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The ***Grassroots Fundraising Journal*** *is happy to consider articles for publication. Please submit copy* ***typed, double-spaced.*** *If computer-generated, please submit highest quality printing possible (no dot matrix printouts, please). Please do not submit material typed in all capital letters.*

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In This Issue

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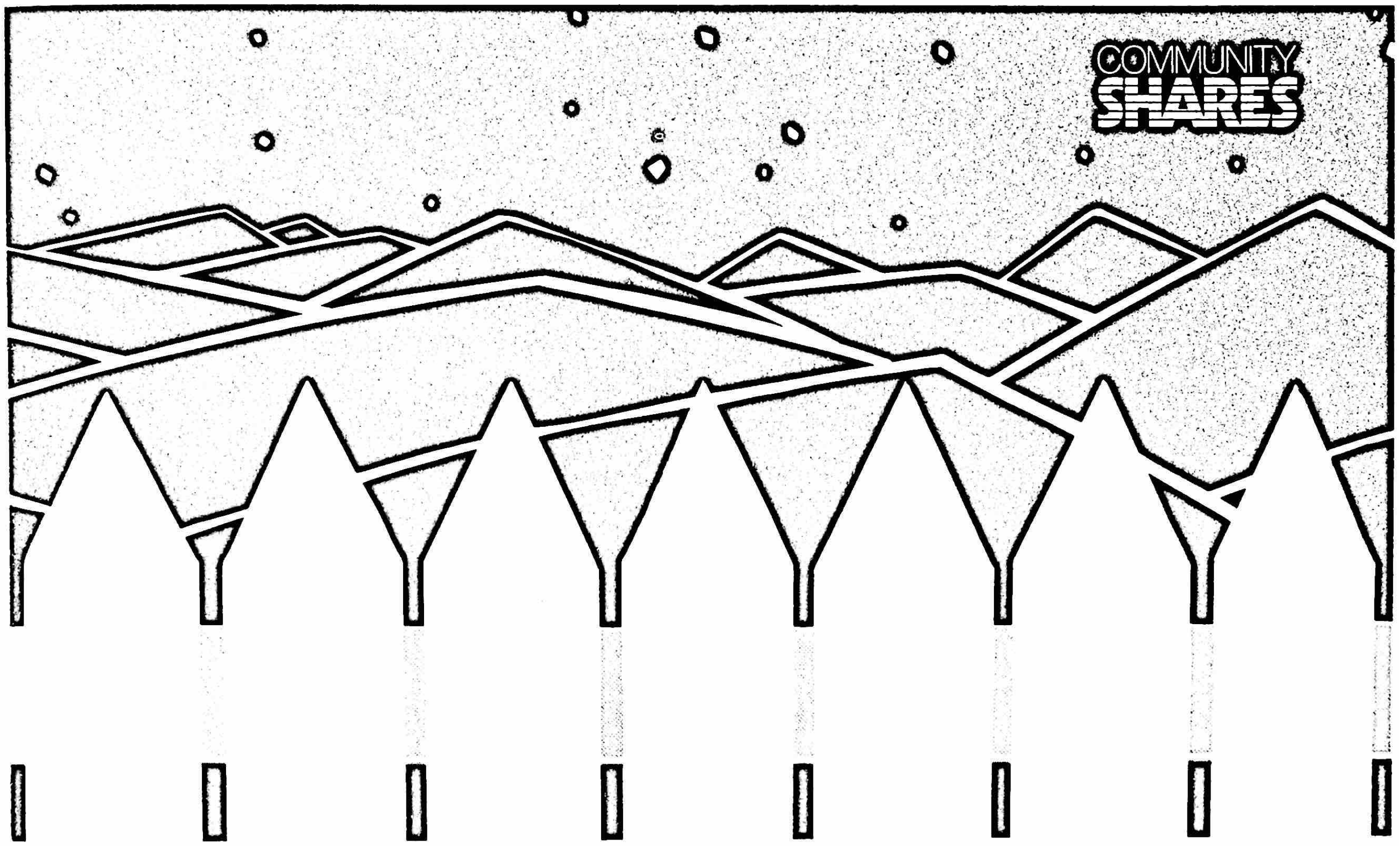


THE ALTERNATIVE FUND MOVEMENT, PART 2

Community Shares:

Case Study of a Small Social Action Alternative Fund in the South

by Peggy Mathews

Ronald Reagan had been president for over three years and small community organizations in East Tennessee were feeling the effects of his administration—deregulation of industries created a greater need for citizen action and watchdog groups, and defunding of social service programs created a greater demand on private foundation funders.

