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OPINION COMMENTARY Follow

To Raise Revenue, Tax the Nonprofits

Hospital chains and universities are businesses more than charities. They don't deserve a break.

By Scott Hodge

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Some House Republicans are considering a hike in the corporate income tax rate to help offset the estimated $4.6 trillion cost of extending the individual provisions of the 2017 Tax Cuts and Jobs Act. That would be bad for competitiveness and economic growth. A fairer solution would be to tax business enterprises that masquerade as nonprofit entities.

In 2019, tax-exempt nonprofit organizations generated $3.3 trillion in gross income, managed $8 trillion in assets, and pocketed some $186 billion in net income from sources such as royalties, broadcast rights, insurance reimbursements, ticket sales and membership fees—much of it untaxed. Many nonprofits are true charities, such as food banks and women's shelters. But most of the largest tax-exempt organizations function like businesses. These include credit unions, hospitals, universities, athletic associations and consulting firms.

America's largest tax-exempt nonprofit, Kaiser Permanente, generated more than $110 billion in revenue and $5.6 billion in net income in 2019 between its hospital, insurance and state health plans. Of the $2.5 trillion in revenue generated by 501(c)(3) organizations in 2019, nearly $1.4 trillion, or 55%, went to hospitals and health insurers. They netted more than $60 billion in profit that went untaxed.

The second-largest tax-exempt sector is higher education, with more than $294 billion in revenue and $22 billion in net income in 2019. There were 51 private universities that reported more than $1 billion in revenue in 2019. Only 19% of university income comes from charitable donations.

Should an organization be considered “nonprofit” when most of its income comes from sources that resemble business transactions? Should investment income accrue largely tax-free for the 800 university-related endowments, foundations, real-estate holding companies and fundraising entities that collected nearly $27 billion in 2019 and held almost $210 billion in assets? Is the $1.1 billion per year in tax-free income the National College Athletic Association generates from broadcast rights and corporate sponsorships justified while college athletes pay income tax on their earnings?

Subjecting tax-exempt organizations' business-like profits to the 21% corporate rate could generate nearly $40 billion each year. Washington should reform nonprofit tax laws by imposing principled distinctions between charities and commercial enterprises.

Congress tried in 1950, when it enacted the Unrelated Business Income Tax. But UBIT is so riddled with loopholes that it raises little revenue. It allows large nonprofits to raise billions from business-like activity that is “substantially related” to their overall mission. AARP offers a good example of UBIT's lax rules. AARP collects more than $1 billion in tax-free royalty income a year from selling its name to insurance companies and other commercial ventures.

UBIT rules should be eliminated, the corporate income tax should be levied on net program service income, and nonprofits' investment income should be taxed at the same rate other businesses pay. Broadening the corporate tax base to include the business income of nonprofits is the fairest way to level the playing field and raise new revenue in a less economically damaging manner.

Mr. Hodge is president emeritus of the Tax Foundation and author of “Taxocracy: What You Don't Know About Taxes and How They Rule Your Daily