Current Research in the Nonprofit Sector

Paul Arnsberger, Melissa Ludlum, and Margaret Riley, Internal Revenue Service

▶ The Nonprofit Sector

The nonprofit sector supports and advances a variety of religious, social, and economic endeavors. Tax-exempt nonprofit organizations dedicate billions of dollars annually to operating or supporting various initiatives in education, environmental protection and preservation, the arts and humanities, social welfare, health, and other critical areas. Programs offered by the nonprofit sector may supplement those provided by government agencies or offered by the corporate sector. Nonprofit organizations, which include hospitals, schools, churches, and other public charities as well as private foundations, receive an exemption from income taxes under Internal Revenue Code section 501(c)(3). As of October 2005, there were 909,224 such organizations recorded as active by the Internal Revenue Service (IRS).[1]

Nonprofit organizations that receive tax-exempt status are expected to use this status to assist in carrying out their charitable activities, which in turn benefit individuals, households, and communities. Each nonprofit organization is responsible for ensuring that its tax-exemption is not used to benefit individuals having personal or private interest in the organization, such as shareholders or organization founders or their families. Also, nonprofit organizations are limited in their ability to influence political campaigns and lobby. Because private foundations are generally more narrowly controlled and supported than public charities, they are required to meet stricter guidelines than other nonprofit organizations. Nonoperating private foundations, which generally make grants to other charitable organizations, rather than operating charitable programs of their own, are required to pay out a minimum amount for charitable purposes, annually. Additionally, all private foundations are required to pay an excise tax on any net income that they earn from investments. All types of tax-exempt organizations, including nonprofit organizations, are subject to Federal taxation of income produced from activities that are unrelated to their charitable purposes. Nonprofit organizations are required to file annual information returns with the IRS and to make these documents widely available to the public. They must also file a tax return for any year in which they receive "unrelated business" income or engage in activities that are prohibited under regulation. Information obtained from these documents can provide valuable insight into the composition and financial activities of the nonprofit sector.

The Statistics of Income division (SOI) of the Internal Revenue Service conducts a variety of ongoing research projects using data from information and tax returns filed by nonprofit organizations. This paper will focus on the manner in which this research is being used in analyses that address three key issues in the nonprofit area: the quality of reporting by tax-exempt organizations on their annual information and tax returns, the magnitude of compensation of executives and board members, and the extent to which tax-exempt organizations are known to violate the rules that govern their permissible activities.

▶ Recent Growth in the Nonprofit Sector

The nonprofit sector is a substantial and growing portion of the overall economy. The aggregate book value of assets, as reported by nonprofit organizations that filed IRS information returns for Tax Year 2002, was $2.1 trillion. In real terms, this amount was 66 percent larger than the aggregate book value of assets held by nonprofit organizations for Tax Year 1993.[2] These organizations earned 41 percent more in revenue for Tax Year 2002 than they had earned for Tax Year 1993. Nonprofit organizations directed much of the income from their considerable asset growth and other sources into additional expenditures to promote their charitable programs. Total charitable expenditures reported by nonprofit organizations for Tax Year 2002 were 50 percent larger than those reported for Tax Year 1993 and experienced a real annual rate of growth of nearly 5 percent.[3] In contrast, the Gross Domestic Product grew at a real annual rate of 3 percent over the period.[4]

In addition to experiencing significant growth in recent years, the nonprofit sector has also seen increased public interest in its financial dealings and charitable activities. With the development of GuideStar and other Internet sites that provide easy access to nonprofit organizations' IRS returns, public scrutiny of nonprofit organizations has increased, and, in some instances, high-profile cases of potential abuse have been documented. In response to these developments, various government officials and independent organizations have proposed a variety of additional legislative options aimed at curbing abuses of tax-exempt status.

In evaluating proposed tax legislation and initiatives directed toward improving oversight, it is crucial that policymakers and researchers have access to high-quality statistics and microdata for nonprofit organizations. Such information can be useful in determining characteristics of various types of nonprofit organizations, as well as in establishing standards for the administration of charitable programs. In many cases, data collected from tax return records and disseminated by the IRS provide the most comprehensive information available on the financial composition and charitable activities of nonprofit organizations. These data can reveal emerging trends and developments in the nonprofit sector and can be used to evaluate the effectiveness of tax regulation and IRS oversight. Analyses conducted using such data provide a framework for the development of tax policy related to nonprofit organizations and assist practitioners and nonprofit staffs in the establishment of key self-governance principles. Data for nonprofit organizations can be obtained from a number of Web sites and independent organizations. They are also available from IRS sources, such as the Statistics of Income division (SOI).

