

# The Landscape for Private Foundations in 2017: Navigating Tricky Terrain

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## Introduction

*“May you live in interesting times”<sup>2</sup>*

This statement aptly describes our country at a time of seismic change, but appears particularly prophetic for private foundations in 2017. Foundations face a myriad of issues as we enter a new year in a fast changing and unpredictable world.

This paper identifies some of the most likely challenges facing private foundations in 2017 and suggests steps and strategies that a foundation consider to address them.<sup>3</sup> It focuses largely on the most relevant tax, legal, regulatory, and governance issues as perceived by the author and other observers may well have different perspectives. Given the diversity of foundations and their different needs, cultures, and strategies, a variety of perspectives should be no surprise.

*“It's déjà vu all over again”<sup>4</sup>*

For those who have long labored in the fields of philanthropy, many of the debates in 2016 (and debates likely to continue in 2017) are a familiar crop. This includes, among others, the following:

- Whether the minimum payout requirement should be increased;
- The extent to which investment assets should be invested to further mission;
- Whether foundations should exist in perpetuity or spend-down;
- The appropriate role of foundations in a democratic society amid efforts to achieve policy changes;
- How big data should be used to increase impact;
- How to use emerging technologies to maximize impact;

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<sup>2</sup> This statement is often described as a Chinese curse, but there is considerable debate whether it originated in China or is a curse. Nevertheless, it seems to capture the moment whether as an observation or a curse.

<sup>3</sup> At the start of each year, there are several experienced philanthropic observers who provide their predictions about upcoming trends for the new year. See, e.g., *Philanthropy and the Social Economy*, Blueprint 2017; GrantCraft (Lucy Bernholz); Vikki Spruill, *Five Philanthropic Trends for 2017* (Council on Foundations); Inside Philanthropy (<http://www.insidephilanthropy.com/home/2016/11/9/philanthropy-in-the-age-of-trump-five-predictions>). Each takes their own perspective and approach to the trends in philanthropy.

<sup>4</sup> Widely attributed to that noted philanthropic philosopher, Yogi Berra.

- Whether the traditional foundation should be rejected in lieu of alternative structures that provide greater flexibility and increase impact; and
- What constitutes a charitable purpose in a world where lines between commercial and philanthropic are blending.

Yet beyond these recurring issues, the landscape of philanthropy continues to change at an accelerated pace as opinions on the recurring issues evolve and new issues emerge for debate.

### ***“What’s past is prologue”<sup>5</sup>***

Trends that began several years ago will continue to gain momentum in 2017. This includes the blurring of boundaries across different fields long thought to be fenced off at a time when the current regulatory apparatus strains to keep up with these changes. Lines between the activities of for-profit entities and not-for-profit organizations will continue to erode spurred by the growth of social enterprises, benefit corporations, impact investing and the desire of many millennials to achieve social impact in all that they do.

In a similar vein, the seeming reluctance of regulatory authorities to enforce existing limitations on political activity or to define those limitations more clearly has prompted more use of tax-exempt organizations in the political arena in one form or another. The presence of 501(c)(4) organizations operated independently or in conjunction with 501(c)(3) organizations or more aggressive use of public charities in the latest political campaigns was yet the latest manifestation of the erosion of the lines between charitable and political activities.

More organizations are also seeking charitable status using business models or rationales that challenge the conventional wisdom of what constitutes a charitable purpose in the areas of economic development, entrepreneurship, business incubators, affordable housing, and the environment. In an area of interest to many funders, the growing threat of climate change and multifaceted efforts to address this risk through market-based solutions will continue to challenge the conventional wisdom of the IRS that requires a direct environmental impact for there to be a charitable purpose (as reflected in private letter rulings that rejected various efforts to address carbon emissions through installations of solar panels and other means).

### ***“The Future is No More Uncertain than the Present”<sup>6</sup>***

Amidst this growing breakdown of previously defined boundaries, new technologies, including the growth of big data and artificial intelligence, legal changes, and new participants bringing fresh perspectives, will all contribute to the changing environment confronting private foundations in 2017 and beyond.

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<sup>5</sup> William Shakespeare, *The Tempest*.

