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UNRELATED BUSINESS ENTERPRISE AND UNFAIR BUSINESS  
COMPETITION ISSUES FACING NONPROFIT ORGANIZATIONS

by

LARRY GLEN SCRUGGS

A dissertation submitted in partial fulfillment of the  
requirements for the degree of

DOCTOR OF PHILOSOPHY  
in  
URBAN STUDIES

Portland State University  
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DISSERTATION APPROVAL

The abstract and dissertation of Larry Glen Scruggs for the Doctor of Philosophy in Urban Studies was presented July 16, 1996 and accepted by the dissertation committee and the doctoral program.

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## **ABSTRACT**

An abstract of the dissertation of Larry Glen Scruggs for the Doctor of Philosophy in Urban Studies presented July 16, 1996.

**Title: Unrelated Business Enterprise and Unfair Business Competition Issues Facing Nonprofit Organizations**

Unrelated business enterprises have been an appropriate way for nonprofit organizations to generate income since the first income tax was enacted into law. The Internal Revenue Act of 1950 clarified this opportunity and enacted the Unrelated Business Income Tax to ensure that fair competition existed between nonprofits and for profit organizations.

Nonprofit organizations conducting unrelated business enterprises are faced with a dilemma: it is legal for them to conduct such enterprises but if they do so they face potential litigation from for profit business for unfair competition and/or potential loss of tax-exempt status for operating outside of their exempt function.

This dissertation traces the history and theory of tax-exempt status, the history of unrelated business enterprises, and how several states, including Oregon, have addressed the issue. It then explains two major pieces of litigation in Oregon in the 1980's, Southern Oregon State College and YMCA of Columbia-Willamette,

then discusses the history of the media attention and legislative/bureaucratic action in the same period. Current litigation and media attention is then discussed.

The paper then discusses two theoretical frameworks, Agenda Building and Advocacy Coalition, as a means to analyze the data. Following is a discussion of how the issues of unrelated business enterprises and unfair business competition can be handled by nonprofits and the changing criteria for tax-exempt status in Oregon.

The dissertation concludes with the changing criteria for tax-exempt status in Oregon and fundamental philosophical and political issues yet to be decided. Included are recommendations such as a periodic review of tax-exempt status of nonprofits, the need for nonprofits to continually review their mission and exempt purpose, the need for nonprofits to maintain their relationships with the community they serve, and how nonprofits need to develop a self-governing program before government develops one for them.

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## TABLE OF CONTENTS

	PAGE
ACKNOWLEDGMENTS	iii
CHAPTER	
1 INTRODUCTION	1
2 HISTORY OF UNRELATED BUSINESS ENTERPRISES BY NONPROFITS	7
History of nonprofits in the United States	7
The Theoretical Justification of Tax-Exempt Status	11
History of unrelated business enterprises by nonprofits in the United States	14
How several states have addressed the issue	21
The history of unrelated business enterprises by nonprofits in Oregon	23
3 METHODOLOGY	27
4 THE EARLY 1980'S	32
Southern Oregon State College Litigation	33
The YMCA of Columbia-Willamette Litigation	43



5	MEDIA ATTENTION IN THE 1980'S	54
	National Media Attention	54
	Media Attention in Oregon	59
6	LEGISLATIVE ACTION IN THE 1980'S	66
7	CURRENT LITIGATION AND MEDIA ATTENTION	80
	Current Litigation	81
	Current Media Coverage	91
8	THEORETICAL FRAMEWORKS TO ANALYZE THE INFORMATION	97
	Agenda Building	97
	Advocacy Coalition	105
9	CONCLUSIONS AND RECOMMENDATIONS	112
	Issues in the Dissertation	112
	The Changing Criteria for Tax-Exempt Status	117
	Fundamental Philosophical and Political Issues	119
	Recommendations for Nonprofits	122
	REFERENCES	127

## CHAPTER 1

### INTRODUCTION

Oregonians have a long and rich history of forming associations to meet specific needs of the society. As will be discussed in greater detail later in this dissertation, many of the services enjoyed in Oregon today: such as hospitals, schools, job training, etc., began as associations in their initial stages.

Associations were formed long before tax codes existed in the United States. In recognition for their contributions to the society, associations were defined in the federal and state tax codes as charitable organizations and granted tax exempt status to allow them to use their income to better serve the society. As pointed out by Wellford and Gallagher (1988)

In 1863, the income tax of charitable organizations was exempted from the corporate income tax enacted to finance the Civil War. Since that time , exemption from income taxation for nonprofit organizations has marched hand-in-hand with enactment of federal corporate income tax laws. (p. 78)

Today, as always, those charitable associations and organizations (now and in this dissertation referred to as nonprofits) in Oregon need funds to fulfill their mission of service

to the community. The tax code allows them to generate income through a variety of means such as contributions, bequests, grants, fees, government support, and business enterprises relating to the exempt function of the organization. Under current tax law they can also generate income through unrelated business enterprises.

However, there is a dilemma inherent in the area of unrelated business enterprises. On one side, the legislature and the courts have consistently upheld the opportunity for nonprofits to generate income through such unrelated enterprises. At the same time, if a nonprofit conducts unrelated business enterprises it faces potential claims of unfair competition from private enterprise and potential loss of its nonprofit status. The process of losing nonprofit status involves litigation and through such a process, even if the nonprofit prevails, it has its name in the media in a negative manner for years until the litigation is complete.

The current dilemma creates confusion within the nonprofit community, unrealistic expectations within government and private enterprise, and sometimes, even conflict with the private sector. Pires (1985) offers a clear explanation of the dilemma:

At best, the government and business sectors send mixed signals to the nonprofit community. On the one hand, they encourage entrepreneurial activity as a means of increasing self-sufficiency. On the other, they complain of unfair competition when nonprofits engage in entrepreneurial activity designed to promote self-sufficiency. At worst, government and business policies are creating a frustrating, "no win" situation for many nonprofits. (p. 9)

The dilemma in unrelated business enterprises by nonprofits is the topic of this dissertation. It discusses the historical perspective of what has occurred, what is happening now, and what can be done to resolve this issue in the future. The central issues discussed are as follows:

1. Other states have taken legislative action and addressed this issue, yet no significant legislative action has occurred in Oregon since 1960. Even though there has been a number of public requests and significant media coverage of public concern, why has no recent action been taken in the Oregon Legislature to address this issue?
2. Can this issue be resolved? Is it appropriate for a nonprofit to conduct an unrelated business enterprise or is the concept in inherent conflict with the concept of nonprofit status?
3. To ensure that fair competition exists between a nonprofit and private enterprise, current tax law requires a nonprofit to pay tax on unrelated business income. Is this really fair competition or does a nonprofit always have an unfair advantage because it does not pay property tax? If not, should additional controls be placed on nonprofits to ensure that fair competition exists?
4. What action needs to be taken in Oregon to resolve this issue? Is the current law sufficient or do additional steps need to be taken to provide for the funding needs of nonprofits while meeting the fair competition needs of private enterprise?

The following steps were taken in this dissertation to study these issues:

1. The history of the issue was investigated in the legislature, the courts, the tax offices, and the media. Interviews were conducted with many of the prominent people involved with all sides of the issues.
2. The history of these issues and the previous attempts at resolution are discussed.
3. How the issues could be handled and a solution to the dilemma of unrelated business enterprises by nonprofits is presented at the conclusion of this dissertation.

There are three peripheral issues that will not be discussed in this dissertation. First and foremost is the discussion about what constitutes a charitable or nonprofit organization eligible for tax exempt status. As this dissertation will show, that is an emerging issue today and will be determined in the courts and the legislature in future years. The second is whether or not nonprofit status should be provided for any nonprofit conducting a business enterprise. That is a much broader issue and possibly the subject of another dissertation. Third is the issue of tax deductibility of contributions to nonprofits. That is a broad issue with many social and political ramifications far beyond the scope of this dissertation.

The analysis of the dilemma of unrelated business enterprises by nonprofits begins in Chapter 2 with an introduction to the history of nonprofit status and the unrelated business

enterprise provision in the federal tax code which establishes the precedent for Oregon law. Following will be a brief discussion of how this issue has been addressed in several states in the West. Finally, it will give the history of the unrelated business enterprise provision in Oregon tax law up to 1980, which is where Chapter 4 will begin.

Chapter 3 will present the research methods used to study this issue including how the information was obtained, who was interviewed, and how the information was used to analyze the issue and make recommendations for resolution.

Chapter 4 is a discussion of the litigation that occurred in the 1980's in Oregon. There were two major cases, one involving Southern Oregon State College and the other involving the YMCA of Columbia-Willamette, which clearly established the issues as defined in the 1980's. This chapter will discuss the two major cases in detail. There were others which established precedents for litigation in the 1990's which will be briefly discussed.

Chapter 5 is a discussion of how the media helped to shape the issues and public opinion in the 1980's. This chapter will look at how two organizations, the Business Coalition for Fair Competition and the International Racquet Sports Association, developed national networks to help their clienteles fight what they perceived to be unfair business competition by nonprofits. Major articles in the local press will also be discussed.

Chapter 6 is a discussion of the legislative and bureaucratic action that occurred relating to this issue in the 1980's. The

chapter will begin with a brief review of prior legislative action, followed by discussion of the bills introduced into the 1987 and 1989 legislatures. Also to be discussed is the action taken by the Oregon Department of Revenue in 1987 and beyond.

Chapter 7 is a review of the current litigation and media coverage which has occurred since the 1980's. There have been three major cases of litigation decided in the past few years. A fourth case is currently with the Multnomah County Assessor but is expected to be appealed through the Department of Revenue and the Oregon Tax Court to the Oregon Supreme Court. These cases will be discussed along with the media attention to this issue during the same time period.

Chapter 8 is a discussion of two theoretical frameworks and how well they work in analyzing the information developed in this dissertation. The first to be discussed is the agenda building framework and the accompanying analysis of the information. The second is the advocacy coalition approach and the reasons why, even though it may not be the best framework to evaluate this information, it may well be the best framework to use following the completion of current litigation.

Chapter 9 contains the conclusions and recommendations of this dissertation. This chapter will discuss the issues as presented earlier in this chapter and provide a brief discussion about the changes that are occurring in the way that assessors and the Department of Revenue are determining if an organization qualifies for tax exempt status.

## CHAPTER TWO

### HISTORY OF UNRELATED BUSINESS ENTERPRISES BY NONPROFITS

The history of unrelated business enterprises by nonprofits, as it relates to this dissertation, has five distinct parts which will be the five primary subdivisions of this chapter: the history of nonprofits (including tax exempt status) in the United States, the justification and theory of nonprofit status, the history of unrelated business enterprises by nonprofits in the United States, the action taken by some states to address the dilemma of unrelated business enterprises by nonprofits, and the history of unrelated business enterprises in Oregon.

#### HISTORY OF NONPROFITS IN THE UNITED STATES

Throughout the history of the United States there has been a fascination with volunteerism and the formation of associations and charitable organizations. The initial issue was religious freedom, or as O'Neill (1989) calls it, the "Godmother of the nonprofit sector." (p. 20) As the tax laws were developed in this country, religious organizations were among the first to receive nonprofit status because of the need for freedom of religion and their contributions to the society.



For example, many local private schools and hospitals can trace their beginning to a religious organization. Locally, for example, the University of Portland, Lewis and Clark College, Concordia College, and St. Mary's Academy were all founded by religious organizations. Many of the social service agencies, such as the YMCA and YWCA, St. Vincent dePaul, and the Salvation Army also have their foundation with some religious organization.

Aside from religious freedom, another part of the American idealism has been individual responsibility, volunteerism, and the forming of associations to solve specific problems of the society. As Wellford and Gallagher (1985) point out:

Americans have been forming charitable associations since the beginning of the republic. As with education, health care, job training, and even roadbuilding and asylums, many of the services we now take for granted from government or commerce originated with groups of volunteers freely associating to solve a social problem or advance a public good. It is the peculiar genius of American democracy that it unleashes the energy of individual voluntary activity in both commercial and charitable endeavors. (p. 2)

Tocqueville (1945, Volume 2) discovered in his travels and research in the United States in the early 1800's that Americans fully utilize the right to congregate together and to form associations.

Americans of all ages, all conditions, and all dispositions constantly form associations. They not only

have commercial and manufacturing companies, in which all take part, but associations of a thousand other kinds, religious, moral, serious, futile, general or restricted, enormous or diminutive. The Americans make associations to give entertainments, to found seminaries, to build inns, to construct churches, to diffuse books, to send missionaries to the antipodes; in this manner they found hospitals, prisons and schools. If it is proposed to inculcate some truth to foster some feeling by the encouragement of a great example, they form a society. Wherever at the head of some new undertaking you see the government in France, or a man of rank in England, in the United States you will be sure to find an association. (p. 114)

When discussing the use of political associations in the United States, Tocqueville (1945, Volume 1) acknowledged that Americans see their ability to form associations as a right of assembly, and use it in many different ways.

If some public pleasure is concerned, an association is formed to give more splendor and regularity to the entertainment. Societies are formed to resist evils that are exclusively of a moral nature, as to diminish the vice of intemperance. In the United States associations are established to promote the public safety, commerce, industry, morality and religion. There is no end which the human will despairs of attaining through the combined power of individuals united into a society.

I shall have occasion hereafter to show the effects of association in civil life; I confine myself for the present to the political world. When once the right of association is recognized, the citizens may use it in different ways. (pp. 198-199)

With associations having been formed before the emergence of a tax code, there has been a recognition of need for tax exempt

status for nonprofit charitable organizations since the first tax laws were developed. A brief history of tax exempt status will be helpful in understanding the discussion on unrelated business enterprises by nonprofits found later in this Chapter.

Research has found that since the enactment of the corporate tax of 1863, the United States Tax Code has always contained an exemption for the income of charitable organizations. Literary, scientific, or other charitable organizations were first exempted. Later tax acts included fraternal and other organizations deemed to have a mission or purpose of service of sufficient value to justify tax-exempt status (Wellford, 1985, pp. 78-79).

With the assistance of tax exempt status, and the need for the provision of services not provided by government, the growth and diversity of nonprofit organizations has been amazing. As O'Neill (1989) points out, after citing Tocqueville's reference to American associations:

Today, more than 150 years later Tocqueville would be even more amazed or amused. There are nonprofits whose assets exceed those of several nations, such as the Ford Foundation..., and there are nonprofits that conduct intense civic campaigns out of someone's kitchen with volunteer labor and never more than \$500 in the bank....There are organizations such as the Democratic and Republican parties, which want to get all of their candidates elected; and there is Mike of America, which only wants to get anyone named Mike elected President of the United States....There are 350,000 churches, synagogues, and mosques for the religious; and there is Atheists Anonymous for those of a different persuasion. (p. 5)

To justify the tax-exempt status and cite the contributions of nonprofits, the American Society of Association Executives (ASAE) (1993) states that "Associations are one of the largest and most powerful forces in the United States today, yet they are also among the least visible. Representing an enormous collective presence, associations impart social and economic benefits that touch each of us every day" (pp. vii-viii).

ASAE (1993) also points out that associations provide many services to their members and to the society. They cite education; establishing and maintaining professional standards; advancing health, safety and quality; educating workers and the public; aiding exemplary conduct; unearthing and disseminating new information; nurturing the political process, and reaching out to others as examples of those services. (pp. vii-viii)

#### THE THEORETICAL JUSTIFICATION OF TAX-EXEMPT STATUS

As discussed in Chapter 1, associations were being formed long before tax codes existed in the United States. When the first tax codes were written, nonprofit organizations were exempted from taxation as an acknowledgment of their contributions to the society as a whole. The following are some current justifications and theories for having tax-exempt status for nonprofits.

Bookman (1991) summarizes the general justification of those in favor of the current approach to tax exemption as follows:

1. (Nonprofits) actualize and support society's values of giving, volunteerism, self-help and community involvement;
2. (Nonprofits) provide service stability, irrespective of profitability;
3. (Nonprofits) minimize social problems, develop new markets and technology, and fill voids, particularly in emergency situations;
4. (Nonprofits) lessen (sic) the burden on government to provide services;
5. (Nonprofits) have a governance structure which make them accountable to the entire service community;
6. (Nonprofits) have a bottom line of service, not profit;
7. (Nonprofits provide) service to the most vulnerable populations; and
8. (Nonprofits) respond to a greater range of values, particularly those generated by minority populations in our society. (p. 6)

These justifications come from three basic theories about why we should have tax-exemptions for nonprofits. As discussed by Hill and Kirschten (1994, Section 15.02) they are: the traditional subsidy theory, the income definition theories, and the promotion of secondary benefits theory.

The first, the traditional subsidy theory, holds that nonprofits should be tax-exempt because the primary benefits from their activities are of great benefit to the society. Hence, since the society benefits from the goods or service it should be tax-exempt. There is also the secondary benefit of how the

product or service is derived. This premise holds that nonprofits are more efficient in their delivery of services and goods, and their very existence promotes pluralism and diversity, which is good for the society as a whole.

Discussion of this theory falls into two parts, the worthiness issue and the fitness issue. This theory states that nonprofits are worthy of tax exemption subsidy because of the services they provide to the society and that the tax exemption is the appropriate place for society to provide that subsidy. This thinking has been one of the foundations for the justification of tax-exempt status for nonprofits.

The second set of theories involve income definitions. Their premise is that logically income should only be taxable if it is from activities undertaken for profit. If the activity is conducted for charitable purposes then the income should not be taxable. These theories have generally not worked because of their basic flaw: the same standards that they apply to nonprofits can also be applied to for profits as well.

