"TRUST-BASED PHILANTHROPY" AND THE FOUNDATION BOARD

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This article explores the concept of "trust-based philanthropy" from a legal perspective, primarily for advisers, but also for foundation directors and senior leadership interested in giving (or seeking) funding according to this model.

The movement for "trust-based philanthropy" is based on the premise that greater public good and impact could be achieved if more funders adopted grant-making practices that prioritize long-term and unrestricted funding, avoid unnecessary documentary burden, and seek to redress traditional power imbalances in favor of a more collaborative approach. Funders attracted to these concepts may nevertheless be unclear about the legal implications of adopting this approach. In particular, foundation boards will want to ensure that doing so can be compliant from a fiduciary and fiscal perspective.

The unprecedented circumstances of 2020 highlighted the need for funders to be timely, impactful, and flexible in their grant-making. The moment is therefore ripe for funders and advisers to examine their approach.

This article will first identify three challenges of the current relation between funders and grantees, then will introduce the principles comprising "trust-based philanthropy," and consider its legal implications for funders, before concluding with a note on the current context for grant-making.

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Challenges of the philanthropic status quo

Philanthropic funders are a varied group. They may be individuals, businesses, exempt organizations (including private foundations, donor-advised fund sponsoring organizations, and community foundations), or the non-exempt structures sometimes used by philanthropists willing to forego/defer tax-exemption in favor of more complete control.[1] From a legal and fiscal perspective, these are very different beasts, of course, and the funding they give is subject to different levels, and types, of regulation. From the perspective of a grantee, however, they are more alike than not, and certainly tend to share the following issues:

Power imbalance, generally. It is self-evident to anyone with experience of the nonprofit sector that not all funders are engaged and thoughtful partners to communities they fund. Some are capricious and untimely; others are over-eager to influence, perhaps overvaluing the benefit to charitable projects of their business acumen; others still are benignly disengaged, but limit their support to only the most established and mainstream institutions.

Funders *can* take these various approaches, precisely because philanthropy's voluntarism

gives funders outsized and almost unchecked power. Philanthropists and foundations can choose to fund or not to fund, can select grantees and projects with almost unlimited freedom, and can impose considerable burden on grantees, from initial due diligence through to bespoke grant reporting. At its most extreme, funders can even influence the strategy and direction of grantee organizations – the worst sort of "mission drift."

Restricted funding. Many funders eschew unrestricted or "core costs" funding as a matter of policy – one study showed as much as 90% of U.S. foundation funding over a 20-year period was restricted.[2] Several motivations may lie behind a preference for restricted project funding. Funders may prefer project funding for *accountability* reasons — confirming proper application of grant funds as against a budget is comparatively simple. Funders naturally want their grants to make a significant *impact* and application of grant funds to "front line" charitable projects may seem an easy way to achieve this, while the more applied to a grantee's overheads, the more abstract measurement of impact may become. Project-funding is more often linked to naming opportunities so may attract funders set on *recognition.* Finally, some funders are concerned that supporting core costs will lead to grantee *dependency.*

Whatever the motivation, it is clear that a lack of unrestricted funding is challenging for nonprofits. Project funding that does not bear a portion of the core costs burden leaves pure core costs that need to be met somehow. Organizational energy is needed to fundraise to address this shortfall, a challenge for all the reasons listed above, as well as the ever-increasing scrutiny of the "administrative costs" of nonprofits (which of course include the cost of employing fundraisers to seek unrestricted funding). Funding core costs in turn provides organizational resilience, and arguably allows nonprofits to adapt and innovate.[3]

The "funding gap;" grantee exclusion. Black-led nonprofits have been shown to receive less revenue and possess lower levels of unrestricted funding than their counterpart organizations. This disparity pertains even when the nonprofit's work is directly related to racial justice, or other areas in which lived experience is highly relevant.[4] In addition, new and innovative organizations are being left out as they struggle to satisfy conservative funder requirements.

These issues may seem peripheral to the work legal and tax advisers do to support clients. However, they are anything but irrelevant to funders and grantee organizations.