▶ Overview of the Statistics of Income Exempt Organization Program

SOI provides statistics and microdata derived from a number of administrative records filed with IRS. Sample and population data from information and tax returns are transcribed and corrected using a variety of error resolution and data perfection procedures. Since the 1970's, data for organizations exempt under section 501(c)(3) have been included in the SOI program. Currently, SOI collects information from Forms 990, 990-PF, 990T, and 4720. Forms 990 and 990-PF are used by tax-exempt organizations to report standard income statement and balance sheet items, as well as additional information on tax-exempt activities and charitable distributions, compliance with the regulations that govern tax-exemption, involvement in various types of nonexempt activities, and certain information regarding employees.

Tax-exempt organizations, other than private foundations, file Form 990; private foundations file Form 990-PF. Form 990-T is filed by nonprofit and other types of tax-exempt organizations to report any unrelated business income (UBI) and taxes. Tax-exempt organizations use Form 4720 to calculate and pay taxes on prohibited activities, such as engaging in excessive lobbying, making political expenditures, or providing private benefit to "disqualified persons," which include organization founders, board members and executives, substantial contributors, and certain other individuals. SOI produces a variety of statistical tables and articles annually for all of the exempt organization programs. Also annually, microdata files that include all information collected for the Form 990 and Form 990-PF samples are made available for purchase. (Microdata derived from Forms 990-T and 4720 cannot be disclosed to the public.)

SOI samples approximately 10 percent of all Forms 990 and 990-PF, and about 20 percent of all Forms 990-T filed for a given tax year.[5] The Form 990-T study incorporates a special Forms 990/990-T "integrated" sampling routine which ensures the inclusion of any Forms 990-T (with gross UBI of $1,000 or more, the filing threshold) filed by organizations whose Form 990 or Form 990-EZ information returns were selected for the separate sample of section 501(c)(3) charitable organizations. For any designated tax year, tax-exempt organizations have various fiscal periods that collectively span 2 calendar years; to ensure complete coverage of a single tax year, SOI draws samples of Form 990-series returns over a 2-year timeframe. For example, the Tax Year 2002 studies include returns filed for Tax Year 2002 in Calendar Years 2003 and 2004. The SOI study of Forms 4720 was recently added to the exempt organizations program and includes data collected for the population of Forms 4720 filed over a calendar year. The SOI files

contain most financial items from each return, as well as a number of additional fields dedicated to codes or nonfinancial information. The SOI staff enter data into an online system, which identifies taxpayer and other errors. These are corrected during the data entry process. Often, supplemental information is included with tax returns on schedules and other attachments. Where appropriate, information from these attachments is used to adjust data reported by the filer.

The sample designs and data collection methods that are applied to the SOI files allow clear statistical patterns to emerge. Consistency or variation in such patterns can provide insight into changes in reporting patterns, which may be attributable to tax law modifications or changes in the degree or quality of IRS oversight. Additionally, the largest organizations that appear in each SOI file are sampled with certainty, which creates, in effect, a panel of large tax-exempt organizations. The longitudinal nature of the SOI sample and population files can assist researchers in establishing typical statistical patterns for tax-exempt organizations and identifying cases that deviate from the expected norm. Analyses derived from these data can provide insight into a variety of current issues in the nonprofit sector.

► Current Research Issues

Reporting Quality

With the advent of electronic filing and imaging of IRS nonprofit-organization information returns and their widespread availability to the public, the quantity of data available for regulation and research has increased dramatically. Technological improvements that make more data more accessible are certainly desirable, but ensuring that preparers fill out the forms completely and accurately is equally important. Is "more" really better without quality reporting of return information? Ensuring reporting quality is a shared responsibility of both IRS and return preparers. IRS needs to ensure that information and tax forms require essential information for effective regulation, oversight, and public transparency; and it needs to develop form instructions that are complete, explicit, and clear enough for preparers to follow. Preparers need to be meticulous in providing complete responses to the requested information on the forms, especially itemized financial components. During the past year, SOI has conducted special analyses, using data from its Forms 990 and 990-T statistical files, to assess the quality of information reported by return preparers.