The third set of theories are attempts to synthesize the first two to develop a substantive, not merely technical, justification for tax-exemption. Several of these are discussed. Hill and Kirschten place little value on them and they are mentioned only for informational purposes for further research.

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## HISTORY OF UNRELATED BUSINESS ENTERPRISES BY NONPROFITS IN THE UNITED STATES

At the federal level the issue of unrelated business enterprises addresses the tax liability of the income derived, as compared to Oregon where the state and counties address the issue of property tax exemption but not tax on the income derived. Section 513 (a) of the federal tax code states that tax liability of income is determined by how substantially related the business activity is to the exempt function of the organization. This is called the relatedness test and is the basic determination of whether or not the income is taxable or tax-exempt. Determinations are made through legislation, revenue rulings, court cases, and private letter rulings.

Congress has usually allowed unrelated business enterprises as long as the use of the income was to fulfill the charitable purpose of the organization. As shown in the Standard Federal Tax Reporter, the Internal Revenue Code of 1954 contains the definitions of Unrelated Trade or Business (3256) and Unrelated Business Income (3243) which are in use today:

Section 513 (a) states that "Unrelated trade or business is any trade or business the conduct of which is not substantially related (aside from the need of an organization for income or funds or the use it makes of the profits derived) to the exercise or performance of an organization of its exempt function."

Section 512 states that unrelated business income is "the gross income, with certain modifications, derived by an organization from any trade or business regularly carried on

by it, less allowable deductions which are directly connected with the carrying on of such trade or business."

These definitions are the result of discussion which took place from the development of the first corporate tax in 1863 through the development of the Internal Revenue Act of 1950. While these definitions and their application did not resolve the issue, they did quiet down the issue for almost thirty years.

A brief history of the development of the federal tax law will give some insight into the how and why the current tax law was developed. The following is a brief summary of my earlier research for Conferences on Campus: Marketing and Managing (1988).

From 1909 through 1924, discussion in Congress about taxation of nonprofits dwelt mainly on the issue of unrelated business enterprises, the taxation of income from those enterprises, and whether or not the income from feeder companies (for-profit companies whose income goes to a nonprofit) should be allowed. A major precedent was established when the United States Supreme Court ruled on *Trinidad v. Sagrada Orden de Predicadores* and established the destination of income test to determine if the income was taxable.

This case involved a small religious order in the Philippines who generated a small amount of income by purchasing items at wholesale then selling them at retail to their various orphanages, churches, and a school. The income from the sales went to support



the order. Trinidad was a tax collector and he filed a tax against the income stating that the order was not solely religious because it generated the income from a business enterprise.

The court ruled against Trinidad, stating that "In using the properties to produce the income, it is therefore adhering to and advancing those (charitable) purposes, and not stepping aside from them or engaging in a business pursuit." (p. 582) This established what became known as the destination of income test. As long as the income from a business enterprise was being used to further the mission of a nonprofit it was tax-exempt.

This precedent was further expanded in *Roche's Beach v. Commissioner*. In this case an organization owned a beach house willed to it by Roche. The beach house generated income for the organization, which had no purpose except to distribute the income from the beach house. In this case the court ruled that "This does not mean that to come within the exemption a corporation may not conduct business activities for a profit. The destination of the income is more important than the source." (p. 778) The court further ruled that "Exemptions of income devoted to charity are begotten from motives of public policy and are not to be narrowly construed." (p. 779)

This led to a veritable cornucopia of opportunity for nonprofits. They developed an operation known as bootstrap and buyback (also as bootstrap and leaseback), where a nonprofit would borrow money, buy a for profit business, and use the income from the business to pay back the loan. Of course, since

the profits of the business were used to further the purpose of the nonprofit they were tax-exempt.

By the 1940's nonprofits owned hotels, sand and gravel companies, radio stations, macaroni companies, various manufacturing companies, and about anything else that they could buy. It was becoming obvious that nonprofits were going to carry this precedent to the fullest and so something had to be done. At the same time as more nonprofits purchased for profit businesses and the income became tax-exempt, the tax base was eroding just when Congress needed funds in the post World War II and Korean War era.

In 1947, Congress began hearings on income tax revision and included unrelated business enterprises by nonprofits on their agenda. They heard testimony for three years then passed the Internal Revenue Act of 1950, which allows nonprofits to conduct unrelated business enterprises while placing a tax on the income derived to ensure that fair competition exists between nonprofits and for-profit business. This was codified into law with the Internal Revenue Code of 1952, then further revised in the major tax revisions which occurred in 1954 and 1969. The definitions which were written then are virtually the same as those in use today.

The law has been refined since 1954 by Internal Revenue Service regulations, revenue rulings and private letter rulings, by various cases in the appellate courts and the Supreme Court, and by Congressional review.

Revenue Rulings are given by the Internal Revenue Service as rulings on various issues, such as the taxability of income derived by a nonprofit, and are reported in the Internal Revenue Cumulative Bulletin by ruling number. There is also a complete list of revenue rulings in the work by Hill and Kirschten (1994). While they do not rule on whether or not a nonprofit should be conducting unrelated business enterprises, or the issue of fair competition, they do provide a clarification of the ability of a nonprofit to conduct such enterprises and determine whether or not tax should be paid on the income derived.

For example, an institution of higher education had a ski facility which it kept for its students, but also had open to the public at rates comparable to other ski facilities in the area. In Revenue Ruling 78-98, the IRS ruled that having the facility open to the public was a legitimate use of the facility as long as the primary use was for the students, faculty and staff of the institution. Operating costs could be deducted from revenues before determining the unrelated business income tax. This ruling, called the "dual use of facilities," ratifies the capability of nonprofits to rent the use of their facilities and services when they are not being used for the exempt function of the nonprofit.

In Revenue Ruling 73-104 the question is whether or not an art museum operating a gift shop to sell greeting cards, etc., featuring works of art in the museum should pay tax on the income. In this ruling the IRS found that "The fact that the cards are promoted and sold in a clearly commercial manner at a profit

and in competition with commercial greeting card publishers does not alter the fact of the activity's relatedness to the museum's exempt purpose."

These two rulings, which are examples of IRS clarification of the ability of a nonprofit to rent facilities and services and sell commercial products in competition with private enterprise, are but two of the many examples of how a nonprofit can conduct unrelated business enterprises.

Not all government agencies support unrelated business enterprises by nonprofits. The United States Small Business Administration (1984) has published a booklet entitled Unfair Competition by Nonprofit Organizations with Small Business. This document identifies the issue of unfair competition as the major emerging issue of the 1980's. The agency also held a series of conferences on small business where its conclusion was that unfair competition from nonprofits and governmental agencies was one of the most important issue facing small business in the 1980's.

Another national organization, the Business Coalition for Fair Competition (1985), has the issue of unfair competition as its major issue. They have published data stating that

Income reported by nonprofits to the IRS has grown from \$114.6 billion in 1975 to over \$314.4 billion in 1985. That is an annual growth rate over eight years of 21.8%. It is estimated that nonprofit income now represents over 9 percent of the gross national product. ...

SBA figures indicate that the most important source of revenue for nonprofits in 1983 was sales, which accounted

for \$239.9 billion or 76 percent of nonprofits total revenue...  
(p. 3)

The complaints and concerns about the competition issue led the House of Representatives Committee on Ways and Means to charge the Oversight Subcommittee in 1985 to examine the issue of unrelated business enterprises and unfair competition by nonprofits. The committee, chaired by Rep. Pickle of Texas, heard an enormous amount of testimony from all sides of the issue. As reported by Stern (1987) Treasury determined that one of the problems was there was not sufficient information about nonprofits and unrelated business enterprises and gave the following recommendations:

1. There needs to be much more detailed reporting of the unrelated business income reported by nonprofits to provide data on the extent of unrelated activities by nonprofits.
2. The size and scope of unrelated business activities should be reduced or limited.
3. There needs to be a clarification of expenses between exempt functions and unrelated activities.
4. There needs to be an increase in the tax rate for passive income from subsidiaries and investment income. (pp. 1-4)

Following that testimony there has been an increased level of scrutiny of nonprofits by the IRS, but to date there has been no significant change in the ability of a nonprofit to conduct unrelated

business enterprises and retain its tax exempt status. However, the issue has not been resolved at the federal level and will probably be included in discussions for years to come.

#### HOW SEVERAL STATES HAVE ADDRESSED THE ISSUE

In the 1980's the issue of unrelated business enterprises by nonprofits was a hot issue. In conjunction with what was happening at the federal level, many states took action on their own to restrict unrelated business enterprises by nonprofits. In the West, Arizona and Washington passed legislation to limit unrelated business enterprises by nonprofits to reduce competition between nonprofits and private enterprise.

In 1987, Arizona passed Senate Bill 1088 to restrict the ability of government agencies to compete with private enterprise. The purpose of the bill was to

limit government competition with private enterprise in the offering of goods and services, to provide additional economic opportunities to private industry, to regulate competition by institutions of higher education unless it enhances an educational or research function, and to address issues and complaints concerning competition through a private enterprise review board. (p. 1)

The bill contained specific prohibitions on governmental agencies providing goods and services which are "offered through private enterprise" (p. 3). The bill has a separate section on competition with private enterprise by community colleges and universities and placed a number of restrictions on everything

from bookstores to use of facilities and services by off-campus groups.

The bill also established a Private Enterprise Review Board which was charged with the responsibility of resolving complaints about unfair competition by state agencies. The bill required the board to meet at least four times per year, established the process for filing complaints, and provided the authority for the board to investigate and hold public hearings on complaints. It did not provide the board with punitive authority, however, as findings of violation of the bill were to be reported to the legislature and the governor. The bill also did not restrict the ability of a complainant to seek redress through the judicial system (pp. 5-7).

In Washington the 1987 legislature passed an act relating to the commercial activities of institutions of higher education which required them to "define the legitimate purposes under which commercial activities may be approved, and to establish a mechanism for review of such activities" (p. 1). The act established definitions of commercial activities and fees and required institutions of higher education to work with local business organizations to minimize competition between institutions and private enterprise.

The net result of these two pieces of legislation was a reduction of complaints about unfair competition with private enterprise. The policies and processes established in these two states restricted the ability of nonprofits to conduct unrelated business enterprises. At the same time they provided private

enterprise with the opportunity to conduct more business with government and nonprofits.

#### THE HISTORY OF UNRELATED BUSINESS ENTERPRISES BY NONPROFITS IN OREGON

In Oregon the issue of unrelated business enterprises relates to the exemption of real property from taxation, and not with the tax liability of income as addressed at the federal level.

Oregon has no constitutional provision for tax exempt status for nonprofits, however, the Oregon Revised Statutes (ORS) provide for some nonprofits to have tax exempt status. ORS 317.080.4 (1985) provides for tax exempt status for those organizations which qualify for 501 (c)(3) status in the federal Internal Revenue Code. Property tax exemption is granted under ORS 307.130(1) (1985) for property used in "literary, benevolent, charitable or scientific work."

ORS 307.090(1) provides for property tax exemption for "all property of the state and all corporate property used or intended for corporate purposes of the several counties, cities, towns, school districts, irrigation districts, drainage districts, ports, water districts, and all other public or municipal corporations in this state."

In the 1950's there was concern expressed about the tax exempt status of nonprofit organizations. Several court cases established the guidelines under which an organization can be determined to be charitable.



In *Multnomah School of the Bible v. Multnomah County* (1959) the Oregon Supreme Court ruled that "A given facility does not have to satisfy the test of 'absolute indispensability' to the purposes of the institution in order to enjoy tax exemptions." Rather, "it is enough if it can be said to be incidental to the prime purpose of the institution and reasonably necessary to the accomplishment of that purpose."

The court provided six factors that may be used to determine whether or not an organization is charitable in Oregon *Methodist Homes, Inc. v. Horn* (1961):

1. Whether receipts are applied to the upkeep, maintenance and equipment of the institution or are otherwise employed;
2. Whether patients or patrons receive the same treatment irrespective of their ability to pay;
3. Whether the doors are open to rich and poor alike and without discrimination as to race, color or creed;
4. Whether charges are made to all patients and, if made, are lesser charges made to the poor or any charges made to the indigent;
5. Whether there is a charitable trust fund created by benevolent and charitably-minded persons for the needy or donations made for the use of such persons;
6. Whether the institution operates without profit or private advantages to its founders and officers in charge.

The court stressed that not all of the factors need to be present for an organization to be charitable, but did state that the

fifth and sixth factors "are among the two most universally applied in tests of charitable character."

In *Young Men's Christian Association v. Department of Revenue* (1974) the court ruled that a nonprofit will not lose its tax exempt status merely because it engages in activities that may compete with private enterprise. In that case the YMCA was providing housing for armed services draftees, the Job Corps, and leased space to a barber shop and a tailor shop. The Park Haviland Hotel lost in competitive bidding to the YMCA and filed suit claiming unfair competition and that the YMCA should lose its tax exempt status for competing with private enterprise. The Oregon Tax Court ruled in favor of the Park Haviland Hotel.

The Oregon Supreme Court reversed the decision, saying that

A charitable organization does not lose its exemption merely because it engages in competition with businesses which are subject to taxation. Nor is the exemption lost because the property is not required in carrying out the primary goals of the charity. It is enough if the activity undertaken on the property substantially contributes to the furtherance of the charity's goals. If this test is met, it is immaterial that the charity competes with similar activities by those who are subject to taxation.

This case solidified the ability of a nonprofit to conduct unrelated business enterprises in Oregon. However, it also sowed the seeds for significant dissent within the business community. The flexibility allowed in *YMCA* (1974) led to excesses by nonprofits when conducting unrelated business enterprises. These excesses led to major pieces of litigation such as *Jansen v. Atiyeh*

(Southern Oregon State College) and YMCA of Columbia-Willamette which will be discussed in detail in Chapter 4.

## CHAPTER 3

### METHODOLOGY

In order to gather the information necessary to complete this dissertation, the following steps were taken to research the subject:

1. Archival research. The history of this issue was studied in the legislative records, court records, various county assessors offices, the media, and various associations. The primary evidence was obtained in the tax code and legal research.
2. Extensive interviews were conducted with people who have participated in various sides of this issue in the past. People were selected based upon their participation and level of involvement. All sides were contacted to determine what has happened in the courts, the legislature, the assessors' offices and the media on this issue. A complete list of those interviewed is provided later in this chapter.
3. In every case open ended questions were asked to allow the interviewee the opportunity to respond to the question and discuss their motivation for participation. The purpose of the interviews was to

determine what they had been doing, why they were doing it, and what they wanted to attain as a result of their actions.

The following questions were asked of most of the people during the interviews:

1. What has been your interest and involvement in resolving the issue of unrelated business enterprises by nonprofits in Oregon? How long have you been working on this issue? To what organizations have you belonged while working on this issue?
2. In your experience, what have you done and what has happened in the following areas: the courts, the legislature, the county assessors, the media?
3. How can this issue be resolved to your satisfaction?
4. What do you think is going to happen in the future?

Some people were interviewed for responses to specific questions such as current litigation and thoughts about why no bills have been brought to the floor of the legislature.

People were selected to be interviewed based upon their participation on various sides of this issue. People were selected from those who have opposed unrelated business enterprises by nonprofits, such as representatives from Oregon Taxpayers United, Northwest Alliance for Market Equality, attorneys who have participated in litigation against nonprofits, various tax assessors, and others as the research developed.

Also interviewed were those in favor of unrelated business enterprises by nonprofits such as representatives from Southern Oregon State College, the YMCA of Columbia-Willamette, the office of the Oregon Attorney General, and various Portland area hospitals.

The third group interviewed included those who had to rule on the decisions such as various tax court judges and various county assessors.

The following are the people interviewed and their involvement in unrelated business enterprises or unfair business competition issues in Oregon:

Phil Campbell	Director of Housing, Food Service and Stevenson Union at SOSC, who represented SOSC
Pamela Abernathy	Assistant Attorney General, State of Oregon, who represented SOSC
Leo and Regina Jansen	Owners of the White Motel, Ashland, plaintiffs against SOSC
Cliff Moran	Owner of the Palm Motel, Ashland, plaintiff against SOSC
Don Rist	Ashland businessman and plaintiff against SOSC
Jim Chapel	President and CEO, YMCA of Columbia-Willamette
Leslie Haines	Director of Public Relations, YMCA of Columbia-Willamette

Michael J. Morris	Attorney representing the Northwest Alliance for Market Equality (NAME) and Ted Tosterud in the hospital litigation
Steve Skinner	Tax Exemption Specialist, Multnomah County, Oregon, who has participated in many of the cases in this dissertation, and will do the research for the hospital case in progress
Carl Byers	Judge, Oregon Tax Court, has ruled on many of the Oregon cases discussed in this dissertation
Laura Jeibman	Executive Director, Metro Crisis Intervention Service and ProtoCall, developing a for-profit subsidiary
Bill Sizemore	Executive Director, Oregon Taxpayers United, involved in many cases involving government and nonprofit organizations
Hon. Neil Bryant	Chair of the 1993 Oregon Senate Judiciary Committee
John Francis	Former attorney for the University of California System in charge of tax issues
Hon. Rod Monroe	Vice Chair of the 1987 Oregon Interim Committee on Revenue and School Finance
Hon. Vera Katz	Speaker of the 1987 Oregon House of Representatives
Hon. Carl Hosticka	Chair of the 1987 Oregon Interim Committee on Revenue and School Finance

Jim Scherzinger

Legislative Revenue Officer for the  
Oregon Legislature, 1984-present

Following the archival research and interviews the information was assessed and it was determined that the best context for presentation was to follow the progress of major pieces of litigation and the media attention paid to those cases from their beginnings to what happened after the litigation was complete, then to discuss the current situation. Following that should be the conclusions and recommendations from the information available.