But east Tennessee is not overflowing with Fortune 500 corporations or large private foundations, let alone progressive funders that would support organizing around issues such as utility rate reform, strip mining, or the needs of low-income people. Historically, Appalachian community groups have had to go outside the region for foundation support, mainly to New York City or Washington, D.C. But in 1984 several organizations were realizing that this small progressive well of foundation money would have more cows coming to drink, and there would be less water to go around in the future.

Under the leadership of David Dotson at The Youth Project, six east Tennessee community organizations met for a year, examining various grassroots fundraising strategies and figuring out which ones could work for them. Throughout the discussions, the groups always came back to the idea that they would be better off to pool their resources and fundraise together. Meanwhile a Washington, D.C.-based organization called the National Committee on Responsive Philanthropy (NCRP) was helping similar groups set up "alternative funds" all across the country to break into the lucrative workplace "payroll deduction" campaigns. Mr. Dotson had previously met the folks at National Committee for Responsive Philanthropy and asked them to research the feasibility of an alternative fund in Knoxville, Tennessee. With NCRP's assistance over the next six months, the original six groups created the necessary by-laws and charter, developed policies and a long-term growth plan, and established a new alternative fund called Community Shares as a federation of locally controlled social change organizations in east Tennessee. We opened our doors in April, 1985.

At that time, most of the alternative funds were in the heavily populated cities on the East and West Coasts and in the Midwest. Knoxville, Tennessee was not the best example of a "prime" location for the next alternative fund—it had a relatively small population of 200,000 people of predominantly middle and lower income range, and few major corporations or other large employers. But NCRP's feasibility research did identify two large workplaces that would be likely to let Community Shares into their payroll deduction campaigns: the Tennessee Valley Authority, a federal workplace with 8,000 employees, and the University of Tennessee with 7,000 employees. The feasibility study was right—it was fairly easy to convince these employees to let Community Shares set up a workplace giving program for their employees. However, the founding Community Shares board knew we had to get into many more workplaces and be soliciting many more employees before we would really be a successful fund.

The founding Community Shares board set as its marker of success to be able to distribute $15,000 to $20,000 to at least 10 member groups. They also felt that if there were truly a "market" for a social action alternative fund in Tennessee, Community Shares should be doubling its income each year for the first five years.

Meeting the Challenges

These goals, both long and short term, presented many challenges for Community Shares, as there were several factors working against us.

1. A small to moderate-sized population whose household income is below the national average. The success of any federated fund depends upon the numbers—numbers of employees solicited, numbers of employees actually giving, and the average size of the gift or pledge. Early on we decided that we could not meet our ultimate goal of raising over $200,000 from the Knoxville employee base alone. So the board established Community Shares to be a regional fund, incorporating all of east Tennessee (including the cities of Knoxville, Chattanooga, and Kingsport/Johnson City) and middle Tennessee (including Nashville with a population of half a million people) as its territory. We have since added members that are statewide or regional in their constituency served, or based in towns outside of Knoxville. This combination of local and regional groups makes Community Shares appealing to more employees in many more towns.

2. A strong United Way that has enjoyed a virtual monopoly in workplace payroll deduction campaigns and does not want to share the turf. In places across the country one hears stories of the "dirty tricks" that some United Ways have played—from withholding information about how an employee can give to a non-United Way agency, to advocating legislation that bars other federated funds from participating in public workplace campaigns. In our case a Knoxville United Way board member and key political figure in east Tennessee called the state employee campaign coordinator upon learning of Community Shares' admission into the state campaign. The person demanded the campaign coordinator exclude Community Shares from the campaign and threatened to go directly to the Governor when he was told the state regulations allow non-United Way agencies to participate in the public employee campaign.

Doing battle with United Way can be time consuming and a drain on your resources. It can also gain a lot of publicity and possibly increase your support from employees who do not appreciate United Way's tactics. The Women's Way in Philadelphia, for example, gained tremendous support when they positioned themselves as an alternative to United Way, pointing out how few United Way dollars go to local girls' and women's programs compared to programs for boys and men.

Community Shares chose to go about building a public image of a fund that stands side by side with United Way, raising funds for organizations that do not receive United Way funding and do not duplicate United Way agencies' work. We point out that United Way's direct service organizations are important because they help individuals with immediate needs. Then we point out that Community Shares' social change organizations are addressing the root causes of those needs and are searching for longer term solutions so the need will be lessened in the future. We encourage employees to split their pledge rather than demanding they choose between United Way and Community Shares. This kind of approach makes sense to people who believe that "throwing" money or food at a problem will not make it go away.

