



# Theory of Change Tool Manual

Full Version

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We would like to thank the "INTERNATIONAL NETWORK ON STRATEGIC PHILANTHROPY" (INSP) ([www.insp.efc.be](http://www.insp.efc.be)) for the opportunity to develop and implement this product. The INSP is a result of the considerable foundation sector growth both in Germany and internationally. Endowed funds, the amount of grants, the number of employees, and the social impact of foundation work are on an increase. To cope with the future challenges, an emphasis must be focused on the professional standards of the Sector and on the capacity to innovate. Both will be desperately needed when facing the work that lies ahead.

In light of this, the Bertelsmann Foundation initiated the International Network on Strategic Philanthropy. The network aspires to convene the minds of the sector and provide them with an infrastructure and the support to:

- Create tools and resources to help professionalize the Sector,
- Enhance management capacity,
- Increase organizational effectiveness and,
- Promote strategic thinking and management to maximize their impact for society.

Acting as a decentralized think tank, the network enables foundation leaders, staff, consultants and researchers as well as representatives of support organizations to gather and disseminate know-how, to place issues of the Sector on the national and global agenda and to design innovative implementation mechanisms for new approaches in strategic philanthropy.

The project is an international co-operation of several foundations which have decided to invest in the infrastructure of the sector: *The Bertelsmann Foundation, The Charles Stewart Mott Foundation, The Compagnia di San Paolo, The Ford Foundation, The King Baudouin Foundation, and an Anonymous Donor.*

We would also like to thank the participants in the development of this product for their contributions of time, hard work, creativity, and commitment to the project.

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## Introduction

*"Social change philanthropy aims explicitly to facilitate the changing of social institutions so they don't produce the very problems that charity tries to alleviate." Alan Rabinowitz, Social Change Philanthropy in America*

Welcome to the INSP Theory of Change Development Tool. We are pleased that you have chosen to use the Tool and encourage feedback. The Tool allows users to create a framework or model of change, also known as a "theory of change" or "logic model" which maps out how your program or initiative plans on getting from present conditions to your vision of success. It provides a guide for planning, implementing, and evaluating your initiative or effort. Once completed, it provides a picture of how your program or initiative will bring about change in order to accomplish an identified goal.

On the following pages, you will learn how the Tool works and what to expect. Beginning on page 14, we have created a number of worksheets to assist you in preparing to work with this Tool. Do not let these worksheets overwhelm you. They have been designed to assist in planning for and using this Tool for maximum benefit. Much of the information requested is probably readily available within your organization. This workbook provides a guide to facilitate gathering the needed information, stimulate dialogue and build consensus as you work through each section.

## The Purpose of the Tool

This Tool was designed for use by organizations such as Foundations, Trustees, NGOs, and individuals such as donors, philanthropists or consultants to facilitate the development of a Theory of Change, the first step in strategic philanthropy. As assets continue to shrink, the strategic, conscientious, and thoughtful use of resources is vital. Research, planning, collaboration, monitoring, and evaluation are key components of the work, particularly as all parties are seeking the maximum benefit from social investing.

The practice of Philanthropy is taking a turn, moving from the traditional practices that historically have met immediate needs and short term goals, to one of strategic or social-change giving, with the long-term goal of "funding change, not charity." Although a slow process, institutions and individuals that support social-change are continuing to increase in number as they seek to more effectively address issues at their root causes.

A basic premise of strategic philanthropy is that those in need can often solve their own problems if they have the power and opportunity to do so. For example, where mainstream foundations typically fund projects created by intermediary organizations on behalf of the community, social funders look to those in the community to find solutions to their own problems. Please see Appendix A for an overview of Strategic Philanthropy.

Defining your work and the systems, strategies, and activities that support it is a challenge. It requires a clear link between ideas about how a system can be built and the actual strategies implemented. Creating this clear link can be accomplished through the use of theory-based frameworks. These frameworks are tools that can guide you through the process of articulating ideas about the best approaches for developing programs and solutions. Stakeholders can benefit from using theory-based frameworks because they make explicit links between ideas or *theories of change*, the strategies they plan to implement, and the outcomes they hope to achieve. Theory-based frameworks support implementation efforts as well as strategic planning and evaluation

processes by helping stakeholders reach consensus about the populations they plan to serve, strategies they implement, and the results they expect to achieve.

This guidebook accompanies this Tool to provide:

- *A preparatory handbook to enable the most efficient use of the Tool.*
- *A "paper" version that can be the basis for a facilitated group meeting with the stakeholders involved in creating your Theory of Change.*
- *A stimulus for discussion among stakeholders, clients, staff, etc. to enable input from varied sources.*
- *A handbook version that can be used by anyone who does not choose to utilize or have access to the software program.*

### **What is a "Theory of Change?"**

"A theory of change is the articulation of the underlying beliefs and assumptions that guide a service delivery strategy and are believed to be critical for producing change and improvement. Theories of change represent beliefs about what is needed by the target population and what strategies will enable them to meet those needs. They establish a context for considering the connection between a system's mission, strategies and actual outcomes, while creating links between who is being served, the strategies or activities that are being implemented, and the desired outcomes."

A theory of change has two broad components. The first component of a theory of change involves conceptualizing and operationalizing the three core frames of the theory.

These frames define:

- **Populations:** who you are serving.
- **Strategies:** what strategies you believe will accomplish desired outcomes.
- **Outcomes:** what you intend to accomplish.

The second component of a theory of change involves building an understanding of the relationships among the three core elements and expressing those relationships clearly. The theory of change is defined by the three core elements and the relationship that exists between them.

### **Why develop a Theory of Change?**

- Theories of change help move stakeholders from being passive collectors and reporters of information to active users of information for system planning and service delivery.
- Theories of change help system and program staff better understand the kind of evaluation information they need to make day-to-day decisions.
- Theories of change help the evaluator develop research questions that focus measurement on changes that can occur given the particular strategies that are operative at the system, program, and client level.
- Because they facilitate understanding the link between strategies and the achievement of outcomes, theories of change facilitate the integration of data from broader evaluation and accreditation requirements into local evaluation efforts.

- Ultimately, having a theory of change helps those implementing strategies to understand assumptions and expectations that guide their decisions, actions, and resulting accomplishments.

### **Who was the Tool designed for?**

The Tool is designed for flexibility; for use by organizations or individuals, in a group setting or on your own. It can be used if you are in the early stages of developing your philanthropy, considering the right vehicle(s) for your giving - *Start a foundation? Continue personal charitable giving? Create a Donor Advised Fund?* It can if your practices are in development or well established; an individual new to philanthropy or an organization with quite an established history - the considerations and questions are fundamentally the same.

The Tool provides “Things to Consider” to stimulate thinking and discussion around each question; to give you guidance in the critical considerations before you start. “Supporting Resources” are there to assist in forming your answer by providing food for thought through varied resources – papers, reports, documents, and websites. Depending on your experience in the Sector, or that of your group, the resources are varied to meet a range of knowledge and expertise.

Working through this Tool and creating a theory of change allows organizations to be more strategic by identifying upfront the boundaries of their work – the population, the strategies and the desired outcomes. Whether a new organization or an established one rethinking current work, being clear at the start of a program or initiative can accelerate the learning providing an opportunity to adapt or modify strategies earlier vs. later for greater value, more efficient delivery and more effective outcomes.

Resources are finite and needs are not. Understanding the need, developing strategies and creating the best plan for the available resources are all vital and that begins with articulating a clear theory of change.

### **Foundations**

- Personnel in a group setting, such as a formally facilitated meeting, to solicit input, gather insights, and brainstorm through the stages of new program development.
- A Program Officer, individually or with colleagues, to develop a Theory of Change to present to department heads or trustees, to launch a new initiative; to redirect efforts in a present area of funding or to assist in the decision process regarding working in new areas.
- Foundation Trustees to structure discussions in planning and strategy sessions. Organizations grow, downsize, and change; this requires a review of the mission and current work and strategies. With a clear articulation of their Theory of Change, a more effective message can be delivered to the staff and the field as the organization moves forward.
- Staff to access readily available resources found under “Supporting Resources” to assist in their work.

- Stakeholders to test and review current strategies, programs and initiatives: Are they still valid? Are they on target? Can they be improved? Are there gaps?

### ***Foundation Trustees***

- Structure discussions in planning and strategy sessions. Organizations grow, downsize, and change; this requires a review of the mission and current work and strategies. With a clear articulation of their Theory of Change, a more effective message can be delivered to the staff and the field as the organization moves forward.
- Create new programs and initiatives to introduce to foundation executives and staff.
- Test and review current strategies, programs and initiatives: Are they still valid? Are they on target? Can they be improved? Are there gaps?

### ***NGOs***

- Personnel in a group setting, such as a formally facilitated meeting, to solicit input, gather insights, and brainstorm through the stages of new program development.
- A staff member, individually or with colleagues, to develop a Theory of Change to present to the board or the Executive Director to launch a new program; to redirect efforts in a present area of work or to assist in the decision process regarding working in new areas.
- Board members to structure discussions in planning and strategy sessions. Organizations grow, downsize, and change; this requires a review of the mission and current work and strategies. With a clear articulation of their Theory of Change, a more effective message can be delivered to the staff and the field as the organization moves forward.
- Staff to access readily available resources found under “Supporting Resources” to assist in their work.
- Stakeholders to test and review current strategies, programs and initiatives: Are they still valid? Are they on target? Can they be improved? Are there gaps?

### ***Donors/Philanthropists***

- With Stakeholders in a group setting, such as a formally facilitated meeting, to solicit input, gather insights, and brainstorm through the stages of new program development.
- Individually or with colleagues, to develop a Theory of Change to launch a new initiative; to redirect efforts in a present area of funding or to assist in the decision process regarding working in new areas.
- To structure discussions in planning and strategy sessions. Intent and assets change, grow, downsize; this requires a review of the mission and current work and strategies. With a clear articulation of the Theory of Change, a more effective message can be delivered and implemented as the work moves forward.