## CHAPTER 4

### THE EARLY 1980'S

As discussed at the conclusion of Chapter 2, in the mid-1970's the Oregon Supreme Court had ruled that a nonprofit could conduct unrelated business enterprises without jeopardizing its nonprofit status. This precedent in YMCA (1974) said that

It is enough if the activity undertaken on the property substantially contributes to the furtherance of the charity's goals. If this test is met, it is immaterial that the charity competes with similar activities by those who are subject to taxation.

This ruling provided nonprofits with the feeling that they could conduct unrelated business enterprises and compete with private enterprise without fear of further reprisals.

Legally that was true. However, some of them either failed to consider or underestimated the depth of concern of members of the business community about this issue and the commitment of those people to seek redress. Consequently the seeds were sown for conflict and litigation in the 1980's.

As will be shown in Chapter 5 when the media attention generated by them is discussed, in the 1980's there were a number of lawsuits filed claiming that nonprofits were competing unfairly with private enterprise. Suits were filed against hospitals,

unfairly with private enterprise. Suits were filed against hospitals, pharmacies, symphony orchestras, museums, and universities, to name a few. Two of those cases were filed by Theodore Tosterud, president of Northwest Medical Laboratories. In those cases, both cited as *Northwest Medical Laboratories, Inc. v. Good Samaritan Hospital and Medical Center*, Tosterud challenged the nonprofit status of testing laboratories and pharmacies of nonprofit hospitals. These cases, plus the YMCA litigation to be discussed later in this chapter, laid the foundation for future litigation regarding the tax exempt status of hospitals which will be discussed in Chapter 7.

In the early 1980's there were two major pieces of litigation, Southern Oregon State College (SOSC) and YMCA of Columbia-Willamette (YMCA), which received most of the publicity on the local and national levels. These two cases clearly define the three component parts of this issue: unrelated business enterprises, unfair business competition and tax-exempt status of nonprofits. The cases also show the positions of both sides and the outcome under current law. The remainder of this chapter will be devoted to a discussion of these two cases.

#### SOUTHERN OREGON STATE COLLEGE LITIGATION

The Southern Oregon State College (SOSC) litigation is not only a study in unrelated business enterprises, the relatedness test, and competition between nonprofit and for profit organizations, it is also a study in relationships between a nonprofit, for profit business, and the community at large.

For years the college and the town enjoyed a very good relationship. The college was (and still is) a major employer and a source of pride for the community. In the late 1960's and early 70's, when I was a student at SOSC, the school was expanding to meet the needs of rising enrollment by building a new student union, a new classroom structure for Social Sciences, and new residence halls called the Green Springs Complex. The future seemed to be very bright for my alma mater.

The other major activity and employer in the town was (and still is) the Oregon Shakespearean Festival. This festival was founded in 1935 by Angus Bowmer, a professor at SOSC, and has grown to what Johnson (1985) in his research has called "one of the country's most significant professional theaters." (p. 38)

The relationship between SOSC and the festival has been long and mutually beneficial. I know from my own experience as a student of Bowmer's in my undergraduate days that SOSC provided equipment, labor, expertise and other support to the festival. In return SOSC received recognition as a participant in the festival and the appreciation of the community for helping the festival grow into an extremely popular tourist attraction. The college also housed and fed students from high schools in the Northwest who were attending the plays and received income from that as well.

In the late 1970's the relationship began to change. Enrollment at SOSC declined and the residence halls were not being filled to capacity. SOSC needed to generate additional income to

maintain financial stability. They also wanted to fully utilize their facilities and services to fulfill their mission of education to the community. At the same time the Country Cousin (1982), a newspaper in Ashland, reported that while attendance at the festival had grown to 121,916 by 1982, the hotel/motel occupancy rate had decreased from 80% in 1981 to 65% in 1982. While that could have been caused by many different things, including an increase in the number of rooms available, some of the merchants in Ashland began to feel that there was a relationship between the decline in hotel occupancy rates in the area and the new ventures of SOSC.

As one way to generate income SOSC converted its oldest residence hall, Siskiyou Hall, to the Siskiyou Center for Continuing Education, increased its conference business, and actively began to rent their dormitory space to off-campus groups. One of the groups they contracted with was Elderhostel, an organization which puts together educational opportunities for senior citizens. In the Elderhostel program at SOSC participants could go to Ashland, see four plays of the Oregon Shakespearean Festival, and visit the surrounding area.

In her affidavit in this litigation, Katherine Fletcher (1983, p. 2), State Director for Oregon Elderhostel Program, stated that the program at SOSC was the largest of the 10 programs in Oregon. It has also been claimed but not substantiated that the program at SOSC was the largest in the world at the time.

Sitting across Siskiyou Boulevard from SOSC was the White Motel which was owned and operated by Leonardus and Regina Jansen. They noticed that there seemed to be more activity at SOSC during the summer. At the same time, their business was decreasing during the summer months when Shakespeare was open. They began to check on this and found what they believed to be a number of activities occurring at the college which they felt were unfair competition.

In an interview they said that they discovered that SOSC was not only renting lodging to Elderhostel but to all kinds of people that were not students at the college - even to people who were guests at weddings in the area. They also said they found that SOSC was providing services such as catering off-campus, ski rentals, river rafting, airport transportation, and other such services.

In 1981 they contacted the college and asked about these activities. They expressed their concern about what they thought were unrelated business activities at the college which were unfair competition with their motel, and asked if the college could cut back on some of its activities and/or send some of the business to the community. They said they talked to Larry Helms, Director of Continuing Education and Summer Sessions at Southern Oregon at the time, and that Helms agreed that some of these activities were probably unfair competition. However, Helms could only speak for his part of conference activities and not for all the conference activities on the campus. The initial response from SOSC was that

they were doing nothing wrong and they were going to keep doing what they were doing (Jansen, 1995).

At the time, according to the Southern Oregon State College Report (1983, pp. 8-10) there were nine auxiliary enterprises on the campus. Six of those, Residence Halls, Bookstore, Snack Bar, College Union, Educational Activities, and Athletic Activities, could either conduct a conference activity, provide food service, or rent space to an outside group. There was no one person assigned the responsibility of monitoring the activities of these enterprises as they related to off-campus groups. Consequently, no one at SOSC really knew the full extent of those activities on the campus.

Since they were unable to obtain a response they liked from SOSC, the merchants approached the Ashland Chamber of Commerce and asked for assistance. The Chamber responded by expressing concern and forming a task force to investigate claims made by members of the business community (Jansen, 1995).

In the summer of 1982 SOSC also set up a Campus Committee on Conferences and Special Events and a Regional Advisory Board Committee on Business/ Community Relations. The committee was charged with the responsibility of investigating the campus operations relating to conferences and special events and to report by the end of the year with their analysis and recommendations.

In October, 1982, the Chamber task force made their findings and recommendations in a report to the Ashland Chamber of Commerce which is summarized in the SOSC Report (1983, pp. 47-49). They listed a number of concerns expressed about SOSC and

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the task force response to those concerns. To briefly summarize, they concluded that there wasn't sufficient information available to draw specific conclusions about the impact of SOSC programs on the merchants and that the Chamber should undertake research to obtain reliable information; that the Chamber should assist in improving communication between the college, the festival, and the business community; that the college should look carefully at its definitions of groups to ensure that only educationally related groups stay at the college; and that the college should review its guidelines concerning those areas of auxiliary services which are open to the public to ensure that unfair competition does not exist between the college and the business community.

In January, 1983, the SOSC Report was published with the report and recommendations of the committees. This 66 page report examines the role of the college, the community, and the issue of unfair competition with the business community. In general terms they advise that SOSC should "reaffirm and emphasize its regional educational, social and cultural center role", "place more emphasis on the mission of public service," and "assign one person the responsibility for conferences on the campus" (pp. 64-66).

Regarding housing of groups on the campus, SOSC determined that it needed to take steps to ensure that only those groups that are educationally related will be allowed to stay on campus. Regarding food service and catering, SOSC decided no longer to accept requests from non-campus groups who wanted

catering service on a regular basis, and will cater off-campus only when there is no other satisfactory service available in the area. Regarding the bookstore and the union, SOSC decided to discontinue the Loft and not to carry items in the store aimed at off-campus needs. Regarding the outdoor programs, SOSC determined that it should only provide transportation and equipment rental services to members of the campus community (pp. 64-66).

The SOSC report also discusses the Chamber of Commerce Study and states that prior to August 17, 1982, no one from the college had been contacted or invited to any meetings of the "concerned business people," and that there was no approach to the president of SOSC until November 9, 1982 (pp. 47-49). This contradicts the dates provided by Jansen and his group by almost a year. There is no explanation as to why SOSC did not send someone to meet with the business people to find out what the issues were and what could be done to solve the problem.

SOSC acknowledged the work of the Chamber and forwarded copies of the report to the SOSC committees immediately upon receipt. SOSC also addressed the three recommendations relating to the college in its report: review of policies and guidelines relating to auxiliary services, review of the definition of a "group to ensure that only educationally related groups stay in the residence halls, and to allow time for Elderhostel participants to shop downtown" (p. 48).



While the studies were being done, the merchants had asked for an opinion from the Oregon Department of Revenue about the activities of SOSOC. Revenue in turn asked for an opinion from the Department of Justice and on January 10, 1983, a memo from Theodore W. deLooze, Attorney-in-Charge of the Tax Section gave it's response. They said "Our review of information...leads us to conclude that the programs and services are generally within the guidelines for operation established by the State Board..." (p. 6) They did have some concerns about the Loft, a small retail operation, and asked for further information. But in summary they stated that "...we find no evidence that SOSOC is using its property for purposes inconsistent with its role as a regional educational institution." (p. 7)

Neither the Chamber of Commerce Task Force Report or the SOSOC committee reports satisfied the concerns of the merchants, so they felt they had no other option but litigation. On January 14, 1983, the merchants filed their first suit in Marion County Circuit Court asking for 20 million dollars in damages and asking for an injunction to stop SOSOC from conducting a variety of business activities which were unrelated to their mission and were competing unfairly with private enterprise.

The specific claims of their suit are summarized as follows in Leonardus and Regina Jansen, dba as White Motel, et al. v. Victor Atiyeh (Jansen v. Atiyeh):

1. By renting to non-matriculating students, SOSOC has rented its dormitories, food service, transportation and

recreational services to such persons as to whom it lacks the authority under the Oregon Constitution or any applicable statutory or administrative law (and therefore the activity is unrelated to what SOSC should be doing). It is important to emphasize that they were not discussing the taxability of the income but whether or not the activity was substantially related to what SOSC could do under statutory authority.

2. By receiving on consignment a substantial number of tickets to performance of the Oregon Shakespearean Festival and reselling them to individuals or through "package plans" to groups which included housing, food, transportation and recreational services, SOSC is acting outside of its legal authority.
3. SOSC has provided retail merchandise to the general public and to persons who are not students or guests of students and is operating outside of its authority.
4. SOSC has advertised and marketed said goods and services without proper authority from the State.
5. Defendants have established policies and rules which allowed the above activities while knowing or having reason to know that such activities are contrary to applicable and pertinent law in Oregon. (pp. 2-4)

The State responded with a memorandum in opposition prepared by Pamela Abernathy, Assistant Attorney General of Attorneys for Defendants. Her response in her Memorandum in Opposition to Motion for Preliminary Injunction is summarized as follows :

1. Based upon the merits of the case, there is no likelihood of success. She then challenges the claim of inappropriate use of facilities by demonstrating that the auxiliary enterprises do not use state money and

states that SOSC has the authority to conduct the programs in question. She also challenges the claim that the actions of the defendants caused the damages to plaintiffs and states that plaintiffs have not demonstrated the causal relationship between programs at SOSC and the decline in room rentals.

2. Abernathy challenges that, even if plaintiffs were able to demonstrate a likelihood of success on the merits of their case, the injunction should not be granted because it is the defendants, not the plaintiffs, who would be irreparably harmed by the injunction. She says that "the revenue obtained from engagement in 'Auxiliary Enterprises' is of great necessity to the maintenance of Southern Oregon State College's provision of services to students." (pp. 8-16)

For those reasons Abernathy states that the preliminary injunction should not be granted. In that brief she also established the foundation for the defendants' case for years to come.

Following the SOSC report from the committees, SOSC developed guidelines which they published in Conference and Special Events Guidelines in April, 1983. In it they consolidated responsibility for rental of facilities and services into the Division of Continuing Education, which had Larry Helms as its director. The guidelines tried to clarify roles and responsibilities for rentals and the conditions under which SOSC would rent to outside groups. However, even though the report and guidelines addressed most of the concerns of the business people, it was too late to stop the litigation.

The litigation lasted almost four years with the preliminary decision coming in May of 1985. In the end the results were just

as confusing as the litigation itself. When the decision was announced both sides claimed victory. In reality the net result was what SOSC had already done by following the guidelines established in 1983.

One positive outcome of the process was that SOSC had completely reviewed its operations and their application to the mission of the college. By doing so SOSC not only refined its business operations but improved its relationship with the community.

#### THE YMCA OF COLUMBIA-WILLAMETTE LITIGATION

The YMCA of Columbia-Willamette (YMCA) litigation deals with a different but related part of this issue: whether or not a nonprofit can compete with private enterprise and retain its tax-exempt status.

In the SOSC litigation the plaintiffs sought to have the college stop competing with private enterprise by eliminating activities they felt was outside of its statutory authority. They dealt with the issue of what kinds of activities could the college conduct and remain within its statutory authority or exempt purpose.

In the YMCA litigation (YMCA of Columbia-Willamette v. Department of Revenue [1989]) the plaintiffs argued that the YMCA should not be allowed to have tax exempt status because they were competing directly with for profit business and the tax exemption gave them an unfair advantage. The issue in this case was property tax exemption, not income tax exemption, and was handled solely at the state level.

This case is not only a study in competition and relationships between business and nonprofits, but is also a study in how a nonprofit can move away from its exempt purpose over time and lose sight of why it was privileged with nonprofit status in the first place.

Hopkins (1951) states that the YMCA was initially formed in London in 1844 to improve "the spiritual conditions of young men engaged in the drapery and other trades by the introduction of religious services among them." (pp. 4-6) It moved to the United States soon after and achieved success during the revivals of the 19th century. While its foundation had been in the spiritual development of the individual, it changed its focus under the leadership of Dr. Luther Gulick in the 1890's. He saw the work of the YMCA as being the development of the whole individual, body, mind and spirit, and under his stewardship physical education and conditioning became an essential approach to the YMCA's concept of overall wellness. (p. 255)

In its decision on appeal, the Oregon Department of Revenue tracks the mission of the YMCA from its original articles of incorporation to 1986 when the decision was announced.

The YMCA (1987), as cited in the Matter of the Appeal to the Department of Revenue, in its original articles of incorporation emphasized the religious nature of its mission:

The object and business of this corporation shall be the development of Christian character and activity in its members, the promotion of evangelical religion, the

cultivation of Christian sympathy, and the improvement of the mental and spiritual condition of young men. (p. 4)

By 1976, however, that mission had changed. In restated articles of incorporation, the new mission was:

To promote the development of Christian character in its members, the cultivation of Christian concern, and the improvement of the mental, physical, and spiritual condition of its members and other persons. (p. 4)

And in 1986, when the decision was announced, the mission statement stated that

The YMCA of Columbia-Willamette is an association of people . . . men and women of all ages, ethnic origins, religious affiliations and socio-economic levels, who believe in Judeo-Christian values, and who practice these values. (p. 5)

This change in mission was extremely important because it expanded the potential membership base of the YMCA and freed the YMCA from its Christian commitments. It also came at a time when the YMCA was near to the development of a new fitness center.

For years the YMCA had operated in an antiquated facility in downtown Portland. It was old and in need of extensive repair in 1961 when I stayed there as a military inductee. In the 1970's

the YMCA successfully completed a capital campaign and built a new facility called the Metro Y on Barbur Boulevard next to Duniway Park. How they completed the campaign is not important to this dissertation. What is important is that by the early 80's they had a new mission statement which moved them away from their religious beginnings and a new location which moved them further away from the poor people they were supposed to serve to justify their tax exempt status.

Buoyed by the success of the Metro facility, the YMCA was looking to expand into other areas of the community. Two possibilities arose. Tri-Met, the public transportation agency in the Portland area, was completing plans for a light rail line to Gresham, a suburb of Portland. A part of those negotiations included leasing part of the land adjacent to the light rail line in Gresham to the YMCA for construction of a \$7.5 million dollar facility. At the same time Cornerstone Columbia Development Co. was completing plans for the Riverplace Development in Southwest Portland just down river from the downtown area, which included housing, shops, a hotel, and a health club, which could be leased by the YMCA. That facility was opened as the Riverplace Family YMCA in mid-September 1986.

These developments presented wonderful opportunities for the YMCA but also brought to light the possibility that the YMCA might be operating outside of its exempt purpose.