Comparing and Reconciling Unrelated Business Income Data Reported on Forms 990 and 990-T

An analysis of Tax Year 2002 data from 2,894 linked records in the Forms 990 and 990-T integrated sample of section 501(c)(3) public charities concludes that taxable unrelated business income (UBI) reported on Form 990-T oftentimes cannot be reconciled with that reported on Form 990.[6] Anecdotal information from reviewed cases indicates that the data entered on Form 990-T are much more accurate, perhaps because the purpose of Form 990-T is to calculate tax liability, which carries a greater potential for the assessment of monetary penalties for misreporting than Form 990, whose purpose is to supply information only. Applying Form 990 weights to the sample records produced an estimated population of 8,992 public charities that were required to file both a Form 990 and a Form 990-T. The main sources of data for this analysis were Form 990, Part VII, Analysis of Income-Producing Activities, and Form 990-T, Part I, Unrelated Trade or Business Income.

Form 990, Part VII, provides a three-tiered breakout of an organization's total revenue (excluding any contributions, gifts, and grants received from Government or public sources): potentially taxable UBI reportable on Form 990-T, UBI excluded from taxation under the Internal Revenue Code, and mission-related (exempt function) income. For each taxable UBI item entered, the filer is instructed to provide an associated business activity code from a list of North American Industrial Classification System (NAICS) codes. Form 990-T, Part I, contains a statement of gross UBI, direct expenses, and net UBI.

As illustrated in Table 1, the Form 990 returns in the integrated sample were separated into three groups based on potentially taxable UBI reported in Part VII: those with positive total UBI (80 percent of all returns), those with zero UBI (13 percent of all returns), and those with negative total UBI (7 percent of all returns). Within

Table 1. Reconciliation of Unrelated Business Income (UBI) Data From Form 990, Part VII, and Form 990-T, Part I, Tax Year 2002

[All figures are estimates based on samples. -- Money amounts are in thousands of dollars]

Item	Number of returns	Percentage of all returns	Form 990 UBI	Form 990-T Gross UBI[1]	Form 990-T Net UBI	Form 990-T Adjusted UBI[2]
	(1)	(2)	(3)	(4)	(5)	(6)
Matched returns, total	**8,992**	**100.0**	**3,807,095**	**4,089,889**	**3,343,626**	**3,771,948**
Number with Form 990 UBI greater than zero	**7,194**	**80.0**	**3,869,524**	**3,574,474**	**3,009,050**	**3,411,944**
Number with UBI that could not be reconciled[3]	2,447	27.2	1,870,317	1,521,271	1,253,569	1,433,963
Number with Form 990 UBI equal to zero	**1,183**	**13.2**	**--**	**270,348**	**225,634**	**236,913**
Number with UBI that could not be reconciled[3]	853	9.5	--	251,173	229,754	234,908
Number with Form 990 UBI less than zero	**614**	**6.8**	**(62,429)**	**245,067**	**108,942**	**123,091**
Number with UBI that could not be reconciled[3]	124	1.4	(29,903)	181,211	131,100	132,128

[1]All returns in the Form 990-T sample had gross unrelated business income of $1,000 (the filing threshold) or more.

[2]Adjusted UBI is derived from a combination of Form 990-T gross and net itemized UBI amounts, based on their correlation to the combination of gross and net UBI amounts required to be reported on Form 990.

[3]The amount of total UBI reported on Form 990, Part VII, does not equal gross UBI, net UBI, or adjusted UBI (within $100 tolerance) reported on Form 990-T, Part I.

these groups, Form 990 total UBI was matched against both total gross UBI and total net UBI reported in Part I of Form 990-T, and also against a computed amount of total "adjusted UBI." Adjusted UBI is derived from a combination of Form 990-T gross and net itemized UBI amounts, based on their correlation to the combination of gross and net UBI amounts required to be reported in Part VII, Form 990. If organizations had reported income consistently on both forms, it was expected that the Form 990 total UBI amount would be the same as the Form 990-T adjusted UBI amount, a value that was no more than gross UBI and no less than net UBI, depending on what types of income were reported in each individual case.

