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***Feasibility Study on a European
Foundation Statute
2008***

Annex G

Definition of Foundations

Definition of Foundations: General Remarks

When elaborating a definition for our purposes, we had to be mindful of the history of definition approaches for comparative work in the non-profit and foundation sectors. In its most basic form, the foundation idea is based on the transfer of property (assets) from a donor to an independent institution whose obligation it is to use such property, and any proceeds derived from it, for a specified purpose or purposes over an often undetermined period of time. Definitions vary along several dimensions: There are different legal definitions that reflect either common law traditions with an emphasis on trusteeship, or civil law traditions and the distinction between membership and non membership-based entities. Other definitions bring in additional aspects such as type of founder (private or public), purpose (charitable, other), activities (grant-making, operating etc), revenue structure (single or multiple sources) or asset type (own endowment or regular allocations), and the degree of independence from public agencies or corporate interests. The history of definition efforts includes examples such as the EFC definition, the US Foundation Center definition and the definition of the Johns-Hopkins Comparative Non-profit Sector Project. We give a brief account of these approaches.

The EFC suggests the following definition:

(http://www.efc.be/ftp/public/EU/EURweb/Facts_Figs_publication.pdf)

- separately-constituted non-profit bodies with their own reliable source of income, usually but not exclusively from an endowment or capital
- their own governing board
- their financial resources for educational, health-related, social, research-oriented, cultural, or other public benefit purposes either by making grants to third parties or operating their own programs and projects

The EFC groups foundations into the following four broad categories:

- Independent foundations, which form the largest part of the sector
- Corporate foundations
- Governmentally-supported foundations
- Community foundations with a local/community focus and other fundraising foundations

Efforts to define foundations have a longer, modern history in the US: Already during the 1950s, Andrews (1956, p. 11) proposed a definition that was later adopted by the New York-based Foundation Center, a clearing house for information on US foundations. According to this definition, a foundation is

“a nongovernmental, non-profit organization with its own funds (usually from a single source, either an individual, a family, or a corporation) and program

managed by its own trustees and directors, established to maintain or aid educational, social, charitable, religious, or other activities serving the common welfare, primarily by making grants to other non-profit organizations.” (Renz et. al., 1997, p. 111).

Under common law, foundations typically take the form of a *trust*, which is legally speaking not an organization but a relationship between property and trustees. Most common law countries use this rudimentary legal definition, and leave the actual development of foundation law to case law. One exception is the United States, which, in 1969, established a precise, though negative, definition: Foundations are tax-exempt organizations under section 501(c)(3) of the International Revenue Code that are neither public charities nor otherwise exempted organizations. This basically means that under American tax law, foundations are those charitable organizations that receive most of their resources from one source and are as such considered to be donor-controlled.

The contribution of the Johns-Hopkins Project started from the insight that there is little use in trying to reconcile different definitions and privilege one over others. Instead, the partners in that project to put in place a more generic approach that goes beyond national definitions and forms and informs our functional definition. Yet how to achieve this, and how to come to terms with the diversity of actually existing forms and complexity of legal treatments across jurisdictions for the purposes of economic reporting on the scale, activities etc of foundations in Europe? To cut across this terminological tangle, scholars have suggested an approach that has proven fruitful in a closely related area, the comparative study of non-profit organizations (Salamon and Anheier, 1997) and foundations (Anheier 2001, Anheier and Daly, 2005), and that has been adopted by the United Nations Handbook on Non-profit Institutions (United Nations 2003).

The UN Handbook states that the non-profit sector as consisting of (a) organizations; that (b) are not-for-profit and, by law or custom, do not distribute any surplus they may generate to those who own or control them; (c) are institutionally separate from government; (d) are self-governing; and (e) are non-compulsory. In the context of this definition, foundations are non-profit entities that have at their disposal assets or an endowment and, using the income generated by that asset, either make grants to other organizations or carry out their own projects and programs.

In the International Classification of Non-profit Organizations, the UN Handbook adds a special class 8 100 (Grant-making foundations) for organizations whose principal activity is making grants to other non-profit entities using funds from donations and from the property income and other returns on the organization’s endowment. Although such endowments are classified as financial intermediaries in the International Standard Industrial Classification (ISIC, Rev3; and similar in NACE), the defining characteristic for that class is the fact that most of the organization’s current outlays are transfer payments, not operating expenses. Foundations, then, as a subset or special type of non-profit organizations but grouped into two large subgroups: grant-making and operating.

We can use the UN definition and apply it to foundations more specifically by identifying those characteristics that seem essential for their structure and operations; we define a foundation as an *asset*, financial or otherwise, with the following characteristics:

1. Non membership-based organization based on an original deed. The foundation must rest on an *original deed*, typically signified in a charter of incorporation or establishment that

gives the entity both intent of purpose and relative permanence. Other aspects include some degree of internal *organizational structure*, relative persistence of goals, structure and activities, and meaningful organizational boundaries. What are excluded are ad hoc and temporary funds and other assets that have neither real organizational structure around them, nor relatively permanent identity and purpose. Also excluded are membership-based associations and owner-based organizational forms. Note that a membership-based organization would be either an association or a corporation.

2. *Private entity.* Foundations are institutionally separate from government, and are “non-governmental” in the sense of being structurally separate from public agencies. Foundations can be created and set up by government, can receive significant government support and can even have government officials sit on their boards. Yet they cannot be instrumentality of government whether international, national or local. Therefore, foundations do not exercise governmental authority and are outside direct majority control. Note that a non private organization would be a public or quasi-public agency.

3. *Self-governing entity.* Foundations are equipped to control their own activities. Some private foundations are controlled either by governmental agencies or corporations, and function as parts of these other institutions even though they are structurally separate. Self-governance implies that foundations must have their own internal governance procedures, enjoy a meaningful degree of autonomy, and have a separate set of accounts in the sense that assets, expenditures, and other disbursements must not be part of either governmental or corporate balance sheets. Note that a non self-governing organization would be part of another organization, which could be a government agency, a corporation or a non-profit organization.

4. *Non-profit-distributing entity.* Foundations are not to return profits generated by either use of assets or the conduct of commercial activities to their owners, members, trustees or directors. A foundation may accumulate surplus in a given year, but the surplus must be applied to its basic mission (depending on any payout requirements stipulated in the relevant tax laws), and not be distributed to owners or their equivalents such as board members. In this sense, foundations are private organizations that do not exist principally to generate profits for owners, either directly or indirectly, and that are not primarily guided by commercial goals and considerations. Note that entities which distribute surplus to trustees, family members or any person whose welfare is not covered by the stated charitable purpose would be classified as private profit distribution.

5. *Serving a public purpose.* Foundations should do more than serve the needs of a narrowly defined social group or category, such as members of a family, or a closed circle of beneficiaries. Foundations are private assets that serve a public purpose or benefit. The public purpose may or may not be charitable or tax-exempt in the relevant laws of a country, what is important is that the purpose be part of the public domain. Note that organizations making payments to family members or entities benefitting a family through trust funds or other private equity considerations would not qualify as foundations in the sense proposed here.

The history of definition efforts shows that even such a functional approach needs to be further qualified by dealing with special country cases and deviations from the rule.