

Reining in America's \$3.3 Trillion Tax-Exempt Economy

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Key Findings

- For over a century, lawmakers have exempted politically favored organizations and industries from the tax code. As a result, the tax-exempt nonprofit economy now comprises 15 percent of GDP, spans more than 1.8 million organizations, and manages over \$8 trillion in assets. In 2019, it pocketed more than \$238 billion in net income.
- The tax-exempt sector is overdue for review and reform. The U.S. needs a principled, rules-based approach to 1) distinguish between benevolent organizations and tax-exempt businesses, and 2) level the playing field between the business activities of nonprofit and for-profit entities.
- Many industries exempted from the income tax were designated as such in the Wilson-Gorman Tariff Act of 1894 and the Tax Act of 1909, but they reflect the social norms of the 19th century, not our 21st century economy.
- The majority of tax-exempt organizations today are business-like in form and function, including credit unions, hospitals, utilities, insurance companies, universities, professional athletic associations, golf clubs, and consulting firms, to name a few.
- Business-like income has been the fastest growing source of income for 501(c)(3) tax-exempt organizations over the past 30 years, now accounting for 71 percent of their income. Charitable donations make up just 12 percent of nonprofit income.
- More than half (55 percent) of all the income generated by 501(c)(3) organizations comes from tax-exempt hospitals and health-care plans. The largest nonprofit in America is Kaiser Permanente. Kaiser's health plan, hospitals, and state health plans generated over \$110 billion in revenues in 2019.
- In 2019, there were 325 501(c)(3) nonprofits with more than \$1 billion in revenues—nearly all of which are hospitals and universities.
- The unrelated business income tax (UBIT) rules that were intended to rein in tax-exempt businesses have become toothless and have allowed the growth of large nonprofit businesses.
- A reasonable rewriting of the tax-exempt rules should include narrowing the definition of “public charity” and subjecting all non-charitable income to the corporate tax rate of 21 percent. Doing so could raise nearly \$40 billion annually in new tax revenues.

Introduction

America has a \$3.3 trillion tax gap. But it's not the tax gap we hear most about: the revenues the IRS fails to collect because of underreporting, mistakes, or outright tax avoidance. This tax gap rests squarely with Washington lawmakers who, starting more than a century ago, began exempting politically favored institutions, organizations, and activities from the tax code.

The result today is a massive untaxed economy that comprises 15 percent of GDP¹, spans more than 1.8 million organizations², manages over \$8 trillion in assets, and collectively pocketed more than \$238 billion in net income in 2019³.

After more than a century of unbridled expansion, the scope of this untaxed economy is overdue for review and reform. Many of the nearly 30 nonprofit designations under 501(c) of the Internal Revenue Code have their origins in the Wilson-Gorman Tariff Act of 1894 and are artifacts of a more communitarian 19th century American society, not a reflection of our modern 21st century economy.

Contrary to the common image of nonprofits as purely benevolent organizations surviving on charitable donations, such organizations are in the minority. The vast majority of tax-exempt organizations are business-like in form and function, such as credit unions, utilities, insurance companies, hospitals, universities, professional athletic associations, golf clubs, casinos, cemeteries, and consulting firms, to name a few. And many of these organizations use their tax-exempt status to compete with taxpaying for-profit firms.

Unfortunately, the guardrails lawmakers have created to prevent unfair competition from nonprofits have been either too weak or too flexible to draw firm lines between benevolent activities, such as a local women's shelter, and large business enterprises, such as the \$1.1 billion NCAA. Both are considered "charitable" nonprofit organizations.

Business-like income has been the fastest growing source of income for 501(c)(3) charitable organizations, entities that can accept tax-deductible donations. Indeed, of the nearly \$2.5 trillion in revenues that charitable organizations received in 2019, just 12 percent came from donors' tax-deductible contributions and gifts. The majority of their income came from business-like revenues such as insurance payments, ticket sales, TV broadcast rights, royalties, and federal programs such as Medicare and Medicaid.

This raises the question: should an organization be considered a nonprofit, or even a charity, if only a fraction of its revenues come from charitable donations?

The tax base is narrower than it need be because of how much nonprofit income is fully exempt from taxation. Charitable donations are tax deductible for the donor and tax-exempt for the receiving organization, what economists call double-non-tax-income. Similarly, corporations may deduct payments to nonprofits for such things as memberships, broadcast rights, and licensing fees. Thus, all of this income is outside of the federal tax base.

1 Author calculations.

2 Internal Revenue Service, "Exempt Organizations Business Master File Extract (EO BMF)," <https://www.irs.gov/charities-non-profits/exempt-organizations-business-master-file-extract-ao-bmf>

3 Author calculations, See Table 1.

As Congress’s Joint Committee on Taxation (JCT) has observed, “There is no unifying theme or singular principle that explains tax exemption for the many diverse organizations in the exempt sector.”⁴ Nor, JCT says, is there an “agreed upon explanation of the rationale behind the charitable tax exemption and tax deduction.”

A principled, rules-based approach to narrow the scope of qualified tax-exempt entities is needed. For example, taxing the income of nonprofits from sources other than charitable donations would broaden the tax base in a fair and economically efficient way. Such a rule would protect the charitable donations received by benevolent organizations while putting nonprofit businesses on the same level playing field as for-profit firms.

As we’ll see, based on 2019 data, taxing the business-like income of nonprofits could raise nearly \$40 billion annually.

While there still may be a role in today’s economy for insurance-providing fraternal organizations, credit unions, and collegiate sports leagues, there is no longer a justification to exempt them from taxation.

The Scope of This Study Is Limited to 501(c) Organizations

It should be noted that the Tax Foundation is a 501(c)(3) tax-exempt organization whose mission is to advocate for economically principled tax policy, even if it means questioning our own industry.

The scope of this paper is limited to organizations that fall under 501(c) of the Internal Revenue Code, but the true scope of the tax-exempt economy is much larger. Churches, for example, are not required to file tax returns, so the government does not track how much income they collect annually, although Giving USA estimates that churches raised \$143.6 billion in revenues in 2022.⁵ Churches are not included in the study, but some 501(c) religious organizations are included.

Another tax-exempt sector that is not included is quasi-government entities such as state public universities, the Tennessee Valley Authority, and Federal Home Loan Banks. These tax-exempt enterprises generate roughly \$500 billion in untaxed annual income.

The paper also ignores the charitable deduction and other tax breaks that shield income from taxation. Tax expenditures in the code topped \$1.7 trillion in 2023 and deserve their own separate analysis.

The Nonprofit Tax Code Reflects America’s Pre-20th Century Self-Help Roots

Volunteer and benevolent organizations existed in America long before our founding and even longer before the first federal income tax. Fraternal beneficiary societies provided insurance benefits for widows, aid for those too sick to work, and education for orphans.⁶ Farmers banded together into cooperatives

4 Congress of the United States, Joint Committee on Taxation, Historical Development and Present Law of the Federal Tax Exemption for Charities and Other Tax-Exempt Organizations, Apr. 19, 2005, <https://www.jct.gov/publications/2005/jcx-29-05/>.

5 Giving USA, “Giving USA Limited Data Tableau Visualization, 2022 Giving Overview,” <https://givingusa.org/giving-usa-limited-data-tableau-visualization/>.

6 B.H. Meyer, “Fraternal Beneficiary Societies in the United States,” *American Journal of Sociology* 6:5 (March 1901): 647, <https://www.jstor.org/stable/2762005>.

to provide lending for crops and marketing assistance. Credit unions and building and loan associations were formed to provide banking and lending to their members who worked in specific trades or lived in local communities.⁷ Charity hospitals were common in most cities.

Such was the state of American society when lawmakers drafted a new income tax in the Wilson-Gorman Tariff Act of 1894 and decided to exempt certain organizations. But their decisions seemingly were based on social conventions rather than a coherent theory or principle.

The act specifically exempted “corporations, companies, or associations organized and conducted solely for charitable, religious, or educational purposes, including fraternal beneficiary societies, orders, or associations operating upon the lodge system and providing for the payment of life, sick, accident, and other benefits to the members of such societies, orders, or associations and dependents of such members.”⁸ It also exempted savings banks, institutions that lent only to members, mutual insurance companies, and the income generated by the stocks and securities owned by charitable organizations.

