



New donations are out there.  
Capture them with DipJar.

GET CASE STUDY

DipJar

Non Profit News For Nonprofit Organizations | Nonprofit Quarterly | (<https://nonprofitquarterly.org/2016/10/14/shifting-burdens-unrelated-business-income-tax-proposal-nonprofits/>)

## Shifting the Burdens of the Unrelated Business Income Tax: A Proposal to Nonprofits

By **MARTY MARTIN** | 34 mins ago



(<https://nonprofitquarterly.org/wp-content/blogs.dir/56/files/2016/10/Stringed-sculpture-nonprofit-taxes.jpg>)

Stringed figure (1937) – Henry Moore (1898 – 1986) / Pedro Ribeiro Simões (<https://www.flickr.com/photos/pedrosimoes7/>)

Close your eyes for a moment. Imagine any sector of our economy, including the nonprofit sector, and its array of related business entities. There are two things occurring on their behalf. First, tax-exempt nonprofit associations and lobbyists represent their interests in Congress and state legislatures daily. Second, their goal is to maintain—or diminish, or better yet eliminate—taxes paid by the sector and related economic entities with little regard to the overall impact to the public good. What they don't do is simplify and clarify.

When these efforts apply to the “other guys,” they are a “special interest group” with “tax loopholes.” When applied to business entities near and dear to one's own interests...well, now doesn't it just make good sense that we encourage Congress and state legislatures to limit our taxes? Like a carnival, the object in the ensuing shell game of tax deductions, credits, and depreciation is to hide the ball while extracting money from the player. The relevant question becomes, “To whom does the burden of taxation shift?”

Recent events highlight the continuing need for substantive tax reform that simplifies, clarifies, and provides for a tax code that captures revenue equitably, broadly, and simply from businesses and individuals. One presidential candidate appears to have deferred, if not avoided, paying income taxes on nearly a billion dollars of personal income for eighteen years or more. This apparently lawful use of the federal and state tax codes is representative of the thousands of individuals and business and nonprofit corporations that pay little or no taxes domestically and in some instances maintain billions of dollars offshore to avoid domestic taxes. When this occurs, to whom does the burden of taxation shift and what public services go underfunded?

There are substantive tax policy reasons why income inequality and rising tensions in society have increased significantly during recent decades. The failure to collect taxes on income through this shell game represents federal and state legislative tax policies too often derived from “special interest” lobbying efforts, campaign contributions, and gerrymandered districts. As a result, individuals and corporations pay

reduced federal and state taxes without regard to the cumulative impact for the common good or cost to others. Then, federal and state political leadership decry their inability to provide needed public goods and services because they don't have the money, instead of honestly admitting that they could solve much of the problem by improving the tax code.

Collectively, these individual, legislative, and policy choices affect federal and state government's ability to provide necessary revenue for public services and goods. Economists call this problem the "tragedy of the commons." While seeking to maximize one's individual advantage, the overall well being of the community suffers over time. When federal and state legislators continue to remove significant segments of economic activity from taxation, to whom does the burden of taxation shift?

The tax-exempt nonprofit sector currently enjoys significant government tax subsidies. The Urban Institute's "The Nonprofit Sector in Brief 2015. Public Charities, Giving, and Volunteering (<http://www.urban.org/sites/default/files/alfresco/publication-pdfs/2000497-The-Nonprofit-Sec%20tor-in-Brief-2015-Public-Charities-Giving-and-Volunteering.pdf>)" reported that in 2013 nonprofits had revenues of \$2.26 trillion and \$5.17 trillion in assets. Reporting 501(c)(3) charities had revenues of \$1.73 trillion and assets of \$3.22 trillion while private giving by individuals, foundations, and corporations, which is often tax-deductible, totaled about \$358.38 billion. When nonprofits do not pay taxes, to whom does the burden of taxation shift?

But nonprofits also engage in business activities unrelated to their tax-exempt purposes. Because their unrelated business income (UBI) is derived from economic activities apart from their exempt purposes, the resulting tax, unrelated business income tax (UBIT), is taxed at the corporate rate after deductions, depreciation, and credits. Paying UBIT may provide the nonprofit sector with an economic and moral leadership opportunity to advocate for changes in the tax code. As a sector whose tax exemption is premised on creating public good, nonprofits could serve as a control group for changes in the tax code.