3. Lack of political power or access to power. This is a common block to many alternative funds. Whereas the United Way boards and the local Chamber of Commerce boards typically have many members in common, the alternative funds boards are made up of grassroots community activists and representatives from the disenfranchised segments of the community. This is the case with the Community Shares board. Yet often it takes power to convince an employer to let your fund into their campaign. Most large employers are closely allied with United Way and have been convinced by United Way that opening up their workplace to other funds would take money away from United Way.

Our strategy has been to build our power by building our employee support base. We concentrate on organizing employees from within the workplace to demand their employer include Community Shares in their payroll deduction campaign. Just like any social change organizing, we know that when a large number of people are pushing for something, the decision makers have to listen. Certainly it takes longer to go this route instead of going directly to the boss. But we are more likely to get the boss' ear if his/her employees have already made their desires known.

The Proof is in the Payroll Deductions

After three years, Community Shares has grown 500% in money raised through workplace payroll deduction campaigns. In 1988 we raised more than $34,000; we plan to raise $60,000 in 1989. Whereas we were in three workplace campaigns in 1985, Community Shares is now in 25 workplaces in Knoxville, Chattanooga, Oak Ridge, and Nashville. This growth is proof that there are people who want more choices in giving and who want to support local social change.

But we would not have gotten this far without a broad base of volunteers and leadership. In nearly every workplace where we run a campaign, we have employee volunteer committees to help spread the word about Community Shares and encourage their coworkers to pledge to Community Shares. These committees also advise us on the most effective way to raise employee awareness about Community Shares. These volunteers are our direct link to employees. They are critical to our ability to increase our donor base. And we have found than when employees get involved in Community Shares as volunteers, they give more generously and they maintain their support over the years.

Now in our fourth year, we are facing the challenges of a maturing fund: Can we get into the big private corporations? Can we gain direct and equal access to employees in multiple-choice campaigns that are controlled by United Way? Can we continue to grow in membership and in territory without becoming too difficult to manage? Can we appeal to a greater market than the natural core of progressive donors?

As they say here, "God willing and if the creek don't rise," we will. ■

Peggy Mathews is a founding member and the executive director of the Community Shares alternative fund in Knoxville, Tennessee.

Lessons from Grassroots Groups

by Kim Klein

Introduction

The following article was adapted from a lecture to the NSFRE in August, 1986 in San Francisco. The audience was made up of development directors from a wide variety of large traditional non-profits such as the symphony, museum, various hospitals and colleges, Red Cross, and other social service agencies, private schools, and the like. They asked me to speak on some aspect of working with low-budget grassroots groups. I spoke about what groups like theirs could learn from grassroots groups. In reading the transcript of this talk, I realized these are lessons all non-profits should keep in mind.

When I became a fundraising consultant and trainer full-time, I tried to take the lessons I had learned from successful large organizations and apply them to smaller groups. Having now worked for a number of years with dozens of small, grassroots groups around the country, I see that there are some lessons larger, more traditional organizations can learn from their smaller associates.

I have worked with a lot of groups whose budgets primarily are under half-a-million dollars and even those whose budgets are at the $20,000–$30,000 level. These are the grassroots groups that are kind of feisty and scrappy—they make do with very little. I thought about a wide variety of these groups and what they know that the rest of us need to be reminded of.

When you're a small organization and you do something wrong, you always pay for it—you know it right away, and you know it in your bottom line. Technically with larger groups that should be true also, but I've seen larger institutions carry on for years and years without ineptness and boredom showing up just because they've had that kind of lag time. When a group only has money for one month ahead, they don't have that option. So here are some of the things that I think small grassroots groups can remind larger groups about.

Mission, History and People

The first is that all groups need to have a very clear sense of their mission. We all know that every group needs a case statement and the case statement starts with a mission. I'm amazed at the number of groups, regardless of size and politics, that don't have case statements. Or that have one they wrote four or five years ago filed away under "C" but they don't know what it is. When you're a small group working on controversial causes you absolutely have to know your mission, otherwise you lose your volunteers. A group in Appalachia called Save Our Cumberland Mountains—an anti-strip-mining group that works for promoting deep coal mining and looking at the environmental and economic impact of strip mining—is opposed by some very wealthy strip-mining industries. If all the people there don't have a very clear sense of mission, they would not be in this work for long because it can be life-threatening.

> *When you're a small organization and you do something wrong, you always pay for it—you know it right away.*

Second, it's absolutely imperative that all organizations—staff, volunteers, board members and so on—know your history, know your facts, know your background information. In a small organization, say working in a political concern, the opposition loves nothing more than to catch you out, catch you in a wrong fact or wrong statistic and then that's it—end of credibility from then on. It can take years to recover it. It doesn't tend to show up as much in major institutions, but I've found people that may have been on a board for three or four years and they don't know when the group started, why it started, what the context was, the track record. They say, "Read our brochure," but that won't do. We don't do a good enough job of educating people about the background, the history, the facts of the organization and reestablishing every year the need for our groups.