Although the Supreme Court struck down the 1894 income tax, the bill’s tax-exempt language became the foundation for all subsequent tax legislation addressing nonprofits, including the Revenue Act of 1909, which established an excise tax on corporate profits.

The 1909 Tax Bill Formalized Many of the Exempt Sectors We Know Today

The Revenue Act of 1909 expanded the sectors first recommended for exemption in 1894 by adding labor, agricultural, and horticultural organizations. It further defined the nature of nonprofit organizations as those “operated exclusively for the mutual benefit of their members.” And “no part of the net income of which inures to the benefit of any private stockholder or individual.”⁹

The prohibition against private inurement became a key factor in defining a “nonprofit” organization. “Non-profit” is a bit of a misnomer because charitable organizations do have net income after expenses, what would otherwise be called “profits.” But nonprofit tax rules prohibit such surpluses from being distributed to any individual or “shareholder” and must be reinvested in the mission of the organization.

Despite these provisions, lawmakers never really clarified a defining theory of why some organizations should be tax-exempt and not others. Indeed, the Senate debate over the 1909 tax bill illustrated the ad hoc nature of the decision-making, not to mention the propensity of senators to stretch the definitions to include their favored industries and organizations.

Sen. Augustus Bacon (D-GA) was the lead sponsor of an amendment to define which activities should be exempt from the new corporate tax. One senator asked Sen. Bacon if the for-profit Methodist Book Concern in Nashville, Tennessee, should be exempt because it devoted all of its profits to “religious, benev-

7 Scott Hodge, “After 90 Years, It Is Time to Wean Credit Unions off Taxpayer Subsidies,” Tax Foundation, Jan. 30, 2024, <https://taxfoundation.org/research/all/federal/credit-union-tax-treatment/>

8 Tariff of 1894 (Wilson-Gorman Tariff), Aug. 27, 1894, <https://fraser.stlouisfed.org/title/5901>. (The income tax is defined on p. 553 and the tax-exempt language begins on p. 556.)

9 American Association of Public Accountants, The Corporation Tax Law of 1909, https://egrove.olemiss.edu/cgi/viewcontent.cgi?article=1955&context=aicpa_guides.

olent, charitable, and educational purposes.”¹⁰ Bacon argued that it should be tax-exempt because “It is organized for profit, but it is not organized for individual profit.”¹¹

To address such questions, senators inserted the word “exclusively” into Bacon’s amendment to distinguish between the use of business profits worthy of tax exemption and profits that were not worthy.

An even more intense debate erupted over exempting building and loan associations from taxation. While some senators argued that the mission of helping the poor purchase homes was worthy of tax exemption, others argued that there were many large building and loan associations that were wholly commercial in nature and should not qualify for tax exemption. Senators ultimately agreed to add the words “mutual” and “domestic” to distinguish between small, local, and member-oriented building and loan associations and the large commercial firms.

Lawmakers Worried That Too Much of the Economy Was Exempted from Tax

Even with the adoption of qualifying language, some senators worried that too many sectors were being exempted, thus putting an unfair burden on the businesses still subject to the corporate tax.

Sen. Coe I. Crawford (R-SD) said, “The only question here is, Is it a corporation for profit and has it a net income to which this proposed [tax] law should apply? If so, why should it be exempted?”

Further, he predicted that groups would take advantage of the ambiguous language. “I think there is too much false sentiment about this matter,” he said. “Some one will come here and say ‘We are a lodge; we are an organization for the mutual help and benefit of our members, and therefore this law ought not to apply to us.’”¹²

Sen. Weldon B. Heyburn (R-ID) went a step further and asked, “Will some Senator tell me what remains and who there is remaining to pay this tax? I have just made a casual summary of the amount of capital exempted, and, according to the statistics, it is something over \$1,800,000,000. There cannot be very much remaining.”¹³

Heyburn warned about the cumulative impact of the efforts by his fellow senators to exempt their special interests from the income tax. He said, “Having made a hasty mental summary as the various exemptions were proposed, and knowing as I do that you can call one of these concerns a ‘mutual benefit association,’ a ‘building association,’ or anything else, when it really may be a bank. I am merely calling attention to the fact that there will be very little left upon which to collect this revenue.”

Perhaps the most prophetic comment came from Sen. Joseph Bailey (D-TX), a strong proponent of the corporate tax, who said, “I would rather exempt some that ought to be taxed than to tax some that ought to be exempt.”

As we will see below, that philosophy likely explains the \$3.3 trillion size of the untaxed economy today.

¹⁰ 44 Cong. Rec. 4151 (1909).

¹¹ *Ibid.*

¹² *Ibid.*, p. 4155.

¹³ *Ibid.*, p. 4156.

Lawmakers Continued to Exempt More Sectors and Added the Charitable Deduction

Sen. Crawford's concern that lax definitions would lead to a proliferation of tax-exempt organizations proved to be far-sighted. The Revenue Act of 1913 expanded the list of exempt organizations even further, adding mutual savings banks, cemeteries, business leagues, chambers of commerce, civic leagues, and boards of trade. The Act also introduced the notion that civic leagues and similar organizations be "operated exclusively for the promotion of social welfare," a term lawmakers did not define.¹⁴

The Revenue Act of 1916, which increased income tax rates and brackets, added to the list of tax-exempt organizations "clubs organized and operated exclusively for pleasure, recreation and other non-profitable purposes . . . cooperative banks, mutual hail, cyclone, or fire insurance companies, mutual ditch or irrigation companies, mutual telephone companies . . . farmers' marketing associations . . . federal land banks and national farm loan associations," to name just a few.¹⁵

The deduction for charitable gifts was established in the Revenue Act of 1917 out of concern that the high income tax rates levied during World War I would discourage charitable giving. Deductible contributions were limited to 15 percent of taxable net income.¹⁶

A "Nonprofit" Pasta Company Led to Stricter Limits on Business Activity

Lawmakers' failure to establish principled guardrails regarding how much business activity a nonprofit could engage in finally reached a head in the late 1940s when New York University acquired C.F. Mueller pasta company with the intent of benefiting from the profits generated by selling macaroni.¹⁷ Such arrangements were not uncommon at the time because nonprofit law operated under a "destination of income" principle, which allowed income from any source to be tax-free as long as it was dedicated to a charitable purpose.¹⁸

In 1949, the Bureau of Internal Revenue, the precursor to the Internal Revenue Service, released the first-ever analysis of 990 tax returns, representing all tax-exempt organizations in 1946.¹⁹ The report separated the returns into two groups: business types, such as farm marketing cooperatives and mutual savings banks, and nonbusiness types such as civic clubs, charities, labor unions, and recreational groups that were not principally formed for business activities.

There were nearly 100,000 tax-exempt returns filed for 1946, and they reported total revenues of \$9.8 billion. Of these, nearly 28,000 were business returns, accounting for \$7.0 billion of the total revenues.

Interestingly, the report found that more than one-third of nonbusiness organizations reported business

14 H.R. 3321, 63rd Cong. (1913), p. 172, <https://fraser.stlouisfed.org/files/docs/historical/congressional/underwood-tariff-1913.pdf>.

15 E. Gordon Keith, "New Data on Tax-Exempt Organizations," *Proceedings of the Annual Conference on Taxation under the Auspices of the National Tax Association* 38 (1945): 257-269, www.jstor.org/stable/23404793.

16 Individual Income Tax Return for Calendar Year 1917, Form 1040 Instructions, <https://www.irs.gov/pub/irs-prior/f1040-1917.pdf>.

17 Mark B. Edwards, "It All Started With Macaroni: A Trip Through the Shadowy World of UBIT," prepared for the 2005 Legal Forum, September 2005, <https://www.inumc.org/wp-content/uploads/2024/01/unrelatedbusinessincome-1.pdf>.

18 Joint Committee on Taxation (2005), 100.

19 United States Treasury Department, Bureau of Internal Revenue, "Supplement to Statistics of Income for 1946, Part 2," October 1949, <https://www.irs.gov/pub/irs-soi/46eosupsec2.pdf>.

income totaling \$1.1 billion. Business income accounted for 62 percent of the total revenues for “nonbusiness” organizations.

But even for organizations that did not report business-related income, charitable contributions and gifts were not a major share of their revenues. Indeed, charitable contributions and gifts composed 37.6 percent of their receipts. The majority of their income was generated by dues assessments from members as well as investment income.