UBI reported on nearly 4 out of every 10 Forms 990 could not be reconciled with UBI reported on Form 990-T, meaning that total UBI on Form 990 did not match gross UBI, net UBI, or adjusted UBI on Form 990-T (within a $100 tolerance). The reasons for the inconsistency are twofold: some filers reported a combination of gross and net taxable income that differed from that specified in the Form 990 instructions; other filers did not report taxable UBI on Form 990 at all. Of the 7,194 returns where the Form 990 UBI amount was positive, 34 percent could not be reconciled. In some observed cases, the Form 990 amounts simply did not correspond to any Form 990-T amounts. In many other cases, filers of Form 990 erroneously reported gross receipts from sales and services in Part VII, rather than gross profit from sales and services, which is the net of gross receipts minus cost of goods sold. Gross profit, not gross receipts, should be included in total UBI on both Forms 990 and 990-T.

Twenty-eight percent of the 1,183 organizations that reported no taxable UBI amounts on Form 990 filed Forms 990-T with net UBI that was negative. The organization may have presumed that negative net UBI amounts need not be reported on Form 990. These cases were not deemed irreconcilable for this analysis. However, 72 percent of the organizations reporting no taxable UBI on Form 990 filed Form 990-T with positive amounts of gross, net, and adjusted UBI. There is no known reason for this, with the exception of some degree of nonreporting on Form 990.

About one-fifth of the 614 organizations reporting negative UBI on Form 990, Part VII, filed a Form 990-T with positive amounts of gross, net, and adjusted UBI. In some cases, negative amounts entered on Form 990, Part VII, for gain or loss from sales of investment assets were not reported on Form 990-T. Generally, income from investments is not considered unrelated business

income for public charities that file Forms 990 and 990-T. In other cases, negative entries on Form 990 could not be correlated with any amount reported on Form 990-T.

In 36 percent of the linked Forms 990 and 990-T cases, the primary unrelated business activity indicated on the organization's Form 990-T did not match any activity code reported in Part VII of Form 990 for each itemized taxable UBI amount. This, along with UBI reporting inconsistencies, seems indicative of preparers who fill out Form 990 and 990-T exclusive of any attempted reconciliation of reported information on the two forms.

Researchers, both in and outside of IRS, use Form 990 to make assessments of nonprofits' financial activities, operations, and programs. Form 990, Part VII, for example, provides data that should be useful for gauging how much of an organization's income is from taxable unrelated business activities and what types of activities are producing the income. Currently, an IRS team is designing a revised Form 990 that will be geared toward obtaining data that will be useful for better regulation and oversight of nonprofit and other tax-exempt organizations. Taxpayer education, comprehensive IRS form instructions, and complete and accurate reporting by return preparers are vital for making Form 990 a consistent and reliable tool for research and public accountability.

Form 990-T Deductions Allocation Study

The deductions allocation study measures the extent to which high-income organizations (those with gross UBI of $500,000 or more) misreported specifically defined, itemized deduction components as "Other deductions" on Tax Year 2002 Forms 990-T. During the data entry process, SOI staff check the required Other deductions statement for inaccurately reported items and move (allocate) amounts, when appropriate, to one or more of the specifically defined deduction components, such as Salaries and wages. The study examined the difference between deduction amounts as initially reported by filers and as corrected, through allocation, by SOI staff.[7]

During normal IRS processing of paper and e-file returns, data are captured as reported by the return filer. Misreported amounts are not allocated from residual "other" categories to the proper, specifically defined return line items. Researchers and IRS staff that use Returns Transaction File (RTF) data for examination or administrative purposes may find this study useful for gauging the extent to which deductions data may be understated, and extrapolating its results to draw conclusions about the possible understatement of itemized income, deductions, assets, and liabilities reported on other types of IRS exempt-organization returns.

Of the 2,381 high-income returns filed, 20 percent required at least one allocation from Other deductions during SOI data entry. Paid preparers completed 79 percent of these 485 returns with taxpayer reporting errors.[8] Sixty-eight percent of the returns that required SOI allocations of misreported amounts were filed by section 501(c)(3) nonprofit organizations; the remainder were filed by organizations exempt under other sections of the tax code. Section 501(c)(6) business leagues, chambers of commerce, and real estate boards and section 501(c)(7) social and recreational clubs accounted for 11 percent and 7 percent, respectively, of all returns that required allocations from Other deductions to specifically defined components.

