

Trust-Based Philanthropy

Legal Considerations

Oftentimes in philanthropy, we tend to think of legal considerations in the context of compliance and risk mitigation — i.e., preventing things from going wrong and protecting funders from liability or harm. As a result, foundations that are curious about trust-based philanthropy may have questions about its legal compliance and legitimacy. Is trust-based philanthropy consistent with a foundation's legal requirements? Can it be done prudently and responsibly?

The good news is that trust-based philanthropy is both fully consistent with the legal requirements for responsible grantmaking, and it also allows funders to use legal frameworks creatively and expansively toward reinforcing trust and relationships at the structural level.

This primer answers frequently asked legal questions about trust-based philanthropy, and offers guidance on how to work within legal parameters to reinforce trust and relationship-building with grantee partners. There may be greater flexibility for individual donors and public charities; please consult with your legal advisor to explore these questions further.



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LEGAL REQUIREMENTS

Is trust-based philanthropy consistent with legal requirements?

Yes! None of the legal requirements for grantmakers inherently conflict with trust-based philanthropy principles. In fact, there are no legal requirements for funders to restrict grants for a specific purpose or project, nor are foundations required by law to collect proposals or reports from 501(c)(3) public charity grantees.

While grantmaking to other types of grantees (such as 501(c)(4)'s, individuals, for-profits or international entities) may require some additional paperwork and process, as you'll see in the following sections, there are still ways to approach grantmaking in a way that minimizes the burdens on grantee partners and allows for the development of a trust-based relationship.

What are the minimum legal requirements a foundation has to abide by when making grants?

From a legal standpoint, a grantmaking entity is required to:

- 1) Ensure that its grants further its mission and charitable purposes
- 2) Know the tax status of its grantees (e.g., 501(c)(3) public charity or otherwise)
- 3) Comply with the legal requirements for grantmaking to that type of organization

The first trust-based principle of "doing the homework" is in fact closely aligned with these legal requirements—engaging in this careful front-end due diligence allows grantmakers to identify grantee partners that are mission-aligned, while also determining the grantee's tax status in order to make grants to them accordingly.

What are the differences in legal requirements for grantmaking to 501(c)(3) organizations versus other types of organizations?

If a grantee organization is a 501(c)(3) public charity (other than Type III, non-functionally integrated supporting organization) or a governmental entity:

- A funder can freely provide multi-year, unrestricted funding to the grantee
- Grant agreements are not legally required
- Narrative and financial reports from grantees are not legally required
- You can provide any type of support beyond the check (in-kind resources, technical support, strategic advice, promotional support, etc.)

For other types of grantees — including for-profits, 501(c)(4) organizations, individuals, and international groups — some additional paperwork and process (often known as "expenditure responsibility") is needed. This is because the IRS does not have assurances based on the grantee's tax status that they will necessarily use your funds for charitable purposes.

In these cases, a written grant agreement is required to define the charitable project, prohibit non-charitable expenditures and certain other uses of the funds (e.g., for lobbying, political intervention, voter registration drives, and grants to individuals), require repayment of funds not used for the grant's charitable purposes, and require recordkeeping and making books and records available to the funder upon request and annual reporting on the use of funds. That said, there are still ways to streamline this process to be more trust-based:

- Commit multi-year support
- In the grant agreement, define a broad charitable purpose so the grantee has flexibility to use the funds within 501(c)(3) parameters
- Limit written reporting to what is legally required (e.g., annual reports on the manner in which the funds are spent and the progress made in accomplishing the purposes of the grant)
- Build a relationship focused on learning and supporting grantee's self-defined measures of success
- Provide grantees with support beyond the check to advance their charitable purposes and mission



FIDUCIARY DUTIES / “RISK” MITIGATION

Does it put my foundation at risk if a grantee uses an unrestricted grant for lobbying or advocacy?

Under the Internal Revenue Code, foundations are prevented from directly engaging in legislative lobbying or from making grants to grantees that are earmarked for lobbying. An unrestricted grant, which gives grant recipients the ability to use the funds however they choose, is perhaps the least risky way for a foundation to support an organization that may engage in advocacy. This is because the Treasury regulations expressly provide that an unrestricted grant allows the grantee to expend up to its own limits for lobbying with no attribution whatsoever to the funder.

Does trust-based philanthropy create legal risks or liabilities for my board or foundation?

Not any more so than traditional grantmaking practices. According to the law, nonprofit board members generally owe three main fiduciary duties to the organization:

- The duty of **CARE**, i.e., devoting time, care and attention to organization’s operations and finances in order to make prudent decisions on behalf of the organization
- The duty of **LOYALTY**, i.e., acting solely in the foundation’s best interests and recusing oneself from situations of conflict of interest
- The duty of **OBEDIENCE**, i.e., making sure the foundation is complying with the law and staying faithful to its mission

Essentially, this means that a foundation board’s key fiduciary duties are to act in the foundation’s best interests to ensure that the foundation’s funds are prudently managed and spent in support of its charitable purposes, and to ensure compliance with applicable laws.