Cases such as the New York University pasta company renewed concern among lawmakers that nonprofits were unfairly competing against for-profit firms and potentially shrinking the corporate tax base.

Lawmakers’ solution was to establish the unrelated business income tax (UBIT) rules as part of the Revenue Act of 1950. UBIT requires that any business income be “substantially related” to the organization’s core mission. Business income that is not substantially related is taxed at the statutory corporate tax rate.

Shortly after the passage of UBIT, Congress voted in 1951 to remove the tax exemption for mutual savings banks and savings and loan associations “to establish parity between competing financial institutions.”²⁰

However, as we’ll see later, UBIT has become so generous in defining what is allowable business income for nonprofits that it generates very little revenue each year.

There Are Two Types of Nonprofits: Public-Serving and Member-Serving

The Internal Revenue Code of 1954 was a watershed moment in tax policy.²¹ In addition to establishing the modern progressive income tax code that we recognize today, the Act formalized the designation of tax-exempt organizations under section 501(c) of the Internal Revenue Code.

The 1954 Act listed 16 types of tax-exempt organizations, but as Table 1 illustrates, the list has since grown to nearly 30 designations, although some are legacy designations and no longer in use.

The nonprofit world is generally split into two broad categories: public-serving and member-serving organizations.

- **Public-Serving:** The most well-known nonprofits are 501(c)(3) public charity organizations intended to serve broad, public interests such as tending to the poor, education, public health, scientific research, and cultural interests. These organizations can accept tax-deductible contributions.
- **Member-Serving:** All other 501(c) designations are largely member-serving organizations, including credit unions, business leagues, professional associations, rural utilities, real estate holding companies, insurance companies, and cemeteries. These organizations cannot accept charitable donations.

²⁰ Hodge, “After 90 Years, It Is Time to Wean Credit Unions off Taxpayer Subsidies.”

²¹ Internal Revenue Code of 1954, <https://www.govinfo.gov/content/pkg/STATUTE-68/pdf/STATUTE-68A-Pg1.pdf>.

The Tax-Exempt Sector Is Equal to the Fifth-Largest Economy in the World

The senators who worried about the expanding list of tax-exempt entities in the Tax Act of 1909 would be shocked at the size of the tax-exempt economy today. Sen. Heyburn made a casual estimate of the amount of capital exempted at “something over \$1,800,000,000,” or roughly 5 percent of U.S. GDP in 1909.²² Today, the tax-exempt economy commands 15 percent of GDP, roughly equal to the GDP of California, which has the fifth-largest economy in the world.

Table 1. The \$3.3 Trillion Universe of Untaxed Industries, Organizations, and Institutions, 2019

Tax-Exempt Organizations	Total Returns or Entities	Total Revenue (Billions)	Total Expenses (Billions)	Net Income (Billions)	Net Assets (Billions)
501(c)(1) Federal Credit Unions	3,283	\$43.5	\$36.1	\$7.4	\$803.0
501(c)(2) Title Holding Corporations for Exempt Organization	2,965	\$1.7	\$1.3	\$0.4	\$15.6
501(c)(3) Charitable Tax Exempt Organizations	218,516	\$2,489.2	\$2,337.6	\$151.6	\$4,785.0
501(c)(3) Domestic Private Foundations	98,515	\$141.7	\$111.2	\$30.6	\$965.8
501(c)(4) Civic Leagues and Social Welfare Organizations and Local Associations of Employees	11,639	\$127.2	\$117.6	\$9.7	\$181.2
501(c)(5) Labor, Agricultural and Horticultural Organizations	10,085	\$27.5	\$24.3	\$3.2	\$43.3
501(c)(6) Business Leagues, etc.	19,154	\$51.0	\$47.9	\$3.1	\$54.6
501(c)(7) Social and Recreation Clubs	9,257	\$14.6	\$14.2	\$0.4	\$20.2
501(c)(8) Fraternal Beneficiary Societies	3,932	\$20.8	\$19.1	\$1.7	\$23.4
501(c)(9) Voluntary Employees' Beneficiary Associations	4,668	\$159.6	\$149.4	\$10.2	\$253.2
501(c)(10) Domestic Fraternal Societies	2,510	\$0.5	\$0.5	\$0.1	\$3.7
501(c)(11) Teachers' Retirement Fund Associations	10	\$134.8	\$125.3	\$9.5	\$1.1
501(c)(12) Cooperative Public Utility Companies	3,810	\$68.8	\$67.6	\$1.2	\$165.2
501(c)(13) Cemetery Companies	3,410	\$1.8	\$1.3	\$0.5	\$16.1
501(c)(14) State Chartered Credit Unions	1,953	\$39.0	\$32.3	\$6.8	\$763.7
501(c)(15) Mutual Insurance Companies or Associations	178	\$0.05	\$0.05	\$0.004	\$0.26
501(c)(16) Cooperative Organizations to Finance Crop Operations	12	\$0.03	\$0.02	\$0.01	\$0.37
501(c)(17) Supplemental Unemployment Benefit Trusts	87	\$0.34	\$0.34	\$0.003	\$0.35
501(c)(18) Employee Funded Pension Trusts (created before June 25, 1959)	2	\$0.13	\$0.12	\$0.02	\$0.86
501(c)(19) Veterans' Organizations	8,442	\$1.4	\$1.4	\$0.1	\$3.4
501(c)(23) Other Veterans' Organizations	30	\$0.4	\$0.4	\$0.0	\$4.5
501(c)(25) Title Holding Corporations or Trusts with Multiple Parents	503	\$2.2	\$0.9	\$1.4	\$26.2
501(c)(26) State-Sponsored High-Risk Health Coverage Organizations	6	\$0.1	\$0.1	\$0.0	\$0.1
501(c)(27) State-Sponsored Worker's Compensation Reinsurance Organizations	4	\$1.9	\$1.4	\$0.5	\$13.1
501(c)(29) Qualified Nonprofit Health Insurance Issuers	22	\$1.3	\$1.2	\$0.1	\$1.1
Total 501c orgs =	402,993	\$3,330	\$3,091	\$238	\$8,145

Sources: For Tax-Exempts: Urban Institute, "NCCS 'Core' Data Catalog," Datasets: 2019 501C3-CHARITIES PZ and 2019 501CE-CHARITIES PZ, <https://nccs.urban.org/nccs/catalogs/catalog-core.html>

For Federal Credit Unions: National Credit Union Administration, "5300 Call Report Aggregate Financial Performance Reports (FPRs)," Dataset: December 2019, <https://ncua.gov/analysis/credit-union-corporate-call-report-data/aggregate-financial-performance-reports>.

22 U.S. Department of Commerce Bureau of the Census, *Historical Statistics of the United States, Colonial Times to 1970, Part 1*, (Washington, DC, 1975), 224. Note: In 1909, U.S. GDP was \$33.4 billion in current dollars.

Table 1 illustrates the breadth of the untaxed economy under 501(c) of the Internal Revenue Code. The data in this table is based on the most recent 2019 nonprofit datasets compiled and formatted by the Urban Institute's National Center for Charitable Statistics. The Urban Institute datasets are drawn from various IRS data sources and include "financial information, governance details, and other organizational characteristics."²³

IRS data for tax-exempt organizations is available for COVID-19 years, 2020, 2021, and 2022. However, we chose not to use this data because it does not represent a typical year.

While the total number of nonprofits is over 1.8 million, the table represents organizations that file a full 990 federal income tax return providing complete financial information, which amounts to about 400,000 entities. The exception is 501(c)(1) federal credit unions that are not required to file a 990 tax return. Their financial information is sourced from the National Credit Union Administration. Many small nonprofits are allowed to file a postcard return and, thus, are generally not included in the data sets made available by the IRS.

In 2019, tax-exempt nonprofit organizations reported nearly \$3.3 trillion in income and roughly \$3.1 trillion in expenses, which resulted in \$238 billion in net income. They commanded over \$8 trillion in assets.

The largest category of nonprofit by far is the 501(c)(3) category of organizations. In 2019, these organizations booked nearly \$2.5 trillion in revenues, equal to 75 percent of all nonprofit revenues. Their net income totaled nearly \$152 billion, equal to 63 percent of all nonprofit net income. They also manage the majority of nonprofit assets.

The largest member-serving organizations by income include various insurance and retirement entities under sections 501(c)(4) Civic Leagues and Social Welfare Organizations (the largest of which are health insurers), 501(c)(9) Voluntary Employee's Beneficiary Associations, and 501(c)(11) Teachers Retirement Fund Associations.

