that foundations make certain information and data available to support their compliance with the tax treatment compact. Therefore, the tax compact offers the clearest, most reliable basis for asserting legal accountability. Accompanying that compact, however, are its too frequently forgotten limits on what government may demand in the name of tax-favored treatment, and failure to abide by those boundaries could undermine philanthropy and even the role of government itself.

It should also be clearer that foundations may voluntarily choose to be more open about their operations and decision-making than may be required by law. When pursued strategically, thoughtfully, and with mindfulness of potential consequences, degrees of greater openness can have advantages for foundations and philanthropy more generally.

Those advantages can range from certain gains in operational efficiency to less concrete benefits in terms of reputation and credibility.

What should be less clear is the attractiveness of certain frequently asserted objectives for philanthropic transparency that are too often presented as if presumptively valid. For instance, transparency does not suffice as a legitimate end unto itself but is always in service to some other valid goal, even when applied to the frequently invoked comparisons with government and publicly traded companies. Pursuit of "public good" and "social benefit" lacks disciplined justification for more expansive philanthropic openness. Purported power asymmetry in the grantor-grantee relationship also fails, in part because it is a position that overreaches and can be circular in attacking at one moment what it demands in another. Finally, it should be clear that effectiveness, whether in its own right or as a proxy for accountability, suffers from numerous defects that make it a questionable objective for mandating greater philanthropic transparency.

In all respects, conversations about transparency should facilitate the ways philanthropy fulfills its unique roles in our social, economic, and political systems rather than undermining its performance. The preceding four arguments suffer from too many faults to meet that aspiration, frequently because they conflate philanthropy with government and ignore philanthropy's similarities to business. Whereas government is mostly public and business is mostly private, philanthropy is far less public and far more private than government and less private and more public than business.

As such, philanthropy reflects both the private values of donors and their private decision-making and the public needs of society, such that "something significant is lost" when both are not simultaneously present, with the result being an undesirably "safe but bland philanthropic agnosticism"[1] that risks falling short of its responsibilities. There has been

1. Peter Frumkin notes that the professionalization of philanthropy gave rise to issues of ef-

much in discussions of philanthropic transparency that tends to be overly deferential to the "public" side of the equation and seems prepared to sacrifice the vitality and fundamental character of the "private" side.

The conditions of the tax treatment compact and attorney general oversight of fiduciary duties and donor intent help ensure the presence of the public side, but there is little but philanthropy itself and those who value it to protect the "private" side. Thus, as with the freedom and liberty we as a nation enjoy, vigilance is also important to preserving the freedom, liberty, and corresponding responsibilities that characterize our nation's conception of philanthropy. Such vigilance must ensure that discussions about transparency in philanthropy do not deviate from limited applications that strengthen philanthropy or stray into areas that are likely, at best, to neutralize philanthropy—and may even be harmful and destructive.

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fectiveness and accountability, which make it harder to connect values of donors that are "so critical to philanthropy with public purposes that are the objects of the donation." Thus, donor values are "squeezed out of institutional giving," resulting in a "remarkable level of agreement and complacency . . . hardly a recipe for achieving philanthropic breakthroughs." Peter Frumkin, *Trouble in Foundationland: Looking Back, Looking Ahead* (Washington: Hudson Institute, 2004), 29–30, 36.

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About the Author

John Tyler is general counsel and corporate secretary of the Ewing Marion Kauffman Foundation, a private foundation dedicated to helping individuals attain economic independence by advancing educational achievement and entrepreneurial success. Since assuming his responsibilities in 1999 after ten years as a commercial litigator, Mr. Tyler has operated at the intersections of theory, strategy, implementation, and day-to-day operations and across the foundation's diverse program, administrative, investment, and governance needs. As noted in the text, Mr. Tyler has published several pieces relating to philanthropy and the charitable sector. He also has published articles on hybrid business forms, U.S. policy regarding highly skilled immigration, and the disconnect between university practices and federal policy in the way university leaders approach the results of taxpayer-funded research. Many of his published works are available through ssrn.com. Mr. Tyler is also a frequent speaker on topics relating to philanthropy, including transparency, foundation autonomy and independence, the roles of philanthropy, governance, ethics, intellectual property, structures, and legal compliance. Other topics on which he regularly speaks are hybrid business forms, advancing university innovation and technology transfer, and U.S. policy regarding highly skilled immigration. Mr. Tyler serves on the board of directors and as secretary of The Philanthropy Roundtable, where he also is a member of the board's public policy committee. He also is on the strategy committee for the Alliance for Charitable Reform, chair of the Philanthropic Collaborative, an advisor to the Columbia Law School's program for state charity officials, a member of Independent Sector's public policy committee and several of its work groups, and an officer and director of other

501(c)(3) organizations. He has been on advisory boards and working groups for New York University Law School's National Center on Philanthropy and the Law, Independent Sector, and the Diocese of Kansas City–St. Joseph, among others.

About The Philanthropy Roundtable

The Philanthropy Roundtable is America's leading network of charitable donors working to strengthen our free society, uphold donor intent, and protect the freedom to give. Our members include individual philanthropists, families, and private foundations.

Mission

The Philanthropy Roundtable's mission is to foster excellence in philanthropy, to protect philanthropic freedom, to assist donors in achieving their philanthropic intent, and to help donors advance liberty, opportunity, and personal responsibility in America and abroad.

Principles

- Philanthropic freedom is essential to a free society.
- A vibrant private sector generates the wealth that makes philanthropy possible.
- Voluntary private action offers solutions for many of society's most pressing challenges.
- Excellence in philanthropy is measured by results, not by good intentions.
- A respect for donor intent is essential for philanthropic integrity.