Third, groups need to treat their volunteers really well and take them seriously. In a grassroots organization, volunteers act as unpaid staff; some groups have no paid staff at all, and it's not unusual for someone to have a half-time job and spend the other half of their time working for free for a group—that's a typical sacrifice people make. In a larger institution that's not normally the case, so we feel we don't need to appreciate our volunteers as much.

At both the grassroots and the larger institution we must really put forward an effort to make sure that people feel appreciated. And I'm not talking just about those

You have to ask yourself, 'Who wins by me continuing to think that?'

annual luncheons where we hand out certificates; I'm talking about real serious appreciation on a weekly or daily basis. People shouldn't have to wait a whole year for affirmation. Send them notes, write them, call them, make sure they feel their work was really important. And make sure that you give volunteers decent, fun work. When you're a larger group you can lose a couple of volunteers and it won't show up as an immediate loss; if you're small and you lose a volunteer you could be disabled by that, you could have lost a real important person.

Fourth, we have to be careful not to make assumptions about why people will support us or, more specifically, that they won't. Again, knowing background and history comes into this. My favorite example of this was some years ago when I worked with a group working for the passage of the Equal Rights Amendment in a small town in the midwest. They identified somebody there who was 90 years old and a life-long staunch, avid Republican. She had been a widow for about 40 years, she was a philanthropist, she supported a lot of major arts organizations in the town and she was generous as a donor. Somebody mentioned her name as a potential donor to the ERA campaign and said "I know her, let's ask her." "Oh no," everybody said, "You can't ask her. No way will she give." This person pointed out that she might give because the Republican party had endorsed the Equal Rights Amendment long before the Democratic party did. Therefore, someone as old and as staunch as this woman was more likely to be interested in the Equal Rights Movement than not. Sure enough, that proved to be the case—she had been a suffragette as a young person and she was definitely in favor of the ERA. So that's about background, and letting go of assumptions.

Similarly, people in anti-nuclear groups will say "So many people are against us." Nobody is against the idea of world peace. People have different opinions about how it's going to come about—some people think peace through strength is the way, some don't—but we still have an audience here that we can talk to and try to persuade to our viewpoint.

At larger institutions we make those kind of assumptions in a more benign way. Some of the universities that I've worked with send the same fundraising appeal every year and they have the same tired donors sending in their same tired checks, and there's no effort to move people forward, to get them excited, to get them to upgrade their gifts. That's how I think large institutions make certain assumptions: that the donors are just there, that all you have to do is ask them every so often. We lose a sense of verve in that.

We have got to be careful not to make assumptions about why people will support us . . . or that they won't.

Diversity throughout is critical

The fifth point is that we have to remember that diversity in an organization is critical—not just diversity of funding sources, which is what large groups teach small groups, but diversity of people, diversity of types of people. It's not only right to have ethnic minorities on your board, to have women well represented on your board, people from all classes, it is in fact practical. We want a wide variety of viewpoints on the board, among volunteers, across the staff lines, so that we can reach new markets, so that we can see what people think about us, so that we can draw people in—not because it's stylish but because it will work and it will open up avenues in your fundraising and in your program delivery that you may not have thought of before just because you don't have access to that viewpoint or because you're not that kind of person.

A corollary to that is something we learned from the church (the church is the consummate grassroots organization): make every gift of equal importance. In small organizations large donors—$5,000 donors—sometimes have more importance than $100 and $200 donors. The $5,000 donor might have a better shot at a seat on the board than a $200 donor. Well, we work with reality here and I don't want to challenge that, but I also want to point out that someone who gives $200 could have given a much more significant percentage of their income than someone who gives $5,000, so their interest and their commitment might be higher, and also someone who gives $200 this year may have $2,000 or $10,000 to give in future years, incomes change. So we really want to value all gifts and make them all acceptable. That's what the church does—any gift from a nickel to a million dollars is acceptable in a church and that's why year after year they walk away with half of the money given away in the private sector.