Federal and state credit unions, operating under sections 501(c)(1) and 501(c)(14), respectively, together generated \$82.4 billion in revenues in 2019 and commanded over \$1.5 trillion in assets in 2019, equal to 18 percent of all nonprofit assets.

Let's first take a deeper look at public-serving nonprofits since they are by far the largest sector.

The Majority of Public-Serving 501(c)(3) Nonprofits Are Business-Like Entities

The universe of public-serving nonprofits is vast and diverse. Indeed, to manage this diversity, 501(c)(3) organizations have been further segmented into 28 codes under the National Taxonomy of Exempt Entities (NTEE), as illustrated in Table 2 below.

However, if we were to generalize the public-serving nonprofit industry by its dominant industries, it could be called the hospital, health insurance, university, and education sector. Of the \$2.5 trillion in revenues

23 "NCCS Core Series Overview," National Center for Charitable Statistics, <https://nccs.urban.org/nccs/datasets/core/>.

collected by 501(c)(3) organizations in 2019, 55 percent was generated by nonprofit hospitals and health insurance firms, and another 12 percent was generated by higher education entities such as colleges and universities.

There Are Many Very Rich Nonprofits

In 2019, there were 325 501(c)(3) nonprofits with more than \$1 billion in revenues—nearly all were either hospitals or universities. Among the \$1 billion organizations that were not hospitals or universities:

- Just three are relief-oriented: World Vision, Feeding America, and the American Red Cross.
- One is a museum: the Smithsonian Institution.
- Four are essentially government contractors: the MITRE Corporation, Battelle Memorial Institute, Advanced Technology International, and Aerospace Corporation.
- One is the largest collegiate athletic association: the NCAA.
- Three are university-related organizations: the College Board, the Research Foundation for the State of New York, and the Educational Testing Service.
- And the rest are donor-advised funds or public foundations: the Nemours Foundation, National Philanthropic, Goldman Sachs Philanthropy Fund, Schwab Charitable Fund, and Fidelity Investments Charitable Gift Fund.

The largest nonprofit in America is Kaiser Permanente. In 2019, Kaiser’s health plan, hospitals, and state health plans generated more than \$110 billion in combined tax-exempt revenues and over \$5.6 billion in net income. No other nonprofit came close to Kaiser’s revenues. If Kaiser were for-profit, it would be among the Fortune 40 in revenues.

The other hospitals with more than \$10 billion in revenues included the University of Pennsylvania Medical Center (UPMC) with \$14.8 billion in revenues, Partners Health Care System with \$13.6 billion, the Cleveland Clinic Foundation with \$11.5 billion, and the Mayo Clinic Group with \$10.4 billion.

Overall, nonprofit hospitals and health plans generated \$1.4 trillion in revenues in 2019 and \$61 billion in net income. They held assets of \$1.9 trillion. Very little of this income comes from charitable contributions or grants. Urban Institute data shows that charitable contributions comprised 10 percent of hospital revenues and just 3 percent of health plan revenues.

Most hospital revenues are considered “program service income,” which includes insurance payments, patient reimbursements, and payments from Medicare and Medicaid. For health plans, most income is earned from insurance premiums.

Had these profitable health insurance and hospital firms been taxed at the standard corporate tax rate of 21 percent, they could have collectively been liable for nearly \$13 billion in taxes in 2019.

Table 2. Major Categories of 501(c)(3) Nonprofit Organizations and Key Financial Items, 2019

NTEE Code	501(c)(3) Sector Classification	Total Revenues (Billions)	Program Revenue (Billions)	Expenses (Billions)	Net Income (Billions)	Total Assets (Billions)	Percent Program Service Revenues
A	Arts, Culture & Humanities	\$50.6	\$17.4	\$45.4	\$5.2	\$168.4	34%
B	Education	\$156.1	\$67.2	\$137.9	\$18.2	\$544.8	43%
BH	Higher Education	\$294.4	\$202.0	\$272.2	\$22.2	\$911.2	69%
C	Environment	\$12.7	\$2.8	\$11.2	\$1.5	\$38.8	22%
D	Animal Related	\$11.5	\$3.4	\$9.9	\$1.6	\$27.2	29%
E	Health - General	\$374.7	\$322.5	\$370.6	\$4.0	\$399.8	86%
EH	Hospitals	\$996.8	\$926.0	\$940.0	\$56.8	\$1,517.7	93%
F	Mental Health	\$40.6	\$26.5	\$39.3	\$1.2	\$34.7	65%
G	Health - Disease Specific (general)	\$28.5	\$13.1	\$29.5	-\$1.0	\$43.4	46%
H	Health - Disease Specific (research)	\$14.5	\$2.6	\$13.4	\$1.1	\$51.9	18%
I	Crime, Legal Related	\$10.6	\$2.5	\$9.8	\$0.8	\$11.7	24%
J	Employment, Job Related	\$21.0	\$11.6	\$20.1	\$0.9	\$20.1	55%
K	Food, Agriculture, Nutrition	\$17.8	\$1.4	\$17.0	\$0.8	\$10.1	8%
L	Housing, Shelter	\$32.0	\$18.6	\$29.6	\$2.3	\$111.3	58%
M	Public Safety, Disaster Preparedness	\$3.9	\$1.1	\$3.6	\$0.3	\$8.8	29%
N	Recreation and Sports	\$23.6	\$15.2	\$22.0	\$1.6	\$31.8	64%
O	Youth Development	\$10.9	\$2.6	\$10.2	\$0.7	\$21.3	24%
P	Human Services, Multipurpose and Other	\$163.8	\$92.2	\$158.8	\$5.0	\$231.9	56%
Q	International, Foreign Affairs	\$43.8	\$4.8	\$43.3	\$0.5	\$61.6	11%
R	Civil Rights/Advocacy	\$4.5	\$0.7	\$4.0	\$0.5	\$5.8	16%
S	Community Improvement	\$24.3	\$8.8	\$22.2	\$2.1	\$67.5	36%
T	Philanthropy, Voluntarism	\$76.1	\$4.2	\$54.2	\$21.8	\$304.9	5%
U	Science and Technology	\$28.5	\$11.2	\$27.3	\$1.2	\$32.8	39%
V	Social Science	\$4.8	\$1.2	\$4.1	\$0.6	\$11.5	24%
W	Public, Society Benefit	\$13.7	\$6.8	\$13.4	\$0.3	\$39.3	49%
X	Religion Related	\$23.1	\$5.3	\$21.7	\$1.5	\$44.7	23%
Y	Mutual/Membership Benefit	\$4.5	\$3.3	\$4.7	-\$0.2	\$29.0	73%
Z	Unknown, Unclassified	\$2.1	\$1.7	\$2.1	\$0.0	\$2.9	82%
	Total 501(c)(3) Organizations =	\$2,489.2	\$1,776.7	\$2,337.6	\$151.6	\$4,785.0	71%

Source: Urban Institute, "NCCS 'Core' Data Catalog," Dataset: 2019 501C3-CHARITIES PZ, <https://nccs.urban.org/nccs/catalogs/catalog-core.html>

Private Universities and Their Endowments Dominate the Education Sector

In 2019, there were 51 private universities with more than \$1 billion in revenues. Ten universities reported more than \$5 billion in income, including the University of Pennsylvania, Harvard, New York University, Johns Hopkins, Stanford, University of Southern California, Columbia, Massachusetts Institute of Technology, Yale, and Cornell. As a group, they held \$264 billion in assets.

Collectively, private colleges and universities enjoyed net income of \$22.2 billion in 2019. Had they been taxed as for-profit businesses they could have been liable for \$4.6 billion in taxes.

Despite their tax-exempt status, the majority of university income comes from sources other than charitable donations from alumni. Overall, nearly 70 percent of university income comes from "program service revenue," which includes tuition, fees, ticket sales from sporting events, patent royalties, rents from dorms, and cafeteria sales—all considered substantively related to their mission and, thus, exempt from taxes.

By contrast, charitable contributions accounted for 19 percent of total revenues for private universities and colleges.

Many universities have separate investment arms categorized as general “education” organizations, putting them in the same category as private primary and secondary schools.