In 2014, the IRS Advisory Committee on Tax Exempt and Government Entities' (ACT) Exempt Organizations ([https://www.irs.gov/pub/irs-tege/tege\\_act\\_rpt13.pdf](https://www.irs.gov/pub/irs-tege/tege_act_rpt13.pdf)) subcommittee considered unrelated business income (UBI) for colleges and universities. I served on the ACT and its Exempt Organization subcommittee for three years. The document I hand-delivered to IRS Commissioner Koskinen ([http://martinlegalhelp.com/docs/ACT2014-Concurrence\\_Dissent\\_and\\_Recommendation\\_to\\_ACT\\_UBIT\\_Report-Martin-11Jun2014.pdf](http://martinlegalhelp.com/docs/ACT2014-Concurrence_Dissent_and_Recommendation_to_ACT_UBIT_Report-Martin-11Jun2014.pdf)) at our committee's public meeting asked, "What If?" What if the tax code applicable to UBI were changed to a flat tax on gross income, without deductions, depreciation, or credits?

There are many commentators who have written on the concept of a flat tax with variations on different aspects of the overarching concept. A flat tax is generally recognized to be an easy, efficient, and effective tax which helps to increase economic efficiency and productivity. Commentators vary on the rate of a flat tax, but generally agree it can be significantly below the current rate.

This "What if?" inquiry addressed a policy area involving economic activity that hadn't been considered substantively in sixty years despite the nonprofit sector's significant growth and changes in its economic activity. The inquiry used the 2010 tax year data, which was then the most current public data available.

Based on IRS Statistics Of Income (SOI) Tax Stats – Exempt Organizations' Unrelated Business Income (UBI) Tax Statistics, Classified by: Size of Gross UBI for 2010 (<https://www.irs.gov/uac/soi-tax-stats-exempt-organizations-unrelated-business-income-ubi-tax-statistics>), nonprofits generated approximately \$10.9 billion dollars in gross unrelated business income. Because the IRS based its data on estimates from samples, these figures were significantly underreported in the opinion of ACT members and others. Nevertheless, the IRS reported payment of approximately \$332 million in UBIT.

Of the total 43,814 UBIT tax returns filed in 2010, approximately 28,716 returns, or 66 percent, reported no taxable income on approximately \$7.3 billion of UBI. In their 2008 *Chronicle of Philanthropy* article "A Taxing Matter (<https://www.philanthropy.com/article/A-Taxing-Matter/163253>)," authors Peter Panepento and Grant Williams reported that about two-thirds of nonprofits that generated unrelated business income paid no taxes, which was a "trend that dates back to the beginning of its reporting on unrelated-business income in the 1992 tax year."

By way of a contrasting example, when a sole proprietor, who is the fundamental business entity, or an individual generated \$50,000 in taxable revenue, they would have owed between \$6,666.00 and \$8,688.00 in federal taxes based on marital status. [IRS 2010 Tax Table (<https://www.irs.gov/pub/irs-prior/i1040tt-2010.pdf>)] When nonprofits engaged in business (economic) activity do not pay UBIT, to whom does the burden of taxation shift?

The relatively small number of nonprofit corporations engaging in UBI provides an easy and understandable illustration for considering a flat tax on gross income. Calculating the UBIT as a flat tax means the IRS tax form and schedules can be reduced to simple formula that fits on the back of a postcard:

Gross UBI income  $\times$  X% tax rate = Taxes owed.

In 2010, a revenue neutral rate (i.e., raising the same amount of taxes) was approximately three percent (3.030 percent) if equally applied to all 43,814 returns:  $\$10.9B \times 3.030\% = \$332M$ . This contrasts with the current 15–35 percent statutory tax rate based on taxable income.

Changing to a flat tax will result in wider distribution of taxes paid with taxes based on a corporation's gross income. Some will pay more while others will pay less, but all will contribute based on the same percentage applied to their gross income. A flat tax's application to all entities and significantly lower tax rate confirms the saying, "Many hands make light work." It frees up significant financial resources and eases the reporting and filing burdens, increases productivity and opportunity for the taxpayer, makes tax collection and enforcement highly effective at a significantly reduced cost, especially with electronic payment, and creates a tax system in which taxes are based on an equal percentage of gross income.

There have been and always will be many public goods and services that governments must provide or contract for others to provide. Taxes simply are the most effective and efficient means of raising capital to address many pressing needs in our society. Despite all of the effort, goodwill, and work expended in the nonprofit sector, the sector will never raise sufficient money to meet, much less solve, many of these needs. As a society, we must turn to federal, state, and local governments to provide financial assistance generated by our taxes. Taxes can be raised equally, effectively, efficiently, and easily. Who wouldn't welcome a three-line tax form?

Absent a significant change about how we think and talk about taxes, Congress and state legislatures will continue to create tax codes which defy comprehension and understanding to most citizens. Federal and state legislators will continue to engage in their tax shell game that shifts and disguises the tax burden through deductions, depreciation, and credits for which their full cost to our society cannot be easily determined and which often benefit the few at the expense of the many.

The nonprofit sector can lead the way toward substantive tax reform by changing how UBI is taxed. Change begins by asking, "To whom does the burden of taxation shift?"