
RESEARCH REPORTS

The Nonprofit Sector and Taxes: Invaluable and Largely Untapped Research Bases

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A SMALL but important body of research falls in the intersection between two fields: studies of the nonprofit sector and studies on public finance or taxation. Only a portion of this research is on the effects of tax policy on charitable giving and organizations. Tax returns also provide administrative records or data bases for research on other issues, such as the financial condition of foundations or individual rates of giving out of income. By the same token, research on taxes often makes use of data from other sources. For instance, data reported on surveys can be manipulated so that it is possible to estimate the value of deductions for charitable giving.

Much of the tax policy research on charitable activity is theoretical or involves historical, legal, or social analysis of relations between charitable giving and tax rules. The primary purpose of the current report is to acquaint the reader with some of the research made possible by tax returns themselves. The other types of charity/tax research will be mentioned briefly.

Opportunities and Constraints

A marriage between research on the nonprofit sector and on taxes is analogous to a marriage between Sleeping Beauty and the Beast. Each has tremendous potential waiting to be realized, but neither party has the capability of bringing that potential fully out of the other. The

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researcher needs to be aware of both the opportunities and the obstacles in dealing with the intersection between these two fields.

One major obstacle is lack of resources, not merely for would-be researchers but for the basic maintenance and development of administrative records and other data sets. There is probably less research in our society on the charitable sector than there is on how to sell beer and cosmetics, while tax and budget research pales relative to research on direct expenditures and other policies. Unlike expenditure agencies, tax agencies have very small research budgets. The lack of incentives, not goodwill, explains the limited amount of research in both areas. For instance, because most government involvement in the charitable sector proceeds through the I.R.S. and the Treasury, dealing with nonprofit organizations does not fit neatly with the primary function of any government agency. Correspondingly, there is no private charitable constituency that operates like those surrounding health, housing, labor, and other expenditure agencies.

There are two related constraints: access to data and quality of data. Some of the information reported here—in particular, information on individuals and businesses—cannot be released outside the government because tax records are confidential. Other information, such as that reported by charitable organizations, is required by law to be open to the public, but its quality is sometimes mixed. Because poor reporting of information has few tax consequences for charitable organizations, the information reported by charitable organizations is often incomplete and contradictory. Despite this major caveat, one should recognize that the data available from recent tax returns are more extensive and complete than they were even a few years ago, thanks to the efforts of both the I.R.S. Statistics Division and the National Center on Charitable Statistics.

Basic Sources of Information

Organizational Returns

The I.R.S. has two methods of data collection in the tax-exempt area. First, some data are gathered from the returns of all exempt organizations. Only limited information (for example, total assets, total receipts) is available to the public from this administrative file on a reimbursable basis. Data from this administrative file is subject to limited testing, so the quality is questionable. Another way to obtain current information on exempt organizations is by examining tax filings. Copies of tax returns can be obtained from the I.R.S. district office in the district in which the organization is located or through public inspection at the organization itself.

The second source of I.R.S. data is the annual statistics of income (SOI) program for exempt organizations. The studies in the program are based on samples of returns. Income statement, balance

sheet, and other financial data as well as a great amount of nonfinancial information are collected in these SOI studies. The data are subject to comprehensive testing and correction procedures to ensure that they are of high quality.

There are three major studies in the SOI Division's exempt program: private foundations (Renz, 1991), nonprofit charitable organizations (Hodgkinson and Boris, 1990), and unrelated business income of exempt organizations.

A study of private foundations was first done in 1974, with subsequent studies in 1979 and 1982-1983 helped by financial support from the INDEPENDENT SECTOR (Skelly, 1991; Petska and Skelly, 1982; Petska, 1982; Riley, 1991). In 1985, SOI started an annual series; 1989 data will be available in early 1992.

The first I.R.S. study of nonprofit organizations was done in 1975 and included data on all nonprofits (Sullivan and Gilmour, 1991). Subsequent studies of nonprofit charitable organizations—that is, the organizations exempt under IRC section 501(c)(3)—were done in 1982-1983 (Hilgert and Mahler, 1991). SOI started an annual series on nonprofit charitable organizations in 1985. SOI data from Form 990 now allow researchers to focus on specific types of charitable organizations, for example, educational institutions and hospitals (Meckstroth, forthcoming).

Until recently, only limited information from the I.R.S. administrative file referenced earlier was available on nonprofits other than 501(c)(3) organizations. In 1992, SOI will publish detailed data from its first sample of organizations exempt under subsections 501(c)(4) through (9), including business leagues, labor organizations, social clubs, fraternal societies, and voluntary employee beneficiary associations.

