NONPROFIT CHARITABLE ORGANIZATIONS: A DECADE OF CHANGE (1975-1985)

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The Internal Revenue Code (IRC) classifies nonprofit organizations into 25 subsections, a certain number of which may receive tax deductible donations. Discussed in this paper are the organizations tax exempt under IRC Section 501(c)(3), which are regarded as "nonprofit charitable organizations," excluding private foundations [1]. These organizations receive the largest part of tax deductible donations and are the largest suppliers of philanthropic goods and services. This paper focuses on selected financial data from 1975-1985 for these organizations. The paper also analyzes the sector itself, including a look at the growth since 1975 and the sector's changing overall complexion.

In 1975, there were 208,000 organizations recognized by the Internal Revenue Service as nonprofit charities, compared to 264,890 organizations in 1982, 279,895 in 1983 and 310,221 in 1985 [2]. This is an increase in recognized organizations of 33 percent over the ten-year period. Not all of these recognized charities are required to file returns. Organizations whose gross receipts are less than $25,000 are not required to file. This threshold is up from $5,000 in gross receipts for 1975 and $10,000 between 1976 and 1981. In 1982, the filing requirement reached its current level of $25,000. Although religious organizations are among the 501(c)(3) group, they are not, and have never been, required to file returns, even though some do for purposes of providing information to their donors.

The number of organizations required to file annual information returns (Form 990) has fluctuated over the ten-year period of 1975-1985. This is largely due to changes in filing requirements. In 1975, there were 82,048 required filers. This figure dropped to 75,738 in 1982 when the filing requirement more than doubled before increasing in 1983 and 1985 to 89,052 and 106,449, respectively.

Nonprofit charitable organizations are a unique group pursuing a diversity of activities that further their exempt purpose. Groups receiving tax-exempt status under IRC section 501(c)(3) are typically entities organized for purposes that are charitable, religious, educational and scientific. The granting of exempt status is based solely on an organization's purpose.

Activities of the organization are restricted only in that they must be substantially related to the exempt purpose and they must serve the public interest. Private foundations are also in the 501(c)(3) group; however, they have different filing requirements and serve the charitable purpose in a different way from nonprofit charitable organizations.

The American National Red Cross, Massachusetts Institute of Technology, Shriner's Hospital for Crippled Children, the Metropolitan Museum of Art, and the American Statistical Association represent the broad range of 501(c)(3) organizations and the variety of their activities. These organizations, as well as all nonprofit charities, enjoy a number of benefits. Not only are they granted tax exemptions, but they also realize the advantages of reduced postal rates, as well as state retail sales tax and property tax exemptions. In addition, charitable organizations can also receive government grants. Certain nonprofit charities are given surplus food products and in some cases, gifts of surplus property from the Federal Government [3].

Nonprofit charitable organizations exist for society's benefit. They allow individuals to improve their society by working through a system of organizations other than those of the government or for-profit enterprises. Nonprofit charitable organizations relieve the Federal Government of carrying out certain activities inherent to its responsibility of improving the social welfare. However, they by no means release the government of its societal responsibilities. For this reason, the relationship between charities and the Federal Government is a uniquely symbiotic one.

IMPLICATIONS OF THE TAX LAWS

The first income tax law was enacted in 1913 as the Sixteenth Amendment to the U.S. Constitution. In it were the elements of IRC 501(c)(3), which established tax-exempt, nonprofit charitable organizations. These organizations have remained essentially unchanged in the income tax law since 1913.

An income tax deduction for charitable contributions by individuals was initiated in 1917. This was followed by the deductibility of estate tax deductions for bequests to charitable organizations beginning in 1919 and charitable deductions for corporations beginning in 1935 [4].

The Tax Reform Act of 1969 resulted in a virtual rewrite of the federal tax laws. This act in many ways greatly increased tax incentives for charitable giving while at the same time imposing stricter requirements on certain nonprofits.

The tax revisions of 1981 are regarded as the principal tax legislation of the Reagan Administration. The Economic Recovery Tax Act (ERTA) of 1981 was meant to encourage economic growth by reducing tax rates. This Act added a provision allowing charitable contribution deductions for individuals who do not itemize deductions on their Federal tax returns. Although the Act contains some additional provisions of direct benefit to philanthropy, the benefits were substantially offset by reductions in the after-tax rate of contributions, lessening the incentive for donors to give.

The Tax Reform Act of 1984 was designed to raise $50 billion in revenue as part of a deficit reduction package of tax increases and spending cuts. The Act was a massive piece of tax legislation spanning the entire Internal Revenue Code. However, the implications of the Act on the charitable community were not as significant as the earlier Acts mentioned above.