<sup>6</sup> Walt Whitman.

These challenges are all occurring of course at a time of significant political change. President-Elect Trump’s tax policies and the Administration’s view of philanthropy in general, as they can be deciphered, could have profound implications for foundations and the not-for-profit sector in general.

The implications of the Trump election on regulatory developments are, therefore, useful context in which to start our journey through the landscape.

## Discussion

### ***“There are Only Two Certain Things in Life: Death and Taxes”<sup>7</sup>***

#### ***A. The Likelihood of Meaningful Tax Reform that Could Affect the Sector is High***

The likelihood of substantial tax reform during the first year of a Trump Administration is considered high. Much can change from now until a tax reform package is passed and, as is the case with any tax packages, the devil will be in the details. There are competing plans that must be reconciled and compromises among the respective plans will be made to ensure passage. Fundamental Republican principles, however, such as lower rates for the wealthy, lower corporate income tax rates, and repeal of the estate tax will likely remain in some form. There will be ferocious lobbying from multiple parties on all aspects of the tax proposals. On the philanthropy front, the Council on Foundations, the Independent Sector, and the Philanthropy Roundtable will be actively engaged in the debate. It will be important for these organizations to work together to protect and advance the issues important to philanthropy regardless of political leanings.

#### **1. Tax Proposals and Implications**

In this context, the following are some principal areas for tax law changes. This is intended as a higher-level identification of the possible changes and the implications given what we know now and not a technical analysis of tax law. The result is likely, of course, to reflect a series of compromises.

##### ***a. Elimination of the Estate Tax***

Mr. Trump has proposed the elimination of the estate tax or “death” tax, as he refers to it, and would instead modify the current law that allows a step-up in basis in assets upon the death of the owner. His proposal on his website is scant on details and is ambiguous in certain respects, but provides as follows:

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<sup>7</sup> Benjamin Franklin.

## *Death Tax*

*The Trump Plan will repeal the death tax, but capital gains held until death and valued over \$10 million will be subject to tax to exempt small businesses and family farms. To prevent abuse, contributions of appreciated assets into a private charity established by the decedent or the decedent's relatives will be disallowed.*

The elimination of the estate tax and the provision to prevent contribution of appreciated assets would, if enacted in that form, reduce the incentives to form private foundations or to provide for charitable gifts upon death. The details are not clear, however, on the general principles. Some have suggested that combined with the likelihood that the gift tax and the generation-skipping tax may also be repealed, these steps would perpetuate dynastic wealth. See *New York Times'* article [http://www.nytimes.com/2016/11/12/your-money/trump-changes-tax-codes-may-encourage-dynastic-wealth.html?\\_r=1](http://www.nytimes.com/2016/11/12/your-money/trump-changes-tax-codes-may-encourage-dynastic-wealth.html?_r=1).

### *b. Change in the Charitable Tax Deduction*

There is continual debate about whether even modest changes to the deduction for charitable contributions would negatively affect charitable giving. The deduction for charitable donations is permitted only for those who itemize and many Americans give without taking a tax deduction. On the other hand, the most significant giving is generally from those in higher tax brackets who can benefit from the tax deduction.

In the section on income tax, Mr. Trump's plan provides that all itemized deductions would be capped at \$200,000 for couples and \$100,000 for individuals. Some observers believe these changes will provide a significant disincentive for charitable contributions. Other proposals floated by legislators or commentators would limit the percentage of the deduction for charitable deductions or possibly limit the deduction to only certain types of charity.

### *c. Increase in Standard Deduction and Lower Rates*

Mr. Trump's plan would also increase the standard deduction and lower the tax rates on wealthier individuals. This is believed by many tax policy analysts to result in less incentive to provide charitable deductions and, therefore, limit individual giving.

The Tax Policy Center estimated that, overall, Mr. "Trump's plan would reduce individual giving by 4.5 percent to 9 percent, or between \$13.5 billion and \$26.1 billion in 2017."

d. *Repeal of the Johnson Amendment*

Since 1954, a core pillar of section 501(c)(3) is the prohibition by any charitable organization from participating or intervening in (including publishing or distributing statements for) any political campaign on behalf of (or in opposition to) any candidate for public office.