For example, the \$2 billion Gothic Corporation invests on behalf of Duke University. It held \$7.6 billion in assets in 2019. Similarly, the Harvard Management Private Equity Corporation managed \$31 billion in assets, while the Harvard Private Capital Realty Inc. managed \$3.5 billion in assets. The University of Virginia Investment Management Corporation held \$9.8 billion in assets, while the University of Wisconsin Foundation reported \$4.1 billion in assets.

The Urban Institute dataset contains more than 800 university-related endowments, foundations, and fund-raising entities in 2019. These entities raised a total of \$26.8 billion that year and had more than \$209 billion in assets. They ended the year with \$7.5 billion in net income which, had it been taxed at 21 percent, could have generated more than \$1.5 billion in tax revenues.

Business-Like Organizations Abound in Unlikely 501(c)(3) Categories

Many nonprofit categories contain an eclectic mix of large business-like organizations alongside small local organizations. For example, the Arts & Culture sector contains hundreds of local arts projects, dance companies, theater groups, and orchestras. It also includes some very large institutions that could very well be considered for-profit organizations. The Harvard Business School Publishing Corporation is a good example.

In 2019, Harvard Business School Publishing (HBS) generated more than \$265 million in revenues. According to its 990 tax return, it ended the year with net income of \$3.9 million and paid about \$1.1 million in taxes on \$14 million in advertising income unrelated to its core mission.²⁴ On paper, it would appear that HBS generated very little in the way of “profits” on its book publishing activities, but that is because it made a \$52.9 million transfer to the “President and Fellows of Harvard College” that it booked as an expense, which reduced its true net income. However, if HBS were a for-profit firm, it would be able to deduct any gifts to Harvard or any other nonprofit.

In some respects, this is similar to NYU’s attempt to use the profits from pasta sales to fund university activities. The only difference in Harvard’s case is that both entities are 501(c)(3) organizations.

Other business-like entities under the Arts & Culture umbrella include the Corporation for Public Broadcasting, the Public Broadcasting Service, National Public Radio, and the WGBH network, all nonprofit competitors of for-profit television and radio networks.

Another unique “cultural” entity is Creative Testing Solutions, which generated over \$400 million in revenues in 2019, “Providing innovative, customized and exceptional laboratory testing services, in support of our healthcare partners and their life saving missions.”²⁵ These services seem very commercial in nature.

²⁴ IRS, Form 990, Return of Organization Exempt from Income Tax, 2018, Harvard Business School Publishing Corporation, https://apps.irs.gov/pub/epostcard/cor/043177990_201906_990_2021012817670018.pdf.

²⁵ Creative Testing Solutions, <https://www.mycts.org/>.

Conducting “Science” Can Be Big Business

Science research was one of the earliest activities to be made tax-exempt. But it is unlikely that those early lawmakers could have imagined how big of an industry “science research” and consulting services has become today and how much it lives off of government largess.

The biggest of these organizations is the Battelle Memorial Institute. By all appearances, Battelle is a government contractor. It manages nine national laboratories for the U.S. Department of Energy and Department of Homeland Security. Battelle bills itself as providing “comprehensive scientific solutions to companies and government agencies across multiple markets.”²⁶ According to Battelle’s 2021 990 tax return, the organization generated \$10 billion in revenues, 97 percent of which was from government grants and contracts.

Similar stories can be told about large tax-exempt science and engineering consulting organizations such as the MITRE Corporation, Aerospace Corporation, Fermi Research Alliance LLC, SRI International, Cold Spring Harbor Laboratory, Noblis Inc., SRC Inc., and In-Q-Tel Inc. Each of these organizations provides services for the government and corporations comparable to those provided by for-profit consulting and management firms. They just provide such services as a 501(c)(3) tax-exempt nonprofit.

Many universities have established affiliated research and consulting organizations to provide support and resources for the research activities of the university. The largest of these is the Research Triangle Institute (RTI), which was organized in 1958 by the state universities of North Carolina along with Duke University, which is private. RTI generated more than \$967 million in revenues in 2019.

RTI’s online promotional material reads like a commercial research and consulting firm.²⁷ RTI bills itself as “a leading independent, nonprofit research institute, with the contractual, legal, and business structures to serve any client with projects of all sizes.” It combines “the scientific rigor of a university with the focus of a project management firm . . . to deliver what our clients need—on target and on time.”

RTI’s 990 tax return reports that the organization does have “several for-profit entities subject to corporate income taxation,” and its presence in “certain foreign countries results in income taxation in these countries.”²⁸ Yet, RTI qualifies as a 501(c)(3) tax-exempt organization under the U.S. tax code.

Business Income Is Now the Largest Share of Nonprofit Revenues

Because of the growth of business-like income over the past three decades, it is hard to call the 501(c)(3) sector the “charitable” sector anymore. Figure 1 shows how the growth in program service revenues has driven the overall growth in nonprofit revenues over the past 30 years. Generally speaking, program service revenues can include Medicare and Medicaid payments, payments for medical services from insurers and patients, tuition, ticket sales, royalties, insurance premiums, conference registration fees, fees and contracts from government agencies, and unrelated business income.

²⁶ Battelle Memorial Institute, <https://www.battelle.org/about-us>.

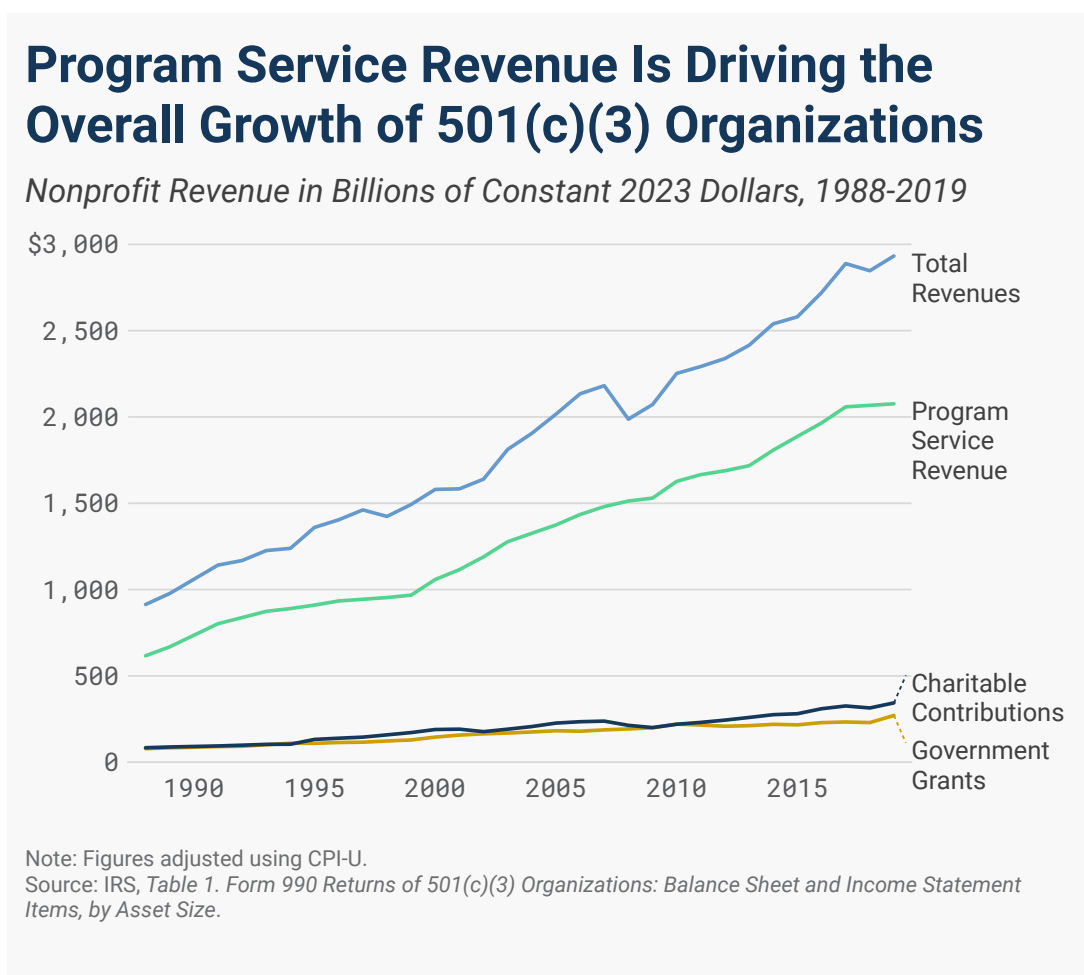
²⁷ RTI International, <https://www.rti.org/about-us>.