Trust-based philanthropy

The articulation of a trust-based approach to philanthropic grant-making is recent, even if the constituent practices are not all new. The Whitman Institute (TWI)[5], a California private operating foundation, credits feedback from its grantees during its decade-long spend-down process. TWI's grantees encouraged it to share its funding practices more widely with its foundation peers to help foster a more equitable and inclusive philanthropy. The Robert Sterling Clark Foundation[6] and the Headwaters Foundation[7] joined TWI in creating The Trust Based Philanthropy Project, a "peer-to-peer funder initiative to address the inherent power imbalances between foundations and nonprofits[8]," in 2018.

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Several key principles form the framework for trust-based philanthropy. From the perspective of legal and tax advisers, the following four principles are of particular interest:

- *Do the homework.* The onus should be on the funder to take active steps to learn about the grantee during its preliminary investigations and pre-grant due diligence process.
- *Provide multi-year, unrestricted funding.* As a practical reality, many grantees will not refuse single-year, project-restricted funding because they cannot afford to do so. However, both time and purse restrictions limit the grantee's ability to develop resiliency and devote its staff time to operations, not grant administration.

- *Simplify and streamline paperwork.* Funders should identify how information they gather from grantees can be obtained in ways that are less time consuming and burdensome. For instance, requesting grantees submit a grant application that they have already submitted elsewhere.[9]
- *Offer support beyond the check.* Capacity of grantees, particularly grantee leadership, can be fostered in a variety of monetary and nonmonetary ways. While funders may provide a sounding board to counsel grantees, this principle is not to be confused with the idea that the guidance of donors with business skills will "professionalize" grantees.

The two remaining principles go to communication: (1) *Be transparent and responsive* and (2) *Solicit and act on feedback.* While these are equally important, they are perhaps less germane to this discussion.

But is it even "legal"?

A funder attracted by the principles of trust-based philanthropy may nevertheless hesitate to adopt this approach out of an abundance of caution. The law and taxation of charitable contributions, and of nonprofit operations, is of course complex and they may wonder if doing so is even "legal." In particular, private foundations, being heavily regulated and operated by fiduciaries, may tend towards skepticism about the trust-based philanthropy approach.

As a general principle, private foundation grant-making procedures will be structured so that grants will not be taxable expenditures.[10] Consequences of noncompliance are serious and include excise taxes borne by the institution and in some cases by individual managers.

Beyond the requirements of the tax architecture, grants should, from a fiduciary perspective, be made for purposes co-extensive or narrower than the funder's own; be made pursuant to proper exercise of the funder board's powers; be overall in the best interests of the organization; and be duly approved (including if relevant managing any conflicts of interest properly). Fiduciaries face potential liability in scenarios of breach of duty, so again, serious consequences.

Particularly where grantee organizations will be varied, *procedural simplicity* may drive funders to adopt highly standardized grant-making processes as a way of mitigating risk and keeping operational costs in check. There is logic to this approach — one template application, grant agreement, and grant report may be all that is needed, as long as those templates are fit for the purpose for the grants requiring the *highest* level of formality. However, this "lowest common denominator" approach is sure to impose an unnecessarily high burden on the *lower*-risk grantees. The funder may justify the over-formality that periodically arises under this approach on the basis that procedural simplicity permits them to delegate more easily (or to less-skilled administrative staff), or perhaps because the templates are provided as a package by a third-party administrator or a legal adviser on the establishment. In practice, such thoughtful justification is probably rare. The balance of power discussed above permits a funder to take this approach seemingly without reflection on the impact on grantees.

A grant-making procedure that instead prioritizes *flexibility* over procedural simplicity can impose on grantees only such obligations as are appropriate to the circumstances of the grant. Provided the funder is willing to bear more of the work, such an approach can be compliant. Even where it is appropriate to exercise expenditure responsibility[11] to "follow the money" so as to ensure its proper application, the required elements can be completed in a way that imposes less burden on the grantee organization.

Lobbying prohibition. It is common for template grant agreements to contain a provision specifying

1 E.g. The Chan Zuckerberg Initiative. For a discussion of this option, see Reiser, "Disruptive Philanthropy: Chan-Zuckerberg, the Limited Liability Company," 70 Fla. L. Rev. 921 (2018).

2 Jagpal and Laskowski, "The State of General Operating Support," National Committee on Responsive Philanthropy (2013), available at: https://www.ncrp.org/wp-content/uploads/2016/11/PhilanthropicLandscape-StateofGeneralOperatingSupport2011.pdf.

3 Gregory and Howard, "The Nonprofit Starvation Cycle," Stanford Social Innovation Review (2009), available at: https://ssir.org/articles/entry/the_nonprofit_starvation_cycle#.

