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Transparency in Philanthropy

An Analysis of Accountability, Fallacy, and Volunteerism

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COMPANION GUIDE

Introduction

Private foundations are 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 the current calls for transparency are based on other rationales. These include:

- Transparency is a good unto itself and should be required of all institutions.
- Transparency is needed to ensure that philanthropy serves “public purposes.”
- Transparency will counteract the “power asymmetry” between foundations and grantees.
- Transparency is necessary for a proper evaluation of philanthropic effectiveness.

Upon examination none of these rationales justifies additional legally imposed philanthropic transparency, which is what the advocates demand.

Even though there is not much of an argument for requiring more philanthropic transparency as a matter of law, there are good arguments for foundations’ providing a certain amount of transparency on a voluntary basis. This would be not a wholesale disclosure of information but measured transparency, undertaken in light of a foundation’s mission and the costs that such disclosure might entail. It is important to understand what kinds of transparency are required, think about what types of transparency might be beneficial to an organization, and consider the costs of disclosing information. The intent of *Transparency in Philanthropy* is to encourage philanthropies to plan and to do so carefully and thoughtfully.

Philanthropic Transparency and Accountability to Government: Keeping the Public Trust

Foundation income is generally exempt from federal income tax, and donors are allowed to take charitable tax deductions for their contributions to foundations. In exchange for these preferences, donors agree to four core conditions:

- The foundations must be organized and operated for charitable purposes enumerated by the tax code. These purposes are not the same as the general “public good” or the responsibilities of government; indeed, they include activities, such as religion, in which government is forbidden to engage.
- The foundations must not use funds for private benefit, even if the use of funds would further a charitable purpose.
- The foundations must not engage in impermissible lobbying or political activity.
- As evidence of their compliance with these conditions, foundations must file information returns with the Internal Revenue Service and make these returns and certain other documents available to the public.

In addition to transparency that is presently required by law, some critics urge still more transparency, so the public can see whether it is getting

benefits from foundations that at least equal the value of the tax money they divert from the public treasury. This argument does not survive examination.

First, there is no basis in law for this kind of “*quid pro quo*” requirement. Moreover, the *quid pro quo* idea is based on flawed economics. A donor does not get a 100 percent tax reduction for a contribution to a foundation; thus, most of the contribution would not ever go into the public treasury. Also, a foundation must distribute a certain portion of its assets for charitable purposes each year. In the absence of the current exemption for foundation income, it is likely that government would ultimately have to fund many services now funded by exempt foundations. There is no reason to think that government could (or should) fund such services with more diversity, economy, or efficiency than is currently done.

The charitable exemption and deduction also provide benefits beyond economics—including the independence of foundations from both politics and the commercial demands of the marketplace. These benefits do not argue against foundations providing the transparency required by law, including the transparency necessary to guard against fraud and abuse. But they do argue against expanding such transparency by law in the name of a *quid pro quo* rationale that is without solid foundation.

Lastly, foundations must consider the roles of different types of “stakeholders,” both government and private, in addition to their accountability to donor intent. Care should be exercised to avoid unintentionally vesting authority to stakeholders that does not exist in law and can be detrimental to decision making and achieving charitable goals.

Four Arguments About Philanthropic Transparency

Aside from the *quid pro quo* rationale, there are several arguments made in favor of requiring more philanthropic transparency. However, think about the following four cautionary flags and what they could mean for your organization.

1. Transparency as an End in Itself. Some critics speak as if transparency were an independent value—a good like democracy, liberty, justice, or moral virtue. We require transparency in government, they say, and in for-profit corporations; why should foundations be immune from the same standard?

In fact, a liberal democracy like ours does not treat transparency as an end in itself; instead, transparency is a tool—a vehicle or strategy for pursuing other, higher objectives, values, and principles. We impose different degrees of transparency on different institutions, depending on the purposes they serve in our larger political, economic, and social systems. We require a great deal of transparency from government officials in order to make them accountable to the citizens they serve. In contrast, when citizens exercise their right to vote, they do so in secret. We require extensive transparency from publicly-traded corporations to make them accountable to their shareholders and because of their broader effects on markets and the nation's (and even world) economy. Privately held companies, in contrast, are not required to provide the same degree of transparency.