This provision was added at the urging of Lyndon Johnson, who reputedly was angry that ministers were arguing against his candidacy to Congress in his early career. Since then, the provision has aroused controversy and some ministers actively ignore it in the hope that another test case will be heard by a court to test the First Amendment concerns arising from this prohibition against speech. In practical terms, the IRS is loath to go after ministers for statements made on the pulpit, but has, on occasion, sought to enforce the rules against other charitable organizations, most notably several years ago against the NAACP, a case that was later dropped.

Mr. Trump urged repeal of this provision during his campaign. If the provision is repealed and applied to all charities, we would see even more political activity and even more blurring of the distinction between 501(c)(3) organizations and 501(c)(4) organizations.

e. *Corporate Integration*

Tax changes proposed by Senator Orrin Hatch, and known as corporate integration, would impose taxes at corporate rates on dividends and interest paid to charitable organizations. Currently, foundations pay limited tax on such dividends and interest at either one or two percent.

f. *Donor-Advised Funds*

Donor-advised funds continue to attract significant amounts of capital and donors receive an immediate tax deduction. The combination of ease of use, exponential growth, and allegations of hoarding of assets has led to continued debate whether legislative or regulatory changes are necessary, such as minimum distributions from such funds.<sup>8</sup>

g. *Review of Endowments*

Over the last year or so, large university endowments, particularly at Ivy League schools that have substantial endowments, have been criticized for the size of

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<sup>8</sup> This article does not address the merits of these arguments. There are many articles, blog posts, and other commentaries regarding the pros and cons of donor-advised funds.

their endowments, the costs of education, and their tax exemptions. The House Ways and Means Oversight Committee has held a series of hearings on the subject and legislation has been proposed by Congressman Tom Reed of New York that would, among other things, tax endowments over a certain amount (the Reducing Excess Debt and Unfair Costs of Education Act). This review and any potential legislative change could spill over and impact foundation portfolios if Congress believes the size of foundation endowments is also too large. The Council on Foundations is working on preparing responses and persuasive stories on the benefits of endowed philanthropy.<sup>9</sup>

## 2. The IRS is Constrained

The blurring of lines arising from the activities of some for-profit entities and charitable organizations and proposed tax changes that could impact not-for-profit sector occur at a time when the IRS is constrained by various factors: The IRS Commissioner has been threatened with impeachment, the alleged targeting scandal by the IRS involving 501(c)(4) organizations has provided ammunition to critics of the IRS who want to substantially limit its review of alleged political activities, and the IRS budget has been drastically cut.

It appears in the face of these factors that the IRS is reluctant to take on the issue of providing better guidance on the activities of 501(c)(4) organizations. Efforts to prod action in this area, such as the Bright Lines Project ([www.brightlinesproject.org](http://www.brightlinesproject.org)), have, to date, failed to gain the necessary traction. This suggests that 2017 will continue to see organizations and individuals using not-for-profit or charitable organizations to accomplish their political objectives and stretching the envelope of legal compliance. Yet it would be a mistake for foundations to think that the IRS will not exercise its regulatory responsibilities when merited. Even with more limited resources, the IRS will presumably focus on cases that are brought to their attention through the press or complaints by legislators or others. Foundations should govern themselves accordingly.

## 3. Mr. Trump's Attitude toward Philanthropy and the Approach that Will Be Taken by His Administration Is Unclear at Best

Mr. Trump's claims that he has given significantly to charity are difficult to confirm since he did not release his tax returns. The Trump Foundation's giving from contributions made by Mr. Trump does not appear to be significant over the last five years or so. He has, up to now, not signed the "Giving Pledge" and his view toward philanthropy in general is mixed. Under the Obama Administration, philanthropy, public/private partnerships, and the use of new tools, such as social impact bonds and other impact investments, were encouraged. The Bush

