DIVINE 9: GOVERNANCE, FUNDRAISING, AND TAXES?

Historically black Greek letter fraternities & sororities are woven into the fabric of middle & upper class African American society. D9 organizations serve the community through many social improvement programs including mentoring and scholarships. These programs are primarily funded by the local chapter of these organizations. These organizations were created as 501(c)(7) entities under the Internal Revenue Service (IRS) code and are considered “social clubs”. Many chapters also created 501(c)(3) organizations, which are considered public charities, to raise funds to assist them in their social action programs. It is important that we understand the relationship between these entities to ensure the long-term health and sustainability of the chapter and the public charity. I will address the relationship between the chapter and the public charities they have created focusing on 1) Board Governance, 2) Fundraising and 3) Taxation.

Board Governance

Governance can be defined as providing strategic direction, ensuring that objectives are achieved, ascertaining that risks are managed appropriately and verifying that the organization’s resources are used responsibly. In my research, 40% of public charity board members did not understand their governance responsibility. Much of this can be attributed to 1) the limited understanding of how governance is defined, and 2) a lack of understanding regarding the relationship between the chapter and the public charity.

In my years of auditing and consulting with D9 organizations, properly defining the relationship between the chapter and the public charity is one of the biggest challenges. While in all cases the chapter created the public charity, it remains a separate legal entity with different leadership and similar but different objectives from the chapter. The public charity mission should support the ultimate goals of the chapter because the public charity should see itself as the fundraising arm of the chapter; however, challenges often arise when the chapter feels it cannot “control” the public charity.

While the overall mission is to support the chapter, the public charity leadership is independent of the chapter and it has the autonomy to make decisions that the chapter may not agree with, but the end goal remains to raise funds for the chapter.

Fundraising

While all D9 organizations create public charities to serve the community and support philanthropic efforts, 60% of organizations still raise funds through the chapter. A disadvantage of raising funds through the chapter is that most corporate businesses do not contribute to 501(c)(7) organizations. Consequently, corporate sponsorships,contributions or grants should be sought through the public charity.

60% of public charity board members felt they should be better at fundraising. In my experience, this is partly due to the over reliance on “signature events” as their primary mode of fundraising. In many cases, they fail to consider funding options such as grants and direct asks. In the NFP (not-for-profit) world, “events” require the greatest amount of time but if they are not financially successful, they bear the least amount of return. Public charities should consider obtaining grants as an additional source of revenue. But to obtain grants, organizations must provide greater detail on who they are serving and the outcome of the services they are providing. Grantors want metrics on programs before they begin to form a relationship with the organization.

Public charity boards should also consider requiring board members to contribute to the organization through board dues and/or personal fundraising. Only 50% of boards have a dues or fundraising requirement.

Lastly, only 20% of the chapter members were required to contribute to the public charity. The limited financial or time commitment from the chapter members across the board is a contributing factor to the lack of success of the public charity fundraising efforts.

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Taxation

A major underlying issue that could financially damage D9 organizations, but none considered a risk are taxes. As an NFP organization, chapters 501(c)(7) and public charities 501(c)(3) are both exempt from taxes. But based on IRS regulations, unrelated business income may be taxable.

Social clubs may be exempt from federal income taxation if they meet the requirements of section 501(c)(7) of the Internal Revenue Code. Although they are generally exempt from tax, social clubs are subject to tax on their unrelated business income, which includes income from non-members. Additionally, a social club may lose its exempt status if it receives too much unrelated income.

“A social club may receive up to 35 percent of its gross receipts from nonmember sources, including investment income. Where the permitted levels of nonmember income are exceeded, all facts and circumstances will be considered in determining whether the club continues to qualify for exemption.”

This means that dues, fees, and assessments must make up at least 65% of its gross receipts. For example, if the chapter 501(c)(7) has $26,000 in dues, fees, and assessments for the year,it is only allowed an additional $14,000 in unrelated business income for a total of $40,000 for the year. In this example, any additional income above the $14,000 threshold may be subject to taxes, penalties, and interest. The tax rate could range from 15% to 39.6%

To mitigate these risks, all fundraising activities should be conducted via the public charity because it accomplishes two goals; 1) it reduces the financial risk to the chapter of excess income being taxed, and 2) it actually may increase revenue because it opens up the possibilities for; a) business sponsors and partners, b) charitable deduction contributions from chapter members/general public, and c) grant opportunities from external funding agencies.

Divine 9 organizations have a great legacy in the African American community, and we need to take all appropriate steps to ensure they get stronger to secure greater and continued success in our communities.

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