This is where the trust-based philanthropy principle of “doing the homework” comes in. If the board has assurances that your foundation has done the front-end due diligence to determine that the grantee’s programs substantially further the foundation’s mission and you have gotten to know a prospective grantee’s tax status, leadership, programs, finances and track record prior to entering into a grant relationship, and you make grants consistent with the legal requirements for the grantee type, then there is generally little to no liability or risk to a foundation or its board members associated with making such grants.

Other legal risks to a foundation (such as being sued by a third party) based on its grantmaking are incredibly rare, particularly if the funder provides unrestricted funding to a grantee. Generally, a funder would need to be deeply involved in a grantee partner’s operations in order to have any liability for their actions. Additionally, it is not clear that grants with narrow use restrictions or voluminous reporting are necessarily better checks against grant funds being misused by a grantee. Indeed, prioritizing trust-based relationships with grantees may be a better way to keep an eye out for possible risks before they happen.



GRANTEES / LEGAL BENEFITS

What are the legal considerations when providing trust-based funding to a fiscally-sponsored project?

Fiscal sponsorship can come in different forms, but it generally refers to the practice of existing non-profit 501(c)(3) organizations offering their legal and tax-exempt status to programs and projects that further the sponsoring organization's mission and charitable purposes. For many fiscally-sponsored projects, this means that they are not independent 501(c)(3) organizations, but are instead a part of their fiscal sponsor's legal entity. As a result, grants to support these projects cannot be completely "unrestricted" in a technical sense, since a truly unrestricted grant to the fiscal sponsor would allow the fiscal sponsor to use the funds for any of the fiscal sponsor's charitable activities, including supporting other fiscally-sponsored projects. Accordingly, a funder must, in making a grant to support a fiscally-sponsored project, provide a restricted "project grant" to the 501(c)3 fiscal sponsor, specifying the particular fiscally-sponsored project that it wishes to support.

Despite this limitation, however, it is still entirely possible to follow other trust-based principles. Funders can provide support to the fiscally-sponsored project that is as unencumbered as possible, allowing the project to use the funds for any activities related to the project's charitable purpose. Funders can also still make multi-year commitments and simplify paperwork—indeed, since most fiscal sponsors are 501(c)(3) public charities, reporting from such grantees is not required and could be streamlined. One distinction to keep in mind, however, is if a fiscally sponsored project is engaged in lobbying—given that the grant to support a fiscally-sponsored project is not technically an unrestricted general operating support grant, a private foundation would not be able to avoid attribution of the grantee's lobbying through the unrestricted grant exception (described below). Instead, the private foundation would need to employ other methods (e.g., the project budget method) if it wishes to support a fiscally-sponsored project's lobbying activities.

Are there any legal considerations or differences in funding a previous grantee vs. a new prospective grantee?

When contemplating funding a new organization, a funder necessarily needs to spend more time doing the homework to get to know the prospective grantee. From a legal standpoint, this also involves taking the time to determine the grantee's tax status, which, as described above, affects the grantmaking practices one can engage in.

From a legal standpoint, when offering a grant to an organization you've funded before, you will need to re-confirm the grantee's tax status, in case it may have changed since the previous grant. But it is generally possible to have much more streamlined processes for a renewal grant once that tax status has been confirmed.

Are there legal benefits to trust-based philanthropy?

Trust-based philanthropy allows you to more deeply uphold your responsibilities as a funder by resourcing and empowering grantee partners to do what they do best, as the moment requires and as their best judgment determines. Overall, by giving nonprofit leaders the flexible resources they have been asking for, it can in fact reduce the risk of grant and grantee failure.

Are there creative ways to use legal requirements to emphasize our trust-based values?

While a grant agreement is not required for unrestricted grants, you can still utilize grant agreements as an opportunity to reinforce your commitment to partnership and shared learning with your grantee partners. For a sample grant agreement that embodies trust-based values, please see General Service Foundation's grant agreement at www.trustbasedphilanthropy.org/resources.

For all grantee partnerships, regardless of whether written reports are required, trust-based philanthropy encourages going beyond transactional reporting to more relational dialogue. Conversational check-ins create space for funders and grantees to discuss learnings, goals, progress, and challenges over time (including any shifts or changes to fund allocation) in order to build a trust-based relationship rooted in dialogue and learning.



LEGAL CONVERSATIONS

How do I talk to my lawyer about trust-based philanthropy and bring them along on this journey?

It is important to emphasize to your lawyers that trust-based philanthropy is not an attempt to skirt around legal compliance, but rather an effort to help the foundation be more successful in its work by ensuring that grantees have the resources and flexibility they need to achieve your mutually-held charitable goals.

Start by clarifying the goal of simplifying unnecessary burdens on grantees and treating them as equal partners in learning and collaboration. You can ask your legal team to help identify what is absolutely necessary from a legal standpoint in your grantmaking process (and what is not), and then explore whether you can eliminate unnecessary processes that might get in the way of your grantees' success.

You can also assure your legal team that trust-based philanthropy encourages front-end due diligence that can reduce legal risks. And you can invite them to collaborate on reenvisioning a grantmaking process that truly serves both the foundation and your grantees, while deepening your commitment to relationship and learning with grantee partners.

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