The sixth point is to make sure that all your volunteers are willing to ask for money. A lot of times three or four people on a board do all the soliciting and the rest do whatever else is to be done. But we don't make them ask for money. I hear people from all walks of life say "I don't want to ask for money, it makes me uncomfortable, it makes me nervous, it seems rude." We've all heard this kind of excuse. Well, yes, it does mean we have to look at some taboos, it probably does make you uncomfortable. But nobody ever died of embarrassment. Something I tell social justice groups that I think has a corollary to other institutions is that we're carefully taught not to ask for money. You notice that children have no trouble asking for anything. This is learned behavior, this unwillingness to ask. As such, it can and should be unlearned. Also, whenever you're carefully taught anything you have to ask yourself, "Who wins by me continuing to think that?" Who wins when we can't ask for money? When you refuse to ask for money because you're embarrassed or scared you collaborate with the very system you claim to be wanting to change. Because if you don't have money you can't make change. All world leaders recognize that, even the most radical; Castro said, "A revolution without capital is not a revolution."

Nobody ever died of embarrassment.

You don't have to feel comfortable with the process of asking for money, just do it. When I was working at a shelter for battered women, a woman came who was married to a very prominent surgeon who had burned her back badly with an iron. I went with her to the hospital, and the thing about burns is they're not only painful, they're very horrible to look at, so from the point of view of the person not burned it's also a painful experience. After that when I was out asking for money—because I used to have the same trouble as everyone else—I would simply imagine this woman's back in my mind and I would say "Her pain and her suffering are so much more important than my fear, am I going to let my fear get in the way of the shelter getting money?" I recommend to people, whatever group you're in, that you pick an image that means something to you and hold on to it and tell your volunteers to do the same, and that image will give you courage to overcome your anxiety about asking. ◼

"Imagine you're responsible for an organization that suddenly finds itself roughly $10,000 in debt. . . . What do you do?"

Financial Management 101

by Steven Post

Annual income twenty pounds, annual expenditure nineteen, nineteen and six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought six, result misery.

—*David Copperfield*, by Charles Dickens

It occasionally happens that social change groups find themselves in financial trouble. This is usually not as much fun as hosting a major disarmament conference or receiving a large grant from a foundation. On the other hand it need not be a disaster. If faced creatively it can leave your group stronger than it started.

Having had the dubious honor of being involved with more than one organization that found itself financially troubled, I will give you free the lessons I learned at great cost. Please do a good thing and learn these lessons from me, instead of on your own. My advice will be most applicable to relatively large organizations (annual budget $70,000 and up) with high fixed costs such as staff and rent. Smaller groups have more financial flexibility. But with modifications the advice applies to you too.

At the risk of being obvious, financial woes are dangerous for your organization. They can cause you to incur fines from the Internal Revenue Service (never an understanding outfit), they can cause you to cut programs, they can force you to lay off staff, they can put you out of business. And they are lousy for morale. I have seen all of those things happen; they are consequences to be avoided if at all possible.

So, imagine yourself in a position of major responsibility for an organization that suddenly finds itself roughly $10,000 in debt. (This has happened to me; as I say it's not a lot of fun). Later we'll discuss ways to avoid *suddenly* learning anything about your financial situation. But for now assume that things look bleak. What do you do?

In her wonderful primer *Fundraising for Social Change* Kim Klein advises that if you have a fundraising flop, "Don't Panic" (if you don't have a copy of this book buy two immediately, one for you and one for your group). Kim's advice is excellent technical advice, but I think it's poor psychological advice. I think you *should* panic. If you are suddenly responsible for managing a $10,000 shortfall I think you should do the best job of panicking you possibly can. Find a quiet beautiful place to panic for as long as you need to. When you've gotten it out of your system you'll be calmly and efficiently ready to implement the changes that need to be made in order to bring happiness, serenity, and financial stability back to your organization.

What went wrong?

The next step is to analyze your financial situation in order to learn why you're in trouble. Probably you will learn one of three things.

One: Perhaps you just had a flop. Your fundraising plan was being implemented according to schedule, Board and staff were all doing their part, the money was rolling in, when Boom! Your Bruce Springsteen benefit was a dismal failure, here you are in trouble (and gee it seemed like such a great idea when Bruce offered to do the concert).

This is actually good, because your need for money is a one-time thing. With the rest of your plan on schedule you are in a perfect position to approach funders (members, major donors, foundations) and ask for a one-time extra gift or (if necessary) a loan to tide you over. Combined with temporary program cuts as needed, this should be enough to help you through the rough spot. Advice for the future: do better market research (if no one in your town has ever heard of Bruce Springsteen then he's not going to make much money for you), try to build up a cash reserve instead of living hand-to-mouth, and pad your annual budget so everything doesn't have to work perfectly in order to come out even.

Two: It's a cash flow problem. Everything is going according to schedule but you made a mistake in the schedule. Bruce's big concert ($25,000 net minimum) isn't till October and you need $10,000 to reserve the stadium now.