Current tax law allows for contributions to nonprofit charitable organizations made by both individuals and businesses to be deducted in calculating the taxable income of the donor, up to certain limits. Contributions to these organizations are also tax deductible under U.S. corporate, gift, fiduciary and estate tax laws. Nonprofit charitable organizations are exempt from tax on earned income as long as the income is related to their charitable purpose. However, income derived by tax-exempt organizations from any trade or business that is regularly carried on by the organization and that is not substantially related to the performance by the organization of its exempt purpose is taxable.

COMPARISON OF SELECTED NONPROFIT FINANCIAL DATA

The first Statistics of Income study of the nonprofits was in 1975. Comparing these data to more recent results for 1985, it is clear from Figure A that both total assets and total revenue in real terms more than doubled while total contributions, again in real terms, increased at a slightly lesser rate. On the other hand, GNP grew in real terms by only 34 percent over this period.

The principal factor contributing to the growth of nonprofit assets over the decade was the increase in the value of land, buildings and equipment, and also securities. The principal reason for the growth of revenues was the increase in program service revenue (i.e., fees charged by nonprofits).

The nonprofit charitable sector is both unique in its financial characteristics and diverse in scope. One of the dominant characteristics of the nonprofit charitable sector is the concentration of financial resources among a small number of organizations. Organizations with asset holdings under $1 million filed 80 percent of the returns, but held less than 3 percent of the total assets. On the other hand, organizations with assets of $10 million or more filed approximately 5 percent of the returns but accounted for 83 percent of total assets.

Primary revenue sources for charitable organizations include program service revenue, contributions, dues and assessments. Figure B shows the components of revenue for 1985. Program service revenue (fees) accounted for 63 percent of revenue, while contributions represented 21 percent of revenue. One phenomenon that has occurred since 1975 has been the relative decline (from 26 percent) in contributions as a percent of total revenue for all nonprofit charitable organizations.

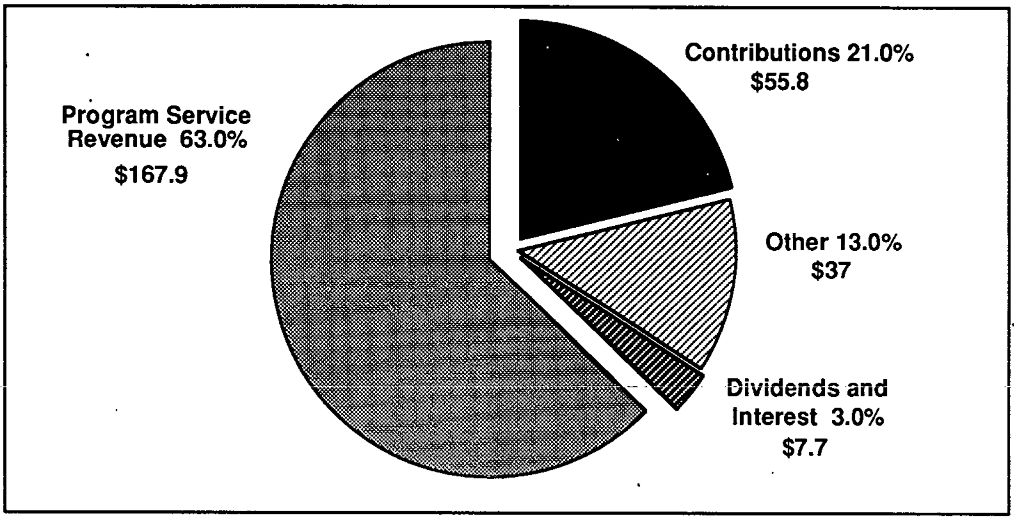
The nonprofit charitable sector shows great variation in sources of revenue as total assets increase. The larger an organization's total assets, the greater is its reliance on program service revenue. In 1985, those nonprofit charitable organizations with assets of less than $1 million relied on program fees for 34 percent of revenue, while organizations whose assets were $10 million or more relied on this type of income for 68 percent of total revenue.

Figure A -- Growth of Nonprofit Charitable Organizations, 1975 - 1985

Income Year	Total Assets (Billions)	Total Revenue (Billions)	Total Contributions Received (Billions)	GNP (Billions)
1975	$183.0	$110.5	$28.8	$2,695.0
1982	$279.6	$196.3	$41.3	$3,166.0
1985	$381.9	$242.1	$50.3	$3,618.7
Average Annual Increase 1975-1985	10.9%	11.9%	7.5%	3.4%

Note: Figures are in 1982 constant dollars, derived using the gross national product implicit price deflator

Figure B.--Components of Revenue (in Billions), 1985



As shown in Figure C, contributions as a percent of total revenue varied inversely with the size of total assets. Organizations with assets under $1 million relied on contributions for 56 percent of revenue while those with assets of $10 million or more depended on contributions for only 14 percent of revenue.