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<sup>9</sup> See, e.g., Kaustuv Basu, Rep. Reed to Introduce College Affordability Package Soon, BLOOMBERG BNA DAILY REPORT FOR EXECUTIVES, Nov. 17, 2016 ([http://dailyreport.bna.com/drpt/7010/split\\_display.adp?fedfid=100707184&vname=dernotallissues&wsn=499675500&doctypeid=3&type=dat\\_e\\_notifmeta&mode=doc&scm=7010](http://dailyreport.bna.com/drpt/7010/split_display.adp?fedfid=100707184&vname=dernotallissues&wsn=499675500&doctypeid=3&type=dat_e_notifmeta&mode=doc&scm=7010)); Naomi Jagoda, GOP Lawmaker Developing Blueprint on Containing College Costs, The Hill, Nov. 17, 2016 (<http://origin-ny1.thehill.com/policy/finance/306676-gop-lawmaker-developing-blueprint-on-containing-college-costs>)

Administration also viewed philanthropy as playing a critical role in providing certain human services.

Nothing in Mr. Trump's past, his stated philosophies, or his appointments to date would suggest his administration would be receptive to the types of initiatives favored by the Obama administration, but, as with other issues discussed during the campaign, it is difficult to know for sure. Organized philanthropy should keep an open mind to working with the Administration toward shared goals. It is possible that, given the Trump (and Republican) views that smaller government is better than larger government and the likely cuts to social programs, there may be a willingness to help bolster philanthropic efforts that address social services to make up for missing federal dollars.

### ***Foundation Responses to Possible Tax Law Changes and Other Developments***

#### ***“The best defense is a good offense”<sup>10</sup>***

##### *Stay abreast of developments*

*Foundations should stay abreast of meaningful regulatory developments and the potential impact on their programs and activities. There are a variety of ways to stay engaged and knowledgeable. This includes tracking the work of membership groups such as the Council on Foundations and Independent Sector, joining relevant listservs, and following the blogs or feeds of organizations or individuals who follow regulatory developments.*

##### *Support your membership groups*

*National membership groups such as the Council on Foundations, the Independent Sector and the Philanthropy Roundtable all are gearing up to advance and protect the field in response to potential legislation or regulatory efforts. Foundations should consider whether membership in one or more of the organizations is appropriate.<sup>11</sup>*

##### *Don't assume Congress and others know what you do and your impact: Tell your stories early and often*

*Sitting around waiting for the “other shoe to drop” is not a viable strategy given current circumstances. Foundations may also consider taking part in “Foundations on the Hill” and other programs whereby they can inform their representatives of the important work supported by their foundation and foundations in general.*

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<sup>10</sup> Unknown.

<sup>11</sup> Full disclosure: The author is on the Board of the Council on Foundations and believes membership in the Council is important for private foundations who wish to see a robust Council advancing and protecting the interests of all foundations. It also serves to avoid a “free rider” problem whereby non-members benefit from the memberships of other foundations.

*Foundations must be prepared to tell their stories of impact in a variety of ways. This includes the use of websites, social media, and videos in which the work of their grantees and their impact are highlighted.*

*Consult your counsel if political activity is your thing*

*If a foundation is inclined to wade into political activity through support of 501(c)(4) organizations (or for that matter aggressively pursue or support activities that have both a commercial and philanthropic purpose), the foundation would be well-advised to seek counsel. Simply because it appears another foundation or not-for-profit is engaged in an activity does not mean that the activity is lawful or without risk. Especially at a time when the boundaries of existing laws and regulations are being tested, the expense of quality counsel is well worth the cost.*

***“Off with their heads”<sup>12</sup>***

*B. Private foundations in the spotlight*

1. Possible scrutiny of private foundations arising from the attention on the Clinton and Trump Foundations

The Presidential campaign put private foundations in the spotlight for all the wrong reasons. The Clinton Foundation came under attack for alleged conflicts of interests and pay to play allegations and the Trump Foundation eventually acknowledged what appeared on its face to be clear acts of self-dealing. The recent announcement by Donald Trump that he is dissolving the Trump Foundation, and the response of the New York Attorney General’s office that a New York not for profit corporation can’t dissolve until its investigation is complete, suggest that there will be continued attention on the Trump Foundation. In the meantime, some in Congress have suggested that oversight committees should continue to investigate the Clinton Foundation. Whether this focus on political candidates’ foundations will trigger a more intensive review of private foundations by Congress or the IRS is unclear, but the risk is there.