This is even better than before. All you need is a loan (although underwriters for the concert would be even sweeter). In any case you are in an excellent position to approach funders for some short-term money. Advice for the future: when making your financial plan next year make a cash flow budget as well so this can't happen. If the plan works, how much money will you have in the bank at the end of every month? If the answer in any month is negative then you're not through working on your budget.

Three: It's more serious. An analysis of the situation reveals that you've been losing money slowly but steadily for the past five months and that your income just does not cover your expenses. This is serious bad news. This is a systemic problem rather than an accidental one.

What to do

I will now give you the one piece of real wisdom in this article. When you find yourself in a serious situation like this, there are only two things you can do: raise more money, or spend less. Just to be sure you got it, here it comes again: when serious long-term financial problems arise you can do only two things—RAISE MORE OR SPEND LESS. (Of course you can also do some of both.)

If you are serious about raising more money then you have to have a plan.

So I've now given you the most obvious piece of advice on two continents. What's the big deal? The big deal is this: Your group will not want to do either of these things. Not at all. It is the easiest thing in the world to talk about the problem at Board meetings for three months, plan what to do for the next couple months, decide to really take action the next month, and six months into the crisis (if you haven't gone under yet) you face the same choices: raise more, or spend less.

Neither choice is very appealing. Spending less means cutting programs and/or people. Raising more means that someone has to do it. It is much more appealing to try to talk the problem away, bring in a fund raising trainer, or procrastinate in other ways as long as possible. The same two choices will face you at the end.

Raising more money

Raising more money will be a Board of Directors' first choice because it will allow them to avoid laying off staff or ending a cherished program. The problem is that most ways of raising money are probably already being utilized—if there were some easy way to raise $10,000 quickly you would already be doing it. But because Board members tend to be good caring people who want to do the right thing, the first remedy they'll think of is raising more. This is fine if they really do it; the danger is that it won't happen.

If you are serious about raising more then you have to have a plan. Here is the two minute explanation of a plan—

This is not a plan: We'll all go home and think of ways to raise an extra $1,000 each.

This is also not a plan: We'll all ask our personal friends and relations for $100 until the problem is solved.

This is a plan: Carol will raise $1,000 from her parents, her three best friends, and her ex-husband who will still do anything for her and the money will be in within two weeks.

Charles will host a reception in his home for an old college friend named Meryl Streep whom people will pay to meet. He'll do it next month when she's in town for their reunion and he'll raise $1,000 from it. Melanie will donate $1,000 herself within ten days, etc., etc., through ten Board members.

A plan has a *"Who," "How,"* and *"When."* A plan is written down for all to see and a plan has a designated "howler." (A "howler" is someone who calls you up every three days and howls at you: how's it going? are you on schedule? will you be able to get 50 people who want to meet Meryl Streep? This continues until your $1,000 is in the bank.)

O.K., you're now out of debt but you're not out of the woods. If you've been losing money steadily for months, chances are you need ongoing solutions or you'll be in trouble again five months from now. It's not enough just to make up the current debt. You also have to counterbalance the monthly shortfall. To do this you have—guess what—two choices: raise more or spend less. This means incorporating new fundraising into your ongoing program, making it part of your annual plan, or else looking seriously at the expense side of the budget. Which brings us to . . .

Spending less

When troubles hit I recommend spending less first. Cutting expenses immediately will keep you from falling further into debt and it will graphically illustrate the seriousness of your problem. If you cut spending, and thus program, it may spur the committed to raise the money necessary to erase the debts and restore the program. (Jane Boardmember may not be willing to raise money to erase an abstract debt but *would* be willing to do so to get the newsletter back up to bimonthly instead of quarterly.)

Cutting expenses is painful, but once you decide to do it, it's not that hard. Just decide what you're going to do without. Your largest expenses are probably staff and you should consider laying staff off or cutting back their hours. *Don't* ask staff to do the same work for less money. Most nonprofit staff are miserably enough paid as it is. Other ways to cut back are to stop your newsletter or any other ongoing program that incurs expenses. Don't ask: How can we *possibly* live without that. Ask instead: would giving this up be better than going under?

Are You at Risk?

1. Do you have more than 10 *active* Board members?

2. Do you have more than three staff and Board who understand your monthly financial statement?

3. Do you have an annual budget and fundraising plan?

4. Who is responsible for raising your annual budget?

5. Do you know each month the approximate size of your outstanding bills to pay?

6. Do you know the relevant state and federal laws governing the financial operations of your organization? Are you current on all FICA, FUTA and SUTA payments?