The same logic of institutional function should be applied to philanthropy. Foundations do not exercise coercive powers over citizens, as government does; their function is not to provide equal resources to all

but to supply the energy that comes from pluralism and independence. Similarly, foundations do not to respond to market forces, as corporations do. Instead, they give society the benefit of the longer time horizon that their freedom from market forces makes possible.

2. Transparency for the Sake of “Public Benefit” or “Social Good.” A foundation, some critics argue, is not simply a private organization. It “seeks to enact a private vision of the common good,” projecting its own private values into the public sphere. Therefore, foundations must provide enough transparency to enable the public to share power with them.

But the decision by a private person to renounce the ability to use his or her resources for personal benefit, and to devote them to charitable purposes instead, is an irreducibly private decision; it is in fact a quintessential expression of the distinctively American values of freedom of speech and association. Moreover, if only because of limited resources, no foundation can provide “public benefit” or “social good” in general. Indeed, there is no consensus about the meaning of a general “public benefit” or “social good.” What foundations can and do provide is an array of pluralistic visions. The degree of disclosure currently required by the tax code is the degree that is sufficient for ensuring that foundations are using their assets for charitable purposes.

3. Transparency as a Tool for Assessing Effectiveness. This argument claims that the public should require effectiveness from foundations—and must impose the transparency needed to make judgments about such effectiveness. Pursuing effectiveness can be a benign goal, and openness can help reach it. But legally imposed “effectiveness” is not so benign and its consequences are insurmountable.

First, what would the new standards of effectiveness be? How would they apply across the diverse foundation world? Next, what body

should actually set the standards? Would it be the already-overtaxed Internal Revenue Service? Would it be a private organization? If history is a guide, such a group would become a home to vested interests and the status quo. And whatever organization might conceivably be chosen, it would almost certainly become a vehicle for further politicizing philanthropy. Third, would the same organization also judge compliance with the standards it sets or would there be an independent arbiter? If the IRS, it would be beyond irony if the IRS or any government agency were to be the arbiter of organizational effectiveness. Finally, what consequences would there be for failure to be “effective” according to the new mythical rules, as applied by the new regulators? Would they take account of the fact that a foundation’s effectiveness most often depends not on the foundation itself but on its grantees? Would there be fines, excise taxes, or public reprimands? Would government be able to replace directors, officers, or managers?

We know that in order to comply with any such rules, many foundations would likely become more involved in grantees’ day-to-day operations, a result grantees would presumably resist. Others would give fewer grants, operating more of their own programs instead. History tells us that another consequence could be increased deference to tax lawyers and accountants, “safer” grant-making, a tendency to pursue popular or at least non-controversial programs, and an absence of innovation or risk-taking. The consequences to the country would not be insignificant.

4. Transparency to Address “Power Asymmetry.” Foundations have money that grantees want. Foundations make applicants and grantees provide information. Sometimes foundation staffers, confusing themselves with their foundations, are disrespectful to those with whom they deal. Some critics say that in order to remedy this unfairness, foundations must become more transparent and open to their grantees and surrounding communities.

There is no justification for disrespectfulness to grant applicants and grantees, but disrespectfulness is not the central reason for the asymmetry that the critics resent. The central reason is that foundations have limited resources; and, as part of their core responsibilities, they are in the business of exercising discretion and turning people down. As discussed below, foundations can take steps to minimize the unhappiness inherent in this process; but they cannot eliminate it. Indeed, the exercise of discretion—which includes asking for the information and taking the time required to make intelligent use of such discretion—is precisely the way in which foundations add their greatest value to society. Therefore, “power asymmetry” does not provide a valid argument for increasing the transparency that is legally required of foundations.

Value in Voluntary Transparency: Practical Applications

While there is not much to be said for an increase in legally mandated transparency, foundations may well decide, for their own purposes and other reasons, to disclose more than the law requires. So, now that you have a better understanding of some of the issues around transparency in the philanthropic sector, take a look at your organization and ask these questions:

Who are you?

- What is your foundation’s mission?
- How large is your board and who is on it?