As reported by Hill (1986), in the Gresham area at the time of the YMCA announcement there were "several private (health)

clubs that were not at membership capacity." (p. 15) The owners of those clubs were not the least bit excited when they heard that the YMCA was planning to move into their area. They saw this as totally unfair competition. Hill (1986) states that they tried unsuccessfully to prevent Tri-Met from leasing the land at "very favorable lease rates." (P. 15) When negotiations broke down they organized themselves into the Northwest Alliance for Market Equality (NAME) and decided to fight the YMCA.

As reported in the Matter of the Appeal by the Department of Revenue (YMCA, 1987) they petitioned the Oregon Tax Court in *Court Club v. Wilcox* to instruct the Multnomah County Assessor to examine the real and personal property of the YMCA Metropolitan Fitness Center to determine if it was being used for charitable purposes. On April 30, 1985, the Tax Court issued a writ of mandamus directing the County Assessor to comply. He did so and on May 16, 1985, the assessor gave notice to the YMCA of the intent to place certain exempt property on the tax rolls. On December 6, 1985, the assessor sent another notice to the YMCA stating that "It is our conclusion that the real and personal property of the organization is not primarily used for charitable activities." (p. 3)

This was reaffirmed in his supporting memorandum on December 12, 1985, in which he placed the property on the tax rolls, applied the five year retroactive statute, and gave the YMCA a tax bill for \$969,802.46. The YMCA appealed the decision in a



process that took several years and eventually went to the Oregon Supreme Court.

During the two years that it took for the appeal to move through the Department of Revenue several significant related things occurred.

First, in 1986, the YMCA joined with the Oregon Association of Hospitals, the United Way of Columbia-Willamette, and the other YMCA's in Oregon through the Oregon Cluster of YMCA's to form the Coalition of Concerned Agencies (COCA). The coalition retained Northwest Strategies, a Portland area consulting firm, to develop a position paper and assist them with the development of a political strategy to combat the threats to their nonprofit status. The position paper was completed in August, 1986, and Northwest Strategies assisted the coalition with testimony before legislative committees and development of a legislative agenda.

Second, as reported by Manley (January 9, 1987), James Chapel, the president and chief executive officer of the YMCA, resigned his position on January 8, 1987. Though he gave no specific reason for his resignation, in his resignation statement Manley says he referred to "a tax squabble and other developments that have blocked the organization's fund raising efforts" (p. D10). In the same article Manley notes that, during Chapel's term the YMCA opened the Riverplace Family YMCA but that "plans for an Eastside Family YMCA project in the Gateway area were shelved until the conclusion of appeals pending against a . . . challenge to the organization's tax exempt status" (p. D10).

The next day, January 9, 1987, the YMCA announced that it was going to close the Riverplace Family YMCA. In an article Manley (January 10, 1987) quotes Gordon Davis, vice chairman of the board of directors of the YMCA, as saying that "membership level was probably about one-third of what was needed to effectively operate that facility as a family YMCA." (p. D1)

The YMCA had argued that it should retain its tax exempt status on all of its properties because each pays a proportionate share to help fund the headquarters and the non-revenue producing branches. For example, the Metropolitan Fitness Center paid \$358,539 as its proportionate share in 1984-85. The YMCA also argued that its scholarship programs further qualified it for tax exempt status because "no individual of family will be excluded from membership because of inability to pay". They also argued that no one building should be tested as charitable by itself because "a 'Y' is not just a building, it's a facility which helps us arrive at our basic mission and purpose. (pp. 5-6)

The YMCA gave extensive testimony about the thrust of its programs and its various facilities and branches. They demonstrated that some of the branches were not self supporting and needed help from other branches and programs. Regarding the Metropolitan Fitness Center they testified that, of 3,500 memberships involving about 4,400 participants, only 154 were on scholarships, about 20% volunteered in some capacity to develop their leadership qualities, and no United Way funds are used at the center. (p. 12)

The Y also argued that its Cardiac Therapy Program (YCT) is a "special feature" which is offered at the Metro Fitness Center. They gave data that showed that, of the 230 participants in 1985-86, 26 were on scholarship. They stated that participation "requires written referral by a physician, the majority of participants are non members of the Y before referral, no United Way funds are used in the program, and it has "separate offices for record keeping and medical testings." (p. 14)

Those arguing against the YMCA tax exempt status compared the Metropolitan Fitness Center to other health clubs in the area. Their argument was that there was little or no difference between the Metro Y and the private clubs. The facilities, programs, mission and rates were virtually the same. Because there was little or no difference, the private health clubs felt that the Metro Y was being operated as a commercial enterprise in a very competitive market, and that the tax exempt status it enjoyed gave it an unfair advantage. (p. 16)

An analysis of the financial statements was provided by Richard W. Oszustowicz, an associate professor at the University of Minnesota. His prime issue was to determine if a gift was being given to the community because of the operation of the Metro YMCA. His conclusion was that there was no government relief because government was not required to provide those services, there were low contributions from the general public, there was a high profit margin from the operation of the facility, and that the

major recipient of the charitable good were the members of the Y and not the community as a whole. (p. 16-17)

On November 16, 1987, the Oregon Department of Revenue issued its preliminary opinion in the Matter of the Appeal. The decision summarizes the testimony and findings, and draws the following conclusion:

The clear weight of the testimony reveals that the Metropolitan Fitness Center and the competing facilities owned and operated by the intervenors are almost equal. The physical facilities are very much alike; identical programs are offered, with the possible exception of the YCT mentioned above. The private operators subscribe to the same belief in the benefit of health enhancement and fitness. Fees charged are similar. (p. 16)

The Oregon Department of Revenue has very thoroughly studied the record in this case. Based on careful readings of the statutes and cases, I am not convinced that the fitness goals and activities of the YMCA's Metropolitan and Commonwealth Fitness Centers meet the charitable purposes contemplated by ORS 307.130. Any further expansion of this narrow exemption is a matter for legislative enactment. (p. 27)

The call for legislative enactment is an acknowledgment by the Department of Revenue that it does not have the authority to expand the interpretation of ORS 307.130. It acknowledges that only the legislature can do that. In Chapter Six we will discuss the many calls for a legislative examination of nonprofit status and the establishment of new rules for the operation of nonprofits.

In this decision both sides won. The Department of Revenue agreed that two of the major facilities should not receive tax exempt status but disagreed with the assessor and granted tax exempt status to the rest of the properties of the YMCA. The assessor won because the Department of Revenue agreed that two of the properties, especially the Metro Y, should be put on the tax rolls. The YMCA won because the Department of Revenue agreed that some of their properties were tax exempt. As might be expected the case was appealed to the Oregon Tax Court and eventually the Oregon Supreme Court.

As explained in the decision of the Supreme Court the Tax Court affirmed the decision of the Department of Revenue's denial of exemption for the two properties. On December 28, 1989, the Oregon Supreme Court upheld the decision of the Tax Court and the YMCA lost its tax exempt status for the Metro Fitness Center and the Commonwealth Fitness Center.

While this case was moving through the appeal process, however, the YMCA was going about the business of reorganizing and redefining its mission and goals. On October 26, 1989, it announced a number of changes in its operation. In an article by Laatz (1989) on the same day some of the changes mentioned were: the addition of youth members and programs at the formerly all-adult Metro YMCA; an increase in the scholarship fund; expanded youth programs at 28 locations; and a reorganization of the board of trustees to chart the future of the organization. (p. B10)

Gordon Davis, chairman of the YMCA board, is quoted in the article as saying that the problems of the YMCA occurred because "The Y had lost its vision about what the YMCA was supposed to be in the community and got focused on issues like the Riverplace facility." (p. B10) Eventually, after the reorganization and redefinition of mission had been implemented, and one more round of litigation vs. the Multnomah County Assessor which will be discussed in Chapter 7, the YMCA regained its tax exempt status.

These two cases generated an immense amount of publicity, not only in Oregon, but throughout the nation. These cases became very important because in both, for profit businesses had challenged nonprofits for either operating outside of their statutory authority (exempt purpose) or for not fulfilling their charitable purpose, and the business community had won partial if not full victories. This publicity had brought the issue to the public eye and is the subject of the next chapter of this dissertation.

## CHAPTER 5

### MEDIA ATTENTION IN THE 1980'S

As the number of cases of litigation about unrelated business income and unfair business competition continued to grow, several organizations began national campaigns to make the public aware of the issue of competition between nonprofit and forprofit business. As national interest in the issue began to grow so did the interest of the media.

This chapter will look at two of the organizations who generated media attention, some of the media attention paid to the issues of unrelated business income and unfair business competition on the national level, then media attention on the statewide level in Oregon.

#### NATIONAL MEDIA ATTENTION

In the early 1980's not much national media attention was being given to the issues of unrelated business income and unfair competition. Some of the states had groups or individuals pursuing local cases but no one was collecting information from all of the states or developing a national media campaign. Then several things happened about the same time which consolidated the efforts of many different groups and brought about at least

two national organizations who were working to generate media attention to increase public awareness of the issues.

First, in 1983, the U.S. Small Business Administration published their booklet Unfair Competition by Nonprofit Organizations with Small Business: An Issue for the 1980's. This booklet, also discussed briefly in Chapter 2, identified the issue of unfair competition as the major emerging issue for small business in the 1980's.

Second, as identified by the Business Coalition for Fair Competition (1985):

In June of 1984, representatives of the leading small business organizations held a Small Business National Issues Conference at the headquarters of the Chamber of Commerce, in Washington. The delegates identified 41 issues of concern to small business and ranked them by order of importance. The top concern was the federal deficit. The second was expressed in these terms: Reduce government competition with private business... (p. 1)

Following those two events, at least two organizations began national programs to generate media interest in their goal of eliminating unfair competition between nonprofit and forprofit organizations. The first to be discussed is the Business Coalition for Fair Competition (BCFC). The second will be the International Racquet Sports Association (IRSA) Committee for Fair Competition.

Founded in mid-1983, as stated the BCFC (1985) was formed "to help small business, not to harm nonprofits." (p. 1) They continue on the same page, stating that "We do not contend that



nonprofits should be excluded from the marketplace. But we insist that fairness requires them to "... compete in it on equal terms."

Following the 1984 meeting, BCFC developed a handbook entitled Unfair Competition in the States: How to Combat Competition from Nonprofit Business Ventures. This handbook suggests a variety of ways that small business can take steps in their states to combat unfair competition. Included are chapters on forming state coalitions and what to do after the coalition is formed, state officials to be contacted, how to get media coverage, how to establish commissions to review private enterprise and handle complaints of unfair competition. This handbook is a step-by-step guide to starting a campaign from scratch and developing a strong organization to develop media attention about unfair business competition by nonprofits.

The media chapter is particularly important because it provides the user with ways to generate publicity about unfair competition. It advises how to get an article in the local paper, how to use the article to get similar businesses involved in the coalition, how to hold a press conference, how to follow-up with those news agencies who didn't attend the press conference, and how to professionalize your news releases. This document became the handbook for those fighting against unfair competition in the 80's.

The second organization to operate on a national basis was the IRSA Network for Fair Competition. This organization, co-chaired by Frank Eisenzimmer of the Cascade Athletic Club in

Portland (who was most responsible for the YMCA litigation), developed a network for private athletic club owners to discuss ways to stop unfair competition from YMCA's. In their monthly updates they talk about the progress of various cases, what is happening in the state and federal legislatures, and what will help them stop unfair competition.

As reported by Durkin (1984), at the 1989 IRSA National Convention Frank Eisenzimmer and Scott Garrett gave a presentation they called the "YMCA Self-Defense Course." (p. 1) In their 89-3 Update there is a summary of their presentation. In it they give the ideas and strategies that were successful in their cases. Their cases were very successful. Eisenzimmer led the challenge to the Portland Metro YMCA tax exempt status and won. Garrett led the challenge to the Pittsburgh YMCA tax exempt status and won. The highlights of their presentation are as summarized from the report by Durkin (1984) as follows:

1. Start the campaign as soon as you hear of the start of a tax-exempt club. Early response is a great advantage.
2. Don't let fear of a negative response stop you. Public opinion will be on your side because you are right.
3. Don't be overwhelmed by this - the issues are very simple. Tell the same story to anyone who will listen, especially the media, and tell it over and over.
4. A single full-page ad, if designed properly, can be a very effective tool.
5. Don't reinvent the wheel - use what has been effective elsewhere. (pp. 1-2)

The efforts of these organizations, as well as others, greatly increased the amount of attention the national media was paying to the issue of unfair competition. By late 1986 there was an article almost every month in one of the national magazines. For example, in January and early February, 1987, I found the following articles just browsing through periodicals I normally read at the time:

1. Calonius, Erik, and Sue Hutchison, Vicki Quade, and Brad Risinger. "There's Big Money in Nonprofits." Newsweek.
2. Institutions, January 21, "Institutional Operators Get Entrepreneurial Itch," p. 24.
3. Harvey, Philip D. and James D. Snider. "Charities Need a Bottom Line Too." Harvard Business Review.
4. Herzlinger, Regina E. and William S. Krasker. "Who Profits from Nonprofits?" Harvard Business Review.
5. Jaschik, Scott. "Small Business Leaders Launch Campaign to Curb Campus Sales of Consumer Goods." The Chronicle of Higher Education.

Additional media attention was paid to the House of Representatives Ways and Means Oversight Subcommittee which was continuing its work on a review of unrelated business income tax and unfair competition by nonprofits, as discussed in Chapter 2. As they continued public hearings various articles would appear depending upon who had testified and the position they had taken.

National forums were held to discuss the issue. In 1988, for example, the BCFC held their first National Conference on Unfair Competition and the National Association of College and University Business Officers held a national workshop on unrelated business income. The subject also became a topic for many national conventions involving nonprofits or executives who manage nonprofits.

Nationally the efforts of the BCFC and the IRSA, plus the efforts of many of their state organizations and related organizations were working. They had the attention of the media as well as the attention of the Congress and legislatures of many states. As predicted by the U.S. Small Business Administration (1984), they had made unrelated business income and unfair competition "an Issue for the 1980's". (p. 1)

#### MEDIA ATTENTION IN OREGON

In Oregon there was already a significant amount of media attention being paid to the issues of unrelated business income and unfair competition because of the SOSC and YMCA litigations as discussed in Chapter 4. Virtually every newspaper in the state carried articles following those litigations. However, there were also other cases and other organizations which generated media attention as well.

In 1983, Wright, et al, (1983), began circulating a "Free Enterprise Petition" throughout Oregon. In the petition they called for an amendment to the Constitution of the State of Oregon which would create a new Article XIX which contained the following:

SECTION 1. ...limit the number of public employees to those absolutely necessary and thereby protect and advance the enterprise resources within the state.

SECTION 2. Agencies of the State of Oregon and political subdivisions thereof have no authority to engage employees for the provision of public services or the manufacture of any goods where the services or goods are to be offered to the public in competition with services or goods offered by private enterprise or are to be used by the agency or political subdivision instead of services or goods provided by private enterprise...

SECTION 5. The construction of new public improvements and the reconstruction and renovation of existing public improvements shall be accomplished by contract with private enterprise. The betterment, maintenance and repair of existing public improvements shall be accomplished by contract with private enterprise... (p. 1)

This petition, which never garnered enough signatures to make it to the ballot, was circulated throughout the state. By its circulation the petitioners generated public awareness of the issue of unfair competition.

As reported by the Business Committee (1986) , in November, 1986, a group of small business leaders held "The Oregon Small Business Legislature, the nation's first..." (p. 1) According to the article the legislature "developed sweeping recommendations in a variety of areas from education, procurement and international trade to taxation (sic), liability insurance and tort reform." (p. 1)

The article also cites the Procurement Committee as establishing as its top priority to "Prohibit non-profit tax exempt

(sic) organizations from abusing their tax exempt status in competition with small business" , and to "Prohibit direct government created competition where services are available from the private sector." (p. 5)

While the Business Committee and their newsletter never did achieve substantial recognition, they were players in the hospitality and tourism industry in Portland and in Oregon. They made people within the industry aware of the issues and made it a point to talk about the issues every chance they could get. I personally attended meetings of the Portland/Oregon Visitors Association where, during self introductions, members of the Business Coalition would introduce themselves, their business, then talk about an example of what they perceived as unfair competition by government or nonprofits.

Frank Eisenzimmer of the Cascade Athletic Club, and other private club owners in the Portland area, formed the Northwest Alliance for Market Equality (NAME), and began their own media campaign. They went after any media source they could find to tell their story. They also pursued the Oregon Legislature as will be discussed in Chapter 7. Eisenzimmer was particularly effective. He impressed many people because of his appearance, his candor, and his belief in what he was doing. One example of his effectiveness is shown in the following paragraphs.

Hill (1986) wrote one of the most influential articles done by the media to influence public opinion and bring the issue to the attention of the Oregon Legislature. His article, "What's Fair is

Fair," summarized the ongoing cases in Oregon and succinctly stated the issues as perceived by those pursuing change in the law.

Hill talks about the SOSOC litigation and why the motel owners had to go to court because they could not get help from the school or the legislature and about Ted Tosterud, owner of Northwest Medical Laboratories of Portland, who challenged the tax exempt status of nonprofit medical laboratories of four Portland area nonprofit hospital organizations because they compete with private enterprise. (pp. 19-20) This litigation and the ensuing litigation against the nonprofit status of the hospitals themselves will be discussed in greater detail in Chapter 6.

But, when discussing the media and this issue, most of all he talks about Frank Eisenzimmer, who he says is "the individual most responsible for pushing the issues into the public limelight." (p. 15) He then describes how Eisenzimmer has operated his media campaign:

Any reporter who gets on Frank Eisenzimmer's mailing list will need to get a bigger mailbox.