For all the 1990 studies of organizations exempt under 501(c)(3) through (9), SOI will capture detailed data on related and unrelated sources of income. For the first time, researchers will be able to look at all sources of income for exempt organizations: income that is "substantially related" to the exempt purpose of the organization, unrelated business income, and income excluded by statute from the unrelated business income tax.

The third annual program is unrelated business income of exempt organizations. This annual study (Boroshok, 1991) focuses on the detailed sources of unrelated income and deductions—for example, gross profit, advertising, debt-financed income, rental income.

Information on all three of the major programs is published in the quarterly *Statistics of Income Bulletin*. In addition, a *Compendium of Studies of Tax-Exempt Organizations: 1974-1987* (1991) was recently released by the SOI Division containing more than twenty previously published articles on exempt organizations.

Copies of the microdata tapes for foundations and charitable organizations are available for purchase from the Statistics of Income

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Division. These tapes contain identifiable records since the returns are open to public inspection. Data from the tax returns of exempt organizations on unrelated business are not available on tape since these returns are not open to the public. However, special tabulations can be prepared from all three sources on a reimbursable basis.

Merging data sets is an invaluable way of using tax information. For instance, the National Center for Charitable Statistics is sponsoring a national survey of nonprofit charitable organizations. Financial information provided in this survey will in many cases be based on the latest I.R.S. Form 990 filed by the organization.

Past studies that made use of organizational returns have examined trends of changes in asset size, grant-making activity, administrative expenses, allocations of investments (Foundation Center *National Data Books*, various years), rates of return (Salamon and Voytek, 1991), and equity accumulation (Tuckman and Chang, 1991). Recent congressional debates over the charitable and business activities of nonprofit organizations have also relied on information on the so-called unrelated business income tax (UBIT) reported on Form 990-T. Useful references for any researcher are Weisbrod (1978, 1988), Rose-Ackerman (1986), Steinberg (1987), Hopkins (1987), and various publications from the Yale Program on Non-Profit Organizations.

Federal Individual Income Tax Returns

Another major source of tax information is provided by individuals who itemize their tax returns and declare charitable deductions. Information on total contributions, cash and noncash contributions, and carryovers of contributions from prior years, classified by size of adjusted gross income (AGI), is available for 1988 in the annual *Statistics of Income Individual Income Tax Returns* report. In addition to annual published data, the public can obtain access to select files of individual income tax returns. For example, a Statistics of Income public use file of 110,000 records for 1988 is now available for researchers on a reimbursable basis. A new public use file for 1988 will be based on a much larger sample size of 500,000 records. Some geographic detail will be available, but for individuals with more than \$200,000 of AGI, records will be combined and shown only on an aggregated basis.

Archival files similar to the public use files just described are available with data on contributions. These files are available annually from 1972 forward and for odd-numbered years between 1960 and 1972. Formats and items of information are not always the same.

Much research using these data has centered on the effect of taxes on charitable giving (Feldstein and Clotfelter, 1976; Clotfelter and Steuerle, 1981; Auren and Rudney, 1985; Lindsey, 1985; Schiff, 1990; Steinberg, forthcoming). The studies simulated taxes by applying tax calculators to underlying data. These calculators allowed estimation of the tax rate that would apply to an additional dollar of charitable

giving. While the tax variable is often given much public attention because it can be manipulated through policy, other variables, such as age and marital status, also turned up as important influences on giving. The public use files can also be used to examine variation in giving by state for other than high-income taxpayers. In addition, comparisons across years can be made by using multiple files.

An alternative way of examining changes over time is through the use of panel files of individual income tax returns (Auten and Rudney, 1985). The University of Michigan's Office of Tax Policy Research, under the direction of Joel Slemrod and through an arrangement with SOI, has constructed a panel file from the annual individual public use file. This Michigan panel file is available for 1979-1986, and by the middle of 1992, it will be available through 1988. It contains the same information on contributions as in the annual public use files. Unfortunately, other panel files of taxpayers have not been released.

Federal Estate Tax Returns and Wealth-Income Studies

Studies of charitable giving at death have been performed with the help of estate tax returns (Boskin, 1976; Johnson and Rosenfeld, 1991; Joulfaian, 1991). The SOI Division periodically publishes studies of estate tax returns, although the data files remain confidential. Estate data are invaluable because they provide information on the relationship between giving and wealth. In most studies, wealth, tax rates, age, and marital status are found to be among the significant influences on giving at death.