- How large is your staff and what are their roles?
- How large is your endowment? How is it invested?
- What do you fund?
- Are there limitations to your grantmaking (e.g., geographic, time, financial)?
- Are there other foundations in your area(s) of giving? In your geographic area?
- What information about your foundation do you currently make public (aside from what is available in IRS tax filings)?
- How is your grant application process advertised and administered?
- How are your internal decisions made? Role of the board? Role of staff?
- How involved is your board in assessing grant requests and other decisions?
- Is the founder of your foundation and his family still alive?

How can your foundation benefit from disclosing more information?

- To fulfill your foundation’s mission, do you want to attract more or better qualified grant applicants?
- Do you want to cut down on the number of grant requests that don’t “fit” the foundation’s mission or that fail to provide the information you need to make good decisions?
- Do you feel a need for more exchange of information about successes and failures, or for more co-ordination of efforts, with other foundations working in your geographic and/or programmatic areas?
- Do you feel a general need to cultivate a better understanding of your activities in your community?
- Do you operate in policy areas that are prone to controversies, so you want to proactively clarify your mission and procedures to the public?

What costs and risks will you incur in disclosing more information?

- How much time and money can you devote to managing the disclosure of information to the public?
- Is the information you disclose likely to be used to challenge the fairness of your practices or the effectiveness of your operations?
- Could the information unfairly harm the reputations of your grantees or those with whom you do business, or even expose them to danger?
- Could the information compromise the legitimate privacy concerns of your donors?

What benefits and costs do the following tools pose for publicizing disclosed information?

- An annual report?
- A website to transmit information? An interactive website to manage applications?
- Outreach to print and electronic media?
- Social media—Facebook, Twitter, blogs, or whatever comes next?

Along with your answers to these questions, consider these three reasons why you may wish to move forward with some carefully considered transparency plans for your organization.

The first reason lies in the reality of today's communications environment. We live in a world of instant communications and direct democracy via social media and the internet. Anybody can be a reporter. So, any organization that wants to be effective must harness the power of communications. Failure to define yourself by communicating your

message may allow other people to define your organization for you. A foundation should consider voluntarily using communications tools as an opportunity to talk about the good work it is doing and the benefits it is providing to the community and society.

Next, there is an argument that foundations should provide reliable information in advance of attacks in order to build reputations that can withstand such attacks. Disclosures made after the fact, or in a defensive manner, can increase suspicion rather than allay it.

Finally, there is an argument that foundations should voluntarily release information to increase their effectiveness. If a foundation communicates its mission clearly, it can reduce the volume of inappropriate grant requests. The better it communicates information about its grant application process, the more grief will be avoided for applicants and foundation personnel. Foundations can mitigate problems of dependency and feelings of entitlement on the part of grantees if they communicate clearly about their funding intentions; they can profit, in terms of their own efficiency and collaboration with others, by communicating information about lessons learned from successes and failures.

However, there are special considerations when it comes to releasing information about failures in philanthropic work. Although there can be good reasons for disclosing such information, communicating information about less-than-successful outcomes may give ammunition to those who want to make foundations legally accountable for “effectiveness.” Also, providing information in an indiscriminate way may harm grantees, contractors, and donors and their families. Therefore, these situations should be considered with special care.

Conclusion

Voluntary disclosure should be a matter of degree, taking many factors—mission, resources, geographic scope, advocacy role, staff capacities, and others—into account. In contrast, in the recent demands for more legally required philanthropic transparency, there has been no room for degree and balance. So far, there has been only a set of undisciplined arguments. Future discussion of transparency would benefit from a re-introduction of clarity and balance to guide the creation of disclosure and information strategies. We hope that this publication will help spark such discussion in general and help you start the discussion within your own organization.

The Philanthropy Roundtable’s mission is to foster excellence in philanthropy, protect philanthropic freedom, assist donors in achieving their philanthropic intent, and help donors advance liberty, opportunity, and personal responsibility in America and abroad. Promoting discussion about what is good for philanthropy is an important part of the Roundtable’s mission. We hope you will engage with us in this activity and reach out to us with your ideas. Please share your thoughts about what works, what doesn’t work, and how others may benefit from talking more about transparency in philanthropy.

for more information, contact



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