After allocation, the increase in the total amount of each specifically defined deduction category reported by high-income filers ranged from 3 percent to 45 percent. Salaries and wages, the largest aggregate itemized deduction reported on Form 990-T, rose by only 3 percent; Contributions to deferred compensation plans rose by 14 percent; and Repairs and maintenance rose by 45 percent. Allocations made to other types of itemized deductions resulted in increases ranging between 4 percent and 9 percent. It is worth noting that no allocations were made to Compensation of officers, directors, and trustees, Excess exempt expenses, or Excess readership costs. Form 990-T filers must provide detailed information on related schedules for these items and then enter schedule totals in the itemized deductions statement. The schedule preparation requirement apparently deters preparers from including these items in Other deductions.

As shown in Table 2, the three deduction items with the largest *aggregate* dollar amount allocated from Other deductions were Salaries and wages ($32.0 mil-

lion allocated), Repairs and maintenance ($21.7 million allocated), and Employee benefit programs ($7.8 million allocated). Allocated amounts accounted for close to half of the SOI-edited amount of Salaries and wages, and three-quarters or more of the other two cited deduction items. The largest *average* dollar amounts allocated from Other deductions were made to Salaries and wages ($381,269), Repairs and maintenance ($92,593), Net depreciation ($92,503), and Employee benefit programs ($69,921).

The deduction items with the highest frequency of allocation of misreported taxpayer amounts were Repairs and maintenance (243 returns), Taxes and licenses (180 returns), Salaries and wages (93 returns), and Employee benefit programs (92 returns). The top three primary unrelated business activities reported by organizations, based on self-reported NAICS codes and percentage of returns with allocations, were medical and diagnostic laboratories (14 percent), gambling industries (9 percent), and advertising and related services (6 percent). Overall, close to 10 percent of the reported Other deductions amount should have been included in the more specifically defined deduction items, and the percentage change in itemized deduction amounts, after SOI allocations, ranged from 12.5 (Salaries and wages) to 106.7 (Repairs and maintenance).

The deductions allocation study makes it clear that Form 990-T preparers could do a much better job of accurately reporting all-inclusive amounts within the specifically defined deduction components listed on the form. If IRS plans to use tax processing data to make intelligent decisions regarding regulation, compliance, or potential abuses of tax-exempt status, it is imperative that a high priority be placed on educating nonprofit organizations and their tax practitioners to report detailed items completely and accurately. Also, because organizations are not allowed to file supplementary electronic financial statements with e-filed returns (they must provide financial data in the IRS format), it is feared that if the data provided are incorrect or incomplete, there will be no additional information available with the e-filed returns, as there is with paper returns, that can be used to correct these reporting errors.

Table 2. Form 990-T Returns with Gross Unrelated Business Income of $500,000 or More and At Least One Allocation Made from Other Deductions, Tax Year 2002

[Money amounts are in thousands of dollars]

Deduction item	Number of returns with allocations	Percentage of all returns[1] with allocations	SOI edited amount	Taxpayer reported amount	Allocated amount	Percentage of SOI edited amount allocated from Other deductions
	(1)	(2)	(3)	(4)	(5)	(6)
Other deductions	485	100.0	753,388	832,164	(78,776)	N/A[2]
Compensation of officers, directors, and trustees	--	--	--	--	--	--
Salaries and wages	93	19.2	68,069	36,043	32,027	47.1
Repairs and maintenance	243	50.1	28,840	7,174	21,667	75.1
Bad debts	32	6.6	1,618	10	1,608	99.4
Interest	39	8.0	2,094	4	2,090	99.8
Taxes and licenses	180	37.1	16,213	10,296	5,917	36.5
Charitable contributions	22	4.5	1,524	37	1,487	97.6
Net depreciation	54	11.1	6,004	1,009	4,995	83.2
Depletion	--	--	--	--	--	--
Contributions to deferred compensation plans	26	5.4	1,242	34	1,207	97.2
Employee benefit programs	92	19.0	9,897	2,119	7,778	78.6
Excess exempt expenses	--	--	--	--	--	--
Excess readership costs	--	--	--	--	--	--

[1]Detail does not add to 100 percent because some returns had allocations made to more than one deduction item.