Periodically the I.R.S. has also matched estate tax returns with the income tax returns of decedents in years before death (1976, 1982, and 1989) and, in one case, of beneficiaries in years before and after the death of those who left the bequests (1976). These files are not available to the public and have only begun to be tapped. One study using these files found that there was much inconsistency among individuals between their lifetime and death-time giving, that giving seemed to be influenced more by realized income than by real economic income, and that individuals do not take maximum advantage of the tax laws (Steuerle, 1987).

Other Important Data Sources

There are a number of other important tax sources of information on charitable giving. Such sources include state probate records. Researchers have already examined probate records in Ohio (Sussman, Cates, and Smith, 1970), New York, New Jersey (Friedman, 1964), California, and Pennsylvania (Shammas, Salmon, and Dahlitz, 1987).

State income tax returns are a valuable but often neglected source. Martin David of the University of Wisconsin, with the cooperation of the Wisconsin Department of Revenue, has been innovative in merging different kinds of administrative records, including estate

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and income tax returns and income and property tax returns (David and Menchik, 1988).

The Internal Revenue Service has only recently opened up its Taxpayer Compliance Measurement Program (TCMP), which combines files of individual returns and changes made through audit or examination. TCMP studies of individual taxpayers are available for 1982 and 1985 and soon will be available for 1988. The 1988 data are based on a highly stratified sample (by income and tax schedule complexity) of 55,000 records. Individual researchers may apply in writing, on a competitive basis, for tabulations to be performed within the I.R.S. These tabulations must be approved by an outside review committee and cannot compromise I.R.S. audit functions, but the files contain unique information on the amounts by which charitable contributions are underreported and overreported and also on the size of large gifts to single charities. Only a few researchers have made use of these data (Broman, 1989).

Corporate giving by size of assets and detailed industry groups can be found in the annual *Statistics of Income Corporate Source Book*. Less detailed industry data on corporate contributions can be found in the annual *Statistics of Income report, Corporation Income Tax Returns*. In certain cases more detailed information on corporate giving is available from surveys (Conference Board).

Any researcher should check with the Foundation Center, the National Center for Charitable Statistics at INDEPENDENT SECTOR, and similar organizations for tax data that have already been tabulated as well as with the various *Statistics of Income* tabulations published regularly by the I.R.S. (*Statistics of Income 1988: Corporate Income Tax Returns* and *Statistics of Income 1988: Individual Income Tax Returns*).

Other Tax Research (Without Tax Return Data)

Survey data are sometimes better, sometimes worse, than tax data themselves. In general, tax data are better reported, especially among high-income individuals, but survey data can be designed specifically to add variables not on tax returns, such as religion of giver or motivations for giving. Survey data also fill in information on charitable giving by those who do not itemize deductions on their tax returns.

Survey files that can be used to examine charitable giving include the *Survey of Consumer Finances* for 1989, one of the best of all surveys for wealth and property income issues. The *Consumer Expenditure Survey* also contains detailed information on charitable giving, although mostly for lower- and middle-income taxpayers. A tax calculator can be added to determine the approximate amount of tax owed and the marginal tax rate of the giver. These files, supplemented by tax calculators, have been used to study charitable giving (Reece and Zieschang, 1982).

Tax policy research often does not proceed from underlying microdata bases. For example, an analysis of the effect of a foundation's distribution or payout requirements on its ability to grow or

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maintain its relative stature required only some assumptions about rates of grant-making out of assets and giving to foundations (Steuerle, 1977). A New York University School of Law Conference in October 1991 examined the theories and history of tax exemption.

Much tax policy research toward charity is theoretical rather than empirical. For example, justifications of tax exemption often derive from theories of the optimal tax base and whether charitable giving reduces the ability to pay tax.

Most issues, of course, involve both empirical and theoretical research. Research on the "business" activities of charities proceeds partly from empirical examination of those activities (Boroshok, 1991) and partly from theoretical consideration of whether tax exemption really provides any competitive advantage for engaging in noncharitable activity (Hansmann, 1980; Rose-Ackerman, 1986; Steuerle, 1988). Research on the effect of taxes on volunteer giving involves theoretical and empirical considerations of such issues as the relative incentives for time and cash contributions (Long, 1977; Clotfelter, 1985).

Conclusion

Much research on the charitable sector involves consideration of taxes. Taxes are one of many influences on giving behavior. At the same time, some of the most comprehensive information on the giving patterns of individuals and on the activities of charitable organizations can be found in tax returns. Even with the limited funding for charitable and tax research, restricted access, and incomplete data, the opportunities remain enormous, and the progress of recent years leaves us optimistic for the future.

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