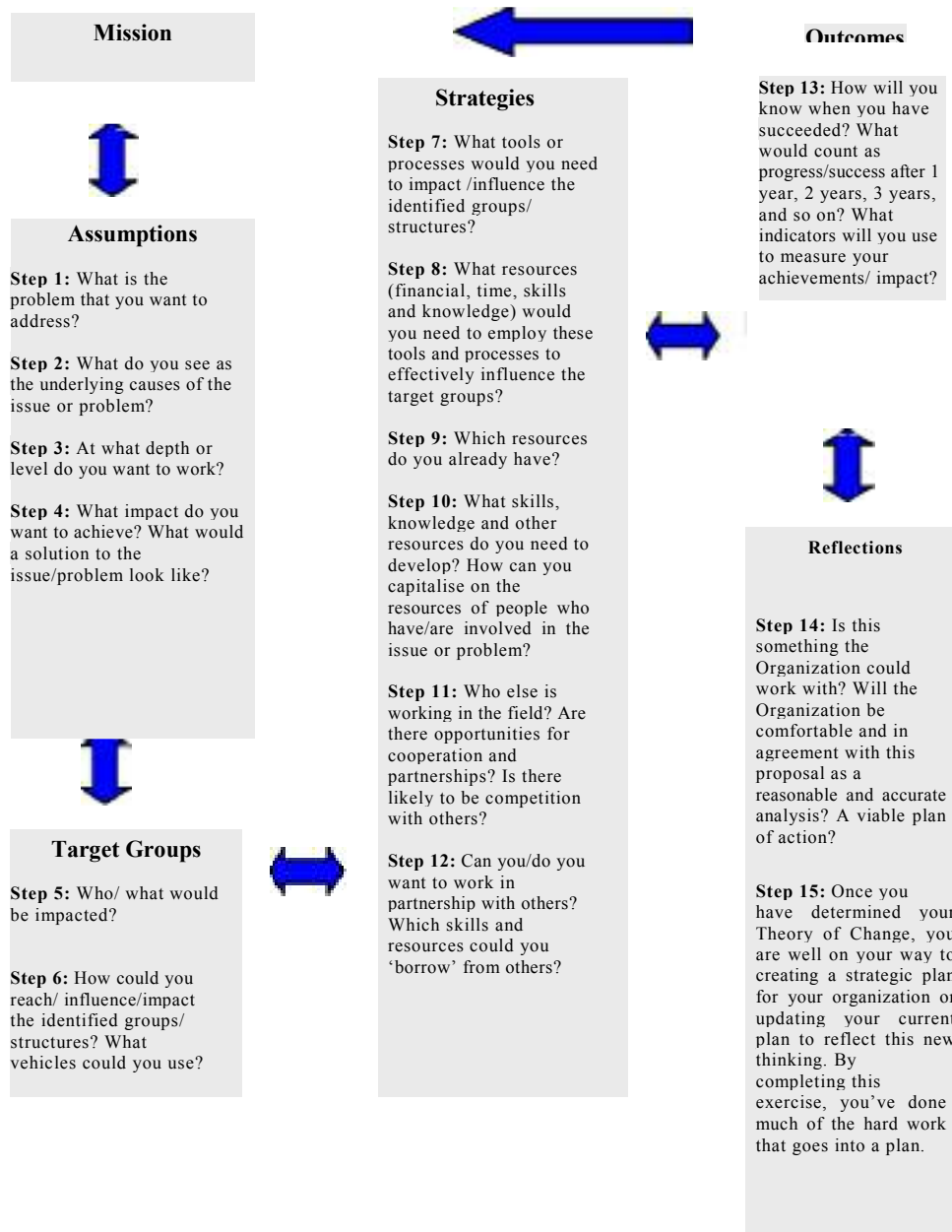
- To access readily available resources found under “Supporting Resources” to assist in their work.

### **Consultants**

- Clients to begin a discussion around new work or to test and review current strategies, programs and initiatives: Are they still valid? Are they on target? Can they be improved? Are there gaps?
- Client personnel in a group setting, such as a formally facilitated meeting, to solicit input, gather insights, and brainstorm through the stages of new program development.
- A Program Officer, individually or with colleagues, to develop a Theory of Change to present to department heads or trustees, to launch a new initiative; to redirect efforts in a present area of funding or to assist in the decision process regarding working in new areas.
- Foundation Trustees to structure discussions in planning and strategy sessions. Organizations grow, downsize, and change; this requires a review of the mission and current work and strategies. With a clear articulation of their Theory of Change, a more effective message can be delivered to the staff and the field as the organization moves forward.
- Consultancy staff to access readily available resources found under “Supporting Resources” to assist in their work.
- Staff to create potential options for new or existing clients.

## Theory of Change Development Overview

The following diagram is an overview of the Steps and the relationship of the information.



## Theory of Change Development Tool Steps:

- 1** What is the problem that you want to address?
- 2** What do you see as the underlying causes of the issue or problem?
- 3** At what depth or level do you want to work?
- 4** What impact do you want to achieve? What would a solution to the issue/problem look like?
- 5** Who/what would be impacted?
- 6** How could you reach/influence/impact the identified groups/structures? What vehicles could you use?
- 7** What tools or processes would you need to impact/influence the identified groups/structures?
- 8** What resources (financial, time, skills and knowledge) would you need to employ these tools and processes to effectively influence the target groups?
- 9** Which resources do you already have?
- 10** What skills, knowledge and other resources do you need to develop? How can you capitalise on the resources of people who have/are involved in the issue or problem?
- 11** Who else is working in the field? Are there opportunities for cooperation and partnerships? Is there likely to be competition with others?
- 12** Can you/do you want to work in partnership with others? Which skills and resources could you 'borrow' from others?
- 13** How will you know when you have succeeded? What would count as progress/success after 1 year, 2 years, 3 years, and so on? What indicators will you use to measure your achievements/impact?
- 14** Now, review your answers to each step and consider:
  - Is this something the Organization could work with?
  - Will the Organization be comfortable and in agreement with this proposal as:
    - *A reasonable analysis of the issues?*
    - *An accurate analysis of the environment?*
    - *A viable plan of action for your Organization given its mission, income, knowledge and other constraints?*
- 15** Once you have completed the Tool and developed your Theory of Change, you are well on your way to creating a strategic plan for your Organization or updating your current plan to reflect this new thinking. By completing this Tool, you've done much of the hard work that goes into creating a plan.

## Summary Document



Theory of Change Development Tool

**Proposed Theory of Change for [Your Name Here]**

**Organizational Mission:**

**The Problem we want to address is:**

**The underlying cause of the problem is:**

**The impact we want to achieve is:**

**Our work will be at the following depth or level:**

**The following target groups/structures will be impacted:**

**We will reach/influence/impact the target groups/structures by:**

**The tools or processes needed to impact/influence target groups are:**

**The resources - financial, knowledge, skills, time- needed to employ these tools and processes to effectively influence the target groups are:**

**The resources currently available are:**

**We can capitalise on the resources of people who have or are involved in the issue or problem. The resources we need to develop or acquire are the following:**

**Others working in the field are as follows:**

**We see the potential for partnerships and the skills and resources that must come from others as follows:**

**We will use the following to measure achievements/impact and to monitor progress:**

## How does the Tool work?

Developing your Theory of Change is an iterative process reflected in the design of the Tool. You may work through the steps at your own pace, starting and stopping as you need. The information is inter-related and not necessarily linear; therefore, you may find it easier to start at a place other than Step 1, working through the information in an order that best accommodates your style and needs.

The Tool is comprised of 15 steps, each proposing a question. Each step provides assistance in three ways:

- **Things to Consider:** to stimulate thinking and discussion around each question.
- **Things You'll Need to Complete This Section:** internal documents and planning tools that would assist in your preparation. (Please see Appendix B for a complete listing of "Things you will need to complete this section")
- **Supporting Resources:** to assist in forming your answer by providing food for thought through varied resources – papers, reports, documents, and websites. Just click on the title and you'll be linked to the resource. (Please see Appendix C for a complete listing of "Supporting Resources")

The assisting documents can reside on your computer or be accessible via the Internet, depending on which version of the tool you loaded.

- The version **INSPTOC.exe** contains all of the supporting documents, and they exist in the subdirectory /SUPDOCS under your installation subdirectory (default is /INSPTOC). When you click on a linked document in the above 3 categories, the document is opened locally.
- The version **INSPTOClite.exe** does not contain the supporting documents. When you click on a linked document in the above 3 categories, the document is opened from an Internet storage location ([www.insp.efc.be/toc](http://www.insp.efc.be/toc)).

## Starting the Program

Once you have downloaded and unzipped the Tool, go to the directory or folder that you just created to house the Tool (default is **INSPTOC**). In that folder, locate the file "home.htm". Right click on that file to create a shortcut on your desktop. This will allow you to run the Tool from your desktop in the future.

If you choose not to create a shortcut, double click on "home.htm" and the program will start. The homepage will look as below.

## Using the Program

Click on any of the links on the Home Page begin using the Tool. Each link on the Home Page will take you to background information until you are ready to start by clicking on **Start the Tool**.



Once you Start the Tool, you will move to the Organization Name and Mission Screen as seen below. When the entry is complete, move to Step 1 by clicking Next.