[2]N/A - not applicable. However, 9.5 percent of the total amount of aggregate Other deductions reported by taxpayers was allocated to one or more specifically defined deduction items.

Form 990 Asset Allocation Study

An asset allocation study, similar to 990-T deductions allocation study but on a smaller scale, was conducted for public charities that filed Form 990. The goal was to measure the degree to which assets were misreported by filers as "Other assets" on Form 990, rather than in the appropriate specifically-defined asset categories. For this study, SOI data were compared to a file made available by GuideStar containing data transcribed from the same information returns. The GuideStar data were chosen because, like the IRS Returns Transaction File, reporting errors were not resolved based on research on attached financial statements during the transcription process. For this reason, the GuideStar data provided a useful record of what each filer reported on the form.

Over 6,600 Form 990 returns from Tax Year 2002, representing virtually all of the certainty strata of the SOI sample, were matched with the same filings from the GuideStar dataset. Eleven returns, for which the balance sheet values in the SOI and GuideStar datasets differed by three orders of magnitude, were excluded from the analysis.[9] Total assets for the SOI group amounted to $1.345 trillion versus $1.338 trillion for the GuideStar group, a difference of less than 1 percent. When the totals for Other assets were compared, the GuideStar total was $34.5 billion (or 41 percent) more than SOI. Most of this difference can be attributed to financial items allocated out of Other assets during the course of SOI processing and, as such, is a measure of filer reporting error. A look at the specific asset categories quickly shows where these "other" assets should have been reported. In the SOI dataset, Investments--other totaled $129.9 billion versus $106.4 billion in the GuideStar dataset. This disparity of $23.0 billion represented two-thirds of the difference in Other assets between the two datasets. Only three other specific asset categories showed an aggregate increase of more than 5 percent after SOI editing: Prepaid expenses and Land, buildings, and equipment, both 8 percent, and Cash, 7 percent.

When the universe of GuideStar-transcribed returns was compared to SOI's weighted population estimates, similar results were seen. The GuideStar sum of Total assets was $1.740 trillion, less than 1 percent larger than SOI's weighted estimate, while the GuideStar sum of Other assets was $51.5 billion (or 50 percent) more. Again, Investments--other was the largest misreported category, with an SOI-estimated total that was $23.3 billion larger than the GuideStar population total.

Researchers and analysts studying the endowments of public charities should be aware of the reporting tendencies of these organizations. To the extent possible, SOI tax examiners allocate assets, liabilities, and expenses to the correct line items; however, not all sources of data have this value added. Further, it is a concern that the growth of electronic filing will be accompanied by a reduction in the amount of usable supplemental data, reducing SOI's ability to correct these types of reporting errors.

Compensation of Executives and Board Members

Nonprofit organizations, which include public charities and private foundations, are legally required to avoid providing "unreasonable compensation" to executives and board members. Recently, Congress and various independent organizations have proposed legislation aimed to further define and limit permitted compensation amounts. As compensation rates for executives and board members differ substantially among organizations of different types and sizes, analyses of compensation data can provide valuable insight into the development of equitable standards. SOI collects a variety of data related to individual compensation amounts paid to executives and board members, which can assist researchers in analysis of such issues.

All nonprofit organizations that file Form 990 or 990-PF are required to provide individual-level compensation data for all paid executives and board members. These amounts are reported in Part V of Form 990 and Part VIII of Form 990-PF for each board member or trustee, foundation manager or organization director, executive, or officer who was paid by the nonprofit organization during the tax year. Nonprofit organizations report compensation paid to executives and board

members not only for their assistance in operating and administering charitable programs, but also for their work in fundraising, investment management, and other activities not directly related to their charitable purposes. Table 3 shows that, for Tax Year 2002, compensation, including benefits, deferred compensation, and allowances, paid by public charities and private foundations to executives and board members totaled $15.0 billion. For both public charities and private foundations, the highest paid executives or board members received over $7 million. Most nonprofit organizations did not report compensating executives or board members; less than half of public charities and less than one-quarter of private foundations indicated that they had paid one or more executives or board members during the tax year.