7. If you needed $3,000 right away do you know who you could borrow it from?

8. Do you have regular Board development sessions?

9. Do grants make up less than 10% of your budgeted income?

10. Is any one source of funds more than 25% of your budget?

11. Do you have a cash reserve of 10% of your annual budget?

Score one point for every "no" answer to 1,2,3,5, 6,7,8,9,11.

Score one point for a "yes" to question 10.

If your answer to 4 was "we all are" or consisted of only one or two people, give yourself one point. If you thought of five or more individuals (who know they are on the list!) subtract one from your total.

If you scored 0–3, congratulations, teach the rest of us how you did it! If you scored 4–8 you have some serious work to do. Start today. If you scored 9–11 then you are an accident waiting to happen.

Better Safe . . .

Now that you know how to get out of trouble, let's briefly discuss ways of avoiding trouble in the first place.

First you need a financial plan, a budget of income and expenditure with who, how much, and when. As soon as you begin to go off course, start implementing changes. Don't wait.

Cutting expenses immediately will keep you from falling further into debt and it will graphically illustrate the seriousness of your problem.

Second, to know if you're going off course, you need a monthly financial statement that is read and understood by Board and staff.

Third, to avoid going off course you need multiple funding sources, *very* conservative planning, and total financial honesty. You can tell yourself that 1,000 people will come to a conference on "Unilateral Disarmament, A New Course for the '90s" even if a more honest figure is 300. But if you're that far off on your financial projections then trouble is just around the corner.

Financial woes are painful but they can be survived. If it forces your group to pull together, make more realistic plans, and tighten up financial procedures, then you will be healthier at the end in all ways. As a parting note, take comfort in the fact that you are in good company—the federal government, numerous Savings and Loans, and about 90% of all new small business also have troubles managing their money. ◘

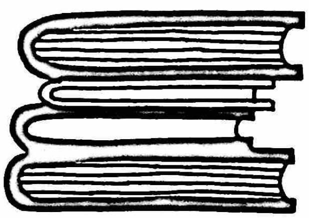
Steven Post has been involved with peace and justice organizations for seven years. Currently he teaches math at Edgewood College in Madison, Wisconsin.

Book Review

Unfair Competiton? The Challenge to Charitable Tax Exemption

by W. Harrison Wellford and Janne G. Gallagher

273 pages, with appendices, $21.95, published by The National Assembly with Support from the Ford Foundation and the Rockefeller Brothers Fund



Nonprofit organizatons' tax-exempt status—one of their most valuable assets—is under attack.

- In 1985, the Navy barred a nonprofit family services agency in Newport, Rhode Island, from bidding on a contract to provide counseling to troubled military families—services it had delivered for years—because the contract had been set aside exclusively for small businesses.
- In 1986, a committee of the Pennsylvania legislature recommended that property tax exemption be denied to any nonprofit offering services that "compete" with for-profit firms.
- In 1987, Congress held six days of hearings on the Unrelated Business Income Tax, which included complaints by various small business advocates that tax exemption gives nonprofits an unfair competitive edge over for-profits offering similar services.

Unfair Competition? The Challenge to Charitable Tax Exemption, a new book from The National Assembly, responds to these and other threats to nonprofits' tax exempt status from small business advocates and revenue-hungry state and local governments.

"The book demonstrates the vital and unique role nonprofits play in American life," says Leonard Stern, executive director of The National Assembly of National Voluntary Health and Social Welfare Organizations. "It also shows why tax exemption is essential to their ability to continue playing that role."

Written by W. Harrison Wellford and Janne G. Gallagher, attorneys active in the debate, *Unfair Competition?* stresses that in order to preserve their tax exempt status, nonprofits must learn how to restate their charitable purpose in language appropriate to the skeptical, cost-conscious '80s.

The book gives nonprofits a way to articulate that purpose by laying out the rationales for and history of tax exemption and the evolving legal status of charities in America.

Of the rationales for granting tax exemption, for example, perhaps none is more important than encouraging nonprofits to provide services that government can't provide. Some activities—AIDS prevention is a good example—are so volatile that it's close to impossible to forge enough of the political consensus to develop adequate programs.

"*Unfair Competition?* focuses on human service nonprofits," says Leonard Stern. "But it's relevant to *all* nonprofit organizations, especially those that charge for services or products or carry out activities that could be seen as competing with a small business."

The dispute between nonprofits and for-profits, as the authors point out, is nothing new. "It tends to ebb and flow with the economic cycles of small business sectors and the shifting fashions of entrepreneurial activity. Nonprofit competition occasionally becomes the scapegoat for for-profit firms caught on the downside of a demand curve."

When the health and fitness boom of the 1970s tailed off, for example, for-profit fitness clubs complained that YMCA exercise facilities had an unfair advantage in competing for members.

