An Overview of the Tax Treatment of Nonprofits

Trina Griffin
Research Division, NCGA
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Outline

- Basics
- Statistics
- Tax Treatment
- Trends
- Issues
Nonprofit Basics
What Is A Nonprofit?

An organization whose purpose is to provide a public or mutual benefit and that does not seek to accumulate profits for distribution to owners or investors.
For Profit vs. Nonprofit

**Similarities**
- Formation
- Governance
- Employees/wages
- Provision of goods and services
- Profit

**Differences**
- Goal or mission
- Profit distribution
- Ownership
- Distribution of assets upon dissolution
- Tax-exempt status
IRC 501(c)(3)

A corporation organized and operated exclusively for:

- Religious, charitable, scientific, testing for public safety, literary or educational purposes

OR

- To foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.
IRC 501(c)(3)

- No part of the net earnings may inure to the benefit of any private shareholder.
- No substantial part of the activities is carrying on propaganda or attempting to influence legislation.
- No participation in any political campaign on behalf of or in opposition to any political candidate.
IRC 501(c)(3)

- 3 basic categories:
  - Public charities
  - Private foundations
  - Other nonprofit organizations
- 501(c)(3)s with gross receipts over $25,000 must report financial activity annually to the IRS on Form 990.
- Churches and church-affiliated organizations are exempt from this requirement.
Statistics
National
North Carolina
National Statistics

- Approx. 1.4 million nonprofits registered with IRS.
- Over 500,000 collected more than $25,000 in gross receipts.
- From 1995-2005, the number of reporting public charities grew 66% and revenues and assets increased 54%.
- Hospitals and higher education institutions account for more than half of total expenses and assets of all public charities ($1 trillion).

*Source: Nonprofit Almanac, National Center for Charitable Statistics (2008)*
Reporting Public Charities by Category (U.S. 2005)

- Human services: 33%
- Health: 13%
- Education: 19%
- Religious: 6%
- Arts, culture, humanities: 11%
- Environment, animals: 4%
- Int’l. & foreign affairs: 2%
- Public & societal benefit: 12%
Reporting Public Charities by Category (N.C. 2005)

- Religious: 25%
- Human services: 27%
- Education: 16%
- Religious: 25%
- Public & societal benefit: 11%
- Int’l. & foreign affairs: 1%
- Arts, culture, humanities: 9%
- Environment, animals: 3%
- Health: 8%
## Comparison of Nonprofits by Category

<table>
<thead>
<tr>
<th>NTEE Major Group</th>
<th>National</th>
<th>NC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arts, Culture, Humanities</td>
<td>11.5%</td>
<td>8.9%</td>
</tr>
<tr>
<td>Education</td>
<td>18.7%</td>
<td>16.4%</td>
</tr>
<tr>
<td>Environment, animals</td>
<td>4.3%</td>
<td>3.3%</td>
</tr>
<tr>
<td>Health</td>
<td>13.3%</td>
<td>8.3%</td>
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<tr>
<td>Human services</td>
<td>32.3%</td>
<td>25.7%</td>
</tr>
<tr>
<td>International &amp; foreign affairs</td>
<td>1.6%</td>
<td>1.0%</td>
</tr>
<tr>
<td>Public and societal benefit</td>
<td>12.1%</td>
<td>11%</td>
</tr>
<tr>
<td>Religious</td>
<td>6.0%</td>
<td>24.2%</td>
</tr>
<tr>
<td>Unknown</td>
<td>0.1%</td>
<td>1.0%</td>
</tr>
</tbody>
</table>
NC Statistics

- 501(c)(3) public charities: 25,747
- 501(c)(3) private foundations: 3,067
- Other 501(c) nonprofit organizations: 12,112

- 62% of NC public charities are non-reporting
- Nonprofits put $29 billion into local economies in 2006 compared to $12 billion in 1996. Nonprofits provide 6% of the jobs in this State (Source: NC Center for Nonprofits).

NC Statistics

- The largest nonprofit landholders are:
  - Religious organizations – comprise 24% of total; not required to report assets
  - Educational organizations – comprise 16.4% of total and possess 41% of the total assets
  - Nonprofit hospitals - comprise 8.3% of total and possess 34% of the total assets

- 50% of reporting public charities are concentrated in 9 urban counties: Wake, Mecklenburg, Guilford, Forsyth, Durham, Buncombe, Cumberland, Orange, and New Hanover

- 80% of NC’s total nonprofit assets are located in these same 9 urban counties.
Tax Treatment

Federal
State & Local
Federal Tax Treatment

- Exemption from federal income tax
- Deductibility of contributions by donors
- Subject to FICA (if they have employees)
- Subject to telephone and gasoline excise taxes
- Subject to “unrelated business income tax”
- Private foundations pay income tax on investment income
- Federal tax-exempt status does not guarantee exemption from state and local taxes.
State Tax Treatment

- No State income tax
- Sales tax refund
- Property tax exemption
- Deductibility of charitable contributions for donors
- Access to tax-exempt bond financing
Sales Tax Refund

- **Nonprofit hospitals**, including hospitals and medical accommodations operated by a hospital authority.
- **Qualified retirement facilities**.
- **501(c)(3)s**, except for organizations classified under NTEE as follows *Effective July 1, 2008*:
  - Community Improvement and Capacity Building
  - Public and societal benefit
  - Mutual and membership benefit
- **A university-affiliated nonprofit organization** that procures, designs, constructs, or provides facilities to a constituent institution of The University of North Carolina.
Property Tax Exemptions

- Property owned by certain named entities
  - e.g. American Legion, VFW, Order of the Moose, Free Masons of NC, Goodwill
- Property used for educational, religious, scientific, literary, or charitable purposes
- Property used for charitable hospital purposes
- Cemeteries
- Qualified retirement facilities
- Health care facilities financed with MCC bonds
Property Tax Exemptions

- Not automatic; single application; 1/8 review
- Different statutes; varying standards for exemptions
  - “Wholly and exclusively used”
  - “Actually and exclusively used”
- “Charitable Purpose”
  - A purpose that has humane and philanthropic objectives.
  - It is an activity that benefits humanity or a significant rather than limited segment of the community without expectation of pecuniary profit or reward.
- “Notwithstanding” provisions
Trends
Generally
National
State & Local
Generally

- Challenges to tax exemptions for nonprofits are not new.
- Revenue Laws has looked at this issue on more than one occasion.
- Factors contributing to increased examination and attention:
  - Rapid and significant growth: quantity and income
  - Increase in “commercial” activities
  - Fiscal crisis
National Trends

- Congress - Sen. Grassley considering legislation
- IRS – 2006 survey; revised 990 regulations (2008)
- GAO Report (September 2008)
- Lawsuits
  - Early 2000s – profiteering
  - More recently – denials of property tax exemptions
- Negative publicity; “scandals” – United Way; WSJ article
The top 50 nonprofit hospitals had an increase in net income from $500 million in 2001 to $4.6 billion in 2006.

77% of U.S. nonprofits hospitals are profitable compared to 61% of for profit hospitals.

Cites strategies used by hospitals to increase profits.
State & Local Trends

- State legislatures and agencies studying issue
  - Washington - Joint Legislative and Audit Review Committee
  - California - Auditor’s report
  - Ohio Attorney General

- Local governments denying property tax exemptions:
  - Minnesota – day care center
  - Illinois – nonprofit hospital
  - Oregon – residential substance abuse treatment center
  - Wisconsin – outpatient health care center

- So far, courts are backing up local governments.
Issues
Issues

- What is the public purpose or goal of the property tax exemption for charitable nonprofits?
- Is the law clear?
- Does the law fulfill its public purpose?