2. Risk of Congressional investigations of foundations

The Presidential election also revealed stark political differences around climate change between many Republicans and Democrats. Some members of the President Elect’s transition team and his cabinet appointees are skeptical regarding the scientific assertions that climate change has been exacerbated by human’s activities or believe regulatory efforts to counteract the impact of climate change, such as the Clean Power Plan, are ill-conceived. Many not-for-profits operating in the environmental field and funders of environmental issues, particularly climate change, are concerned that they could become the targets of Congressional

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<sup>12</sup> Alice in Wonderland (Lewis Carroll).



investigations.<sup>13</sup> Already, some not-for-profits and foundations, including their executives, have been the focus of subpoenas by various Congressional subcommittees.<sup>14</sup> This examination arises out of the ongoing dispute between various Attorneys General who are reviewing Exxon Corporation's history to determine if it misled investors regarding the impact of climate change and House Committees who believe the Attorneys General are politically motivated. Responding to such subpoenas can be very time consuming and burdensome particularly for smaller not-for-profits.

### ***Foundation Responses to the Possibility of Scrutiny or Investigations***

#### *Review your practices and policies*

*The time is now is for a foundation to review its policies and practices around a range of issues. Every foundation should have clear policies and practices regarding the prevention of self-dealing and addressing conflicts of interest, a code of conduct for staff and directors, ethical conduct, and record retention and destruction. It is also timely for a foundation to conduct a risk assessment across multiple areas of its operations and programs.*<sup>15</sup>

#### *Undertake the necessary training of staff regarding e-mail and social media*

*Foundations should also consider training on the appropriate use of e-mails and use of social media. Errant or poorly worded e-mails or ill-advised comments on social media can cause considerable reputational or legal damage. The scope of document requests by the government or private litigants can be very broad and, in certain cases, even require the private e-mail of foundation staff even if not maintained on foundation servers. There are common sense practices to help prevent inappropriate use of e-mail, but emotions or carelessness can often overcome the best of intentions. A properly implemented document retention policy and social media policy can help an organization appropriately mitigate its risk in this area.*

***"I gave myself good advice but seldom follow it"***<sup>16</sup>

#### *C. Identifying a charitable purpose and avoiding private benefit in a blended world*

The rising interest in social entrepreneurship, impact investing, and innovative ways to attack seemingly intractable problems have all contributed to increasing confusion about what constitutes a charitable purpose under the law as commercial activities blend into philanthropic

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<sup>13</sup> There is history to this concern. In 2014, the Senate Committee on Environment and Public Works issued a minority report by Republicans entitled "The Chain of Command: How a Club of Billionaires and Their Foundation Control the Environmental Movement and Obama EPA" which was highly critical of the coordinate between foundations and the organizations which they funded in the environmental areas.

<sup>14</sup> Members of the House Committee on Science, Space, & Technology chaired by Lamar Smith (R-Texas) has been particularly active in seeking information.

<sup>15</sup> Although a thorough risk assessment is best performed by counsel with experience in the areas of interest, an organization can take certain minimum steps even without retaining outside counsel. For a brief description of one approach, see Mintz, [Risky Business: Why All Not-for-Profits Should Periodically Assess Their Risk](https://www.macfound.org/about/people/103/news/), available at <https://www.macfound.org/about/people/103/news/>.

<sup>16</sup> Alice in Wonderland (Lewis Carroll).

activities.<sup>17</sup> The other side of the charitable purpose coin – the private benefit doctrine – also poses challenges in cases where dual purposes of impact and return are often sought. Under the private benefit doctrine, no private interests can benefit more than incidentally from apparent charitable activities. Private benefit must be both qualitatively and quantitatively incidental to the charitable purpose sought to be accomplished. This often necessitates a fact intensive inquiry and can be difficult for lay people (and lawyers) to measure with precision.