4 Dorsey, Bradach, and Kim, "Disparities in Funding for Leaders of Color Leave Impact on the Table — Racial Equity and Philanthropy," Echoing Green and the Bridgespan Group (2020), available at: https://www.bridgespan.org/bridgespan/Images/articles/racial-equity-and-philanthropy/racial-equity-and-philanthropy.pdf.

5 https://thewhitmaninstitute.org/twi-blog/philanthropy-is-in-a-cultural-moment-of-power-reckoning-the-trust-based-philanthropy-project-offers-a-clear-next-step.

6 https://www.rsclark.org.

7 https://www.headwatersmt.org/our-work-2.

8 https://trustbasedphilanthropy.org/the-project.

9 As the Robert Sterling Clark Foundation does. See https://www.rsclark.org/approach.

10 Section 4945(a). Similar rules apply to donor-advised fund (DAF) sponsoring organizations, though in practice it seems unlikely that a trust-based philanthropy approach would be attractive to a DAF sponsoring organization in light of the volume of grants administered (and the potential for some or all donor advisers to prefer the traditional approach for its lower administration costs).

11 Section 4945(h).

that no part of the grant funds may be used for lobbying. Such a prohibition is unnecessarily restrictive for many grants, however. It has been recognized for some time that a private foundation grant made to a public charity need not prohibit application in this way; provided it is not "earmarked" for lobbying and is either an unrestricted, general purpose grant, or a project grant that meets certain anti-avoidance criteria, it is acceptable for the public charity grantee to apply grant funds to lobbying.[12] While a funder may determine that as a matter of policy its funding should never be used to support lobbying to any degree, it seems likely that many funders have defaulted to this restrictive position, perhaps because it seemed the "safest" path to compliance, or because restrictive language was included in the template grant agreement adopted early on.

What does this mean in practice?

If this is all sounding too general to be of use, the following practical points may illustrate the ways in which funder compliance may be consistent with a trust-based philanthropy approach:

- In relation to *grantee due diligence* (including pre-grant inquiry for the purposes of expenditure responsibility), a funder can get to know a grantee organization in ways that require less grantee staff time without compromising fiscal or fiduciary compliance. Funders can pro-actively review publicly available documents and can accept information compiled for another purpose (including applications produced for another funder). Taken with public documents, meetings and phone calls can be used as an opportunity to obtain most if not all the information a funder may require, instead of requiring a grantee to complete a full application form after one or more preliminary meetings. Initial funder research may also avoid wasting both parties' time if the grantee does not meet the funder's eligibility requirements.
- Most funders will be free to make *unrestricted grants* to many, if not all of their grantees. If a default position applies at all, funders should default to unrestricted funding, with project-based restrictions limited to scenarios where this is required for some specific reason. Where a grant for a defined project is made with reference to an agreed budget, it should reflect the true cost of delivery. Funders should consider if a restricted grant could be accompanied by a separate unrestricted grant to address the grantee's burden of having to fundraise for "core" costs.
- In relation to *reporting*, there will again be many scenarios where limited or no bespoke reporting is required for a fiscal or fiduciary reason. Funders aiming to collect data for the purpose of "measuring impact" should consider the potential burden their chosen approach may impose on grantees. Ideally funders should let grantees take the lead as to the best way to demonstrate impact in the particular circumstances of the grantee's performance, and should be open to doing so with reference to general reporting produced by the grantee for other or mixed purposes.
- Funders need not sacrifice compliance and audit-readiness. They can and should maintain grant-making records that include notes of conversations and meetings, memos extracting relevant information from generic or repurposed reporting or applications, and records of the transparent communications they have with grantees. While compliance may feel simpler to the funder where grant records are essentially uniform across all grantees, this is clearly not necessary.

Conclusions: 2021 – the year for trust-based philanthropy?

A trust-based philanthropy approach is not necessarily easy to implement, and may involve more effort and overhead cost on the part of the funder than its existing grant-making approach. However, it is clear that it may be adopted in a way that is consistent with both fiscal and fiduciary compliance by private foundations. Individual and corporation donors are also able to adopt this approach compliantly, even where contributions are intended to be deductible. Within the bounds of professional responsibility, advisers who believe in the potential for philanthropy to impact society are well placed to help funder and grantee clients

[12] Reg. 53.4945-2(a)(6) and Information Letter INFO 2004-0169, available online at: https://www.irs.gov/pub/irs-wd/04-0169.pdf. See also: Warren and Fei, "Lobbying Clauses in Grant Agreements with Organizational Grantees," *Taxation of Exempts* (March/April 2006).