He inundates people with stories on: new luxurious YMCA's being built in Los Angeles, ... court cases from Utah where tax exemptions were taken away from two not-for-profit hospitals; and numerous position papers disputing claims made by YMCA about why it deserves tax exemptions.

Eisenzimmer first contacted this magazine almost three years ago about doing a story on his battle with the YMCA. Oregon Business declined, because the story seemed to be adequately covered in the daily media. But because of Eisenzimmer's persistence, we started to be on the lookout for other instances of alleged unfair competition by not-for-profit organizations. The result is this package of stories on pages 14-23.

Eisenzimmer is articulate, outspoken, very persistent, and knowledgeable about the media. In addition, ... he is good at the one thing that small business owners are almost uniformly bad at - media relations.

He possesses a talent for coming up with that extra little "twist" that will turn a long running battle over tax assessments - basically dry subject matter to say the least - into a news story with some "pizazz (sic)." To accomplish this he has at times resorted to tactics such as picketing YMCA annual meetings or to placing controversial messages about the Y on the big message board outside his club on Division Street. These tactics have worked for him at gaining him the publicity he wants.

But perhaps the greatest reason Eisenzimmer has been effective in getting his message across is that he doesn't convey any trace of the phony media huckster. When he says he's a staunch believer in the free enterprise system and that organizations which do not provide a significant charitable benefit to society should not receive tax exemptions, the listener has no doubt that Eisenzimmer means what he says and will do everything in his power to achieve his goal.

That goal, quite simply, is to get all tax exemptions removed from Y facilities designed and built to cater to the middle- and upper-middle classes and their families. (p. 16)

Through it all Eisenzimmer showed that he learned his lesson about the media: persistence, hard work, appearance, honesty and patience will reap dividends. His efforts through NAME brought about significant media coverage on these issues. While he certainly was not the only person or organization working on behalf of those wanting to change the laws relating to these issues, there is no doubt that he was the right person at the right time to help bring this issue to the public eye.



This article was also the right thing at the right time. It was objective, fair, and stated both sides of the issues. As the Oregon Legislature moved toward convening in January, 1987, this article was often used to describe what was happening and what could be done to change the law to ensure that only those organizations that were truly charities would receive tax exempt status and that fair competition existed between nonprofit and for profit enterprises.

The media efforts continued during and after the 1987 Oregon Legislature, and more of the media attention to these issues will be discussed in Chapters 6 and 7.

What is important about the media attention to these issues is that it developed public sympathy for small business in their efforts to combat what they saw as unfair competition from nonprofits. The media played an important role in enhancing the work of all of those people fighting against unfair business competition by nonprofits.

The media also tended to polarize people on the issues. Depending upon who they had interviewed or which press release they were using, the nonprofits were either victims or persecutors, and those opposing nonprofits were either heroes or crazies. There seemed to be no middle ground on the issues.

By late 1986 everyone involved was calling for legislative action to solve the problem the way they saw it. Frank Eisenzimmer and NAME wanted tax exempt status removed from YMCA's. Leo Janzen and his group wanted SOSC to stop renting facilities to anyone who was not matriculating as a student. Ted

Tosterud wanted tax exempt status removed from nonprofit hospitals. And there were cases involving soils testing laboratories, pharmacies, theaters, symphonies, and others. At the same time there were representatives of the YMCA, the hospitals, the colleges, and the others who wanted to keep things the way they were.

The issue was now a hot topic and those involved wanted the legislature to solve it. How the issue moved through the Oregon Legislature is the subject of the next chapter.

## CHAPTER 6

### LEGISLATIVE ACTION IN THE 1980'S

By 1987 the issues of unrelated business income and unfair business competition had become hot topics in the State of Oregon. There were many cases in the courts and lots of coverage in the media. Many people and organizations were involved and they seemed to be polarized on the issues. You were either on one side or the other. There was a call for legislative action, as had happened in other states as we discussed in Chapter 2. Going in to the 1987 Oregon Legislative Session no one was sure what was going to happen, but all had proposed legislation in hand to be introduced.

This Chapter will discuss what happened in the Oregon Legislature and in the bureaucracy on these issues. It begins with a brief historical perspective of what had happened prior to 1987, discusses the legislation introduced in 1987 and what happened with it, then discusses what happened in the 1989 legislature.

As discussed in Chapter 2, in 1961 the Oregon courts, in *Oregon Methodist Homes, Inc. v. Horn*, had developed a six point test to be used to determine whether or not an organization was charitable and therefore qualified for property tax exemption. As Wellford and Gallagher (1988) point out in their research the test

was used as late as 1986 in Dove Lewis Memorial Emergency Veterinary Clinic v. Department of Revenue. (p. 229)

In the 1985 legislative session, as the issues of unrelated business enterprises and unfair business competition began to surface in the public eye, more cases were brought into the courts and the legislature began to look into the issues. One bill, House Bill 2576, was introduced to make it a policy of the State Board of Higher Education not to allow the use of facilities and services unless directly related to the educational functions of the institution. This bill, which was sponsored by the Committee on State and Federal Affairs, was introduced at the request of the Oregon Motor Hotel Association, Oregon Hotel and Motel Association, Oregon Restaurant and Beverage Association, and the Restaurants of Oregon Association in an attempt to eliminate activities such as those involved in the SOSC litigation. The bill died in committee.

However, the legislature has an interim committee that meets between sessions and it was asked it to look into the issues. The Department of Revenue was also asked to examine the guidelines used to determine if an organization was charitable and eligible for exemption from property tax, and to make changes as necessary in the Administrative Rules.

The interim committee heard testimony in the Fall of 1986. In the context of the times the SOSC litigation was going to the Supreme Court, the Multnomah County Assessor had just removed the tax exempt status of the Metro YMCA, the other cases

discussed in Chapter 5 were underway and measure 5 (property tax limitation) was alive and well. Most of those involved testified to the interim committee and presented proposed legislation which will be discussed later in this chapter when the bills introduced into the 1987 legislature are discussed.

The Oregon Department of Revenue reviewed its administrative rules and in December, 1986, it proposed a revised section 150-307.130(A), the criteria to be used to determine whether or not a property tax exemption should be granted to a charitable organization. The new rule, in effect, was added criteria to determine if an organization should be defined as charitable in Oregon. It is also interesting to note how the new rule responded to the issues raised in the cases under litigation at the time.

The stated purpose of the rule "is to set forth, as a guide for assessors, those tests which are commonly applied by the Oregon courts in determining whether property qualifies for exemption." (p. 498) The organizational and property interest remained about the same, although the new criteria did advise that "whether a corporation is a charity is to be determined not only from its character, but also from the manner in which it conducts its activities." (p. 498)

Some of the new criteria within the rule are summarized as follows:

1. Any organization claiming property tax exemption must have charity as its primary, if not sole, object and must be performing in a manner that furthers that object.

2. The activity conducted must be for the direct good or benefit of the public or community at large. Public benefit must be the primary purpose rather than a by-product.
3. If the activity relieves a government burden then it is an indication that the institution may be charitable.
4. An element of gift and giving must be present in the organization's activities relating to those it serves.
5. Forgiveness of uncollectable accounts does not by itself constitute a gift or giving (i.e. hospitals).
6. The fact that an organization charges a fee for services does not necessarily invalidate its claimed status as charitable (i.e. YMCA and the hospitals).
7. The fact that individuals provide volunteer labor to assist an organization may indicate it is charitable (i.e. YMCA and the hospitals).
8. The property must be used primarily for charitable purposes and there must be an actual charitable use of the property rather than just a charitable use of the income derived from the operation of the property (i.e. Metro YMCA).
9. The use of the property must substantially contribute to the furtherance of the charitable purpose and goal of the organization (i.e. gift shops and cafeterias in hospitals, bookstores and housing on college campuses, pharmacies in hospitals and the Metro YMCA).
10. Only the portion of the property used for literary, benevolent, charitable or scientific purposes shall be granted exemption from taxation. (pp. 498-499)

As might be expected, not everyone was completely satisfied with the new rule. However, the new rule did give the legislature some new criteria to use as they examine bills proposed from the interim committee and from the various organizations wanting change in the law. It also gave them a fall back position if they chose not to act on legislation at that time.

In the 1987 legislature there were four bills introduced which related to the issues of the parties involved: House Bill 2233 sought to deny tax exemption to property that is used for athletic of fitness purposes, House Bill 2234 sought to define an institutions charitable purpose for purposes of ad valorem property tax exemption, House Bill 3018 provided that charitable and nonprofit institutions shall not be deprived of property tax exemption solely because primary funding is from one or more government agencies, and Senate Bill 836 sought to exempt certain property of hospital corporations.

House Bill 2233 was filed at the request of the Joint Interim Revenue and School Finance Committee for the Northwest Alliance for Market Equality (NAME), the people opposed to tax exempt status for YMCAs.

In this bill NAME seeks to define property which shall be exempt from taxation as follows:

1. Only that property which is owned or being purchased by incorporated literary, benevolent, charitable and scientific institutions.

2. Only such property that is actually and exclusively occupied or used in the literary, benevolent charitable or scientific work carried on by such institutions.
3. Parking lots used for parking as long as that parking or other use is permitted without charge.
4. All real or personal property of a sheltered workshop or any retail outlet thereof. Sheltered workshop is defined as any facilities for providing handicapped individuals with occupational rehabilitation activities (i.e. Goodwill).
5. All real and personal property of a retail store dealing exclusively in donated inventory where the inventory is distributed without cost as part of a welfare program (i.e. St. Vincent dePaul). (p. 1)

Specifically excluded from property tax exemption is "real or personal property occupied or used for athletic or physical fitness purposes" (p. 1). In the bill they request that such activities "shall not be considered occupied or used for literary, benevolent, charitable or scientific work." (p. 1) Their bill allows for apportionment if property is used for exempt and non-exempt purposes but only if the primary use of the property is for the exempt purpose of the organization. If passed, this bill would have made taxable the property of all YMCAs in Oregon.

The bill was introduced with the first reading on January 14, had three hearings and two work sessions in conjunction with House Bill 2234, then died in committee.

House Bill 2234 was filed at the request of the Joint Interim Revenue and School Finance Committee for the Coalition of



Concerned Agencies (COCA), an organization in support of tax exempt status for the YMCA's and hospitals.

In this bill COCA seeks to define institution and charitable purpose for the purpose of property tax exemption as follows:

1. Institution means a nonprofit corporation organized and operated for charitable purpose that makes membership and programs available to all members of the community on an ability to pay or free basis and provides equal programs to all users or participants.
2. The assets of the institution are irrevocably dedicated to charitable purpose and no part of the income is distributed to members, directors or officers.
3. The corporation receives in addition to fees from its members or patrons, money or other things of value which may include donations, in-kind contributions, government contracts or grants, nominal interest loans, volunteer time, or combinations thereof, and which uses those contributions to benefit persons other than those who made the contribution.
4. Charitable purpose means any purpose to promote the well-being of the public at large, including but not limited to educational, literary or scientific purposes, the prevention of cruelty to children or animals, promotion and appreciation of artistic endeavors, or for the benefit of religion, health or delivery services, rehabilitation services, public recreation and physical fitness, civic improvement or community services which lessen the burdens of government. (p. 1)

This bill would have been retroactive to 1979, and if passed, would have exempted the YMCA of Columbia-Willamette from all back taxes determined by the Multnomah County Assessor and

included in the YMCA litigation discussed in Chapter 4. It was introduced with the first reading on January 14, had three hearings and two work sessions in conjunction with House Bill 2233, then died in committee.

House Bill 3018 was sponsored by the Committee on Revenue and School Finance. This bill was intended to amend ORS 307.162 to include the following as institutions whose property shall not be deprived of an exemption: an institution whose primary source of funding is from one or more government entities; an institution whose primary purpose is to relieve pain, alleviate disease, or remove constraints.

While not directly related to the issues discussed in this dissertation, this bill does address some of the concerns expressed in the discussion in Chapter 7 relating to the broader issue of what constitutes a charity.

The bill passed the House of Representatives on April 29, the Senate on June 5, and was signed into law by the Governor on June 27. In an interview with Mike Morrison (1996), attorney for the plaintiff in the hospital litigation in 1996, he feels that it is important to note that this legislation did not give tax exempt status to hospitals; it only ratified that they will not be deprived of an exemption because of their mission.

Senate Bill 836 was sponsored by Senator Monroe on behalf of COCA, an organization in favor of tax exempt status for hospitals.

In this bill COCA sought to add to the list of properties that are tax exempt the property owned or being purchased by a hospital corporation as follows:

1. Real and personal property actually used or operated for hospital purposes or health care work carried on by such hospital corporation.
2. Parking lots used for parking or other purposes as long as that parking or other use is without charge.
3. Hospital corporation is defined to include not only the nonprofit corporation that owns or operates a health care facility, but the controlling or controlled hospital corporation or corporations. (p. 1)

This would have been a significant change to the law, as the existing law at the time only allowed for a nonprofit corporation that was a hospital to enjoy exemption from property tax. This bill passed the Senate on June 4. It went to the House on June 5, was referred to the Revenue and School Finance Committee on June 8, and died in committee.

If there is any one constant in the decisions of the legislature it lies with the House Revenue and School Finance Committee in which three of the four bills did not make it out of committee. In interviews with Vera Katz, Speaker of the House, Carl Hosticka, Chair of the Committee, Rod Monroe, Vice Chair of the Committee, Michael Morris, attorney for NAME, and Leo Jansen, plaintiff in the SOSOC litigation, they were asked their opinion as to why they felt that the committee did not take action.

Katz (1996) and Hosticka (1996) said that there was no reason for the legislature to take action as the issue was being resolved in the courts and in the Department of Revenue.

Monroe (1996) said that he felt that the bills were "self serving" and the usual process of the legislature would be to give them a hearing and let them die in committee. He said that this was not only the easy way out but also the most prudent way to go since the issue was in the courts and the Department of Revenue at the time.

Morris (1996), who testified before both the Interim Committee and the House Committee on Revenue and School Finance, felt that the committees, and the legislature in general, did not want to get involved in determining what constitutes a charity in Oregon. He felt that they thought that the courts were taking care of the problem, that the new rule from the Oregon Department of Revenue would help both assessors and the charities, and that legislative action would not help at that time.

Jansen (1995), who testified before the Interim Committee, said that he felt that the legislature just didn't want to get involved. He thought that they weren't sure what needed to be done and that they were willing to let the courts decide. He also said that if he had to do it over again he wouldn't have tried to resolve the issue in the Oregon courts or legislature, but rather "should have gone to Federal Court instead." By going to the Federal Court Jansen felt that he could have made this a constitutional issue and might have had decision more to his liking.

Gragg (1994), in his research on the Theater West litigation (to be discussed in Chapter 7), says that

In 1985, lawmakers opened the issue of tax exemptions - and then promptly shut it, according to Jim Scherzinger, a legislative revenue officer.

"The bottom line," recalls Scherzinger, " was that both the House and Senate committees determined that there were big problems with the statute. But it wasn't clear they could make it any better."

Charitability, the Legislature found, was virtually impossible to define. "Arguably," says Scherzinger, it's better left on a case-by-case basis by the assessors and the courts."

The Oregon Advocates for the Arts agrees. Board member Michael Redden, a Portland attorney, worries that it "would be too easy for the rabble-rousers in the Legislature to get hold of the issue.

"It's not a good climate to ask not to be taxed," Redden adds, referring to the post Measure 5 environment. "Just to get what little arts funding we get from the state, we use all the political capital we have."

"If you ask for too much, you can lose it all." (p. D4)

There are two reasons why the Revenue and School Finance Committee did not let these bills out of committee. First, House Bills 2233, 2234, and Senate Bill 836 were far too specific in addressing issues which were before the courts at the time. The tax exempt status of the YMCA's and the hospitals were in litigation at the time, and the committee was not going to act on them until the litigation was completed. Second, the Oregon Department of Revenue had just completed the new rule and the committee was willing to let the rule be tested before determining if legislation was needed to correct the situation.

The issue had been identified by some as a political hot potato because there were some big names and lots of people involved at the time. The evidence does not indicate that is the major reason why the legislature did not act in 1987. Rather, the legislature felt it was responding to the issues and that the time just was not right for legislative action.

Following the 1987 legislature, in response to the concern of the legislature and the SOSC litigation, in 1988 the Oregon State System of Higher Education adopted a new policy on education-related business activities at its institutions. In that new policy they affirmed that all institution education-related business activities shall meet the following conditions:

1. All activity is deemed to be an integral part of, and directly and substantially related to the institutions mission.
2. The activity is operated for the primary benefit of the students, faculty and staff of the institution. Sales or rental of services to on-campus visitors and conference participants is considered incidental to the purpose of these activities.
3. When considering whether any activity should be provided by an institution, the president of the institution or his/her designee shall consider whether or not the activity is currently and adequately provided by private business. If the president authorizes the activity justification must be sent to the Executive Vice Chancellor for review.
4. An institution may make its services and facilities available to nonprofit or community organizations without charge providing there is sufficient inventory or capacity to do so. Charges to profit making

companies shall cover the direct and indirect costs for use of the facilities and services.

5. An institution may market only those services and events which are of interest to the general public such as cultural presentations, athletics, and educational programs. (pp. 10-14)

By the time of the 1989 legislature things had calmed down. NAME brought no more legislation in their efforts to stop tax exempt status for YMCAs, although the organization still existed and followed cases in litigation. COCA was no longer involved in lobbying for the YMCAs and the hospitals, although the hospitals, the YMCAs and other members continued to work independently for their individual interests.