Some commonly held assets of charitable organizations included investments in securities, land, buildings and equipment and cash and savings accounts. These components of assets have been examined in three different size classes of organizations--those with assets less than $1 million, $1 million less than $10 million, and $10 million or more. Figure D shows that investments in cash and savings accounts decreased as assets increased. They ranged from a high of 35 percent of total assets for organizations with asset holdings of under $1 million to a low of 9 percent for those with assets of $10 million or more. Land, buildings and equipment accounted for approximately one-third of the assets of both the smallest and largest organizations, while comprising 43 percent of assets for organizations with assets between $1 and $10 million. Investment in securities was only 7 percent of total assets for organizations with assets under $1 million while it jumped to 30 percent for organizations with assets of $10 million or more.

Figure C.--Major Components of Revenue, by Asset Size, 1985

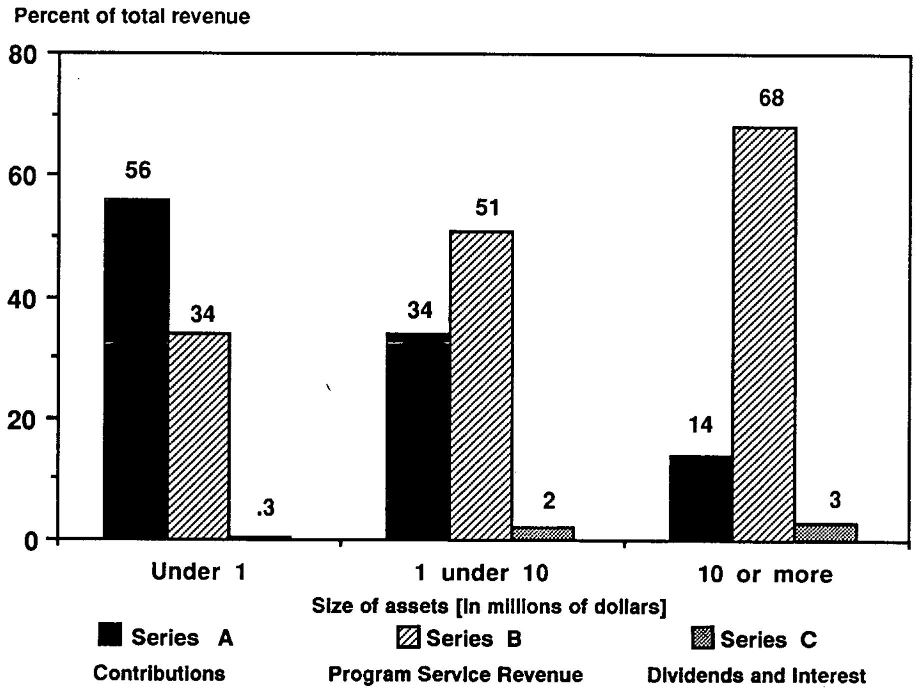


Figure D.--Major Components of Assets, by Asset Size, 1985

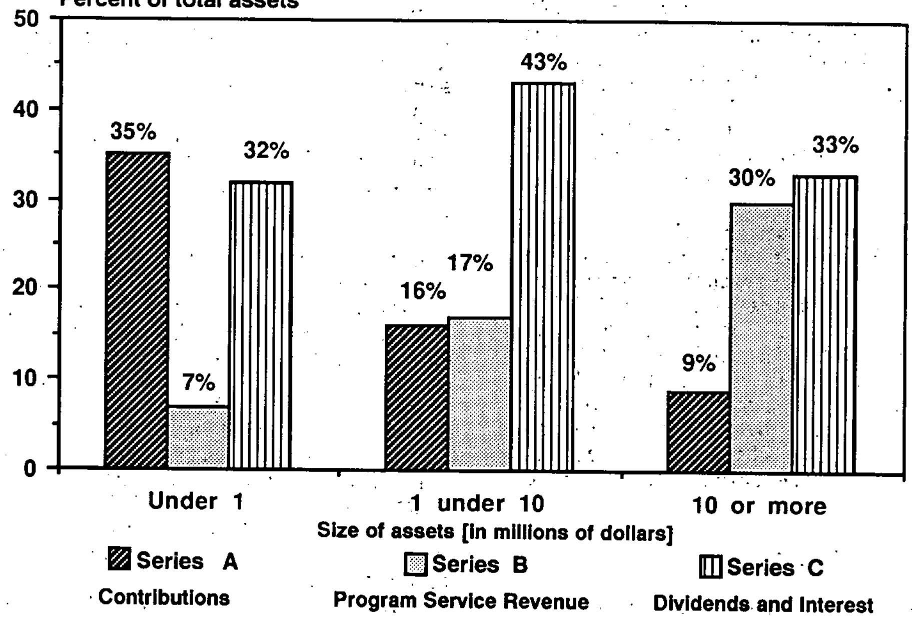
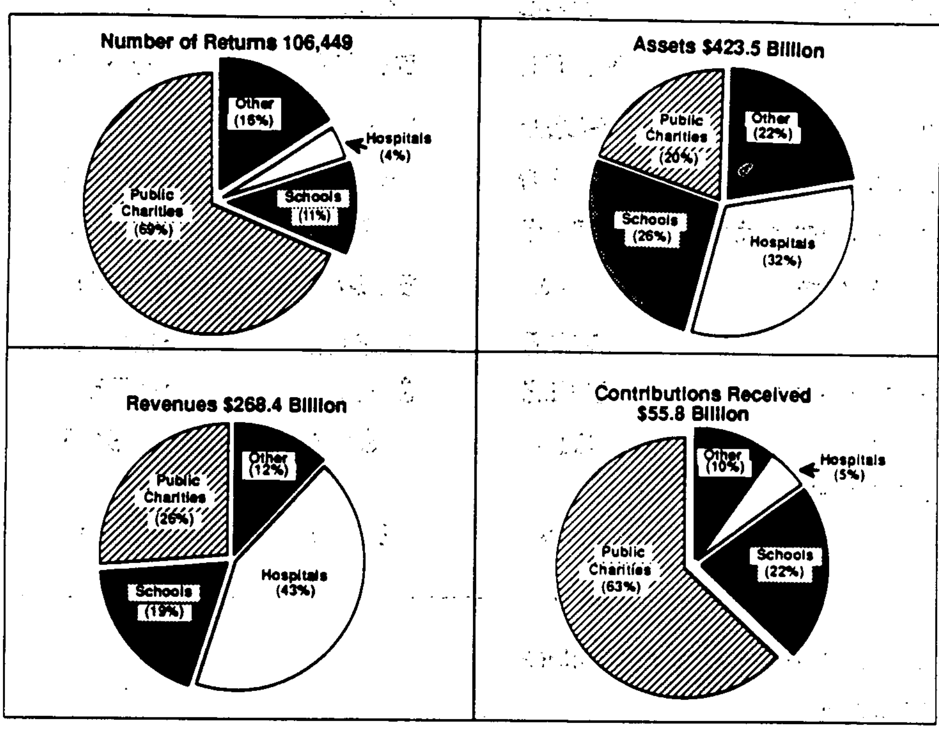


Figure E shows that hospitals dominated the financial statistics for all nonprofit charitable organizations while public charities represented the largest percentage of the total number of organizations. Hospitals, while accounting for only 4 percent of the organizations, represented 32 percent of the total assets and 43 percent of total revenue. Most of the assets of hospitals were in land, buildings and equipment while almost 90 percent of their revenue came from service fees. Public charities, such as the American Heart Association and United Way, accounted for 20 percent of total assets and 26 percent of total revenue, ranking second in total revenue. They also received 63 percent of the total contributions. Schools accounted for only 11 percent of the number of organizations, but

Figure E

Selected Financial Data by Major Type of Nonprofit Charitable Organization, 1985



ranked second in terms of assets with 26 percent.

As seen in Figure F, nonprofit charitable organizations reported total revenues of $268 billion in 1985, 21 percent of which were obtained from contributions, gifts and grants. This is in contrast to $17 billion in contributions received in 1975, which represented 26 percent of total revenue. Total expenditures in 1985 were $244 billion, with direct spending for charitable program services covering 85 percent of that total.

The number of organizations required to file Form 990 rose from 82,048 in 1975 to 106,449 in 1985. As was mentioned previously, organizations whose gross receipts are less than $25,000 are not required to file. This is up from $5,000 in gross receipts in 1975 and $10,000 between 1976 and 1981. In 1982, the filing requirement reached its current amount of $25,000. Total assets over this period increased by $315 billion, which when measured in constant dollars, represented more than a twofold increase.