Notwithstanding long-standing definitions of charitable purpose and private benefit, the IRS has been challenged by bolder efforts to squeeze square commercial-like activities into round charitable holes. In some cases, those seeking charitable status for organizations mistakenly rely on what they understand to be a charitable purpose based on what other organizations appear to be doing. The reason why, however, a particular organization received recognition of charitable status may not be clear to observers who focus only on what they see the organization now doing. Sometimes, an organization drifts from its IRS-recognized purpose and the IRS lacks the resources to address every expansion of purpose.<sup>18</sup> Observers may then take, as a fact, that the mission and activities of a particular organization reflect IRS acceptance that such activity is charitable when that may not be the case.

The following are some common myths regarding what constitutes a charitable purpose:

- All economic development is charitable (economic development is not a charitable activity unless it specifically targets the poor, distressed, unemployed, elderly, children, or other charitable class, or is in a distressed area).
- Affordable housing is always charitable (affordable housing must target specific low income populations and cannot benefit moderate income persons beyond a limited amount).
- Using a fiscal agent that is a public charity allows a foundation to fund an entity that is not charitable (the use of fiscal agents is one of the most misunderstood structures in philanthropy. A fiscal sponsor can be used if done in the right way, but using an organization simply as a conduit without requiring certain steps or responsibility is a recipe for trouble).
- A grant to relieve pain or suffering or to provide support to an individual or a single family is charitable (a charitable organization must serve a charitable class of persons which must be sufficiently large or indeterminate and cannot serve a limited number of persons).
- A grant can be made to a benefit corporation for general operating support because the benefit corporation seeks to achieve both social impact and financial return (the mere fact that a company has a dual purpose will not allow a foundation to make a general operating support grant to the company. The grant must serve a specific charitable purpose).

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<sup>17</sup> Examples of a charitable purpose are found in section 501(c)(3) and accompanying regulations, but are not exclusive. See Treas. Reg. section 1.501(c)(3)-1(d)(2).

<sup>18</sup> One of the allegations against the Clinton Foundation by some Republicans in Congress is that its activities in practice far exceeded the approved purposes when it sought tax exemption: The establishment of the Clinton Library.

- Providing services at or below cost is always charitable (the IRS requires entities seeking exemption as a charitable entity to provide services at “substantially below cost” to avoid competition with commercial entities that have to pay tax. There are circumstances where economic development corporations may be entitled to exemption under section 501(c)(3) even though they provide services to for-profit companies where “the ultimate good received by the general public outweighs the private benefit accorded to the direct beneficiaries [the for-profit companies].”
- Addressing carbon emissions to limit the effects of climate change is always charitable.

### Addressing climate change

Efforts to address climate change have posed challenges for many foundations because of rulings by the IRS casting doubt on whether certain market strategies, such as the installation of solar panels,<sup>19</sup> constitutes a charitable purpose. The following represents a general overview of this area. Foundations funding in this area, however, should consult with counsel.

- Courts and the IRS have recognized that conservation of natural resources benefits the public as a charitable purpose.
- But recent IRS rulings in response to applications for charitable exemption suggest the IRS is reluctant to recognize the promotion of energy efficiency as an inherently charitable public benefit in the way it has recognized other environmental conservation efforts, such as improvement of water conditions or land preservation. The IRS cites the “indirect” benefit on the environment as a critical negative factor.
- The IRS position is arguably wrong as a matter of law because the impact of energy efficiency, while less direct than traditional conservation, is an essential part of addressing the environmental threat of climate change. However, the IRS’ position has not been challenged in the courts.
- Therefore, organizations seeking recognition under section 501(c)(3) often need to adopt alternative approaches to obtain favorable determination – such as to focus energy efficiency efforts on a charitable class of persons, such as low-income individuals or families, or to rely on educational programming or efforts.

### **Foundation Responses to Issues Related to Charitable Purpose**

*Have a sound legal justification for grants to organizations that are not charitable organizations*

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<sup>19</sup> Priv. Ltr. Rul. 201210044, December 16, 2011. See also Clarifying IRS View on Climate Change as a Charitable Purpose in order to Mobilize Program Related Investments for Climate Change Solutions (Lloyd), Columbia Law Environmental Clinic (Spring 2015).