In the 1989 legislature there was only one bill, Senate Bill 241, requested by the Joint Interim Committee on Revenue and School Finance for the Oregon Association of Hospitals. That bill would have exempted hospitals and other health care facilities from property taxes, similar to SB 836 in the 1987 Legislature. One public hearing was held on the bill on April 6, 1989, then the bill died in committee.

At the end of the 1989 legislature it appeared as though the new rule from the Department of Revenue and the just completed court cases might have settled the issue, but that was not the case.

Just getting ready to start was new litigation involving the YMCA of Columbia Willamette and new litigation involving Southwestern Oregon Public Defenders which would test the new Department of Revenue Rule and the precedents from the prior

YMCA litigation. There were also new cases of litigation on the horizon that were not yet started.

Chapter 7 will discuss those cases and the current situation of unrelated business activities and unfair business competition by nonprofits, and the new burst of media attention following these issues and charities in general.



## CHAPTER 7

### CURRENT LITIGATION AND MEDIA COVERAGE

Following the 1989 legislature virtually no legislative action took place on the issues of unrelated business enterprises and unfair business competition. There are no bills on the issue in The Final Legislative Calendar Regular Session 1991. The Final Legislative Calendar Regular Session 1993 changes the classification of charitable organizations to nonprofit organizations to acknowledge newer terminology. No bills were introduced in 1993 or 1995 to change the definition of a charity or property tax exemption for charitable organizations.

In an interview, Senator Neil Bryant (1995), chair of the Senate Judiciary Committee, summed up the feeling of the legislature as

Nothing legislative needs to be done with the issues of unfair business competition and unrelated business income taxation. There are two reasons why: first, the feeling in the legislature is that the laws already on the books protect private business, and second, if a nonprofit competes with private business it can lose its nonprofit status.

There was, however, considerable activity in the courts and in the media, which will be discussed in this Chapter.

First, four instances of litigation in the 90's will be discussed. The first three have been decided through appeal and have helped to define what constitutes a charity and whether or not it can receive a property tax exemption. The fourth is in the courts at the present time and has as its issue whether or not hospitals should receive tax-exempt status. This case will be in process for some time and has the potential to make a major impact on the law in determining what constitutes a charitable organization in Oregon.

Following the discussion about current litigation will be a discussion about media coverage and how it is still helping to shape public opinion on the issues.

#### CURRENT LITIGATION

The first case to be discussed is Southwest Oregon Public Defender Services, Inc., v. Department of Revenue. This case is important because, while it does not deal with the issue of unfair business competition or unrelated business income, it does provide an affirmation of the Department of Revenue rule on defining a charity. It also provides clarity regarding HB 3018 (1987), which states that an institution shall not be deprived of property tax exemption solely because its primary source of funding is from a government agency.

The issues in the case can be briefly summarized as follows: Southwest Oregon Public Defender Services (SWOPD) is a nonprofit corporation whose sole purpose is providing legal services to indigent clients in Coos County, Oregon. It provides those services

with funding received from a contract it has with the State Court Administrator. SWOPD sought a property tax exemption for the 1987-88 tax year on the grounds that it was a charitable organization and the Coos County Assessor denied the exemption on the grounds that, since SWOPD received its funding through government contract it was not eligible for tax exempt status. The assessors argument also said that there is no element of gift or giving present in the operation of SWOPD.

SWOPD appealed to the Department of Revenue and lost. They also lost an appeal to the Oregon Tax Court and so took the case to the Oregon Supreme Court.

The Supreme Court rejected the assessor's argument that SWOPD did not qualify for tax exempt status because it received its funds from a government contract. As discussed in Chapter 6, the 1987 Department of Revenue rule and the amendment passed in HB 3018 (1987) allowed for tax exempt status for SWOPD.

In discussing whether or not SWOPD was giving its services, the Court provided greater clarity to the rule. SWOPD argued that the test for determining whether or not a gift or giving takes place lies not with where the money comes from but how the funds are used. The assessor argued that since SWOPD has a contractual obligation to provide the services no giving can take place and therefore SWOPD is disqualified for property tax exemption.

The Court agreed with SWOPD stating that the assessors interpretation of the rule would prohibit from exemption any institution that expects to receive remuneration from any source.

The Court felt that the "appropriate perspective, we believe, is that of the recipient of charitable giving." (p. 11) In other words, it does not matter if SWOPD is paid for providing the service. What matters is whether or not the client receives the same service regardless of ability to pay.

The second case, which will also be included in the hospital litigation, is the YMCA appeal to the Oregon Department of Revenue to regain its tax exempt status and to gain relief from back taxes charged by the Multnomah County Assessor (Opinion and Order 90-1523). This is the appeal which gave tax exempt status back to the YMCA after it had lost that status in 1989.

In this case the YMCA filed an application with the Multnomah County Assessor in 1990 seeking reinstatement of its charitable exemption. The assessor denied the application and the YMCA appealed to the Department of Revenue. Revenue found in favor of the YMCA. The assessor appealed to the Oregon Tax Court and the Oregon Supreme Court and in both cases the decision of the Department of Revenue was upheld. The following is a discussion of the major points of the Department of Revenue decision as written by Munn.

When the Department of Revenue found in 1989 that two of the YMCA properties were not operating in a charitable manner, it did so because of their policies only to serve only a small segment of the community, their pricing structure, and the minimal element of giving. The focus of the 1991 hearing was to review

whether the operational changes made by the YMCA were sufficient to reinstate charitable exemption for the YMCA.

Eleven witnesses testified on behalf of the YMCA and the changes it had made. The decision contains a 2 1/2 page list in chronological order showing how the YMCA had redirected its programs towards youth and families and how they were placing less emphasis on adult programs. The decision acknowledges those changes as being sufficient and discusses the applicable law to make its decision.

The Department cites SWOPD and the Department of Revenue rule as discussed in Chapter 6 as the basis for the decision. The three major points in that decision are as follows:

1. In order to qualify, the organization must have charity as its primary, if not sole, object. Citing the articles of incorporation of the YMCA, the decision finds that the stated object of the Y is clearly charitable.
2. The organization must be performing in a manner that furthers its charitable object. The decision cites the long list of changes which have occurred in the policies and operation of the YMCA. It determines that the "weight of the evidence clearly establishes a change in focus." (p. 7) Therefore, while it questions whether or not the criteria was met for the 1987-88 and 1988-89 years, it determines that the current operation of the YMCA meets the criteria.
3. Some giving must be present at the Metro Family YMCA for 1989-90 and 1990-91 for the Y to qualify for reinstatement of tax exempt status. In this portion of the decision the Department cites SWOPD and the need to view giving from the perspective of the recipient and not the perspective of the giver. The YMCA gave evidence of four main areas of giving:

- a. Free use by community social service agencies and the military.
- b. Reduced fees for youth and senior community members.
- c. Free or reduced fees for those with limited financial resources.
- d. Free use by the cardiac therapy program.

The decision finds these were sufficient to show that giving was occurring at the YMCA. (pp. 6-8)

A key concern then was to show if sufficient giving was present at the YMCA and how giving can be measured. The YMCA presented evidence to show "increases in scholarship giving ranging from 24 percent to 34 percent and increases in the relationship of total donative effort to revenue, ranging from 38 percent to 53 percent." The assessor challenged the data and urged the department to hold that: giving should be measured by comparing charitable use to total use, and charitable use must exceed 50 percent to qualify for an exemption. (pp. 9-10)

In the earlier YMCA (1989) decision the Department of Revenue had allowed the Northeast Portland YMCA to remain exempt with a giving level of about 20 percent. The decision does not feel that the 20 percent, or any percent, is binding. "Rather, it should be measured by all factors relevant under this department's rule to determine whether gift or giving, in the operation of the YMCA Metro Family Center, is insubstantial or negligible." (p. 11) Consequently the department found in favor of the YMCA for the 1989-90 and 1990-91 years.

The testimony of the YMCA speaks clearly to what they had learned through this process. The appeal cites testimony where the YMCA admits that it had lost its way and had changed back to a "full-family" YMCA. (p. 3) They admit that they had been focusing on adult services but now had changed back to the traditional family and youth programs. They took surveys of the membership and added an expanded childcare, more time for children, volunteer and staff development programs, and more community clinics. (pp. 3-5)

Through it all the YMCA learned what had given them tax-exempt status and how they had lost it. Through the development of the programs listed above they returned to their mission and elevated their level of giving to the community to a level sufficient enough to regain their tax exemption. They learned that to be a charity you had to be charitable - then changed their programs to accomplish that task.

The case was subsequently appealed to the Oregon Tax Court and the Oregon Supreme Court and in both cases the decision was upheld.

The third case to be discussed is Theatre West of Lincoln City, Ltd. v. Department of Revenue. In this case, Theatre West, a small theater company in Lincoln City, Oregon, lost its tax exempt status when a local assessor ruled that an acting company did not meet the criteria of a charitable organization because it was not a literary institution as defined in the code. As you might expect,

this case generated considerable publicity and interest because of its subject matter, which will be discussed later in this chapter.

Theatre West had argued that it was a charitable organization because most of its work is done by volunteers, it provides significant benefits to the community, and it is a literary institution under the code.

Judge Carl Byers of the Tax Court and later the Department of Revenue upheld the assessor's conclusion that literary does not include such things as movies, theater or television. Rather, they felt that literary only applies to literature or written words. In his article Gragg ((1994) states that with this decision Judge Byers "is attempting to hand the responsibility for determining exemptions back to lawmakers." (p. D4)

All parties agreed that Theatre West met all of the other criteria for exempt status. The only issue to be decided was what constituted a literary institution in the eyes of the law. As might be expected theater companies from around the state and the nation were watching for this decision.

The Supreme Court determined that in this case, as with all cases involving the application of statutes, the court should seek to carry out the intention of the legislature that enacted the statute. In this case they had to go back to 1854 to do so, and they presumed how a legislator of that time would look at this issue. In its decision the court determined that any institution that is devoted to the production of plays is a literary institution. The court concludes that



Our research has not found any indications that a legislator in the mid-nineteenth century (the code in this case predates Oregon statehood) would have understood "literary" to have a different and more limited scope than it does today. ... We conclude, from the evidence available, that the word "literary" meant in 1854 what it means today - of or pertaining to that broad range of written materials, including plays, that enjoy the label "literature." (p. 119)

The judgment of the Tax Court was reversed and Theatre West received tax exempt status.

In an interview with Judge Byers (1996) he said that he is deeply concerned about this decision and the eroding tax base in Oregon. He asked the question: "If this decision is interpreted literally, that live theater is literature because they are reading a play, does that mean that movies are literature as well?" He says that eventually the tax base will erode to the point that the legislature will have to look at the issue of tax exemption and what constitutes a charity. He feels that, at the present time, the legislature has not spent enough time on this and does not fully understand the potential ramifications of the decisions coming out of the courts.

The fourth case to be discussed is *State of Oregon ex rel. Theodore A. Tosterud v. Janice Druian, Director, Multnomah County Division of Assessment and Taxation*, filed in the Oregon Tax Court on February 6, 1996. In this case Tosterud, who previously filed similar litigation as discussed in Chapter 4, seeks to have Providence Medical Center, Good Samaritan Hospital and Medical Center, Emanuel Hospital, Physicians and Surgeons Hospital, and

Portland Adventist Medical Center denied tax exempt status and have their property placed on the tax rolls.

In the Writ of Mandamus dated February 6, Judge Carl Byers (the same judge who handled the Theatre West decision) cites a letter from Tosterud to Druian dated October 13, 1995, in which Tosterud provided Druian with what he felt was credible information to show that the hospitals should not be tax exempt. (p. 2) The information was "reports (that) reflect the revenue and deductions reported by each hospital." (p. 2) Tosterud also provided a summary of the hospital information which showed that charity as a percentage of revenue "ranged from a low of 1.68 percent to a high of 4.65 percent." ( p. 2)

Tosterud claims that those percentages, "under YMCA v. Department of Revenue (1989) ...are insufficient to qualify for charitable property tax exemption. Therefore, since the property does not qualify for tax exempt status it must be added to the tax rolls. (p. 2)

Druian acknowledges receiving the letter, "but did not act thereon, partly because of lack of resources." (p. 2) She felt that to respond she needed to show the value of the property in the notice to the owner and therefore could not respond until the value was determined. She felt that she would have to add two employees to the staff to make that determination and did not want to undertake the expense without more assurance that the property was indeed taxable.

The court stated "The issue presented is whether the director (Druian) received credible information or has reason to believe that such property has been omitted from taxation." (p. 3) The court found this to be true. Also important, the court found that the director "has not indicated that she is aware of any other information or explanation that would indicate the hospitals do qualify." (p. 3) Therefore, she should have given the hospitals notice "as required ... and required them to show cause why their property should not be added to the roll." (p. 4)

Byers determined that Druian did not have to show the value of the property in the notice. Rather, the hospitals have the burden of proof to show the right to tax exempt status. If information is furnished to the director that raises a reasonable question then she has a duty to investigate and make a determination.

Byers ordered the director to issue the notice to the hospitals and therefore comply with the law. Tosterud also recovered costs, disbursements and attorney fees.

According to Steve Skinner (1996) the notices have been served. They are now waiting for the responses from the hospitals which do not have to be made until July. He expects no brief to be filed until then. He did say that this case has the potential to impact virtually every hospital in the state and that it will be watched very closely by nonprofits and those fighting against unfair business competition all over the country.

## CURRENT MEDIA COVERAGE

In the early 1990's, after the YMCA regained its tax exempt status, there was not much media attention paid to unrelated business enterprises or unfair business competition by nonprofits. Those issues laid dormant until Theodore Tosterud opened the litigation against the Portland hospitals as discussed earlier in this chapter. Both The Oregonian and Willamette Week ran articles on the litigation.

The article in The Oregonian by James Mayer(1996), entitled "Four hospitals may lose tax break" gives the facts of the case, and emphasizes that the burden of proof rests with the hospitals. The article gives the hospital response that the YMCA case doesn't advise nonprofits how much charity is enough to qualify for an exemption and that the charity figures in Tosterud's case do not take into account the value of community service and other benefits that hospitals provide to the community in general.

In the Willamette Week article which ran about 54 column inches, Chris Lydgate (1996) gives a much more inflammatory explanation of the case. He open the article with

Virtue has been challenged. The rubber glove has been flung to the ground. And Portland's hospitals are now scrubbing up for a delicate operation: defending their tax-exempt status.

During the next two months, attorney's for Portland's four largest private hospitals will be trying to convince the county's tax man that their communal good deeds justify millions of dollars' worth of property tax breaks. (p. 12)

The article then goes on to explain Ted Tosterud's long running battle with the health care industry, how some state legislators such as former House Speaker Vera Katz (currently mayor of Portland) "have tried and failed to kill off the breaks received by churches and fraternal orders" and how the Oregon Supreme Court ruled against the YMCA.

Lydgate explains that this is a difficult situation for the hospitals, especially at this time, and explains the issue as follows:

The challenge to hospitals comes at an awkward moment for the industry. With the advent of the Oregon Health Plan (which added 120,000 people to the Medicaid rolls), private hospitals are providing less and less charity care: In 1995, Portland-area hospitals provided \$38 million in charity care, down from \$65 million in 1993.

The issue is whether tax breaks granted many years ago make sense in an era when hospitals are increasingly run as for-profit businesses and the state is picking up the tab for more patients. Put another way, the question becomes: What is charity and how much is good enough to warrant tax free status? (p. 12)

Lydgate estimates that the "hospitals own land and buildings worth a total of \$227 million, which would translate into about \$3.5 million in tax revenue flowing into the county's coffers every year." He then acknowledges that land and buildings are not the whole issue. As discussed in SWOPD above, for example, property tax also includes equipment and hospitals have very expensive equipment. No one has ever placed a value on all of it but the hospitals are deeply concerned because the value of the equipment could exceed that of the land and buildings.

Lydgate says that "Hospital advocates are confident that they will prevail, but they can't afford to be smug. Some hospitals in Utah recently lost their tax exempt status after a similar challenge." Lydgate also acknowledges that after Multnomah county rules on this case, it will probably go through the appeal process and finally be decided by the Oregon Supreme Court.

As shown by previous media coverage on these issues, there will be much more on this case in the media this Summer and Fall, after the hospitals respond and the case prepares for trial.

This case may well be fought in the papers almost as much as it will be fought in the courts as each side will want to generate as much public opinion as possible in favor of their position.

There are also articles about churches fighting a requirement to pay unemployment compensation taxes, churches being challenged on their tax exempt status, abuses of nonprofit status by a variety of nonprofits, and the Portland United Way citing the development of trust as one of the major issues it faces following misappropriation of funds by the national president. These articles will be discussed in Chapter 8.

Another article of interest was by Fred Leeson (1995) entitled "Metro Crisis Line adds for-profit service." In it he talks about how the Metro Crisis Intervention Service, a nonprofit organization which runs the Metro Crisis Line (MCL), is adding a for-profit service called ProtoCall Services, which is a telephone

after-hours answering service that fields after-hours mental health calls for private companies and clinics. (p. F4)

The article talks about the financial benefits ProtoCall adds to MCL, and quotes the executive director, Laura Jeibmann, as saying "ProtoCall is close to paying half the budget this year. I predict it will be two-thirds by this time next year." (p. F4)

The article says that ProtoCall could make MCL self supporting and how other nonprofits are looking at ways to generate additional revenues. There is no mention in the article about issues of unfair business competition or unrelated business income taxation.