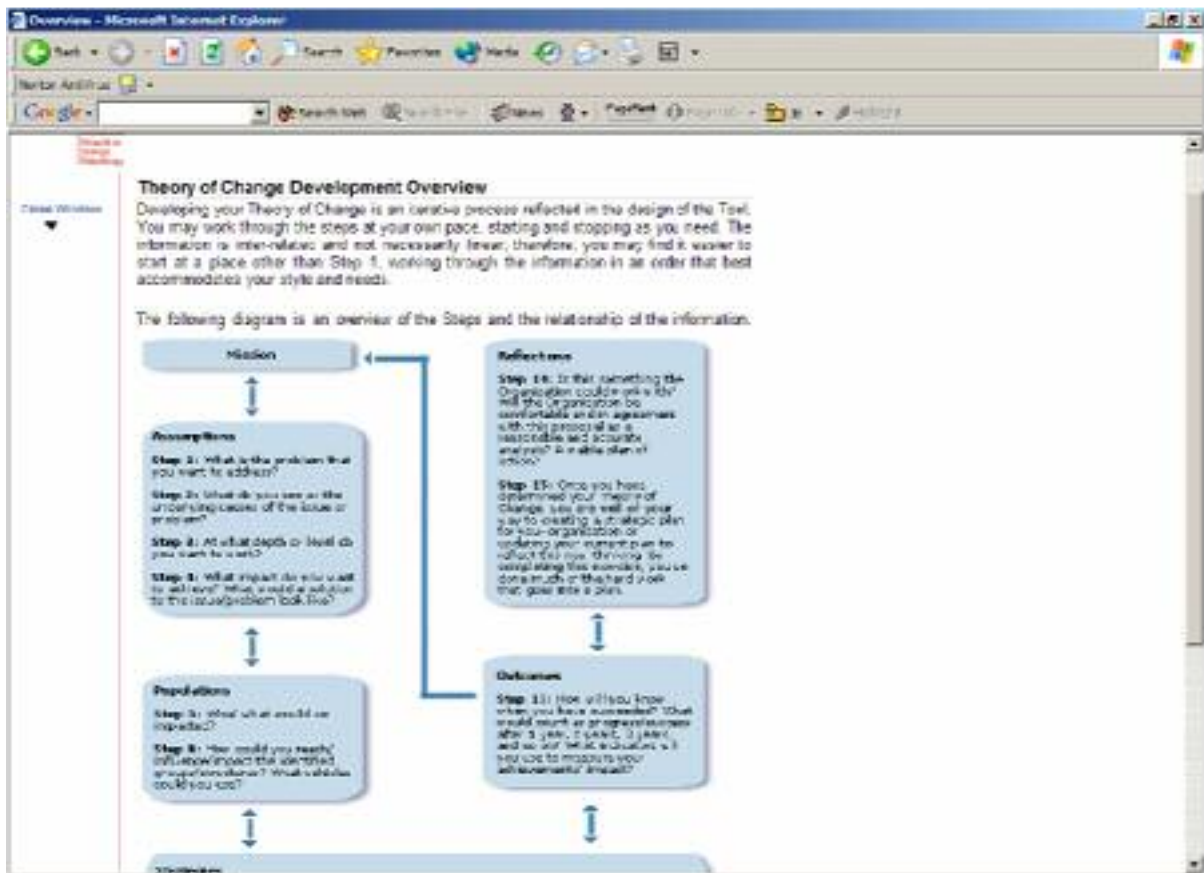


As you work with the Tool you will have the following navigation bar available . It is consistent throughout the program allowing you to move easily through the Steps. If you rollover **Find** with your cursor, you will be able to move to any page in the program by selecting that page: Home, Organization Name/Mission or any Step.

If you rollover **Clear** with your cursor, you can clear the contents of the current page (OrgName/Mission or a Step) or all pages (OrgName/Mission and all steps).

## Tool Overview Page

An alternate method of navigating thru the Tool is to use the **Tool Overview** page.



The Overview is accessible from the Home Page. It shows a diagram of the steps in the tool grouped into functional areas. You can click on the step descriptions and jump directly to that step.

## Data Entry

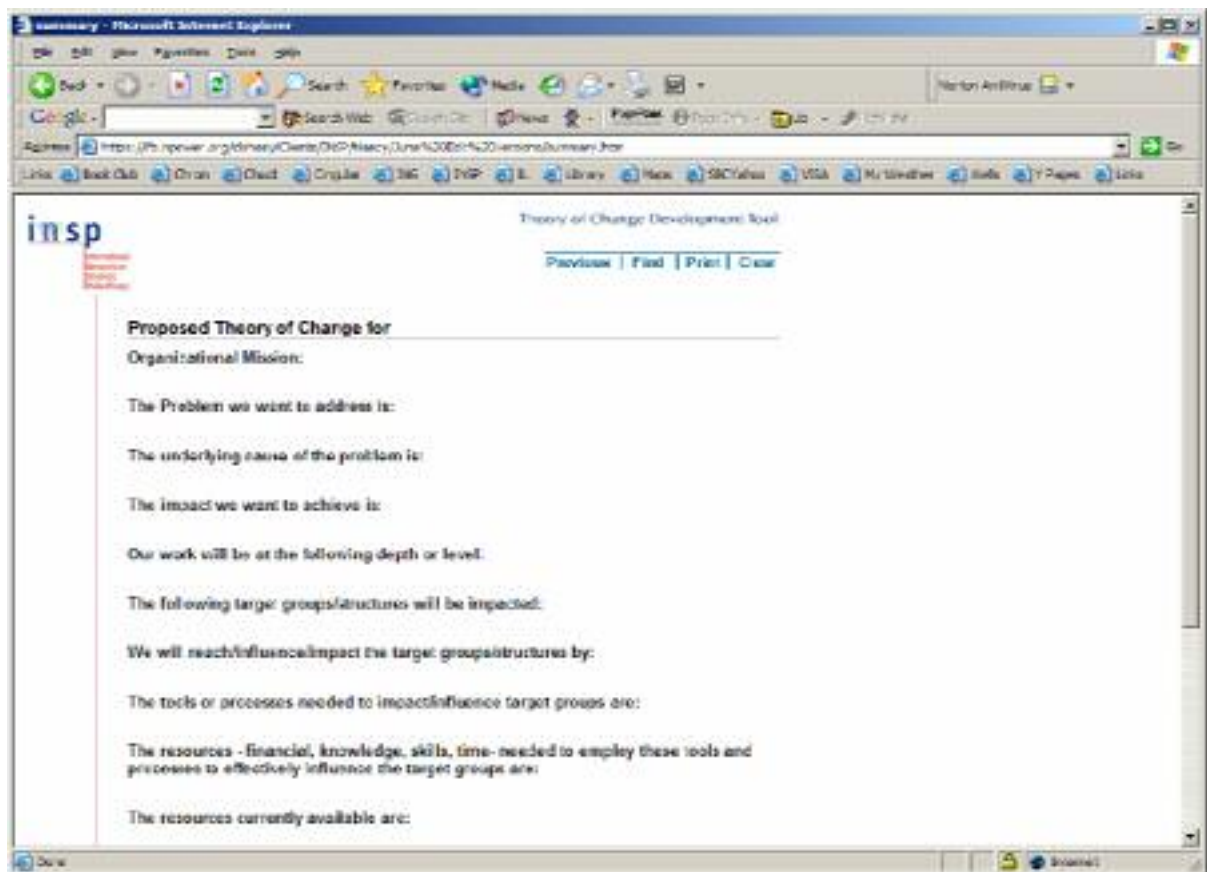
As you enter data, it will be retained until you erase it. You can move through the steps in any order. As you enter information, you can move directly to the **Summary** Page by rolling over **Find** to see how you are progressing. You can stop at any point and return at a later time without losing data.

If you choose to, you can create your answers in a word-processing program such as Word and then copy and paste your entry into the data entry box in the Tool. This will allow you to spell check your information prior to moving it.

**Please note, the Tool will not allow you to use or save any special formatting (i.e. Bold, Italics, Bullets, etc.).**

### Summary Page

As your information is entered, your answers are compiled in the **Summary**. You can move to the Summary as you work to check your progress. You may also print it at any time to review your work. If you want to change an answer, just move to that page and modify your entry. When you return to the Summary, the modifications will be reflected.



Once you have completed your entry, print the Summary for your use. If you have Acrobat Writer, you can print to a PDF file for use as an attachment. To use the text in another document, highlight it on the screen and use the browser's Copy function (or use CTRL-C) to copy it to the clipboard. Then paste the clipboard contents into your document.



## **Before you start: Legal Considerations**

Every country has its own set of laws and regulations regarding philanthropy or charitable giving. While there are similarities between countries, we have not rendered an opinion or created a summarization in this document; it is best to check the latest information for your particular country before starting to use the Tool.

An excellent resource is the International Center for Nonprofit Law ([www.icnl.org](http://www.icnl.org)). ICNL's Online Library and Database offers access to documents affecting NGO law, governance issues, tax regulations, NGO codes of ethics, etc. from more than 160 countries around the world. There are over 2100 documents in ICNL's hard copy library, and these are being digitized so as to make them available to a world-wide audience online. Documents not available on-line may be obtained from ICNL.

*For your convenience, we have included *The Tax Treatment of Nongovernmental Organizations: A Survey of Best Practices from Around the World* by ICNL in Appendix D of the manual.*

## Worksheets

On the following pages, you will find a series of worksheets that will help you prepare for using the Tool. For some it may be easier to sketch your answers on paper prior to using the software. For others, you may want to use this as a guide and jot some quick notes or mentally prepare your answers. In some organizations, these worksheets may be used to stimulate conversation and gather ideas for more of a more collective response.

**Organization Name:**

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### Mission Statement

A Mission Statement helps establish direction for an organization. It allows you to consider how activities contribute toward or detract from what you want your organization to be. A Mission Statement will help focus you on your goals, clarify issues and prioritize efforts so that you can concentrate on the ones that are aligned with your values. Without a Mission Statement, you might find that your organization is going off in too many directions.

The best mission statements are concise (not more than a few sentences) and include your organization's name, overall purpose, and a compelling reason for its existence.

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## Mission Statement Examples

- *The Bertelsmann Foundation is committed to the development of progress in the public sector pursuant to the tradition of its founder, Reinhard Mohn. The work of the Bertelsmann Foundation is based upon the conviction that competition and social commitment form an essential basis for social progress. The Bertelsmann Foundation understands itself as a promoter of social change and supports the goals of the sustainable society. The Foundation wants to identify social challenges and problems at an early point in time, and to develop and realize exemplary solutions.*
- *"To help people help themselves through the practical application of knowledge and resources to improve their quality of life and that of future generations. "*

*The W.K. Kellogg Foundation is a nonprofit organization whose mission is to apply knowledge to solve the problems of people. Its founder W.K. Kellogg, the cereal industry pioneer, established the Foundation in 1930. Since its beginning the Foundation has continuously focused on building the capacity of individuals, communities, and institutions to solve their own problems.*

- *NCIB's mission is to promote informed giving and to enable more contributors to make sound giving decisions. NCIB believes that donors are entitled to accurate information about the charitable organizations that seek their support. NCIB also believes that well-informed givers will ask questions and make judgments that will lead to an improved level of performance by charitable organizations.*
- *The Robert Wood Johnson Foundation's mission is to improve the health and health care of all Americans. Remaining faithful to our mission means keeping our commitment to the American people in everything we do from encouraging healthier living and the conditions that promote better health to promoting positive changes in the way health care is delivered in this country.*

## Step One

### What is the problem that you want to address?

*(For example, Poverty, Inequality, Discrimination, Poor health, Violence/crime, Environmental degradation, Child abuse, Substance abuse....)*