²⁸ IRS, Form 990, Return of Organization Exempt from Income Tax, 2018, Research Triangle Institute, https://apps.irs.gov/pub/epostcard/cor/560686338_201909_90_2020101517377917.pdf.

Since 1988, program service revenues have risen from \$548 billion, in today's dollars, to more than \$1.8 trillion in 2019—an increase of 310 percent.²⁹

Program revenues comprised 71 percent of nonprofit revenues in 2019, up from 67 percent in 1988. By contrast, charitable contributions comprised just 12 percent of nonprofit revenues in 2019.

Figure 1.



As surprising as this may seem, the real story is that charitable contributions have never been the dominant source of income for 501(c)(3) organizations or for tax-exempts generally. As we saw in the Treasury Department's 1949 study, even for organizations without business-related income, charitable donations were exceeded by dues, membership fees, and other income sources.

IRS data shows that as a share of 501(c)(3) income, contributions fell from 27 percent in 1975 to 18 percent in 1982 and 12 percent in 2019.³⁰

Nonprofits Are Increasingly Dependent on Funds from Government

While the 1949 Treasury study separated tax-exempt organizations into business and nonbusiness types, a third type of nonprofit has emerged since the Great Society of the 1960s—government-dependent or-

²⁹ Scott Hodge, "Nonprofits are Financially Healthy and Doing Big Business," Tax Foundation, Oct. 6, 2023. <https://taxfoundation.org/blog/501c3-nonprofit-revenue/>.

³⁰ Ibid.

ganizations. Such organizations derive most of their income from government grants, contracts, or programs such as Medicaid, Medicare, public housing, and anti-poverty aid.

As we saw with the research and consulting organizations discussed above, many government agencies rely on nonprofit organizations as contractors or subcontractors, managing programs such as public housing, transit systems, social services, and job training.

Figure 1 shows that government grants alone nearly equal charitable contributions in most years, and government grants do not include revenues from government contracts or programs such as Medicare and Medicaid, which are considered program service income.

Identifying Purely Benevolent 501(c)(3) Organizations Is Challenging

Many of the organization types we have reviewed so far are business-like in form and function. But looking at the list of 501(c)(3) NTEE categories, a few stand out as containing more benevolent organizations than business-like organizations.

Employment and job-related organizations (category J) range from job training services to local trade unions. Perhaps the most prominent name in this category is Goodwill Industries, with some 180 local chapters. Dress for Success is another national organization with more than 50 chapters providing business attire and training to women seeking jobs.³¹

A sizeable number of organizations in this category are lesser-known community-based vocational training and apprenticeship organizations supported by government grants and private donations. Trade unions operate similar apprentice and training programs for carpenters, masons, electricians, and pipe fitters, for example.

Standing out from such training programs are numerous local union chapters, supported by member dues.

The most benevolent-centered category is K, representing food, agriculture, and nutrition organizations. The Urban Institute dataset includes more than 5,700 food, agriculture, and nutrition organizations with total revenues of nearly \$17.8 billion in 2019. Here we find that nearly every organization is a food bank, food pantry, child hunger-related organization, or adult nutrition service such as Meals on Wheels. The largest such organization is the \$2.8 billion Feeding America, but most are local in nature such as the \$10 million Food Bank of East Alabama and the \$30,000 Westlake Meals on Wheels.

Overall, contributions and grants comprised 90 percent of the revenues for food and nutrition organizations in 2019, which clearly sets these benevolent organizations apart from most other nonprofits.

The housing and shelter organizations comprising category L include a mix of benevolent organizations, government contractors, and business-like entities. Many of the larger organizations in this category are public housing providers or management contractors. The largest such organization is Navigate Afford-

31 Dress for Success, <https://www.dressforsuccessqc.org/>.

able Housing Partners in Birmingham, Alabama, which received 99.7 percent of its \$605 million in 2019 income from U.S. Department of Housing and Urban Development grants and contracts.³²

Vetter Senior Living in Elkhorn, Nebraska, is also representative of the more business-like organizations in this category. Started in 1975 by Jack and Eldora Vetter, this chain of senior living facilities received more than half (\$134 million) of its \$222.5 million in revenues from Medicaid and Medicare in 2019.³³ Most of the remaining income came from “patient service revenue” and “management revenues.”³⁴ On the surface, it is difficult to distinguish between the services that Vetter provides as a “nonprofit” and those provided by for-profit senior living companies.

Habitat for Humanity is the largest of the more traditional volunteer-based service organizations found in this category. The vast majority of its \$288 million in revenues in 2019 came from grants, contributions, and in-kind gifts.³⁵

Multipurpose is the operative term for human service organizations in category P. The largest organization in this category is the American Red Cross with more than \$2.8 billion in income in 2019. The AARP Foundation is also listed as a human service organization and illustrates how some large nonprofits use related tax-exempt entities to expand their operations. Its 990 for 2019 shows that it is affiliated with other AARP entities, including the main AARP entity, which is a 501(c)(4) nonprofit.³⁶ The main AARP entity booked some \$1.7 billion in revenues in 2019, including more than \$977 million in tax-free royalty income.³⁷

The Urban Institute datasets include more than 600 separate filings for local YMCA or WYCA chapters, which have combined income of \$6.1 billion and assets of \$12 billion. By contrast, the largest for-profit fitness company by income is LA Fitness, which also has 600 locations but only \$2 billion in revenues.

But the category also includes an interesting variety of smaller organizations, such as dog rescues, adult day care centers, children’s day care centers, hospice care, community centers, thrift stores, pregnancy centers, diaper banks, and yoga studios.

A Look into Member-Serving Tax-Exempt Organizations: 501(c)(1) – 501(c)(29)

Almost by definition, organizations other than 501(c)(3) entities have a business orientation in some manner, even if they were intended to be member-serving. These include credit unions, rural utilities and coops, insurance companies, pension funds, business and sports leagues, cemeteries, real estate holding companies, farmer coops, fraternal organizations, social and recreation clubs, and veterans organizations.

32 IRS, Form 990, Return of Organization Exempt from Income Tax, 2019, Navigate Affordable Housing Partners Inc., https://apps.irs.gov/pub/epostcard/cor/630985617_201912_990_2020110517414338.pdf.

33 Vetter Senior Living, <https://www.vetterseniorliving.com/we-believe/history/>.

34 IRS, Form 990, Return of Organization Exempt from Income Tax, 2018, Vetter Senior Living, https://apps.irs.gov/pub/epostcard/cor/471108168_201906_990_2021012817669748.pdf.

35 IRS, Form 990, Return of Organization Exempt from Income Tax, 2018, Habitat for Humanity International Inc., https://apps.irs.gov/pub/epostcard/cor/911914868_201906_990_2020020617119545.pdf.

36 IRS, Form 990, Return of Organization Exempt from Income Tax 2019, AARP Foundation, 2018 https://apps.irs.gov/pub/epostcard/cor/520794300_201912_990_2021022617763807.pdf.

37 IRS, Form 990, Return of Organization Exempt from Income Tax, 2019, AARP, https://apps.irs.gov/pub/epostcard/cor/951985500_201912_990_2022042920018144.pdf.

Let's explore a few of these categories.

501(c)(4) organizations are a good example of how tax-exempt definitions can be expanded to include big businesses. While tax laws require that such organizations be “operated exclusively to promote social welfare,” that concept seems to have been interpreted broadly.³⁸

Washington insiders may associate 501(c)(4) organizations with activist and public policy organizations like the Sierra Club and the American Civil Liberties Union, but such organizations are in the minority. Social welfare organizations seem to be split between a few hundred large health-related firms and thousands of smaller 501(c)(4) organizations such as Rotary clubs, Kiwanis, Lions clubs, Optimist clubs, American Legion, Links chapters, homeowners associations, and volunteer fire departments.

The largest 501(c)(4) entities, those with more than \$100 million in revenues, are predominantly health-related firms such as dental plans, HMOs, and health-care networks. Delta Dental Plans, with roughly 30 state entities, is the largest of these organizations. In 2019, it had combined revenues of more than \$15 billion and net income of \$339 million.