In an interview, Jeibmann (1996) said that MCL had no problem with either the unrelated business income tax, which they did not pay, or unfair business competition.

The ProtoCall business is significantly related to the mission and goals of Metro Crisis Line and therefore no tax has to be paid. There are no forprofit businesses doing the same thing in Oregon, in fact the nation, so there is no problem with unfair business competition. However, our Board of Directors has recommended that we spin ProtoCall off into its own company, with the Metro Crisis Line designated as the charity of choice.

If they do spin off ProtoCall into a separate business that eliminates any concern about unrelated business income tax or unfair competition by a nonprofit. ProtoCall becomes a for profit business and designates the MCL as its charity of choice. ProtoCall then pays property taxes like any other business and any and all

profits are then sent to MCL. However, profit from income is not usually taken as the profits are donated to the charity of choice.

As explained by Hill and Kirschten (1994) there are two main purposes for forming a for profit subsidiary: (1) protecting the exempt status of the parent corporation, and (2) reducing the overall tax burden. (p. 9.54) The exempt status of the parent is protected by reducing the total amount of income the parent generates through unrelated activities and ensuring that the total unrelated income does not exceed 50% of the gross income of the nonprofit. However, they freely admit that reducing the tax burden is difficult, and that the main purpose of forming the subsidiary is protecting the tax-exemption of the parent.

The current situation of unrelated business enterprises and unfair business competition is as follows:

1. The legislature has taken no significant action on the issues. Legislation was introduced in 1985 and 1987 which was relevant to the issues but never made it out of committee.
2. The Oregon Department of Revenue implemented a new rule to help clarify the definition of a charity. As stated in Chapter 6 some of the criteria of the new rule relate to charity as the primary objective of the organization, the activity must be conducted for the benefit of the general public at large, an element of giving must be present, and other indications that an organization may be charitable.

This was done to help county assessors in their efforts to determine who should be paying property taxes and who should be receiving tax exempt status. This rule is still in effect in the Property Assessment and Taxation Laws and Administrative Rules in effect today.



3. The Oregon Courts have a big case coming to them in State of Oregon ex rel. Theodore A. Tosterud v. Janice Druian, Multnomah County Tax Assessor. This is the case which will determine the tax exempt status of hospitals in Oregon. No matter which way the Multnomah County Assessor decides the case will be appealed, probably all the way to the Oregon Supreme Court.

At the present time, under the current scenario, the Supreme Court will probably be the one to decide what will be the criteria for hospitals to retain tax exempt status. Depending upon the outcome of that case, if the hospitals lose their exemption, it is highly probable that there will be significant pressure put on the legislature to establish criteria for the hospitals to regain their exempt status. But only time will tell the outcome of that case and that may well be the subject matter for another dissertation.

It is very interesting to note how this issue has evolved over time. In 1983, when the SOSOC litigation began, the issue was whether or not the college could conduct unrelated business enterprises and if those enterprises were within the statutory authority of the college. In 1986, when the YMCA litigation began the issue was fair competition and whether or not the YMCA should be a tax exempt organization. In 1989, when the YMCA case was at the Supreme Court the issue was tax exempt status. In 1992 and beyond, in SWOPD, Theatre West, and now the hospitals, the issue is what constitutes a charity and when should tax exempt status be granted.

## CHAPTER 8

### THEORETICAL FRAMEWORKS TO ANALYZE THE INFORMATION

Initially this dissertation began as a non-decision analysis as developed by Bachrach and Baratz (1970). However, as the analysis proceeded, it became apparent that the lack of legislation was not a non-decision by the legislature. Attempts were being made to solve the problem. What was really happening was the real issue was becoming clearer as more information was becoming available through the actions of the major players, the media, the assessors, the Department of Revenue, and the courts. Therefore, the non-decision framework did not apply.

This chapter will be an analysis of the information using the agenda building framework and how it applies to the information in this dissertation. It will be followed by a discussion about the advocacy coalition framework and how that framework can be used to analyze the information from the future legislation and litigation on the issue of what constitutes a charity and when should it receive tax-exempt status.

#### AGENDA BUILDING

An applicable framework to use to analyze the information is that of agenda building as developed by Kingdon. This approach is to look at the participants, the process, the problem, and the politics involved in the setting the public agenda. This format will

be used in the analysis of the issues discussed in this dissertation. Each portion will begin with a discussion of how Kingdon approached the individual part of the agenda building process, followed by a discussion of how the issues in this dissertation fit into the agenda building framework.

The first part of this discussion is about the participants in the process. Kingdon breaks the participants into two groups: those inside of government and those outside of government. When talking about those inside of government he focuses on the top down model with the leader influencing the agenda and the actions of others. He notes that the president can "dominate his political appointees, and that the appointees can dominate the civil servants." However, he also notes that, while elected and appointed officials may dominate the agenda, how the decisions are implemented is up to the bureaucrats. (p. 33)

The bureaucrats have resources available to them that are not available to elected officials - one of which is their longevity. (p. 35) The simple fact is that the bureaucrats last longer in office than the elected and appointed officials and therefore they can influence how policy is implemented over a longer period of time. He also discusses how bureaucrats may have more expertise than elected officials, and how bureaucrats develop relationships with the people in Congress and the special interest groups. Kingdon acknowledges that bureaucrats develop clienteles and that those relationships between bureaucrats, committees and special interest groups, "is often called the iron triangle because they are

alleged to be impenetrable from the outside and uncontrollable by the president, political appointees, or legislators not on the committees." (p. 36)

Players also come from outside the government, and Kingdon cites special interest groups, academics, researchers, consultants, the media, elections-related participants, and public opinion as outside influences on the setting of the agenda. (pp. 48-74) Each of those has its own form of influence and we will discuss the special interest groups and the media because those are specifically involved in the topic of this dissertation.

Special interest groups have played an important part from the beginning of the discussion with unrelated business enterprises at Southern Oregon State College. The coalition of local business men led by Leo Jansen took that issue through the court system. When the YMCA litigation began NAME pursued that litigation through the court system and eventually won their case when the YMCA lost its tax exempt status. They were, however, unable to get any legislation through but that seems to be because the legislature felt that the issue was being handled properly in the courts and in the Department of Revenue.

Those for the tax exempt status of the YMCA's and the hospitals also formed a special interest group with COCA and pursued getting legislation passed to support their position. They were also unsuccessful for the same reasons that NAME was unsuccessful in that the legislature had passed on the issue and

was letting the courts and the Department of Revenue decide the issue.

Involved within the bureaucracy and the courts are the tax assessors of the counties, such as Steve Skinner in Multnomah County, who has the job of maintaining rules on tax exempt status for nonprofits; the staff in the Oregon Department of Revenue who usually remain nameless even though their decisions on issues such as these can have significant impact; and Judge Carl Byers, of the Oregon Tax Court, who has made several of the tough decisions such as YMCA and Theatre West, and who will probably have to rule on the current hospital litigation as it moves through the system.

There are two points that need to be made when looking at the future of this issue as it relates to tax-exempt status for nonprofit organizations.

First, neither Kingdon, nor any of the other authors cited above, spend much time on how much impact one individual can make working on an issue. As discussed in Chapter 5, Frank Eisenzimmer made a tremendous impact upon the furtherance of his goals in taking tax-exempt status from the YMCA. He was far and away the most important person in that case. His relentless pursuit of his goal eventually led to the YMCA losing its tax-exempt status.

That same situation is coming again in Oregon as Ted Tosterud pursues his goal of taking tax-exempt status away from

the hospitals. He has the resources and the commitment to stick with his efforts until he gets the decision he wants.

Lindblom (1968) calls these people "interest group leaders" who have no legal authority or power, yet they become powerful through their use of "persuasion through the practice of partisan analysis." (p. 116)

These are the kinds of people who can bring about great changes in policy within a government. As we have seen Eisenzimmer was very successful in what he set out to do, even though the YMCA eventually won back its tax-exempt status. Eisenzimmer changed the way the YMCA conducted its affairs and made them more of a community service organization.

How successful Tosterud will be remains to be seen. However, there is no doubt that he will impact the policy relating to tax-exempt status of hospitals and will bring about a complete review of what constitutes a charity and why it should receive tax-exempt status in Oregon.

According to Kingdon the media also plays a role in changing governmental policy agendas, although he found that it played less of a role than he had expected. He found that the media impacted policy by acting as a communicator within the policy community, by magnifying movements that had already started elsewhere, by changing public opinion on an issue and thereby having an indirect effect on the policy process, and by impacting those players in the policy process who may have need to gain the attention of the important players in the policy process. (p. 63)

As discussed in Chapters 5 and 7 the media has played an important role in bringing these issues to the attention of the public and to the policy makers within Oregon. On the national level the campaigns by the Business Coalition for Fair Competition and the International Racquet Sports Association brought together the information from the various states into one ongoing report and provided the players opposed to tax-exempt status with an operational handbook for their campaigns.

The articles by the various authors cited in Chapters 5 and 7 also contributed by bringing individual cases in Oregon to the attention of the public and the national media. As the cases in Oregon moved through the Department of Revenue and the Courts, they kept people apprised of the issues and the progress of the cases. As the new cases are developing the media is still very much involved and I am sure that they will continue to keep on top of the new cases as they further define the issue and move through the bureaucracy and the courts.

The third part of Kingdon's model is to look at the issue as a problem and how it relates to the long list of problems being addressed by the government. This becomes a situation of identifying priorities and looking at how the particular issue being addressed fits in to the list of priorities being developed for the public agenda.

Kingdon says that government decision makers routinely look at a variety of indicators gathered by various groups within and outside of government. They also look at events, crisis and

symbols to determine what is most important to public policy as they determine priorities. Some problems or issues rise to prominence over time. Others fade away because the government officials feel they have solved the problem. (p. 95)

He also looks at how the definition of a problem may change and how the values relating to the definition may change as well. Depending upon how the problem is defined and presented to the decision makers is very important in determining if it will be placed on the public agenda. (p. 115)

In Chapter 4 this dissertation discussed how the issues came about through litigation in the courts because the plaintiff's could not get satisfaction through the bureaucracy or the legislature. In Chapter 6 this dissertation discussed how the legislature left the issues of unrelated business enterprises and unfair business competition to the Department of Revenue and the Courts. Revenue developed a new rule to assist assessors in determining what criteria were to be used to as tests to determine whether or not a charity qualifies for property tax exemption.

When the new rule was implemented in 1987 the legislature felt that they had the problem taken care of and the issue would be decided by the Department of Revenue and the courts as they interpreted the new rule. In other words, maybe the issue would go away.

But it has not gone away. In fact, it is coming back in new terms looking for a much broader definition of what constitutes a charitable or nonprofit organization and when should it receive



tax-exempt status. These issues are much broader in scale than whether or not SOSOC should be running summer camps or whether or not the Metro YMCA should be exempt from tax on its property. These issues are broad enough in scale to impact the very nature of all nonprofit tax exempt organizations in the State of Oregon.

That is certainly a large enough scale to attract the attention of the legislature and place the issues on the public agenda. The outcome of the most recent litigation by Ted Tosterud could become very important in ensuring that the legislature begins to address the issues.

The fourth part of Kingdon's model is that of politics in the process. Kingdon talks about the importance of the national mood determining the importance of an issue, how key personnel within government can move an item on or off the agenda, and how consensus building becomes very important in this process.

He also talks about policy windows and how they open and close depending upon the situation at hand. Windows open and/or close when people come and go from committees or the bureaucracy, when the national mood shifts and an issue becomes important at the time, and when an opportunity becomes available to align the issue with another in a process called coupling. He recommends that when the window opens for an issue that the advocates for or against have to seize the opportunity and take as much advantage as they can. After all, all windows that open will also close and a second chance may not come around for some time. (pp. 174-204)

This concept is exactly what has been happening to the issues of this dissertation over the past 15 years. The window has not been open because the problem was not seen as large enough or big enough to warrant the attention of the legislature. It was thought that the changes in Revenue and the application of those changes to court decisions would bring the matter to closure.

Instead, the issue has come back in a form that may bigger, more important, and more urgent than anyone thought before. If the hospitals lose the Tosterud litigation the issues of what constitutes a charity and when should it receive tax-exempt status will become very important indeed. That should certainly be enough to open the window and place the larger issue on the legislative agenda.

#### ADVOCACY COALITION

Another framework which could be helpful in analyzing the information in this dissertation is the advocacy coalition framework developed by Sabatier and Jenkins-Smith. This framework has four basic premises as summarized:

1. that understanding the process of policy change - and the role of policy oriented learning therein - requires a time perspective of a decade or more;
2. that the most useful way to think about policy change over such a time span is through a focus on "policy subsystems," that is, the interaction of actors from different institutions who follow and seek to influence governmental decisions in a policy area;

3. that those subsystems must include an intergovernmental dimension, that is, they must involve all levels of government ... and
4. that public policies (or programs) can be conceptualized in the same manner as belief systems, that is, as sets of value priorities and causal assumptions about how to realize them. (p. 16)

Of particular importance to Sabatier and Jenkins-Smith is their concept of policy learning which they describe as being "relatively enduring alterations of thought or behavioral intentions that result from experience and are concerned with the attainment (or revision) of policy objectives." (p. 19) This learning will occur because of several different functions which they list as follows:

1. individual learning and attitudinal change,
2. the diffusion of new beliefs and attitudes among individuals, (as well as changes in the real world which alter the beliefs and attitudes of society [p. 18])
3. turnover in individuals within any collectivity,
4. group dynamics, such as the polarization of homogeneous groups or groups in conflict, and
5. rules for aggregating preferences and for promoting (or impeding) communication among individuals. (p. 42)

They further state:

Policy-oriented learning occurs within the context of a political process where people compete over authoritative allocation of values and over the ability to use the instruments of government - including coercion - in their

behalf (Easton, 1965; Lowi, 1969). This process is not a disinterested search for "truth." (p. 45)

They then discuss the conditions conducive for policy-oriented learning to occur. They list them as a high level of conflict, analytical tractability (agreement among the players as to what counts as valid information), and the occurrence of an analytical forum where open discussion can take place on the issues. (pp. 48-55)

When the information is applied within the advocacy coalition framework it produces an interesting analysis.

First, relating to the issues of unrelated business enterprises and unfair business competition, the discussion took place for a decade or more. It began in the early 1980's and by 1987 it had evolved into a discussion of tax exemption, then moved to a discussion about what constitutes a charity and when should tax-exempt status be granted. The evolution of the issue, or what Sabatier and Jenkins-Smith would call policy-oriented learning, has been going on the entire time and is still going on today.

It has taken this length of time to fully define the issue. Now that the issue has been defined, the real debate can begin, and will take place in the hospital litigation discussed in Chapter 7.

Second, when looking at policy change over a time span the framework looks at policy subsystems, the interaction of actors from different institutions who are seeking to influence governmental decisions. This is important because the actors are changing.

In the 1980's there were private citizens filing litigation against nonprofits. When the discussion began in the early 1980's it involved Leo Jansen and his people from Ashland in their litigation against SOSC. By the mid-1980's it involved Frank Eisenzimmer and NAME in their litigation against the YMCA. Ted Tosterud lost his litigation against the hospital pharmacies in that time period.

By the late 1980's and early 90's the litigation had changed. Instead of private citizens suing nonprofits, it was nonprofits defending their tax exempt status as assessors were trying to take it away. SWOPD and Theatre West are two examples.

Then in the mid-1990's it is changing back to private citizens seeking to remove tax-exempt status from a nonprofit. Ted Tosterud in his litigation against the hospitals, for example.

The information suggests that this case will also bring about a change in the players involved in changing public policy. As reported by Gragg (1994) in his article on "Taxing the Arts," the arts heavyweights, such as the Oregon Shakespearean Festival and the Portland Art Museum, are watching these cases very closely. They see these cases as a threat to their very existence, but have not yet intervened, because the court decisions have been in their favor. (p. D4) The implication is that if a decision does not go in their favor then they will intervene.

Assume for a moment that the Multnomah County Assessor finds against the hospitals. The case goes through the appeal process and the Oregon Supreme Court, bound by the

administrative rules and Oregon Revised Statutes finds against the hospitals and removes their tax-exempt status. Assume for a moment that the reasons given are inadequate level of charitable giving as defined in YMCA (1992).

The precedents in SWOPD, YMCA and Theatre West all indicate that the Tax Court will uphold the assessor. The case would then go to the Oregon Supreme Court. If the Supreme Court upholds the assessor then the only recourse for the hospitals becomes the Oregon Legislature. Following the Advocacy Coalition Model the legislature would be the logical place for coalitions to attempt to shape the public agenda

Such a decision would also attract national media attention and would probably involve national groups from the BCFC to national nonprofit management organizations. At that point this framework would become extremely useful in explaining what was happening in the evolution of policy in the area of tax-exempt status for nonprofits.

The third area they use, the necessity of an intergovernmental dimension, has already occurred. In fact, it may well be coming full circle. In the mid-1980's it was in the legislature and the courts. By 1987 it had moved to the Department of Revenue, who provided a clearer set of standards for the county assessors. By the late 1980's and early 1990's the assessors issued rulings which were appealed to the courts. And the court decisions in the near future could bring the issue right back to the legislature. Certainly that fits within the framework.

When the cycle is complete it should also provide an interesting study showing how it moved from jurisdiction to jurisdiction.