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#### Things to Consider

- Critical Legal Considerations: Charity or Non-profit law Constraints on the Organization's work - resources, legal, cultural, expertise
- The Organization's Vision, Mission and Strategic Plan (if available)
- How this relates to your organization's mandates and goals
- Previous Organizational experience in this area
- Who else is funding in this area?
- The role of government

#### Items you will need to complete this part

- The Organization's bylaws
- The Organization's Strategic Plan (if available)
- The Organization's programmatic planning tools or documents that may relate to this endeavor

*Consider having....*

- The Board minutes from the last year

#### Supporting Resources

- Problem Identification Process
- Problem Solving Checklist
- A US Guide to Programming Under IRS Public Policy Rules
- US Guidelines for Informing Public Policy
- INSP Theory of Change Development Paper:  
~ Foundation Constraints
- The Foundation Center [www.fdncenter.org](http://www.fdncenter.org)
- International Center for Nonprofit Law [www.icnl.org](http://www.icnl.org)





### **Items you will need to complete this part**

- The Organization's Strategic Plan (if available)
- The Organization's programmatic planning tools or documents that may relate to this endeavor

*Consider having....*

- The Board minutes from the last year

### **Supporting Resources**

- Toolkit of Philanthropic Approaches
- Spectrum of Philanthropic Approaches
- Innovative Forms for Foundations – Investments in the Common Good
- Tools for Good Guide
- A US Guide to Programming Under IRS Public Policy Rules
- US Guidelines for Informing Public Policy
- Vehicles of Social Transformation
- What is Social Transformation?
- Venture Philanthropy: Investing in People
- **INSP Theory of Change Development Paper:**
  - *Formulating a Theory of Intervention,*
  - *Designing Effective Interventions : Theories of Programme Implementation*
  - *How social transformation happens*
  - *Approaches to policy making and policy change*
- [ETD and Public Policy Processes www.eto.org.uk/etd/policy/policy01.htm](http://www.eto.org.uk/etd/policy/policy01.htm)
- [The Foundation Center www.fdncenter.org](http://www.fdncenter.org)
- [The European Foundation Center www.efc.be](http://www.efc.be)

## Step Four

### **What impact do you want to achieve? What would a solution to the issue/problem look like?**

*(For Example: 'Everyone would have sufficient education and training to find work and support themselves'; 'People would not need to turn to crime – they would gain income and satisfaction from paid work.')*

*Step Thirteen will provide an opportunity to probe deeper into evaluation.*

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#### **Things to Consider**

- Journey to Transformation
- Using Logic Models to Bring Together Planning, Evaluation, & Action
- What level of experience and expertise is available within the Organization
- What evaluation approaches have been used by the Organization in the past
- How have evaluations looked from the Organization's current programmes and work in this area, if any
- The available resources - financial, time, knowledge, etc.
- The role of government in this area
- The Organization's Vision, Mission, and Strategies

#### **Items you will need to complete this part**

- The Organization's Strategic Plan (if available)
- The Organization's programmatic planning tools or documents that may relate to this endeavor

#### **Supporting Resources**

- Guiding Principles for Programme Evaluation
- Using Logic Models to Bring Together Planning, Evaluation, & Action
- Making Change Matrix
- Program Evaluation Practice in the Nonprofit Sector
- Journey to Transformation
- **INSP Theory of Change Development Paper:**
  - *Formulating a Theory of the Desired Outcome*
- [Innonet Program Development Workstation http://Innonet.org](http://Innonet.org)



## Step Five

### Who/what would be impacted?

*(For example individuals, families? Key bureaucracies such as the education system, welfare services – e.g. benefits, housing; the health care system; legislation at national level, legislation at European level? Unions, professions, culture and values, others?)*

*If you don't know, who could help you identify what needs to change?*

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### Things to Consider

- Vehicles of Social Transformation
- What is Social Transformation?
- Journey to Transformation
- Feedback from target groups
- Complementary programs currently in place in the Organization
- The available experience and expertise within the Organization
- Groups discouraged or prevented from doing the desired activity by a common barrier that you can help them overcome
- Groups most receptive to making the desired changes or benefiting the most from the desired changes
- Peers and associates with related experience
- Future or planned work and strategies of the Organization
- News and commentary regarding dissatisfaction with the "status quo"

### Items you will need to complete this part

- The Organization's programmatic planning tools or documents potentially that may relate to this endeavor

### Supporting Resources

- A US Guide to Programming Under IRS Public Policy Rules
- US Guidelines for Informing Public Policy
- Vehicles of Social Transformation
- What is Social Transformation?
- Journey to Transformation
- Segmenting the Market to Reach the Targeted Population

- Getting a Good Discussion Going
- Change Management 101
- Leading Transition: A New Model for Change
- 10 Tips for Communicating Change
- Guiding Principles for Programme Evaluation
- Making Change Matrix
- Program Evaluation Practice in the Nonprofit Sector
- Using Logic Models to Bring Together Planning, Evaluation, & Action
- **INSP Theory of Change Development Paper:**
  - *Formulating a Theory of Intervention,*
  - *Approaches to policy making and policy change*
- [ETD and Public Policy Processes www.eto.org.uk/etd/policy/policy01.htm](http://www.eto.org.uk/etd/policy/policy01.htm)
- [The Foundation Center www.fdncenter.org](http://www.fdncenter.org)
- [The European Foundation Center www.efc.be](http://www.efc.be)



- What is Social Transformation?
- A US Guide to Programming Under IRS Public Policy Rules
- Program Evaluation Practice in the Nonprofit Sector
- Using Logic Models to Bring Together Planning, Evaluation, & Action
- **INSP Theory of Change Development Paper:**
  - *Formulating a Theory of Intervention,*
  - *Designing Effective Interventions : Theories of Programme Implementation*
- [Community Toolbox Workstation http://ctb.lsi.ukans.edu/tools/CWS/cws.htm](http://ctb.lsi.ukans.edu/tools/CWS/cws.htm)

## Step Seven

### What tools or processes would you need to impact/influence the identified groups/structures?

*(For example: Enabling direct action by citizens. Providing ideas, research and knowledge. Supporting maverick individuals. Supporting community self-help. Supporting personal self-help. Funding voluntary organisations and charities. Encouraging government intervention/ legislative or procedural change. Providing incentives to change. Imposing sanctions against lack of change.)*

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#### Things to Consider

- Make Clear Your Theory of Change
- Theory of Change - Stages
- The accessibility of the target population(s)
- Networks, programmes and processes currently in place with potential constituents
- Previous Organizational experience in this area
- Who else is funding in this area
- Internal tools and techniques that have proven successful
- Available internal resources
- The Organization's Vision and Mission
- The Organization's Strategic Plan (if available)
- Political limitations - the Organization's position on intervention in policy/ politics

#### Items you will need to complete this part

- The Organization's programmatic planning tools or documents that may relate to this endeavor
- The Organization's bylaws

#### Supporting Resources

- Make Clear Your Theory of Change
- Theory of Change – Stages
- Designing Community Interventions
- Segmenting the Market to Reach the Targeted Population
- Behaviour Changes by Making it Easier and More Rewarding
- **INSP Theory of Change Development Paper:**
  - *Formulating a Theory of Intervention,*
  - *Designing Effective Interventions : Theories of Programme Implementation*
- [Innonet Program Development Workstation http://Innonet.org](http://Innonet.org)
- [Community Toolbox Workstation http://ctb.lsi.ukans.edu/tools/CWS/cws.htm](http://ctb.lsi.ukans.edu/tools/CWS/cws.htm)
- [The Grove Tools www.grove.com](http://www.grove.com)

## Step Eight

**What resources (financial, time, skills and knowledge) would you need to employ these tools and processes to effectively influence the target groups?**

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### Things to Consider

- Working knowledge of the skills, needs and accessibility of the target group(s)
- Previous Organizational experience with similar initiatives requiring comparable processes and tools
- Others funding the target population(s) and the possible synergies
- Any messages/work that is being conducted by the Organization on behalf of other initiatives that could be counter-productive
- Availability/limits of financial resources
- The capacity of the Organization to take on this work

### Items you will need to complete this part

- Financial/budget resources to support this work
- Job descriptions of key staff members for potential overlap/ synergies
- The Organization's programmatic planning tools or documents potentially that may relate to this endeavor

### Supporting Resources

- Unleashing New Resources and Entrepreneurship for Common Good
- Intercooperation's Understanding of Empowerment
- **INSP Theory of Change Development Paper:**
  - *Foundation Constraints*
- [Innonet Program Development Workstation http://Innonet.org](http://Innonet.org)
- [Community Toolbox Workstation http://ctb.lsi.ukans.edu/tools/CWS/cws.htm](http://ctb.lsi.ukans.edu/tools/CWS/cws.htm)
- [The Grove Tools www.grove.com](http://www.grove.com)
- [The Foundation Center www.fdncenter.org](http://www.fdncenter.org)
- [The European Foundation Center www.efc.be](http://www.efc.be)



## Step Ten

**What skills, knowledge and other resources do you need to develop? How can you capitalise on the resources of people who have/are involved in the issue or problem?**

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<b>Things to Consider</b>
<ul style="list-style-type: none"><li>• SWOT Analysis</li><li>• Results of the skill and resource gap analysis</li><li>• Results of the SWOT Analysis</li><li>• Results of the mapping of outside skills and resources</li><li>• Cost and financial resources available to acquire needed skills and knowledge</li><li>• Networks, programmes and processes currently in place with target population(s)</li><li>• The accessibility of the target population(s)</li><li>• Previous Organizational experience in this area</li><li>• Others funding or supporting work in this area</li></ul>
<b>Items you will need to complete this part</b>
<ul style="list-style-type: none"><li>• Information/documentation of Previous Organizational experience in this area (if available)</li></ul>
<b>Supporting Resources</b>
<ul style="list-style-type: none"><li>• Skillview</li><li>• SWOT Analysis</li><li>• Human Resource Management in Foundations - Placeholder due in Fall 2003</li><li>• <a href="http://Innonet.org">Innonet Program Development Workstation http://Innonet.org</a></li><li>• <a href="http://www.fdncenter.org">The Foundation Center www.fdncenter.org</a></li><li>• <a href="http://www.efc.be">The European Foundation Center www.efc.be</a></li></ul>