Among organizations that reported executive and board compensation, patterns of such compensation varied greatly for Tax Year 2002, depending on certain organizational characteristics, such as type and size. For example, median compensation for individual executives and board members at public charities was $45,000, an amount much larger than the median compensation of $6,000 paid to individuals with similar positions at private foundations. Likewise, organization size, as measured by total assets, significantly affected compensation practices. For all nonprofit organizations, both median and mean executive and board compensation amounts increased measurably with organization size. Additionally, large nonprofit organizations distributed a larger portion of their total executive and board compensation as employee benefits (13 percent) than medium and small organizations (8 percent and 4 percent, respectively).[10]

A different pattern emerges when the aggregate compensation of executives and board members paid by an organization is measured as a proportion of the organization's total expenditures. Although large nonprofit organizations clearly spend more in absolute amounts for compensation than smaller organizations, small nonprofit organizations direct a larger percentage of their overall expenditures toward executive and board compensation. The median proportion of aggregate executive and board compensation to total expenses for small public charities was 8 percent for Tax Year 2002. For medium-sized public charities, the median was 2 percent. And for large public charities, the median proportion of aggregate compensation was less than 1 percent. Median proportions of aggregate compensation of executives and board members to total expenses also decreased with organization size for private foundations. The median proportion of aggregate executive and board compensation to total expenses was 12 percent for small private foundations, 3 percent for medium-sized private foundations, and less than 1 percent for large private foundations.

In addition to individual executives and board members, many nonprofit organizations also report compensation of institutional trustees, such as banks.[11] While public charities paid less than one-half of 1 percent of executive and board compensation to institutional trustees, private foundations reported that 16 percent of compensation was paid to these organizations. Additionally, institutional trustees represented 28 percent of all compensated individuals reported by private foundations. For private foundations, the proportion of compensation paid to institutional trustees to total expenses greatly exceeded that paid to individual executives and board members. The median proportion of compensation paid to total expenses for institutional trustees was 15 percent. In contrast, this proportion, when calculated for compensation paid to individual executives or board members by private foundations, was less than 2 percent.

► Preliminary Research on Taxation of EO Prohibited Activities

Chapters 41 and 42 of the IRC outline a number of prohibited activities and their associated penalties. Tax-exempt organizations, certain individuals associated with those organizations, and certain nonexempt trusts that engage in such prohibited activities must pay excise taxes for the tax year in which the prohibited activity occurred. Organizations or individuals liable for such excise taxes calculate their total amounts due using Form 4720, *Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the Internal Revenue Code.* Excise taxes may be assessed on a number of activities, such as failure by nonoperating private foundations to distribute minimum amounts toward grants, disbursement of excess amounts toward lobbying, participation in illegal political activities, and

Table 3. Nonprofit Organization Board and Executive Compensation, by Type of Organization and Size,[1] Tax Year 2002

[All figures are samples based on estimates]

