The Tax Expenditure for Tax Exempt Organizations

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Nathan Born
US Department of the Treasury

Adam Looney
Brookings Institution

The views expressed by the authors do not necessarily represent the views of the Office of Tax Analysis or the Department of the Treasury.
Tax Exemption and Tax Expenditures

• Tax Expenditures are large indirect subsidies
  – Exclusions of income, deductions, special treatment etc.

• Tax exempt status under 501(c) provides preferential exclusion in tax law

• Value not currently published by OTA or JCT

• Value of exclusion is unclear
Research Question

• What is the value of tax exempt status?
• Which organizations benefit the most from tax exempt status and why?
• We quantify the cost of the exclusion of positive net income of tax exempt organizations
• **Not** a proposal to include exclusion as a tax expenditure
Overview

• Estimation of the tax expenditure for tax exempt organizations
  – Income exclusion
  – Charitable deduction

• Conceptual issues and ongoing research
Methodology – Exclusion of Income

• Income = Form 990 Microdata Positive Net Income less:
  – Unrelated Business Income
  – Carryforward/carryback net operating losses

• Tax Expenditure = Max {Taxable Income * Graduated Corporate Rate, 0}
Illustrative Example

• Hospital X

Income = 1,000,000
- Expenses = 750,000
- Unrelated Business Income = 20,000
- Imputed NOLs Carried Over = 10,000

Imputed Taxable Income = 220,000
Imputed Tax liability = approx. 77,000
Methodology – Individual Deductions

• Deductions claimed on Form 1040
  – Cash, non-cash, carryover deductions
  – Short/long term gains on donations of financial assets using cost basis and market value data from Form 8283

• Treasury’s Individual Tax Model used to calculate value from Individual Donations
Illustrative Example

<table>
<thead>
<tr>
<th>Charitable Deduction</th>
<th>Current Law</th>
<th>Without Tax Subsidies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deductions of cash contributions</td>
<td>500</td>
<td>0</td>
</tr>
<tr>
<td>Deductions of non-cash contributions</td>
<td>200</td>
<td>0</td>
</tr>
<tr>
<td>Charitable Deduction</td>
<td>700</td>
<td>0</td>
</tr>
</tbody>
</table>

For Donations of Appreciated Assets

<table>
<thead>
<tr>
<th></th>
<th>Market Value</th>
<th>Basis</th>
<th>Capital Gains (Schedule D)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>200</td>
<td>150</td>
<td></td>
<td>50</td>
</tr>
<tr>
<td>Without Tax Subsidies</td>
<td>200</td>
<td>150</td>
<td></td>
<td>50</td>
</tr>
</tbody>
</table>
Tax Expenditure for the Tax Exempt Sector

Billions USD, 2013

Total = 104.4 Billion

Tax Exemption for Tax Exempt Organizations

Donations from Individuals

Donations from Corporations

- $56 [53%]
- $46 [44%]
- $3 [2%]
Largest Tax Expenditures
Billions USD, 2013

1. Exclusion of Employer Sponsored Health Insurance: 185
2. Total Tax Expenditure for Tax Exempt Sector: 104
3. Exclusion of Net Imputed Rental Income: 72
4. Mortgage Interest Deduction: 69
5. Capital gains (except agriculture, timber, iron ore, and coal): 69
6. Deferral of income from CFCs: 63
7. Tax Exemption for Tax Exempt Organizations: 56
8. Net exclusion for DC Plans: 51
9. Accelerated Depreciation: 48
10. Charitable Deduction for Individuals: 46
11. SALT: 44
Tax Expenditure: Exclusion of Net Income

Income/Expenses USD Billions, 2013 Constant Dollars

[Chart showing trends over years for tax expenditure on charitable organizations and other exempt organizations]
Charity Type: Tax Expenditure for Exclusion

Billions USD, 2013

- Hospitals: $15 billion (29%)
- Publicly Supported: $12 billion (22%)
- Education: $13 billion (24%)
- Supporting Organizations: $7 billion (13%)
Tax Expenditure for Individual Deductions
Billions USD, 2013

Total = $46 Billion

- Deductions of Cash: $34 billion (73%)
- Deductions of Noncash Gifts: $9 billion (20%)
- Exclusion of Capital Gain Income Associated with Noncash Gifts: $2 billion (5%)
- Carryover Deductions: $2 billion (4%)
## Tax Expenditure for Non-Cash Contributions by Type of Donation

**Billions USD, 2013**

<table>
<thead>
<tr>
<th>Donation Type</th>
<th>Donations</th>
<th>Tax Expenditure</th>
<th>Subsidy as % of Donation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock</td>
<td>$19.7</td>
<td>$6.9</td>
<td>35%</td>
</tr>
<tr>
<td>Mutual Funds</td>
<td>$1.6</td>
<td>$0.6</td>
<td>38%</td>
</tr>
<tr>
<td>Other Financial</td>
<td>$2.2</td>
<td>$0.9</td>
<td>40%</td>
</tr>
<tr>
<td>Land and Real Estate</td>
<td>$2.0</td>
<td>$0.7</td>
<td>34%</td>
</tr>
<tr>
<td>Easements</td>
<td>$1.1</td>
<td>$0.3</td>
<td>27%</td>
</tr>
<tr>
<td>Art/Collectibles</td>
<td>$1.2</td>
<td>$0.3</td>
<td>22%</td>
</tr>
<tr>
<td>Clothing</td>
<td>$9.7</td>
<td>$2.1</td>
<td>22%</td>
</tr>
<tr>
<td>Household</td>
<td>$4.2</td>
<td>$0.9</td>
<td>22%</td>
</tr>
<tr>
<td>Under $500</td>
<td>$5.2</td>
<td>$1.0</td>
<td>20%</td>
</tr>
<tr>
<td>All Non-Cash Donations</td>
<td>$52.0</td>
<td>$9.1</td>
<td>17%</td>
</tr>
</tbody>
</table>
Conclusion

• Tax Expenditure for Exclusion of net income from the tax base may be associated with a high cost ($56B)

• Tax Expenditure for tax exempt organization benefits hospitals ($15B) and education institutions ($12B)

• The Exclusion of Capital Gains donations is a substantial subsidy to donations of financial assets and land/real estate
Conceptual Issues and Ongoing Research

• Treatment of gifts to charitable organizations

• Charitable and tax exempt organizations would likely alter behavior in the event of being subject to taxation
  – Further research on behavior of tax exempts which switch to F1120 could offer insights on changes in behavior
Thanks for listening!
Total Expenses and Revenue for Charitable and Other Tax Exempt Orgs

USD Billions, 2013 Constant Dollars
Methodology

Tax Expenditure Using Net UBI and UBI ($B)

![Graph showing tax expenditure using net UBI and UBI from 2008 to 2013. The blue line represents tax expenditure using net UBI, and the red line represents tax expenditure. The graph shows a consistent increase in both categories over the years.](Image)
By Charity: Sources of Revenue, 2013

- Hospitals
- Education
- Publicly Supported Organizations

Legend:
- Yellow: Unrelated Business income
- Dark blue: Program Service Revenue
- Red: Investment/Other Revenue
- Purple: Donations and Gifts
Imputed Tax Liability, Excluding Net Gift Income
USD Billions, 2013 Constant Dollars