## Step Twelve

**Can you/do you want to work in partnership with others? Which skills and resources could you 'borrow' from others?**

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### Things to Consider

- Determine Benefits You May Seek in Alliances
- Meeting the Collaboration Challenge
- "Risk-Benefit" of partnering - what are the requirements for collaboration
- Partner profiles: Operational and philosophical issues/topics must be considered
- Potential synergies with Networks of organizations, Associations, programmes and processes currently in place with target population(s)
- Results of the skill and resource mapping (internal and external) and the SWOT Analysis
- Skills and resources of the potential collaborators
- Previous Organizational experience collaborating in this or a related area
- The capacity, experience and resources of the Organization vs. needs

### Items you will need to complete this part

- Results of asset mapping done by the Organization
- Information on Networks, Associations, Funders/Donors supporting this work
- Information/documentation of Previous Organizational experience in this area (if available)

### Supporting Resources

- Determine Benefits You May Seek in Alliances
- Meeting the Collaboration Challenge
- Motivations for Partnering
- The NP Sector and Business Partnerships
- Cashing in on Charity's Good Name
- Types of Partnerships
- INSP Stakeholder Interactions
- **INSP Theory of Change Development Paper:**  
- *Working On and With Others*
- [The Chronicle of Philanthropy](http://philanthropy.com/) <http://philanthropy.com/>
- [The Foundation Center](http://www.fdncenter.org) [www.fdncenter.org](http://www.fdncenter.org)
- [The European Foundation Center](http://www.efc.be) [www.efc.be](http://www.efc.be)
- [Independent Sector](http://www.independentsector.org) [www.independentsector.org](http://www.independentsector.org)

## Step Thirteen

**How will you know when you have succeeded? What would count as progress/success after 1 year, 2 years, 3 years, and so on? What indicators will you use to measure your achievements/impact?**

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### Things to Consider

- Guiding Gathering Information: Monitoring Your Progress
- Developing an Evaluation Plan
- Intent, goals and objectives of the work or initiative
- Evaluation approaches that have been used by the Organization in the past
- Evaluations from the Organization's current programmes and work in this or related areas, if any
- What level of experience and expertise is available within the Organization
- Available resources - financial, time, knowledge, etc.
- The Organization's Vision, Mission, and Strategies

### Items you will need to complete this part

- The Organization's Strategic Plan (if available)
- The Organization's programmatic planning tools or documents that may relate to this endeavor

### Supporting Resources

- Evaluation in Foundations
- The Role of Evaluation in the 21st Century Foundation
- Guiding Principles for Programme Evaluation
- Using Logic Models to Bring Together Planning, Evaluation, & Action
- Program Evaluation Practice in the Nonprofit Sector
- Developing an Evaluation Plan
- Developing an Evaluation Plan - Tools
- Developing an Evaluation Plan - Examples
- Gathering Information: Monitoring Your Progress
- [Innonet Program Development Workstation http://Innonet.org](http://Innonet.org)
- [Community Toolbox Workstation http://ctb.lsi.ukans.edu/tools/CWS/cws.htm](http://ctb.lsi.ukans.edu/tools/CWS/cws.htm)

## Step Fourteen

**Now, review your answers to each step and consider:**

- Is this something the Organization could work with?
- Will the Organization be comfortable and in agreement with this proposal as:
  - A reasonable analysis of the issues?*
  - An accurate analysis of the environment?*
  - A viable plan of action for your Organization given its mission, income, knowledge and other constraints?*

**If not:**

- *Get further input from colleagues and associates.*
- *Consider the mission, strategies and resources of the Organization as the feasibility of this plan.*
- *Repeat the steps in the Decision and Planning Tool: Developing a Theory of Change and edit or modify as needed.*

## Step Fifteen

**Once you have developed your Theory of Change, you are well on your way to creating a strategic plan for your Organization or updating your current plan to reflect this new thinking. By completing this exercise, you've already done much of the hard work that goes into a plan such as:**

*Identifying the problem that you want to address.  
 Articulating your definition/theory of the problem.  
 Specifying the desired outcome.  
 Developing a plan of intervention, including target populations,  
 tools, time scale and required resources.*

***Because tactics without vision doesn't work.***

***Merely working harder doesn't help.***

***Because vision without tactics doesn't work.***

***Merely dreaming doesn't make it so.***

***-John Myrna, Myrna and Associates***

### Things to Consider

- Basic Description of Strategic Planning
- Benefits of Strategic Planning
- When Should Strategic Planning be Done?
- Charity or Non-profit law
- Your Organization's Vision and Mission
- Donor intent

### Items you will need to complete this part

- The Organization's current Strategic Plan (if available)
- The Organization's programmatic planning tools or documents
- Your organization's bylaws

*Consider having....*

- Board minutes from the last year, if available

### Supporting Resources

- Basic Description of Strategic Planning
- Benefits of Strategic Planning
- When Should Strategic Planning Be Done?
- Community Fund Strategic Plan 02-07
- COF 2002 Operating Plan
- Family Foundation Services Strategic Plan
- Sample Strategic Plan Do Good CDC
- [Innovation Network http://Innonet.org](http://Innonet.org)

## Appendix

### A. Strategic Philanthropy

**Strategic philanthropy** refers both to the working philosophy and the program strategies of a foundation (or donor). It originates from an entrepreneurial view of philanthropic activities which focuses around strategy, key competencies and striving for effective contributions to social change.

Strategic philanthropy as understood in the INSP project involves institutions/individuals that are driven by...

- a vision of the desirable society of the future,
- a distinct value orientation in their activities,
- a concept of social change to the effect of greater social justice rather than the mere grant-making to address social problems,
- the conviction that foundations serve as laboratories to develop model solutions, new ways of thinking, and new understanding for resolving societal problems,
- the awareness that innovative models and approaches should include both blueprints and a focus on practical implementation and applicability,
- a concern for the effectiveness of their philanthropic endeavors,
- a proactive approach, be it in their own activities, be it in partnering or grant-making,
- an awareness for capacity building and organizational learning among grantees/partners,
- a public policy orientation driven by the potential of taking project results to scale on policy levels,
- the insight that philanthropy provides for investment in the production of public goods, preferably aiming at innovations or increased effectiveness.

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### B. Complete Listing: "Things you will need to complete this section"

1. Financial/budget resources to support this work
2. Information on Networks, Associations, Funders/Donors supporting this work
3. Information/documentation of Previous Organizational experience in this area (if available)
4. Job descriptions of key staff members for potential overlap/ synergies
5. Results of asset mapping done by the Organization
6. The Organization's bylaws
7. The Organization's programmatic planning tools or documents that may relate to this endeavor
8. The Organization's Strategic Plan (if available)

#### ***Consider having....***

9. The Board minutes from the last year

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### C. Alphabetical Listing of Supporting Documents

1. 10 Tips for Communicating Change
2. A Good, Simple Theory for Change
3. A US Guide to Programming Under IRS Public Policy Rules
4. Addressing Community Gang Problems Case Study Abstract
5. Aspen Racism: Case Study Abstract
6. Basic Description of Strategic Planning
7. Benefits of Strategic Planning
8. Bon Ton Stores Foundation: Case Study
9. Bureau of Justice Administration Refugee Case Study Abstract
10. Cashing in on Charity's Good Name
11. Change Management 101
12. COF 2002 Operating Plan
13. Community-Based Food Systems Enterprises Case Study Abstract
14. Community Fund Strategic Plan 2002-2007
15. Consensus Process
16. Denver Uninsured Case Study Abstract
17. Dictionary of Philanthropic Terms
18. Designing Community Interventions
19. Determine Benefits You May Seek in Alliances
20. Developing an Evaluation Plan
21. Developing an Evaluation Plan - Examples
22. Developing an Evaluation Plan – Tools
23. Family Foundation Services Strategic Plan
24. Gathering Information: Monitoring Your Progress
25. Getting a Good Discussion Going
26. Guiding Principles for Programme Evaluation
27. Innovative Forms for Foundations
28. INSP Stakeholder Interactions
29. INSP Theory of Change Development Tool Paper
30. Intercooperation's Understanding of Empowerment
31. Journey to Transformation
32. Leading Transition: A New Model for Change
33. Make Clear Your Theory of Change
34. Making Change Matrix
35. Meeting the Collaboration Challenge
36. Motivations for Partnering
37. Problem Identification Process
38. Problem Solving Checklist
39. Program Evaluation Practice in the Nonprofit Sector
40. Promoting Behavior Changes by Making It Easier and More Rewarding
41. Sample Strategic Plan: Do Good CDC
42. Segmenting the Market to Reach the Targeted Population
43. Skillview
44. Spectrum of Philanthropic Approaches
45. SWOT Analysis
46. Tax Treatment of NGOs
47. The Role of Evaluation in the 21<sup>st</sup> Century Foundation
48. The NP Sector and Business Partnerships
49. Theory of Change – Stages



## Appendix

50. Toolkit of Philanthropic Approaches
51. Tools for Good Guide
52. Types of Partnerships
53. Unleashing New Resources and Entrepreneurship for Common Good
54. US Guidelines for Informing Public Policy
55. Using Evaluation in Foundations as a Monitoring Tool
56. Using Logic Models to Bring Together Planning, Evaluation, & Action
57. Vehicles of Social Transformation
58. Venture Philanthropy: Investing in People
59. What is Social Transformation?
60. When Should Strategic Planning Be Done?
61. WKKF Policy Case Study

## Appendix

### D. Legal Considerations

**The Tax Treatment of Nongovernmental Organizations  
A Survey of Best Practices from Around the World  
by  
The International Center for Not-for-Profit Law (ICNL)**

Introduction. This paper is designed to give an overview of the fiscal incentives that are granted to nongovernmental organizations (NGOs) and their donors around the world and to discuss a set of principles of best practice for such fiscal incentives. It is based on research conducted by the International Center for Not-for-Profit Law (ICNL) for a project with the World Bank in connection with which ICNL surveyed laws affecting nongovernmental organizations in over 100 countries.