Services

World-Class Conferences

The Philanthropy Roundtable connects you with other savvy donors. Held across the nation throughout the year, our meetings assemble grantmakers and experts to develop strategies and solutions for local,

state, and national giving. You will hear from innovators in K–12 education, economic opportunity, higher education, national security, and other fields. Our Annual Meeting is the Roundtable's flagship event, gathering the nation's most public-spirited and influential philanthropists for debates, how-to sessions, and discussions on the best ways for private individuals to achieve powerful results through their giving. The Annual Meeting is a stimulating and enjoyable way to meet principled donors seeking the breakthroughs that can solve our nation's greatest challenges.

Breakthrough Groups

Our Breakthrough Groups—focused program areas—build a critical mass of donors around a topic where dramatic results are within reach. Breakthrough Groups become a springboard to help donors achieve lasting results with their philanthropy. Our specialized staff assist grantmakers committed to making careful investments. The Roundtable's K–12 education program is our largest and longest-running Breakthrough Group. This network helps donors zero in on the most promising school reforms. We are the industry-leading convener for philanthropists seeking systemic improvements through competition and parental choice, administrative freedom and accountability, student-centered technology, enhanced teaching and school leadership, and high standards and expectations for students of all backgrounds. We foster productive collaboration among donors of varied ideological perspectives who are united by a devotion to educational excellence.

A Powerful Voice

The Roundtable's public policy project, the Alliance for Charitable Reform (ACR), works to advance the principles and preserve the rights of private giving. ACR educates legislators and policymakers about the central role of charitable giving in American life and the crucial impor-

tance of protecting philanthropic freedom—the ability of individuals and private organizations to determine how and where to direct their charitable assets. Active in Washington, D.C., and in the states, ACR protects charitable giving, defends the diversity of charitable causes, and battles intrusive government regulation. We believe that our nation's capacity for private initiative to address problems must not be burdened with costly or crippling constraints.

Protection of Donor Interests

The Philanthropy Roundtable is the leading force in American philanthropy to protect donor intent. Generous givers want assurance that their money will be used for the specific charitable aims and purposes they believe in, not redirected to some other agenda. Unfortunately, donor intent is usually violated in increments, as foundation staff and trustees neglect or misconstrue the founder's values and drift into other purposes. Through education, practical guidance, legislative action, and individual consultation, The Philanthropy Roundtable is active in guarding donor intent. We are happy to advise you on steps you can take to ensure that your mission and goals are protected.

Must-Read Publications

Philanthropy, the Roundtable's quarterly magazine, is packed with beautifully written real-life stories. It offers practical examples, inspiration, detailed information, history, and clear guidance on the differences between giving that is great and giving that disappoints. We also publish a series of Guidebooks which provide detailed information on the very best ways to be effective in particular aspects of philanthropy. These Guidebooks are compact, brisk, and readable. Most focus on one particular area of giving—for instance, Catholic schools, support for veterans, anti-poverty programs, environmental projects, and technology in education. Real-life examples, hard numbers, management

experiences of other donors, recent history, and policy guidance are presented to inform and inspire savvy donors.

Join the Roundtable Today

When working with The Philanthropy Roundtable, members are better equipped to achieve long-lasting success with their charitable giving. Your membership with the Roundtable will make you part of a potent network that understands philanthropy and strengthens our free society. Philanthropy Roundtable members range from *Forbes* 400 individuals and the largest American foundations to small family foundations and donors just beginning their charitable careers. Our members include:

- Individuals and families
- Private foundations
- Community foundations
- Eligible donor advisors
- Corporate giving programs
- Charities which devote more than half of their budget to external grants

Philanthropists who contribute at least $50,000 annually to charitable causes are eligible to become members and register for most Roundtable programs. Roundtable events provide you with a solicitation-free environment.

For more information on The Philanthropy Roundtable or to learn about our individual program areas, please call (202) 822–8333 or email main@PhilanthropyRoundtable.org.

PRINCIPLES OF PHILANTHROPY

Titles in this series available from The Philanthropy Roundtable:

How Public Is Private Philanthropy?
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Evelyn Brody and John Tyler

Transparency in Philanthropy:
An Analysis of Accountability, Fallacy, and Volunteerism
John Tyler

Transparency in Philanthropy

An Analysis of Accountability, Fallacy, and Volunteerism

Regulatory mandates for transparency in philanthropic giving are often touted as an unmitigated good. Private foundations have long been obligated to provide certain types of transparency—the types that are required by the federal tax system and, to a lesser extent, by state laws aimed at maintaining the integrity of donor intent. But today's calls for more transparency argue that it is a good unto itself—that transparency is needed to ensure that philanthropy serves "public purposes," that transparency will counteract a purported "power asymmetry" between donors and grantees, and that it is necessary to evaluate philanthropic effectiveness. In this book, John Tyler critically scrutinizes both legal and practical aspects of these rationales for increased transparency. He also challenges calls for government intervention, including those that seem to presume the legitimacy of transparency as a fundamental principle in itself instead of a dependent value in service to other objectives that must themselves be legitimate. Along the same lines, he dissects the most frequently asserted objectives for government mandates and reveals deeply rooted, potentially insurmountable problems with the practical pursuit of those objectives. Tyler argues that American philanthropy is at its best when donors, with their wide range of charitable purposes, can freely choose to employ the kinds of transparency that enable them to accomplish their goals. To this end, he also offers thoughtful advice about how foundations might, in pursuit of their mission, provide measured transparency on a voluntary basis.

John Tyler is general counsel and corporate secretary at the Ewing Marion Kauffman Foundation.

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