*In context of the more challenging charitable purpose issues, a foundation should have a sound legal rationale for providing support. The foundation should develop an analytical framework for addressing recurring issues or challenges. In areas of doubt, if the amount at issue is significant, consider seeking a private letter ruling.*

*In addition, although a foundation can generally presume a grant to a charitable organization will be used for charitable purposes, if the foundation has reason to know that the organization is using the funds for activities that are outside the scope of its charitable activities, additional caution or inquiry may be warranted.*

*Do not rely on what other foundations may be doing*

*Consulting with other foundations is always a sound step, but do not assume that just because another foundation is funding activity that you can rely on that judgment. You will not always be aware of the rationale or reasons why one foundation is willing to make a grant, and the other foundation may have a different risk tolerance.*

***“If you want to keep a secret, you must keep it from yourself”<sup>20</sup>***

*D. Big data and artificial intelligence are changing the way foundations and other not-for-profits work*

The use of big data and artificial intelligence raise important questions about the right to privacy, how to preserve confidential information, and potential legal exposures for systems gone wrong.<sup>21</sup> Use of artificial intelligence systems pose a bevy of ethical, legal and moral questions regarding their use and impact on affected populations. Yet many such systems are already in place and more are forthcoming. Foundations must understand the import of these systems and the potential for impact on their work.

Foundations must also be aware that their financial data contained in their 990-PF returns will now be machine readable. This means that observers and others can make assessments of patterns and relationships that previously might have been all but impossible or required significant work. Whether for good or ill, this will present challenges for foundations and require them to be prepared to respond to third parties manipulating the data.

## **Foundation Responses**

*Know how big data and artificial intelligence impacts the work of the foundation and the work of grantees*

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<sup>20</sup> 1984 (George Orwell).

<sup>21</sup> For a more thorough analysis of the impact of big data and other technology, see Bernholz, *Philanthropy and the Social Economy: Blueprint 2017* (GrantCraft) (<http://www.grantcraft.org/guides/blueprint2017>).

*It is incumbent on foundations and their legal counsel to understand how the organization is using big data and artificial intelligence and where the controls are to mitigate risks arising from these forces. Foundations should understand the moral, legal, and ethical considerations for projects they fund involving artificial intelligence.*

*Foundations should understand their own data and how it might be presented by unfriendly parties*

*With the advent of machine readable 990-PF data, foundation data can be presented in ways that could present the foundation in a different light than the foundation would want presented. Data can also be manipulated or used with other data in a way that could create misleading impressions. Foundations must be prepared to respond to the use of their data in ways that present a picture different than intended by the foundation.*

### ***“Big Brother is watching you”<sup>22</sup>***

*E. Foundations and other not-for-profits will increasingly face cyber-threats and must be prepared*

Foundations and not-for-profits are increasingly the subject of cyber-attacks by third parties. Attacks can be launched by governments where the work of the organization is seen as a threat to the government or hackers looking to make money or mischief.

### **Foundation Responses**

*Understand the cyber-risks facing your foundation or grantees and take appropriate action to fix vulnerabilities*

*Foundations must ensure that their systems and data are protected as best as reasonably possible. Although it may be all but impossible to keep certain governments from accessing systems, there are steps that should be considered. These include the following:*

- *Understand the nature of private health information or other personally identifiable information that the foundation has in its systems that could be vulnerable and the law applicable to the foundation in the event the information is compromised.*
- *Periodically assess with expert help whether technology systems or servers have been infiltrated.*
- *Install and update strong anti-virus software.*
- *Consider cyber-insurance options and whether it is worth the cost.*
- *Undertake periodic training of staff regarding security of systems and reminders of good practices and ways to identify and avoid phishing attacks.*

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<sup>22</sup> 1984 (George Orwell).

- *Have a response plan or data breach protocol in place governing how the foundation should react in case of a hacking incident.*

*Foundations should also perform adequate due diligence on grantees to understand what steps grantees are taking to safeguard information and systems. Consideration should be given whether a portion of grant funds can be used to provide for more robust defenses.<sup>23</sup>*

### ***Intelligence is the ability to adapt to change<sup>24</sup>***

#### **F. New Structures and Ways of Doing Business**

Wealthy individuals are using different types of structures to achieve impact, including limited liability companies, donor-advised funds, trusts, and foundations or a combination thereof. The use of structures other than just a foundation is not necessarily new (*see Mintz, Emerging Forms of Philanthropy: Transforming the Field or Old Wine in New Bottles (<https://www.macfound.org/about/people/103/news/>)*). The attention paid to the Chan-Zuckerberg Initiative, however, and its use of a limited liability company reflects continued fascination with the use of different structures to achieve impact.