It is clear that there are several different taxes from which nongovernmental organizations may be exempt: income and profits taxes, property taxes, transfer taxes (on gift and death transfers), excise taxes, value added taxes, sales taxes, etc. Nongovernmental organizations are typically not exempted from employment taxes, <sup>1</sup> but frequently are exempted from income, property, and transfer taxes. Some countries may, for example, make certain transactions of nongovernmental organizations subject to VAT, while others will include them but give them a low or zero rating.<sup>2</sup>

The fiscal laws also frequently allow tax preferences such as deductions or tax credits or rebates for contributions by individuals or commercial corporations or other commercial entities to a defined class of nongovernmental organizations (e.g., public benefit organizations). Individuals may be allowed similar deductions from or credits against transfer (estate and gift) taxes for similar contributions. The class of NGOs to which such gifts may be made is sometimes smaller than the class of tax exempt entities. For example, deductions might be allowed for union or trade association dues, but not social club membership dues, even though all three groups of nongovernmental organizations are themselves exempt from the income tax. There also may be numerical or percentage limits on deductible or creditable contributions.

The tax laws also tend to state the extent to which nongovernmental organizations will be taxed on their income from economic activities. It is important to permit nongovernmental organizations to conduct such activities for their support, particularly in countries where there is little private wealth. As will be seen in the discussion below, countries differ on whether profits from activities not directly related to a nongovernmental organization's principal purpose should be taxed.

Legal systems governing nongovernmental organizations frequently make a distinction between mutual benefit organizations (MBOs) and public benefit organizations (PBOs), which is of great importance in the area of taxation. By definition, a PBO benefits the public or some defined segment of it. Accordingly, PBOs are generally regarded as entitled to greater benefits from the state than are MBOs, which primarily serve the interests of their members. Tax preferences are one of the principal benefits extended to NGOs, and in most legal systems they are extended preferentially or even exclusively to PBOs.<sup>3</sup>

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Most legal systems do not use the terms MBO and PBO as such. These reflect an attempt to generalize and put on a sounder theoretical footing the actual, more fragmented practices that exist in various legal systems. Most tax laws focus on the functions or purposes of an organization in determining whether it is entitled to tax preferences. For example, the tax laws of a particular country might extend the privilege of receiving tax deductible contributions or property tax exemption only to organizations formed for the primary purpose of advancing education, health, science, culture, or the relief of poverty. Over the years other purposes may be added to the list, such as the protection of the interests of minority groups or the environment.

As a legal system matures it is often the case that the law writers realize that a common theme runs through the list of purposes or activities they have crafted over the years and that no mere listing can capture all of the possible kinds of organizations that deserve preference and support from the state. It is common, then, to find, tacked on to the end of such a list, a final, catch-all category such as "or any other organization formed primarily for the benefit of the public." In such a catch-all the unifying principle emerges and, in a sense, informs the entire list. It is education, health, and scientific organizations *that serve the public interest* that are entitled to a tax preference. The officials in charge of determining eligibility for tax preferences can now test each organization seeking a tax preference by the more expansive criterion of whether it is formed primarily to serve the public interest. In other words, is it a PBO? It should also be emphasized that the selection of the agency to make the determination of whether an NGO is a PBO or not is crucially important.

In the actual state of development of the tax laws of any country, lists of purposes or activities rather than principles predominate.<sup>4</sup> And the lists vary. The kinds of organizations that qualify for a sales tax exemption may be different from the kinds of organizations that qualify for customs duty preferences. This is the natural result of the ad hoc way in which tax and other legal rules develop. It is useful, though, to look at the entire collection of tax rules affecting NGOs and determine whether a more consistent set of rules founded in principle could be carried consistently across the entire landscape of laws. The strong suggestion here is that the distinction between mutual benefit and public benefit organizations and activities has enormous analytic power and can be used to rationalize and round off what otherwise might be a rather jumbled and inconsistent set of rules.

The focus of the sections that follow is on the special tax preferences that should or might be extended to NGOs, or at least to PBOs. Something that deserves special mention is that, virtually without exception, tax preferences are voluntary and are extended only to organizations that want and seek them. A special application must be filed in virtually every system in order to establish entitlement to one or more tax preferences. This means that any organization that prefers to operate without the higher level of oversight and scrutiny that accompanies tax preferences can choose not to subject itself to the process. Since tax laws, like other laws, can be used improperly to harass unpopular NGOs, this option to either seek or avoid tax preferences is of fundamental importance.

Another point also deserves special emphasis. Aside from the possible imposition of penalty taxes as a sanction for the kinds of special problems that occur in the nongovernmental sector, there should not be special taxes or tax rates imposed on NGOs.<sup>5</sup> Most NGOs add something of

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benefit to society, and society benefits enormously from the existence of a strong, vibrant, and independent nongovernmental sector. The interests of society in having a strong nongovernmental sector would be undermined and frustrated by the imposition of special taxes or tax rates on NGOs. In fact, as societies mature they generally embrace indirect methods of macro-managing the institutions of society, and fiscal preferences have proven to be a powerful tool for encouraging the constructive development of the NGO sector while avoiding discrimination, excessive governmental bureaucracy, and market distortion that results from excessive direct intervention by the government.

### ***Best Practices***

***1. Income Taxation Exemption of Nongovernmental Organizations.*** *Every nongovernmental organization, whether organized for mutual benefit or for public benefit, and whether a membership or nonmembership organization, should be exempt from income taxation on moneys or other items of value received from donors or governmental agencies (by grant or contract), membership dues, if any, and any interest, dividends, rents, royalties or capital gains earned on assets or the sale of assets.*

Discussion: Since NGOs as defined here preclude the possibility of personal benefit or the distribution of profits, there is a powerful argument that they are not proper objects of an income tax in any system.<sup>6</sup> Income taxes are imposed on the "profits" of legal entities because they are surrogates for the individuals who own them or who can receive a distribution of profits from them. In countries, such as New Zealand, which have fully integrated their corporate and individual income taxes, there is no need to impose separate income taxes on corporations. There is a single income tax and it is imposed on corporate profits once, at the shareholder level and at shareholder rates. Profits at the corporate level are subject to a tax, but all dividends are "franked" - that is, the shareholder receiving franked dividends is entitled to take a credit against his or her own taxes for the taxes paid at the corporate level

NGOs, as defined here, stand on an entirely different footing. They are not "owned" by anyone and cannot distribute profits as such. Whatever profits they may earn from economic activities are reinvested or spent on appropriate nonprofit activities. They are not surrogates for the shareholders who own them, and thus it can be strongly argued that they should not be subject to income taxation at all. Unfortunately, most countries around the world assume that NGOs, like for-profit entities, are natural subjects of taxation, and that not applying tax to them is a matter of grace and exemption.<sup>7</sup>

The typical sources of revenue for nongovernmental organizations are donations, membership dues, and interest and dividends on investments. There is general agreement that these items should not be taxed.<sup>8</sup> There are, however, two different ways of arriving at this result. One approach assures that nongovernmental organizations are not taxable on these ordinary sources of revenue by defining those sources as not constituting "income" for tax purposes. The other approach recognizes these receipts as income but confers exempt status on nongovernmental organizations.

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Generally accepted tax theory defines income as any receipt during a defined period of time that is either expended or that increases net worth.<sup>9</sup> Under this approach and in common understanding, it is clear that dividends and interest are generally considered income for tax purposes. Accordingly, the approach taken here is to recognize all receipts of a nongovernmental organization -- donations, membership fees, interest, dividends, and capital gains -- as income, but to advocate tax exempt status for all nongovernmental organizations for these items.<sup>11</sup> This approach leaves several open questions -- should those who make donations receive a tax preference? Should trade or business income of an NGO be exempt? And how should nongovernmental organizations be dealt with under other tax laws? These questions are dealt with in the succeeding sections.

One specialized issue deserves mention here. Should a donation received by one NGO but earmarked for another be treated as a donation to, and the revenue of, the first NGO? For the donor this can be an important question, for the item might be deductible if a donation to the first entity but not if it is given to the second. For example, a donation to a foreign organization might not be deductible, but a donation to a domestic organization, might be, even if it passes the donation along to the foreign organization. Some countries, such as the United States, have complex rules for distinguishing between contributions that have been permissibly earmarked and passed along from those that fail certain very technical tests.<sup>12</sup>

On the side of the recipient NGO, there is a question of whether an earmarked or "passthrough" donation should properly be reflected as its income, and whether it is improperly being used as a mere conduit, perhaps obscuring from regulators or the public the real purpose of the donation. Again, these issues become very technical very quickly, but it is important to note their existence and hence the need to take account of them in any fully developed set of laws.

***2. Income Tax Deductions or Credits for Donations.*** *Within reasonably generous limits, individuals and business entities should be entitled to an income tax deduction or credit with respect to donations made to PBOs (but not MBOs). As a matter of tax policy, credits are preferable to deductions for individuals under a progressive income tax system, though deductions may attract more and larger gifts from wealthy donors.*

Discussion: Under the rule recommended in the previous section, no NGO would be taxed on donations it receives. If, in addition, the giver is entitled to a tax credit or deduction against his or her personal or business income tax, the same donation receives a double tax preference, once to the giver and again to the recipient.<sup>13</sup> As a best practice, this generous tax treatment is deemed justified when the activities of the NGO in question are for the public benefit -- when, in other words, it is a PBO rather than an MBO.<sup>14</sup> If this distinction is drawn in the tax laws of a country -- permitting a tax preference to those who make contributions -- then there will be great pressure on the supervising authority (presumably the tax authority) to classify NGOs as PBOs. As discussed above, this distinction is often difficult to draw. In actual experience the tax authorities tend to proceed on a case-by-case basis.