Perhaps the most unusual of these large “social welfare” organizations is the Prairie Meadows Racetrack & Casino Inc. in Altoona, Iowa. Originally launched as a commercial venture, which went bankrupt, it was converted into a nonprofit in 1994 and is reportedly one of only two nonprofit casinos in the U.S. With more than \$2.3 billion in 2019 revenues, Prairie Meadows says it is “dedicated to lessening the burden of government by raising funds for charitable organizations and community improvement projects.”³⁹

Prairie Meadows' mission statement is an interesting justification for the tax-exempt status of what was a failed commercial venture. It harkens back to the 1909 Senate quandary whether the for-profit Methodist Book Concern should pay the corporate income tax because it gave away its profits to charitable causes. And tying a casino's charitable status to “lessening the burden of government” is a questionable principle that could open the door to no end of dubious “commercial” but tax-exempt enterprises, such as a “non-profit” marijuana dispensary.

The 501(c)(6) “business league” category could be called the tax-exempt home of K Street lobbyists, golf and tennis companies, professional guilds, and tourism boards. The U.S. Chamber of Commerce is said to have led the effort in 1913 to exempt business membership organizations and civic leagues from tax during the debate over the Revenue Act of 1913. Indeed, some of the biggest business groups in Washington, D.C., are organized as 501(c)(6) entities, including the U.S. Chamber of Commerce, American Petroleum Institute, American Hospital Association, American Bureau of Shipping, American Chemistry Council, National Milk Producers Federation, and National Association of Broadcasters.

Many professional sports organizations are also organized as “business leagues.” While the NFL, MLB, and NBA renounced their tax-exempt status years ago, a number of prominent professional sports leagues still maintain their tax-exempt status. These include the PGA, United States Tennis Association, ATP Tour, Ladies Professional Golf Association, WTA Tour Inc., United States Polo Association, the Breeders Cup Limited, National Hot Rod Association, and Professional Golfers Association of America.

38 Internal Revenue Service, “Social welfare organizations,” <https://www.irs.gov/charities-non-profits/other-non-profits/social-welfare-organizations>.

39 Prairie Meadows, <https://www.prairiemeadows.com/about-us/our-company>.

This is also a common organizational form for professional organizations, such as the American Bar Association, American Medical Association, National Association of Realtors, Academy of Motion Picture Arts and Sciences, and Motion Picture Association.

Advertising and promotional organizations are frequently organized as 501(c)(6) organizations. Notable promotional organizations include the Houston Super Bowl Host Committee, Avocados from Mexico, United States Meat Export Federation, Greater Miami Convention and Visitors Bureau, Atlanta Convention & Visitors Bureau, and Dairy Promotion Inc.

The social and recreation clubs represented in the 501(c)(7) classification may consist of some of the most exclusive golf, athletic, and social clubs in the United States. Social and recreational clubs were exempted from tax in the 1916 Tax Act. Many of the largest cities have exclusive social and athletic clubs, including the New York Athletic Club, the Detroit Athletic Club, the Atlanta Athletic Club, the Yale Club of New York City, the Harvard Club of New York City, and the Bohemian Club near San Francisco. Indeed, the Tax Foundation was organized at a meeting of business leaders in 1937 at the University Club in New York City.

Golf courses dominate the 501(c)(7) category of nonprofit organizations, including some of the most iconic and exclusive golf clubs in America, such as the Congressional Country Club, Baltusrol Golf Club, Winged Foot Golf Club, Oakmont Country Club, and Sawgrass Country Club. By contrast, Augusta National Golf Club, which hosts the Masters tournament, is a for-profit corporate entity.

The richest of all the clubs in 2019 was the Desert Mountain Club in Scottsdale, Arizona, which reported \$68 million in revenues. Membership to this exclusive golf and lifestyle community is by “invitation only.”⁴⁰ The Club’s real estate listings include homes ranging from \$1.5 million to nearly \$13 million.

There are certainly smaller, less famous clubs in this category, including a Giant Schnauzer club, local boating clubs, swim and tennis clubs, kennel clubs, singing clubs, model train clubs, a Slovak Citizens club, and various cotillion clubs.

Fraternal beneficiary societies organized under 501(c)(8) of the tax code are now largely insurance companies. Fraternal beneficiary societies were a prevalent part of America’s self-help culture when the first income taxes were being drafted, first in 1894 and then in 1909. Yet, as B.H. Meyer explained in an academic study in 1900, there was always a tension between their social function and their beneficiary function.

Fraternal beneficiary societies, as the name suggests, are dual in their nature. Because they are both fraternal and beneficiary, these societies are really composed of two organizations each: a fraternity and an insurance company . . . In other words, a typical fraternal society rests upon three things: first, voluntary organization on a basis of equality; second, some ritualistic system; and third, a system of benefits. These three are united in different proportions in different societies, and in not a few of them a struggle for predominance is taking place between the first and third. This is the battle between “fraternalism and commercialism.”⁴¹

40 Desert Mountain Club Inc., <https://www.desertmountain.com/membership-information/>.

41 B.H. Meyer, “Fraternal Beneficiary Societies in the United States,” *American Journal of Sociology* 6:5 (March 1901): 646-661, <https://www.jstor.org/stable/2762005>.

More than 100 years later, the commercial side of these organizations has won out. For example, WoodmenLife—which was founded in 1890—offers various types of life insurance and retirement products.⁴² Modern Woodmen (unrelated to WoodmenLife) offers an even broader portfolio of products beyond life insurance, such as retirement planning, estate planning, and employee benefits.⁴³ The Knights of Columbus does have a well-known service side, but also offers its members retirement annuities, mutual funds, donor advised funds, and various life insurance policies.⁴⁴

The products and services offered by these nonprofit organizations are in direct competition with similar products offered by for-profit financial service firms.

Tax-exempt public electric, water, and utility companies are a legacy of Depression-era efforts to promote rural self-help. Today's 501(c)(12) tax-exempt utilities were formed as “cooperatives” during the early 1900s to bring electricity and water services to rural areas at a time when the larger urban utilities didn't find it profitable to reach those markets. In 1934, Congress created the Rural Electrification Administration—now the Rural Utilities Service (RUS)—within the U.S. Department of Agriculture to promote the growth of rural coops and provide them low-cost financing.

Some 90 years later, rural coops are still dependent upon their tax-exempt status and subsidized loans. Notably, many of the “rural” communities these coops were created to serve are now prosperous suburbs of cities such as Washington, D.C., and Atlanta, Georgia, not to mention tony resort communities such as Sanibel and Marco Island in Florida.

This ecosystem of tax-exempt utilities is supported by two larger tax-exempt organizations. The industry's lobbying arm is the National Rural Electric Cooperative Association, a 501(c)(6) membership organization.⁴⁵ The industry's lending arm—independent of the federal RUS—is the \$1.38 billion National Rural Utilities Cooperative Finance Corporation (CFC). CFC is a 501(c)(4) entity and bills itself as “Bridging the financial needs of the rural electric cooperative network with global capital markets.”⁴⁶ It has more than \$35 billion in assets.

The Paper Tiger of Nonprofit Law: The Unrelated Business Income Tax

Congress enacted UBIT in 1950 with the aim of leveling the playing field between tax-exempt organizations and for-profit firms. But as Jeffrey Scott Tenenbaum wrote in his primer on UBIT for the American Bar Association, “instead of prohibiting tax-exempt entities from engaging in any business activities at all . . . Congress chose to specifically permit a certain degree of business activity by tax-exempt organizations, but tax that activity like any other for-profit business.”⁴⁷

Thus, writes Tenenbaum, “such business activities are permissible, so long as the activities are not a ‘substantial part of [the nonprofit’s] activities.’ The tax applies to virtually all tax-exempt entities.”

42 Woodmen Life, <https://www.woodmenlife.org/extras/>.

43 Modern Woodmen, <https://www.modernwoodmen.org/financial-planning/protection/>.

44 Knights of Columbus, <https://www.kofc.org/en/what-we-do/insurance/index.html>.

45 Cooperative Services Corporation, <https://www.cooperative.com/cfc/pages/ncsc.aspx>.

46 National Rural Utilities Cooperative Finance Corporation, <https://www.nrucfc.coop/content/nrucfc/en/about-cfc.html>.

47 Jeffrey Scott Tenenbaum, “Unrelated Business Income Tax (UBIT): A Comprehensive Overview for Nonprofits,” *Business Law Today*, November 2021, https://americanbar.org/groups/business_law/resources/business-law-today/2021-november/unrelated-business-income-tax/.