Some foundations are forming affiliated organizations that are public charities so they can pursue policy objectives more directly or other objectives that the existing structure lacks, such as a desire of the public to provide donations to the causes supported by the foundation. The Gates Foundation recently announced a new public charity that will accept donations from the public who are interested in amplifying the work of the Gates Foundation. Another foundation has formed a 501(c)(3) public charity to pursue more aggressively policy objectives because public charities are permitted to lobby to an insubstantial extent, while private foundations may not lobby except in self-defense (other permitted activities such as nonpartisan study, analysis, and research are excepted from the lobbying definition).

### **Foundation Responses**

***A foundation should consider whether its current structure and way of doing business will enable it to achieve maximum impact***

*Questions to consider include the following:*

- *Is the foundation using all the tools at its disposal?*
- *Is the current form of the foundation restricting its ability to have impact?*
- *Can the foundation create other entities or initiatives to maximize or scale impact?*

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<sup>23</sup> MacArthur and other funders, together with experts in the field, have been working on a Digital Security and GrantCraft Guide for Grantees to address cyber threats. The Guide is expected to be available in the first quarter 2017. This should prove to be a useful resource for grantees that might otherwise lack the sophistication and tools to defend themselves against cyber-attacks.

<sup>24</sup> Stephen Hawking.

- *Does the foundation have the resources and mindset to take additional risk by using other structures?*
- *Will new structures actually increase impact or only add to complexity?*
- *How can the foundation leverage available assets?*
- *With whom can the foundation collaborate to increase impact?*
- *How can the foundation use its “voice” to increase impact?*

**“A perpetual foundation is a completely irresponsible institution ... answerable to nobody ...”<sup>25</sup>**

G. *The role of foundations in a democratic society*

Foundations often face a dilemma in seeking impact. On the one hand, they can be accused of being unaccountable oligarchical organizations imposing their policy views on issues best left for representative democracy.<sup>26</sup> On the other hand, they are accused of lacking relevance or impact if they sit back and fund neutral research. This point has been highlighted for many organizations in the face of the election where campaign rhetoric appeared in some cases to threaten the fundamental values of some foundations. To what degree, when and how foundations should react has been the subject of growing debate.<sup>27</sup>

**Foundation Response**

*Foundations must embrace their values and be transparent*

*Whatever the label they embrace or reject, foundations must identify and be true to their values. This should reflect the donor intent and the consensus of the Board and leadership.*

*Foundations should consider how best to use their “voices” consistent with their values, legal constraints, cultures and program strategies. It is critical that the CEO view of the world align with the Board and with donor intent*

*Foundations can never escape attacks or arguments on lack of accountability entirely, but they can address these accusations through transparency of their operations, programs, and finances. Foundations should not operate in obscurity or with opaqueness. Fortunately, many of the larger foundations have increased transparency significantly over the last decade. The ability of a foundation to tell its story of impact will be increasingly important.*

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<sup>25</sup> Judge Richard Posner (portion of quote only).

<sup>26</sup> See, e.g., <http://bostonreview.net/forum/foundations> -philanthropy-democracy (what are foundations for (Rob Reich)

<sup>27</sup> See, e.g., Foundation CEOs Must Muster Their Money, Voice and Courage To Fight Trump, (LaMarche, Chronicle of Philanthropy, December 19, 2016); Progressive Foundations Brace for Trump Administration (Daniels, Chronicle of Philanthropy, December 20, 2016)

*At a time when trust in all institutions is fading, foundations must recognize their own vulnerabilities in this regard and work to rebuild the trust of their grantees, the public, and government.<sup>28</sup>*

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<sup>28</sup> For a discussion of this phenomena, see the annual essay by Julia M. Stasch, President of the John D. and Catherine T. MacArthur Foundation at <https://www.macfound.org>.