A separate and different question is raised by whether a contributor to a PBO should get a tax credit or a tax deduction. The distinction is of great importance in a tax system with a progressive rate structure. A tax credit reduces the amount of tax owed, often unit-for-unit, whereas a

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deduction only reduces the amount of income that is subject to tax. Where rates are progressive deductions tend to favor higher income tax payers, who are paying a higher rate of tax on income. Tax credits give each taxpayer the same tax preference for a contribution of the same amount, and hence represent greater equity as a matter of tax policy. Most countries with progressive rate structures, however, allow deductions rather than credits.<sup>15</sup> This may be justified by data which show that lower income individuals tend to make charitable contributions without regard to their tax impact, and, indeed, other tax rules may preclude them from getting any tax preference at all from a charitable contribution.<sup>16</sup> On the other hand, there are substantial empirical data showing that high income taxpayers are quite sensitive to tax rates and that allowing deductions rather than credits tends to attract more and larger gifts from wealthy donors.<sup>17</sup>

Another question that must be dealt with in any scheme of taxation are the limits, if any, put on the amount of tax preferences that can be achieved. For example, in Russia individuals can claim deductions only up to 3% of their income, and business entities are limited to 1%. In the United States, by contrast, individuals can claim deductions for up to 50% of their income, and in Australia there is no limit at all. Empirical studies show that few business entities contribute more than 1-2% of their income, so it is an essentially empty debate whether deduction limits should be higher than that.<sup>18</sup>

The same is not true of individuals, however, and where there is no limit on allowable charitable deductions wealthy individuals can avoid paying any taxes by contributing to charity an amount equal to their taxable income each year. In a democracy it is appropriate that each citizen who is financially able to should bear a fair share of the costs of government, and it is therefore not a best practice to allow unlimited deductions. At the same time, if deductions are limited to contributions to PBO -- i.e., organizations contributing to the public good and often relieving the burdens of government -- generous deduction limits are appropriate. The laws of most countries need to be reconsidered in light of these considerations.<sup>19</sup>

**3. Taxation of Economic Activities.** *NGOs should be allowed to engage in economic activities so long as those activities do not constitute the principal purpose or activity of the organization. Any net profit earned by an NGO from the active conduct of a trade or business could be --*

*(a) exempted from income taxation,*

*(b) subjected to income taxation,*

*(c) subjected to income taxation only if the trade or business is not related to and in furtherance of the not -for -profit purposes of the organization, or*

*(d) subjected to a mechanical test that allows a modest amount of profits from economic activities to escape taxation, but imposes tax on amounts in excess of the limit.*

Discussion. The tests involved in selecting among these possible tax rules are complex and technical. Under a "destination of income" test, alternative (a) would apply to a properly formed NGO. Thus, all income from economic activities would be exempt from tax as long as all of the

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profits earned from the active conduct of a trade or business were committed for and actually used to carry out the principal purposes for which the NGO was formed. Thus, an organization that spent 99% of its time and money making profits from a purely commercial activity, such as manufacturing noodles, would be treated as a tax exempt NGO if each year it gave all of its profits to charitable causes.<sup>20</sup> Whether such an outcome would actually exist in practice would depend on whether the proper authorities would accept that such an organization was or was not properly registered as a NGO. They might, for example, require it to reregister as a business entity, depending on the circumstances.

In a country with a developing market economy, it may be appropriate to strike the balance in favor of tax exemption for all profits destined for use by a NGO to carry out its statutory activities. Countries in which the market economy is developing are generally also countries where the civic sector is just beginning to flourish. NGOs in such countries are often desperate for money simply to survive, and the profits from economic activities may make the difference between their continued existence and termination. In such countries it is also possible to argue that there is such a strong need to develop economic activities independent of the state that all entities, whether NGOs or business entities, ought to be encouraged to engage in them.

On the other hand, the problem of unfair competition can become a serious issue, particularly when the scale and number of economic activities by NGOs begins to pose a threat to private enterprises. Obviously, if a large and wealthy NGO can engage in a particular activity (e.g. book publishing) without paying taxes, it has an economic advantage over its for-profit competitors. When this issue becomes significant for the fiscal policy of a country, the obvious solution is to tax such profits, at least if they are unrelated to the purposes of the organization. <sup>21</sup>.

Exempting the profits from "related" activities makes a great deal of theoretical sense. Often the most effective way for a NGO to achieve its purpose is to pursue it through economic means. For example, the most effective way to disseminate information about a particular kind of art or culture that a NGO wants to promote may be to publish and sell a high-quality magazine devoted to that topic. If the primary purpose of the organization is to promote the particular kind of art or culture, it is not primarily seeking to make a profit, and no profits are distributed, then publication of the magazine is simply the method that has been chosen to pursue the civic purpose. Publishing a magazine is a means for achieving the end of promotion of the art or culture. Exempting income from such related activities makes good theoretical sense.

Unfortunately, it is extremely difficult to distinguish "related" economic activities from "unrelated" activities, and hence this rule is very difficult to administer. For example, if a museum sets up a shop on its premises to sell copies of the outstanding works in its collection, or perhaps books that picture them or postcards that replicate them, this can easily be argued to be "related" to the museum's activities. What should happen if the museum opens a chain of retail stores that sell books related to art and culture, most of which have no connection with its collection? Is it engaging in an "unrelated" activity, or has it simply broadened its purposes and chosen to pursue the broader purpose using economic means? The fact that a distinction between related and unrelated economic activities is very difficult to apply is demonstrated by the fact that very little revenue is raised by a tax that is imposed only on "unrelated" activities. <sup>22</sup>.

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If the principal purpose test is adopted, it is then necessary to determine how economic activities undertaken in furtherance of the purposes of a NGO -- "related" economic activities as that term is being used here -- are to be counted in determining whether the principal purpose of an organization is to engage in economic activities or to pursue civic ends. To the extent that economic activities (e.g., publication of a magazine or of books) is simply a chosen means by which most effectively to pursue a given end (e.g., promotion of a particular art or culture), there is a strong argument that they should not be counted as economic activities that would disqualify the entity for status as a NGO if they constituted the principal activity of the organization. One must be careful, however, for if "related" economic activities constituted the only activities of a NGO, one would in effect have come back to the "destination of income" test, under which economic activities can constitute the entire active work of a NGO as long as all profits go to a civic purpose. Designing administrable rules that adequately respond to these considerations is not easy.

A mechanical test for determining the difference between economic activities that are taxed and those that are not is a far simpler system of taxing NGOs. It might be possible, for example, to tax income from all economic activities if it exceeds a certain figure or percentage of all income. Another possible remedy has been chosen by Hungary, where NGOs are exempt on the net profits from economic activities if the annual unrelated business income does not exceed the lesser of 10 million forint or 10% of total revenue. This works fine as a tax rule, for the only consequence of exceeding the minimum in any year is that taxes must be paid. But in the Hungarian case taxes are levied on all business income if the threshold is exceeded, whether the activities are related or not, presumably on the theory that if the organization has a lot of business income it is more like a business than a NGO. The principal purpose test takes a similar approach for determining eligibility for classification as a NGO. Thus, if more than 50 percent of the activities and expenditures of a NGO constitute economic activities for a significant period of time (e.g., 3 years); the organization is reclassified as a business entity. As long as "related" economic activities are not disregarded, this mechanical test will generally be adequate to permit significant economic activities while not creating the risk that the entire sector will develop a bad reputation (as does the destination of income test).

As an alternative to stating an absolute preference for any of these tests is sufficient to state that each of the above rules has been adopted and implemented, and that the NGO sector has been able to flourish under any of the rules. The considerations in choosing among these rules often are determined by considerations unrelated to the NGO sector itself (e.g., a desire to avoid unfair competition with for-profit entities), issues of general tax policy, or considerations of practicability and administrability.

#### **4. VAT and Customs Duties.**

*(a) PBOs should be given preferential treatment under a value added tax (VAT).*

Discussion. If an organization is excluded from a VAT system, it pays VAT on goods and services it buys from other, for the tax is built into the price it must pay (input VAT). However, since it is not in the system, it cannot apply for a refund. Although exclusion from the VAT



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system is not desirable from a tax point of view, small NGOs might rationally prefer it in order to be relieved of compliance burdens.

The best situation for an NGO is to be included in the VAT system but to be zero-rated. This means that, though the NGO pays VAT on the goods and services it buys, it does not have to pay output VAT, and it gets back as a rebate the input VAT paid plus the amount of any imputed VAT on goods and services it sells to others. This approach is not adopted in many countries.<sup>23</sup> The more general approach is to give PBOs a favorable VAT rate, but not a zero rate. For example, if the general rate of VAT is 20%, the special rate for PBOs might be 6-10%.<sup>24</sup>

*(b) PBOs should be given preferential treatment under or exemption from customs duties on imported goods or services that are used to further their public benefit purposes.*

Discussion. Customs duties are among the most contentious and difficult of issues faced by NGOs in practice. If the law of a particular country provided for exemption for NGOs, customs officials often disregard the law, and NGOs must spend a disproportionate amount of time getting more senior officers to actually get the benefit of the exemption.<sup>25</sup> At the same time, laws allowing customs exemptions for NGOs tempt charlatans and crooks into the NGO sector with the prime motive of establishing an NGO to get customs exemption.

If customs duties are imposed on legitimate NGOs, however, they can dramatically increase the costs of operations. This problem faces both foreign and domestic NGOs. The problem can be particularly severe for humanitarian relief organizations that typically must import all of their goods and services in order to meet emergency relief needs. It is a problem, though, for even the smallest NGO, which might want to import a fax machine or computer to make its work more productive.<sup>26</sup>

The best practice in this area is to provide customs duty exemptions to PBOs, to have a fair but thorough process for assuring that only genuine PBOs qualify for the process, but then to have a certification, licensing, or similar process that insure that a PBO's exemption from customs duties will be honored at the border. To protect against the improper use of the exemption, it is appropriate to provide that imports will be exempt only if they are going to be used by the NGO in its operations. Any item sold by an NGO (e.g., a truck or automobile) within a short period (e.g., 2-3 years) would be subject to customs duties at the time of sale.

### **5. Other taxes.**

*(a) Depending upon the extent to which a government wishes to encourage NGOs, exemption from or preferential treatment under other tax laws (e.g., taxes on real or personal property, sales taxes, estate or inheritance taxes) should be considered.*

Discussion. Practices vary widely around the globe. As one example, Indonesia, Thailand, and The Philippines exempt religious organizations from land taxes, while Australia provides not income tax preferences for religious organizations. <sup>27</sup>

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*(b) No NGO should be exempted or given preferential treatment under generally applicable employment or payroll taxes.*

Discussion. Despite the fact that NGO employees typically expect and receive a lower level of compensation than that which is paid for comparable work in the for-profit sector, there is no justification for exempting them from the usual social security and related employment taxes that are exacted from workers in the governmental or for-profit sector. Social security and similar taxes are exacted on the basis of actuarial estimates of what is required in order to meet the state's obligations to retired workers over the long term. Those who are employed in the not-for-profit sector should not be excluded from the benefits of state-provided benefits, nor should they be exempted from the benefits that are provided for those who participate in these state schemes. 28.