FUTURE PLANS

The annual series of 501(c)(3) nonprofit charitable organizations starts with the 1985 study. Conducting studies on an annual basis will allow development of a panel of data which will be invaluable for studying the behavior of exempt organizations over time.

Beginning with Tax Year 1988, the nonprofit charitable organizations study will be expanded to include 501(c)(4)-(9) organizations. The sample size for each annual study of 501(c)(3) organizations will be 10,000 while that for 501(c)(4)-(9) organizations will be an additional 10,000 returns. Information will be available from the IRS Master File on other subsection codes each year.

A study of exempt organizations' unrelated business income (Form 990-T) is being conducted for the first time for 1987. Income derived by tax-exempt organizations from any business regularly carried on by the organization that is not substantially related to the organization's exempt purpose is subject to tax. These annual studies will be based on a sample of 5,000 returns stratified by size of unrelated gross income. Annual studies of Form 990-T returns will allow matching of these returns with the organizations' Form 990 returns. Basic questions can then be answered, such as what types of nonprofit organizations are most likely to engage in unrelated business activities.

Starting with Tax Year 1988, the Form 990 study will cover subsections 501(c)(3)-(9). These organizations file nearly 90 percent of the Form 990-T's. One factor that will diminish

Figure F -- Growth of nonprofit sector, 1975 - 1985

Item	Income Year			
	1975	1982	1983	1985
Number of returns	82,048	75,738	89,052	106,449
Total assets	$108.5	$279.6	$331.2	$423.5
Total revenue	$65.5	$196.3	$224.0	$268.4
Contributions	$17.0	$41.3	$46.4	$55.8
Dues and assesments	$1.5	$2.5	$3.1	$3.8
Program services	n.a.	$124.4	$147.5	$206.6
Total expenses	$62.6	$181.3	$207.5	$244.4
Program services	$36.8	$151.7	$173.6	$206.6
Fundraising	$1.4	$1.7	$1.8	$2.2
Management and general	n.a.	$27.4	$31.8	$34.6

Money amounts are in billions of dollars

n.a. — not available

the matching percentage is that the Form 990 and 990-T studies use separate samples with separate stratifiers, so that an organization can be in one sample without being in the other. We are working to overcome this limitation by developing a sampling strategy to embed one sample into the other.

Another area that we will be exploring in the next few years will be collating information on nonprofit organizations with their for-profit subsidiaries. Much of the income earned by nonprofits from unrelated business activities is earned by for-profit subsidiaries.

Finally, SOI is working on a compendium of exempt studies which will be available next year. This one-volume compendium will be comprised chiefly of articles published in the Statistics of Income Bulletin, in the proceedings of the American Statistical Association and Working Papers of the Independent Sector, along with facsimiles of tax forms and instructions. Also included will be other research papers and previously unpublished articles and tables.

The National Center for Charitable Statistics (NCCS) is working with us on approaches to improve the overall sampling plan for nonprofit charitable organizations, especially in the lower asset strata. The current sample is designed to obtain greater numbers of returns in the larger asset classes. As a result, social welfare organizations, which are primarily in the lower asset classes, are not well represented in our sample. We are working with NCCS to augment the sampling frame for social welfare organizations.

LIMITATIONS OF DATA

The statistics presented in this paper are based on samples of Forms 990 filed by organizations classified under Internal Revenue Code section 501(c)(3). Forms 990-PF filed by private foundations under section 501(c)(3) were excluded. The estimates of nonprofit charitable organizations were based on random probability samples of unaudited information returns stratified by asset level. The samples were drawn from multi-year sample frames based on the latest return filed by each organization. To compensate for the fact that not all returns were secured for a given study year, sample weights were adjusted for those asset classes under $10 million. All returns with assets of $10 million or more were obtained for the statistics.

Because the data are estimates based on samples, they are subject to sampling and nonsampling error. The size of the sampling error is estimated by the approximate coefficients of variation (CV's). For further information on the CV's, as well as other limitations of the data, refer to the articles published in the Statistics of Income Bulletin.

ACKNOWLEDGMENTS

The authors would like to thank Cecelia Hilgert for her technical advice and valuable comments. Thanks are due also to Mike Alexander and Jim Hobbs for reviewing and editing drafts of the paper.

NOTES AND REFERENCES

[1] Riley, Margaret, "Private Foundation Information Returns, 1985," Statistics of Income Bulletin, Summer 1989, Vol. 9, No. 1, pp. 27-43.

[2] These data are published periodically in the Statistics of Income Bulletin. See the following articles for data for:

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