[13] Notice 2020-23, 2020-18 IRB 742.

[14] https://www.cof.org/news/call-action-philanthropys-commitment-during-covid-19.

[15] https://www.opensocietyfoundations.org/newsroom/open-society-foundations-announce-220-million-for-building-power-in-black-communities.

[16] https://mackenzie-scott.medium.com/116-organizations-driving-change-67354c6d733d.

[17] https://www.nytimes.com/2020/06/30/arts/mellon-foundation-elizabeth-alexander.html.

[18] Quoted in Fishman, "The Private Foundation Rules at Fifty: How Did We Get Them and Do They Meet Current Needs?," 17 PITT. TAX REV. 247 (2020).

to explore this approach if they are minded to do so.

And those who think philanthropy can do more, and do better, may recognize the opportunity to influence standard practice for the best at a time when philanthropy is never more needed. 2020 was, of course, an unprecedented year, to say the least. Wildfires, hurricanes, asteroids, and so-called murder hornets were entirely eclipsed by the global COVID-19 pandemic and the emergence of an invigorated racial justice movement in the U.S. and beyond. Extreme political tumult in the first days of 2021 has magnified the situation. For funders considering a trust-based philanthropy approach, the time has never been more appropriate.

Pandemic. The effect of the pandemic on nonprofits and the communities they serve has not yet been fully felt, but it is already clear to many funders that there is an urgent need to increase funding levels overall, to fund both COVID-connected need and other charitable purposes, and to accelerate disbursement. *Moreover, in a year when even the IRS pushed filing deadlines back,*[13] *many funders are recognizing the need to take a pragmatic approach to reporting requirements where possible.*

At the time of writing this article, 792 foundations had pledged to take a number of crisis-responsive steps, including to: (1) loosen or eliminate restrictions on current grants; (2) make new grants as unrestricted as possible; and (3) reduce what is asked of grantees.[14] These have not been couched in trust-based philanthropy language but the pledges contain several common elements with the principles discussed above.

Racial justice movement. 2020 has also seen the massive mobilization of communities around the U.S. and globally in public protest of systemic racism and police brutality. The disproportionate impact of COVID-19 on Black and brown communities has acted as catalyst to bring welcome attention to longstanding inequities.

Philanthropic funders have responded with some significant commitments, including the Open Society Foundations pledging a staggering $220 million to support Black-led organizations, with many multi-year grants committed.[15] MacKenzie Scott wrote[16] about the $1.7 billion in funding she had given or committed since fall 2019, noting "91% of the racial-equity organizations [funded] are run by leaders of color." The Andrew W. Mellon Foundation, an arts and humanities philanthropy, refocused[17] its strategy across the board to "foster social equity." While these commitments do not refer to a trust-based philanthropy approach expressly, they share some of the fundamental principles and drivers of that approach, including unrestricted and multi-year funding, and communication that values grantee experience, including lived experience of nonprofit leaders.

If it sounds radical to look at nonprofit compliance in light of race, it is certainly not new. The bill that was to become the Tax Reform Act 1969 was felt by some to promote an over-cautious approach by foundations, to the detriment of Black communities they fund and serve. As the Executive Director of the National Urban League testified at the Senate Finance Committee hearings at the time:

> "There are features in [the bill] that clearly have had the direct result of making the black community particularly feel that it is a hostile bill, a bill ... with a purpose as much to intimidate as to legislate, a bill designed to discourage foundations who belatedly have found the field of social reform to be one in which they might tenderly tread, a bill to sort of caution and warn them. [A]lready ... there is some evidence that foundations will become again very cautious, very conservative, turn only toward those absolutely noncontroversial things that they feel will remove them from any threat of reprisal, of punitive action, on the part of the Federal Government ...."[18]

This legislation came on the heels of the American Civil Rights Movement of the 1960s, and there are many ways in which that moment differs from the present one. However, looking at the deep societal and political division we are experiencing, this is the right time for those *doing good* to do so *with care*, and to consider the impact of their procedural choices. ■

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