In short, although it is a valuable tax preference to exempt NGOs for many forms of regular taxation, it would prefer such organizations over the long-term interests of their employees to exempt them from the employment taxes usually imposed on employers with respect to employees. Employees of NGOs should not suffer the double disability of working for a lower wage and being excluded from basic employee benefit programs imposed on other employees in that society.

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### Endnotes:

1. Brazil is a notable exception to this rule because it permits a very limited group of NGOs to be exempt from employment taxes. This is, however, not a good practice because employees of such organizations are no different than employees of business entities or government organizations and need access to social taxes for retirement savings.
2. Being excluded from VAT is worse than full inclusion, because the civic organization then pays VAT on all goods and services received but gets no credit for those it provides. Zero rating is the best status.
3. In Cameroon, however, no NGOs receive any tax benefits. South Africa represents a more typical approach, for tax exemptions are limited to institutions and funds that are ecclesiastical, charitable, or educational in nature, and of a public character.
4. Although not desirable, there may be a list of purposes or activities. It is clearly not a best practice, however, to list by name or specific description the organizations that are entitled to receive tax benefits. Such lists nearly always derive from special or political preferences rather than from any consistent set of principles.
5. In a bizarre development, NGOs in Israel are subject to certain employment taxes to which business companies are not subject. The genesis of this rule was the need to encourage employment for recent immigrants to Israel, but there can be no question that the result makes little sense.

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6. Sri Lanka illustrates that there can be positions in between treating NGOs as full taxpayers and exempting them. In that country tax on charitable institutions is levied at a confessional rate of 10 percent on income in excess of Rs. 42,000 per annum, and this tax can be waived for charities providing institutional care. The theory behind this rule is that better accountability will be assured if sizable charities are required to file tax returns, even though the tax rate is quite low. In Uganda, although income tax exemptions were previously available, there are reports that the exemptions will be repealed for the next fiscal year.

7. A typical example of how difficult it is for NGOs to obtain tax exemption is provided by Thailand: In that country NGOs registered as foundations or associations may seek tax exemption of their purpose is charitable, which means that it is related to religion, education, health, or social welfare. No NGO can qualify for tax exemption until it has operated for three years, though this rule may be waived by Ministry of Finance. During the prior three years, the NGO must have spent 60% of its income or 75% of its total expenditures on charitable purposes. The result of these rules is that only about 200 NGOs have tax exempt status in Thailand. ESCAP, *Fiscal Incentives*, p. 22 (1994).

8. For example, the income of any ecclesiastical, charitable, or educational institution of a public character is exempted from the corporate income tax so long as the income is not derived from the conduct of a trade or business.

9. See R.M. Haig, "The Concept of Income, The Federal Income Tax 1, 27 (1921); Henry Simons, *Personal Income Taxation* 50 (1938).

10. In Romania, however, interest is deemed to be "without economic character" and therefore not subject to the profits tax. See Ministry of Finance Methodological Rules No. 5910 of 1991. Obviously, if interest income is not generally taxed, as in the case of Romania, NGOs should not be taxed on their interest income.

11. "It is particularly important that NGOs carrying out "watchdog" functions through policy research, lobbying and public awareness-raising be financially independent of both their own governments and foreign donors. To encourage such independence, dividend income on NGOs' financial endowments could be made tax-free. NGOs providing services to other NGOs (e.g., as "umbrella" organizations, as federations, as subcontractors) or those playing a catalyst role on behalf of the NGO community could also be given that concession on income from all funds held in trust." ESCAP, *Fiscal Incentives*, p. 48 (1994). In Ireland the tax on interest income is the one from which charitable organizations most frequently seek exemption. See Joe Ryan, *Reliefs from Tax on the Income and Property of Charities* (1995).

12. There is no limit to the ingenious tax rules that can be devised, and often tax rules can be used to attempt to achieve very targeted goals. For example, in China enterprises in which disabled persons constitute a minimum of 10 percent of the work force receive a 50 percent tax concession; while those whose workforce comprises 35 percent disabled employees receive complete exemption from income taxation. Some countries place very strict limits on charitable deductions. In Indonesia, Botswana, and Bangladesh, no deductions are allowed for contributions to NGOs. In Thailand companies are limited to 1 percent of net profits for contributions to public

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charities and a further 2 percent for education and sports, though individual contributions of up to 10 percent of gross income are tax deductible. A 100 percent tax deduction is allowed to individuals for donations made to accredited NGOs for disaster relief in areas approved by the President. In South Africa the limit is 2%, and in Egypt it is 3%. By contrast, in the Philippines the limit on contributions for organizations that promote social welfare or serve religious, charitable, scientific, athletic, or cultural purposes is 6% for individuals and 3% for corporations. In the United States individuals can deduct amounts up to 50% of their income for contributions to an even wider group of charities. In Australia the limit is 100%, but the category of eligible recipient organizations ("public benevolent institutions"), organizations set up for the direct relief of poverty, misfortune, destitution, or helplessness, is quite narrow. In Japan rather strict monetary, not percentage, limits are imposed. In many developing countries policy makers generally resist the notion that tax preferences ought to be extended to NGOs, for they are not regarded as contributors to economic development. The structural adjustment policies being pursued by many countries, often with strong support from the World Bank and the International Monetary Fund, emphasize deficit control and fiscal austerity. However, it may be appropriate for policy makers to reconsider the importance of extending tax preferences to NGOs as part of an overall strategy of promoting sound development.

13. Some countries may, for example, make certain transactions of nongovernmental organizations subject to VAT, while others will include them but give them a low or zero rating.

14. India provides an example of a relatively generous tax deduction scheme. India, cash donations to charitable organizations are 50 percent tax deductible up to 10 percent of gross income. A recent study concluded that in India, "The scheme of deductions for charitable contributions increased the quantum of such contributions substantially. In the absence of incentive provisions, the contributions of companies would have been lower by about 64 percent of the actual contributions." ESCAP, *Fiscal Incentives*, pp. 23-24 (1994). Through an inexplicable lapse, the Polish Parliament allowed individuals to take tax deductions during 1996 for contributions to other individuals. Thus, a brother might claim a tax deduction for a donation to his sister to enable her to get her teeth fixed, and she might get a similar deduction for giving him money to provide special education to his children. This law will be repealed for 1997 and subsequent years; deductions will be limited to donations to legally constituted charities, demonstrating again the great value of formal registration. Under the Law of the Leningrad Region on Charities adopted on April 21, 1995, charitable activities may be conducted either with or without establishing a legal entity, but donors receive tax preferences (deductions of up to 3 percent of net profits) only if the state certifies that the activities were charitable. This requirement for certification saves the Leningrad Region law from the defect of the Polish law, which imposed no similar requirement.

15. Canada has allowed a credit for individuals rather than a deduction since 1988. The switch does not seem to have affected giving patterns. See Carl Juneau, *Charity and Taxes in Canada*, (1996).

16. In the United States, for example, taxpayers must choose between claiming the "standard deduction" or itemizing all deductible expenses. For lower bracket taxpayers the standard deduction tends to be more valuable, but by choosing it a taxpayer is precluded from listing, and

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hence from deducting, actual gifts made to charity. In other countries salaried individuals do not file tax returns because taxes are simply subtracted from their wages. In such situations it is difficult to claim a refund if a charitable contribution is made.

17. See, e.g., Charles Clotfelter, Tax Incentives and Charitable Giving: Evidence from a Panel of Taxpayers in 30 *Journal of Public Economics*, 319 (1980); Richard Steinberg, Taxes and Giving, 1 *Voluntas* 61 (1990); Kevin S. Barrett, Anya M. McGuirk and Richard Steinberg, Further Evidence of the Dynamic Impact of Taxes on Charitable Giving (1996).

18. *Id.*

19. Another possibility may be to use a scheme similar to that currently in use in the UK, where the tax benefit is not actually given to the donor but rather is passed on to the charity itself as a cash receipt from the Treasury in addition to the cash receipt from the donor.

20. If the active trade or business is carried out indirectly, through a subsidiary, the legal system might regard the subsidiary as a for-profit business entity, but simply exempt it from income taxation. The result is the same: the activity is permitted and the profits are not taxed. Although the substance of the rule is the same for both associations and foundations in Poland, associations get the benefit of the rule only if they engage in economic activities through a wholly owned subsidiary, whereas foundations are exempt on activities that they carry on directly.

21. For an analysis of the issues related to taxation of profits from economic activities, see Industry Commission, *Charitable Organizations in Australia*, 311-312 and Appendix J (1995).

22. See Henry B. Hansmann, *Unfair Competition and the Unrelated Business Income Tax*, 75 *Va. L. Rev.* 605 (1989).

23. In Bangladesh, Indonesia, The Philippines, and Thailand, NGOs receive no exemption from the VAT, but in some cases they benefit from lower rates levied on primary, unprocessed agricultural products. In most Western European countries there are certain VAT preferences, although these vary considerably from country to country. See Derek Allen, *VAT in the European Community*.

24. For a fuller discussion of VAT issues, see Ole Gejms-Onstad, *VAT*, 1996.

25. In Rwanda the only tax benefits for NGOs are exemption from customs duties and exemption for expatriate NGO employees from the entrance fee.

26. Often the problem is not the absence of an exemption for NGOs, but the red tape involved in claiming it. In India NGOs wishing to obtain concession from duties imposed on equipment imports donated by foreigners have to apply for Central Government approval six months in advance, and strict rules and procedures are invoked. In Sri Lanka and The Philippines exemption from, customs duties and the VAT on donations from foreign sources can be obtained only if the donations are consigned to the relevant government agency. This procedure generally involves numerous bureaucratic obstacles and conditional provisions.

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27. "It may be useful to remove the distinction between NGOs that provide direct relief, social protection or opportunities for self-improvement and those that play representational, catalytic or advocacy roles. Rather, it may be advisable to introduce concessions on the basis of voluntarism, so that those NGOs which are run entirely by volunteers and which provide free services and labour would be entirely exempt from taxes on income from all sources as well as being permitted duty-free imports to build up their organizations. That could provide an especially significant boost to development-oriented community and grass-roots NGOs." ESCAP, Fiscal Incentives, p. 46 (1994).

28. In Australia, however, NGOs involved in social welfare work pay reduced sales taxes and, if their payroll is over A\$10,000 a month, a reduced payroll tax as well, depending on which State they are in.

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## Appendix

### E. Dictionary of Terms

**PLACEHOLDER FOR DICTIONARY OF TERMS**  
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