And finally, their premise is that policies can be conceptualized in the same manner as belief systems, as sets of priorities. They feel that these beliefs include objectives and theories about how to achieve them.

This premise is also applicable to what has happened, but can become an important part of the analysis when one looks at the future debate on the issue of tax-exempt status.

When the discussion was on the issue of unrelated business income and unrelated business enterprises it was issue specific. It was Ashland merchants vs. SOSC or private health clubs vs. YMCA's. As the issue changes to the broader context of what constitutes a charity and when should tax-exempt status be granted, it becomes much broader and discusses the beliefs and values of the society.

The advocacy coalition framework and its concept of policy-oriented learning is a valid framework for the analysis of an issue which has been resolved, or a case where the real issue have been identified and the players are all on board. That is not the case here.

This issue is still in transition and all of the players have not yet been identified. When the hospital litigation is complete, assuming the issue moves to the legislature for resolution the list of players will become quite long and quite powerful. When that discussion is complete the framework of the advocacy coalition

approach would be very useful. However, at the present time, I feel that, as the agenda and the issues are being developed in this situation, the agenda building framework of Kingdon is a better approach to explain what has occurred to date.



## CHAPTER 9

### CONCLUSIONS AND RECOMMENDATIONS

In Chapter 1 this dissertation identified the dilemma facing nonprofits in Oregon today: they can conduct unrelated business enterprises to generate income but if they do, they face potential litigation from forprofit business claiming unfair competition and potential loss of tax exempt status. Does the dilemma still exist today? Yes it does. Are steps being taken to resolve the dilemma. Yes they are, but in the context of a different discussion about what constitutes a charitable organization and when can it receive tax exempt status.

This Chapter will discuss the issues that were to be examined in this dissertation and what was learned about them, discuss the changing criteria for tax-exempt status in Oregon today, then look at what was learned by those nonprofits who have been in court defending their tax-exemption.

#### ISSUES IN THE DISSERTATION

There were four central issues identified that were to be examined in this dissertation:

1. Why has there been no legislative action in Oregon on the issues of unrelated business enterprises and unfair business competition by nonprofits?

2. Can the issue be resolved? Is it appropriate for a nonprofit to conduct unrelated business enterprises?
3. Does the unrelated business income tax ensure that fair competition exists between nonprofits and for profits, or are additional controls necessary to ensure that fair competition exists?
4. What action needs to be taken in Oregon to resolve these issues?

The first issue asks why there has been no legislative action on these issues of unrelated business enterprises and unfair business competition and the dilemma inherent in them even though there have been a number of requests and significant media coverage of the issues. The information shows that the legislatures from 1985-1995 felt that the current law and administrative rules were sufficient. They looked at the law in 1985 and asked the Department of Revenue to clarify it. Revenue did so with a new administrative rule in 1987. The courts then took that rule and further clarified it in a variety of court cases.

But now the issue and discussion have become much broader to ask what is a charitable or nonprofit organization. If the question were to be rephrased to ask if the legislature will have to look at the related issue of what constitutes a charity in the future, the information in Chapter 7 indicates it will have to address it in the future.

Eventually, a case like the hospital litigation discussed in Chapter 7 will go through the Supreme Court. When that happens the legislature is going to have to decide what organizations are going to retain tax exempt status and what organizations will not

retain it. The very necessity of maintaining a stable tax base will require it to be addressed at the legislative level.

Can this issue be resolved? Absolutely. First of all, there are situations where it is perfectly appropriate for a nonprofit to conduct related business enterprises and compete with private enterprise. For example, Goodwill collects used items as contributions then hires and trains handicapped people to repair and sell them. By doing so Goodwill meets the nonprofit criteria of giving and service to the community. Society benefits in many ways even though the retail sale of the used items competes directly with other used item retail outlets.

Another example would be a college campus renting their facilities and services to an athletic or cheerleader camp in the summertime. These camps require large amounts of space and the most inexpensive room and board available. They may also require athletic equipment not usually found in hotels. In many cases they even bring their own linen for the beds. This is not the kind of business usually sought by the hotel industry. At the same time the college meets the nonprofit criteria of education (even cheerleaders have to learn somewhere), fulfillment of mission, and service to the community.

A third is the retail sale of souvenir items by museums, theaters, symphony orchestras, and other similar groups. These organizations have a service that they provide to the community and the sale of souvenir items is clearly related to that service. The key to these kinds of enterprises is that they are directly

related to the mission and purpose of the nonprofit organization. Many of the business enterprises first thought to be unrelated in the 1980's have since been found to be related to the exempt function of the nonprofit.

It is in the area of unrelated business enterprises that the issue becomes less clear, but the information indicates that it may be able to be resolved. Key to whether or not a nonprofit should conduct unrelated business is the availability of the service or activity within the private business community. If private business can offer adequate service at a fair price then a nonprofit should not be offering the same service in competition with private business. If the nonprofit wants to compete with the private business then it should form its own forprofit company and compete on the same level as discussed with ProtoCall in Chapter 7. Why take the risk by conducting unrelated business enterprises when there is such a clear way to conduct the enterprise and not risk litigation or loss of nonprofit status.

There was a time when unrelated business enterprises were necessary for some nonprofits to fulfill their mission and to provide service to the community. The large college in a small town is one example. But now the country has grown and there are just not many of those situations any more. It's different now than it was in 1950 when the unrelated business income tax was written into law.

As discussed in Chapter 2, many states, such as Washington, California and Arizona, have written legislation which restricts the

ability of a nonprofit to conduct unrelated business enterprises. Most of the legislation contains a clause which allows a nonprofit to conduct unrelated enterprises only when the goods or services involved are not available in the local community. It is time for Oregon to review unrelated business enterprises and establish similar legislation to govern nonprofits in Oregon. Those kinds of enterprises are just not as prevalent or necessary as they once were.

Regarding issue three, the unrelated business income tax, when it was written it was to ensure that fair competition exists between a nonprofit and forprofit business. If the steps taken above are implemented that will become a non-issue. Certainly a nonprofit should pay tax on any enterprise or income it derives outside of its exempt function or purpose. But if it conducts an unrelated enterprise that is not in competition with private enterprise then the tax is not needed to ensure that fair competition exists, but rather to ensure that the nonprofit pays its share of tax on income or property it has outside of its exemption, just like everyone else.

Regarding the last issue, what does Oregon need to do to resolve this issue? It needs to determine why we have charitable organizations. It needs to discuss what constitutes a charitable organization and what do we expect from them.

Currently the question of what constitutes a charity or nonprofit is being answered in the courts and the Department of Revenue. Eventually, whether they like it or not, the information

indicates the question is going to go before the legislature. That is where the definition will have to be determined and written into law. When that question is answered all of the other questions relating to tax exemption and business enterprises will fall into place.

#### THE CHANGING CRITERIA FOR TAX-EXEMPT STATUS

When tax-exempt status was first granted it was a controversial issue. In fact, as Simon (1987) states

In the long history of charity and nonprofit institutions, there may never have been an epoch free of controversy over taxation, but the past forty post-World War II years have witnessed an unremitting state of siege. ... Skirmishes of the past, however, were no more than isolated forerunners of the strife - over the taxation of both religious and secular nonprofits - that has prevailed in contemporary America. Since 1945, concern with federal, state and local tax treatment of nonprofit institutions has produced at least eight congressional investigations and hearings, half a dozen major federal statutes..., and a succession of state and local wars over real property tax exemption. ... With nonprofits receiving \$50 billion in federally deductible contributions, generating roughly \$110 billion in fee, sale, and investment revenue exempt from federal income tax, and holding an estimated \$300 billion in real estate exempt from state and local property taxes, it is little wonder that hard-pressed nonprofit institutions and deficit-ridden governments find themselves currently at war. (p. 67)

It does not appear that the level of controversy over tax-exempt status will lessen in the foreseeable future. The information clearly indicates that more challenges will have to be resolved before this issue is solved.

When the Internal Revenue Act of 1950 was passed the rules governing nonprofits were much simpler than they are today. As long as the preponderance of the income was used to fulfill the exempt purpose of the organization unrelated business enterprises were not a problem. Now, with YMCA (1992), and the level of giving at 20%, there may be an inherent conflict developing in the tax law.

At the same time, the new criteria for nonprofits implemented by the Department of Revenue (1988) (Chapter 6) are different than the traditional justifications as shown by Bookman (1991) and the 6 point test of Oregon Methodist Homes (1961) (Chapter 2). There is a much stronger emphasis on giving and contribution to the community than in the previous rules. These new rules, and the precedents which follow such as SWOPD (1991) and YMCA (1992), provide much greater emphasis on proof of giving as seen through the eyes of the recipient, and establishing a minimum level of giving to maintain tax-exempt status.

The information indicates that the assessors, the Department of Revenue, and the courts may well take a much more stringent position on this issue. The information also suggests that there will be stricter enforcement of the rules that apply to tax-exempt status to ensure that all criteria are met.

Included in the review of nonprofits could be a periodic review of the reason for tax-exempt status of each nonprofit organization. This could be done every 5-7 years to ensure that

the organization is still working within its mission of service and exempt purpose. The responsibility for this enforcement would have to rest either with the county assessor where the nonprofit provides its services or by the Oregon Department of Revenue. It would not be unreasonable to charge the fees for funding this service to the nonprofits themselves since they are the ones that would be reviewed.

There is a disparity between the various counties in Oregon as the assessors value property and tax-exempt status. For example, the need for a hospital in a small rural town is far different than that of an urban area. In a small town the YMCA may be the only physical fitness facilities available where in a larger area it may be in competition with a for profit business. The question arises as to whether these are unique to each area or predictable depending upon the demographics and economics of the area involved. Need may be a driving force in the decisions of the assessors. However, differences between the various counties should not be significant enough to negate the basic principle of periodic review of tax-exempt status of an organization.

#### FUNDAMENTAL PHILOSOPHICAL AND POLITICAL ISSUES

Through the development of this research, five fundamental issues emerged which will have to be decided at the legislative level: (1) the erosion of the property tax base through the growth of nonprofit tax-exempt organizations and their acquisition of property and equipment; (2) the justification of tax-exempt status; (3) the justification of tax deductions to tax-exempt organizations;



(4) the state of current tax law, and (5) the legislative reality of change in the law.

The first fundamental issue is the erosion of the tax base in Oregon. There are two kinds of taxes for which an organization faces potential liability: income tax and property tax. The exemption of income tax does not seem to be an important part of the discussion about tax-exempt status. As reported by Simon (1987), even though the total income of nonprofits may be as high as \$76 billion, that is not the amount of taxable income. When deductions are allowed for normal operations "most nonprofits would show very little surplus or profit (p. 81)." With little or no profit there would be very little tax paid and therefore that should not be an important part of this discussion.

The research indicates that the discussion about the exemption from taxation of property owned by nonprofit tax-exempt organizations is the real issue. As discussed by both Byers (1996) and Skinner (1996), estimates of the amount of property currently tax-exempt in Oregon range up to 40% and continues to grow as more organizations become tax-exempt and existing organizations acquire additional property. As more property becomes tax-exempt in the State there is less property to carry the tax load. They feel that this is one of the reasons for the tax revolt that brought about Measure 5.

Both are greatly concerned about the eroding tax base in Oregon. Both are deeply concerned about how to replace the income to the state and the various counties that is lost due to tax

exemption. There is a very real probability that the eroding tax base may well be the issue that brings the discussion of tax-exempt status to the floor of the legislature.

The second fundamental issue is that of the justification of tax-exempt status for nonprofit organizations. As discussed in Chapter 2 there are many traditional ways, but with the changing criteria in current law those methods may no longer hold true. As nonprofit organizations have continued to proliferate the number of examples of abuse of the privilege continues to grow as well.

Any re-examination of the tax law would have to begin with the fundamental reasons for granting tax-exempt status to an organization. The discussion should include the reasons for granting public subsidy through tax-exempt status and why a tax exemption is the appropriate place for that subsidy to occur.

Coupled with the discussion about the reason for tax-exempt status is the third fundamental issue, why to allow a tax deduction for contributions made to a nonprofit organization. This is another form of the public subsidy which occurs through the current tax system. Any discussion which occurs on tax exemption should also include discussion about tax deductions.

The fourth fundamental issue is the state of the current tax laws relating to nonprofit tax-exempt organizations. As discussed above, it is probably time to review the basic assumptions which brought about the current federal and state codes. But there is a larger problem with the current law: most of it is in precedent cases, revenue rulings, private letter rulings, and other places not

included in the tax code. Much of the current law has been decided on a case-by-case basis and is very difficult to research and review.

It is time to consolidate all of this by reviewing the whole thing and bringing it back into code. Cleaning up the tax law would be of great benefit to all involved, not only the nonprofits and the assessors, but the public as well.

The fifth and last fundamental issue is the political reality of bringing about change in this area. The nonprofit sector is very large and continually growing. Bringing about change in the law is going to be an enormous project both in time and resources. Given the number of people involved there will probably be intense public discussion.

One of the realities of change of this magnitude is that it is going to change the way some nonprofits conduct their affairs. Some are going to benefit and some are going to get hurt. However, the information available indicates that change has to occur in this area to ensure that the outcome of tax-exempt status is the greatest public benefit. That is the final criteria by which all change should be measured.

#### RECOMMENDATIONS FOR NONPROFITS

In closing, the information indicates that there are things that nonprofits can do to prevent some of these problems in the future. Currently nonprofits are receiving a tremendous amount of negative press with all of the litigation in process. Articles such as the one by Zagorin, "Remember the Greedy" in Time, and others,

have emphasized the abuses by some nonprofits, not the contributions made to the society by the majority of nonprofits. There are several things that nonprofits should do to avoid the problems some of them face today.

First of all, nonprofits have to stay true to their mission and exempt purpose. When they lose sight of what they are about they get into trouble. Witness the YMCA (1987) case in the 80's in Chapter 4. Tax exempt status is a privilege, not a right once attained, and nonprofits need to stay focused on what they are supposed to be doing, not on what they would like to be doing. They need to constantly examine the role they play in the community and how they contribute to the betterment of the whole.

Also, if a nonprofit is accused of operating outside of its exempt purpose it needs to examine its operations before it responds to the accusations. In both SOSC (Jansen v. Atiyeh, 1985) and YMCA (1987) the nonprofit was not in compliance with current law. When challenged by business each responded by trying to defend what they were doing rather than analyzing their situation and adjusting, if necessary, to come into compliance. This was rather like Nixon trying to defend Watergate and the result was about the same. In each case, after extended litigation, the net result was that the nonprofit came into compliance with existing law and the litigation ceased.

The information indicates that SOSC and the merchants could have avoided all of the litigation had two things occurred in 1981.

First, SOSC did not acknowledge that it had a problem until it was too late. Had SOSC responded to the complaints from the time they first knew about them, as they responded after the findings of the committees were published, they probably could have avoided the litigation. Secondly, and just as important, had the merchants worked with the college to gather accurate information to establish what was really going on, rather than dealing with rumors and innuendo, they might not have entered into litigation either.

However, just as with SOSC, had the YMCA reevaluated its mission and operations when first challenged, rather than try to defend an indefensible position, it could have prevented the entire process of litigation and all the attendant baggage that came with it. The YMCA wound up significantly altering its operations to come into compliance with existing tax law.

Second, if a nonprofit is working within its exempt purpose and wants to enter into an unrelated business enterprise, it needs to analyze the facts and understand the risks it is about to take. Is the extra income generated worth the potential hassle it could receive for conducting such enterprises? The nonprofit needs to make sure that it knows what it is doing before it makes the plunge into unrelated enterprises.

Third, if a nonprofit enters into unrelated business enterprises it should be sure to always pay the tax. If error is to occur it should be in paying too much tax, not in avoiding the tax. Understand that the tax is to ensure that fair competition exists and without the tax the nonprofit has an unfair advantage. That is

one of the central issues of the whole argument. When the nonprofit pays the tax it is perfectly legal. When it does not pay the tax it risks penalties from the Internal Revenue Service, litigation from its competitors, and all of the attendant media baggage that goes along with litigation.

If a nonprofit needs the money from unrelated business enterprises it should form a forprofit subsidiary (per ProtoCall in Chapter 7) or form a separate company and use the profits to fulfill its mission rather than enter into unrelated business enterprises. It is just a cleaner way to go in the atmosphere of today.

Fourth, the leadership of a nonprofit should constantly analyze what the organization does in the context of the society - not the context of the organization. Times change and needs change. A nonprofit should change with the times. Witness the March of Dimes after polio was cured. Outdated missions and goals will be hard to defend under scrutiny that includes community service and giving.

Nonprofits are going to come under increasingly close scrutiny about what they do, how they operate, and the benefits they bring to the community. That is something that is currently underway in academe, government, and the private sector. It will become increasingly important for nonprofits to conduct their affairs in an impeccable manner that is beyond reproach.

Organizations such as the American Society of Association Executives, and other professional associations within association

administration should look to developing some form of self-regulation or self governance. Perhaps they could develop standards of performance, community service and giving, those areas mentioned in the litigation discussed in this dissertation, before those standards are developed in the courts or in the legislature.

Unrelated business enterprises and the dilemma inherent in them are no longer a major issue today. As discussed in this dissertation there are alternatives available which eliminate the need for them in all but the most extreme cases. The Department of Revenue and the courts have moved on to the broader issue. By staying true to their mission of community service and not conducting unrelated business enterprises unless absolutely necessary, nonprofits can move on as well.

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