A frequent example of the difference between taxable and non-taxable sales activities is a museum gift shop that sells greeting cards bearing reproductions of paintings in the museum's collection as well as local maps and souvenirs. UBIT rules would require the museum to pay tax on the income generated by the souvenirs because those items are not related to the museum's mission. But it would not pay UBIT on income generated by the greeting cards with an image of a Monet because those sales are related to the museum's mission of advancing art appreciation.⁴⁸

The Harvard Business School magazine is another example. HBS does not pay tax on the income generated by its business publications or magazine subscriptions because they are determined to be a key element of the organization's mission. However, HBS does pay tax on the income generated by the advertising in the magazine because those promote private and commercial interests separate from HBS's mission.

There are, however, numerous exemptions to UBIT that give organizations wide latitude to earn business-like income. This includes income from corporate sponsorships, royalties, TV broadcast rights, certain rents, interest, dividends, and convention fees to name a few.

As a result of UBIT's narrow scope and numerous exemptions, the tax raises very little revenue. IRS data on UBIT revenues from 1990 to 2017 shows that, on average, 17 percent of nonprofit charitable organizations reported unrelated business income and roughly half of those organizations were liable for UBIT. After adjusting for inflation, UBIT raised an average of \$586 million per year from 1990 to 2017, less than 0.5 percent of the billions in net income charitable nonprofits generated each year.⁴⁹

So rather than level the playing field, UBIT has had little to no effect on preventing nonprofits from engaging in business-like activities nor competing directly with for-profit firms.

Three Reforms Can Level the Playing Field and Broaden the Tax Base

After more than 100 years of nonprofit expansion into the business economy, it is time that lawmakers developed some simple and uniform rules that accomplish two things: 1) distinguish between benevolent organizations and business-like entities, and 2) expressly level the playing field between the business activities of nonprofit and for-profit entities.

Three changes would remove the tax advantage that business-like nonprofits have over for-profit firms while protecting the charitable income of benevolent organizations.

Step 1: The first step is to raise the threshold for the percentage of charitable contributions a 501(c)(3) organization must receive to be considered a "publicly supported" charity. Currently, an organization needs to show that it receives at least 30 percent of its revenues from "public" sources to be considered a public charity eligible to accept tax-deductible donations. Public sources is a broad concept that includes contributions from the public, government grants, grants from charitable foundations, net income from unrelated business activities, membership fees, and gross investment income.⁵⁰

48 Department of the Treasury, Internal Revenue Service, Publication 598: Tax on Unrelated Business Income of Exempt Organizations, Mar. 22, 2021, <https://www.irs.gov/pub/irs-pdf/p598.pdf>.

49 Internal Revenue Service, Statistics of Income, Table 16: Nonprofit Charitable Organization and Domestic Private Foundation Information Returns, and Exempt Organization Business Income Tax Returns: Selected Financial Data, Expanded, <https://www.irs.gov/statistics/soi-tax-stats-historical-table-16>.

50 U.S. Department of Treasury, Internal Revenue Service, Publication 557, Tax-Exempt Status for Your Organization, revised January 2014, <https://www.irs.gov/pub/irs-pdf/p557.pdf>.

Since our goal is to narrow the definition of a “publicly supported” charity to focus on benevolent organizations, the income threshold should be increased to 80 percent and limited to donations from private individuals and grants from charitable foundations. Income from government contracts, government grants for services, membership fees, investment income, and business income should not be included as these sources are more business-like than charitable in nature.

Such a rule would protect the “public charity” status of a women’s shelter that hosts an annual charity ball but would likely deny that status for a nonprofit group such as the Battelle Memorial Institute that receives most of its income from contracts or grants for service from the departments of Energy or Defense, for example.

Step 2: The second step would be to eliminate UBIT and apply the 21 percent corporate income tax to the net program service income of all nonprofit organizations. The calculation of net program service income would differ between 501(c)(3) organizations and other nonprofits because of the need to separate charitable income from program service revenues.

As was discussed earlier, most 501(c)(3) organizations generate income from charitable donations and program service revenue. Program service revenues are the kind of income that a for-profit firm would normally pay tax on, including tuition, fees, Medicare and Medicaid payments, insurance reimbursements, rents, contract income, royalties, and broadcast rights. Under this proposed rule, nonprofits would subtract their program-related expenses from their program service revenues and pay income tax on the remainder.

In the table below, we estimate that 501(c)(3) organizations had \$92 billion in net program service income in 2019. Had this net income, or profits, been taxed at the 21 percent corporate tax rate, it could have raised \$19 billion in new tax revenues. This estimate does not account for any behavioral effects, nor have we accounted for an adjustment to corporate accounting standards such as bonus expensing.

Table 3. Revenue Estimates of Taxing Program and Business-Like Income of Tax-Exempt Organizations, 2019 (Billions)

Tax-Exempt Sector	Total Revenues	Program Service Revenues	Total Expenses	Total Net Income	Estimated Program Service Expenses	Estimated Net Program Service Income	Tax	Est. Tax Revenues
2019 501(c)(3)	\$2,489	\$1,777	\$2,338	\$152	\$1,685	\$92	0.21	\$19
2019 All other 501(c)	\$840	-	\$754	\$87	-	\$87	0.21	\$18
501(c)(1) Federal Credit Unions	\$43	-	\$36	\$7	-	\$7	0.21	\$2
Total =	\$3,373	\$1,777	\$3,128	\$245	\$1,685	\$186	-	\$39

Note: Program service expenses are assumed to be the same ratio to total expenses that program service revenues are to total revenues (71%).

Source: Author calculations based on Urban Institute and NCUA data cited in Table 1.

Calculating taxable income is much simpler for all other exempt organizations since they don’t have to account for charitable contributions. All of their income is assumed to be program service income. These organizations would simply pay the corporate income tax rate on their income net of expenses like any private business.

In 2019, these organizations had \$87 billion in net income, or profits. Had these profits been taxed at the 21 percent corporate tax rate, it could have raised \$18 billion in revenues.

Lastly, federal credit unions generated \$7 billion in net income in 2019 and would have been liable for \$2 billion in taxes had they been taxed at 21 percent.

Combined, taxing the net program income of all nonprofits could have raised \$39 billion in new revenues in 2019.

Step 3: The final step would be to decide how to tax the investment income—dividends, interest, and capital gains—of tax-exempt organizations. Table 3 includes investment income in the total net “profits” of tax-exempt organizations and, thus, assumes they are taxed at 21 percent. Currently, most nonprofits pay no tax on their investment income under the theory that such income supports the mission of the organization. However, private foundations are required to pay a 1.39 percent excise tax on their investment income. Large university endowments are also required to pay a 1.4 percent excise tax if the endowment assets exceed \$500,000 per student.

The rate at which nonprofit investment income is taxed is not a trivial matter. In 2019, the Urban Institute dataset shows that 501(c)(3) organizations reported \$51.8 billion in investment income. All other 501(c) organizations reported \$19.4 billion in investment income, which brings the total of nonprofit investment income to \$71.2 billion. Taxing this income at roughly 1.4 percent rather than 21 percent would yield much less revenue.

The tax exemption for investment income has allowed some large nonprofits to become tax-exempt hedge funds. Tax neutrality demands that all taxpayers pay the same rate on their investment income. Thus, it would make sense to tax the investment income of nonprofits at the 21 percent corporate rate and remove any incentive for arbitrage or income shifting.

Conclusion

Washington faces a brewing fiscal crisis that will force lawmakers to look for additional tax revenues, either to address mounting deficits or to offset the extension of key portions of the 2017 Tax Cuts and Jobs Act—perhaps even both. The fairest and least economically harmful way to raise new revenues is to expand the federal tax base to include business-like income earned by tax-exempt nonprofit organizations.

The rules governing the tax-exempt sector are long overdue for reform. The \$3.3 trillion nonprofit economy is dominated by large, business-like organizations that overshadow the truly benevolent organizations the tax exemption should be reserved for.

A reasonable rewriting of the tax-exempt rules should include narrowing the definition of “public charity,” repealing the toothless UBIT, and subjecting all non-charitable income to taxation. Doing so would protect the charitable income of benevolent organizations while leveling the playing field between nonprofits and for-profit entities. Most importantly, tighter rules would also give a principled foundation to the nonprofit sector that has been missing for the past 120 years.