A particular sore point in the debate is whether nonprofits should be allowed to charge fees for goods and services (such as day care, job training or counseling) and still retain their charitable status. Some business advocates felt that nonprofits' income should be restricted to what they can raise through contributions.

The fact is that there's nothing new in nonprofits charging fees for services; they've been doing it since before the Civil War. Reliance on fees for service grew as social service agencies broadened the scope of their services to include the entire community, but fees remain only a modest part of their overall income.

Even in the face of deep cuts in social spending during the Reagan years, human service nonprofits haven't dramatically increased their reliance on fees for service. Income from fees for service rose from 9.6 percent in 1977 to 12.4 percent in 1982; two years later it was only up to 12.6. The fact is the nonprofits continue to raise the bulk of their income from government (43.9 percent) and private sources (37.4 percent).

Fees for service also have an important public benefit, increasing the reach of nonprofits' services: charging a modest fee to clients who can pay enables organizations to help those who can't.

The first chapter of *Unfair Competition?* describes the rationales for granting charitable organizations tax exemption, using historical and current examples. Besides providing services the government can't offer, nonprofits also help reduce the cost of government. In 1985, Goodwill Industries trained and placed more than 11,000 individuals with disabilities in jobs.

Promoting volunteerism and private initiative also cuts down the government's burden. Through donations and volunteer help, the Salvation Army spends more on alcohol rehabilitation each year than the government, helping 80,000 people.

Nonprofits also offer public benefits for-profits can't provide because there's no way to charge for them or it's too difficult to measure the quality of the service. How do you charge for a service like improving air quality, which benefits all of us, or a suicide prevention hotline, whose beneficiaries are anonymous? The difficulty of monitoring the quality of intimate personal services such as child day care or nursing home care, leads many consumers to prefer nonprofit providers.

Moreover, nonprofits pioneer creative solutions to community problems. They were the first to develop treatment programs for alcohol and drug abuse and, more recently, to respond to problems of homelessness and AIDS.

In the broadest sense, human service organizations provide a public good by offering people the chance to serve their community. They are schools for citizenship, where Americans learn to care about problems and people outside their immediate lives and families.

The second chapter of *Unfair Competition?* summarizes the history of fee-for-service activities among nonprofits. Chapter Three looks at who nonprofit human service agencies serve and how they raise their income.

Chapter Four traces the origins of the federal income tax exemption for nonprofits and the development of the federal Unrelated Business Income Tax. In recognition of their special role, charitable organizations were exempted from the first corporate tax, enacted to pay for the Civil War, and they've been exempted from every federal income tax law passed since.

Congress passed the tax on unrelated business income in 1950, leaving it to the IRS to decide whether a particular activity is "related" to an organization's exempt purpose. Testifying in 1987 and again in 1988, the Treasury Department said that the relatedness test remains the best way to distinguish between activities that should and should not be taxed. (The authors note that few human service nonprofits operate unrelated businesses.)

Unfair Competition? reviews the laws and regulations federal and state governments have developed to ensure nonprofits keep faith with their charitable mission and to deny them tax exemption if they don't.

The authors acknowledge that some nonprofits have broken the trust—witness the recent excesses of televangelists such as Jim and Tammy Bakker. But the correct response to that kind of excess, they point out, is to improve enforcement of the laws that govern tax exemption, not to change them.

The final chapter covers the current standards governing tax exemption charitable nonprofits in the 50 states. All states with corporate profits or business income tax exempt charitable nonprofits. All 50 states and the District of Columbia also exempt nonprofits from property taxes. No state bars an organization from tax exemption because it charges fees for service.

The book concludes with an exhaustive appendix on the status of the charitable property tax exemption in every state.

Unfair Competition? The Challenge to Charitable Tax Exemption was developed and published with support from the Ford Foundation and the Rockefeller Brothers Fund. Published in October 1988, it is available for $21.95, plus $1.50 postage and handling, from The National Assembly, 1319 F. St., NW, Suite 601, Washington, DC 20004. (202) 347-2080. Discounts are available for orders of 10 copies or more.

The National Assembly is an association of national voluntary human service organizations. It offers programs related to organizational leadership and management; it is an advocate for human services providers and the people they serve; and it has been a leader in efforts to protect nonprofits' tax-exempt status. ■KK

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Janne G. Gallagher is Of Counsel to Olwine, Connelly, Chase, O'Donnell & Weyher. With Mr. Wellford, she represents the Grant and Contracts Project (now the Human Services Forum on Government Collaboration) and has also been deeply involved in the competition debate. She co-authored with Mr. Wellford The National Assembly/Family Service America report, "The Myth of Unfair Competition."

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