Type of organization and size	Number of compensated individuals	Total	Median	Mean	Max
	(1)	(2)	(3)	(4)	(5)
Public charities					
All public charities					
Total compensation and benefits	**202,316**	**14,218,864,111**	**45,000**	**70,280**	**7,448,233**
Compensation	194,537	12,806,782,863	45,000	65,832	6,885,926
Employee plans	83,045	1,213,267,385	7,503	14,610	4,559,427
Expense accounts and other allowances	25,042	201,114,311	3,000	8,031	743,349
Small charities					
Total compensation and benefits	108,035	3,723,646,342	28,146	34,467	333,604
Compensation	102,263	3,491,258,605	28,800	34,140	303,113
Employee plans	23,826	161,443,629	4,443	6,776	81,493
Expense accounts and other allowances	11,351	70,944,108	1,445	6,250	51,600
Medium charities					
Total compensation and benefits	73,468	6,393,010,502	70,141	87,018	2,646,940
Compensation	71,954	5,811,838,637	66,453	80,771	2,646,940
Employee plans	42,521	511,513,724	7,276	12,030	634,936
Expense accounts and other allowances	8,875	71,495,761	3,211	8,056	305,400
Large charities					
Total compensation and benefits	20,813	4,102,207,268	152,729	197,095	7,448,233
Compensation	20,320	3,503,685,622	137,249	172,422	6,885,926
Employee plans	16,698	540,310,032	18,338	32,357	4,559,427
Expense accounts and other allowances	4,816	58,674,442	5,341	12,183	743,349
Private foundations					
All private foundations					
Total compensation and benefits	**29,921**	**743,675,862**	**6,000**	**24,855**	**7,182,301**
Compensation	29,086	684,732,874	6,000	23,542	7,182,301
Employee plans	2,566	51,084,960	11,000	19,909	1,450,943
Expense accounts and other allowances	1,563	7,858,028	960	5,026	497,605
Small foundations					
Total compensation and benefits	11,767	76,585,846	2,644	6,509	79,102
Compensation	11,340	74,440,810	2,684	6,564	63,360
Employee plans	388	1,984,176	147	5,108	15,742
Expense accounts and other allowances	550	160,860	99	292	960
Medium foundations					
Total compensation and benefits	14,411	336,743,345	10,000	23,367	1,472,583
Compensation	14,100	320,619,761	10,022	22,739	974,978
Employee plans	1,003	12,420,032	6,315	12,377	627,370
Expense accounts and other allowances	547	3,703,552	1,600	6,767	497,605
Large foundations					
Total compensation and benefits	3,743	330,346,671	29,829	88,257	7,182,301
Compensation	3,646	289,672,303	30,000	79,449	7,182,301
Employee plans	1,174	36,680,752	20,140	31,244	1,450,943
Expense accounts and other allowances	466	3,993,616	3,004	8,570	230,452

[1] For the purpose of analysis, “small” charities hold less than $1 million in book value of total assets; “small" foundations hold less than $1 million in fair market value of total assets; “medium" charities hold from $1 million to less than $50 million in book value of total assets; “medium" foundations hold from $1 million to less than $50 million in fair market value of total assets; “large" charities hold $50 million or more in book value of total assets; and “large" foundations hold $50 million or more in fair market value of total assets.

excess benefit transactions or self-dealing activities that benefit individuals associated with public charities or private foundations, respectively.

SOI recently began collecting data from Forms 4720 filed by organizations and individuals. To date, data collection for Calendar Years 2003 and 2004 has been completed. Statistics derived from the population of Forms 4720 received by IRS during those years include data from returns filed for various tax years. For Calendar Year 2004, some 65 percent of the returns included in the population represented Tax Year 2003, and 27 percent represented Tax Year 2002. The additional 8 percent of the Calendar Year 2004 population comprised returns filed for various earlier tax years. While Form 4720 may be filed by a variety of organizations, Form 990-PF filers accounted for more than 95 percent of the return population in each of Calendar Years 2003 and 2004.[12] For Calendar Years 2003 and 2004, approximately 2 percent of all Form 990-PF filers filed Form 4720.

This paper marks the first publication of data collected for the Form 4720 study. Table 4 shows Calendar Year 2003 and 2004 data from Form 4720. Clearly, the excise tax paid on undistributed income is the largest and most commonly reported excise tax. This tax appeared on 85 percent of returns filed and accounted for more than 70 percent of total taxes reported for both Calendar Years 2003 and 2004. After taxes on undistributed income, the most commonly reported taxes were on self-dealing and excess benefit transactions, which are generally prohibited transactions between nonprofit organizations and associated individuals. Examples of excess benefit transactions include excess compensation to executives or board members and loans made to officers, directors, and trustees. Taxes on self-dealing and excess benefit transactions appeared on 9 percent of returns included in the Calendar Year 2003 study and 10 percent of returns included in the Calendar Year 2004 study. These taxes represented 15 percent of total tax reported for Calendar Year 2003 and 9 percent of total tax reported for Calendar Year 2004.

Data collected from Form 4720 provide additional insight into the types of prohibited activities that occur most commonly and the degree to which such violations occur. However, statistics derived from this information may be limited by both the reliability of nonprofit organizations in reporting prohibited activities and the effectiveness of IRS audit procedures and oversight. For example, a steady annual increase in the percentage of organizations using Form 4720 each year could indicate improved reporting compliance among nonprofit organizations, or increased involvement in prohibited activities. Nevertheless, the statistics may prove helpful in measuring the effectiveness of this oversight. In the future, data from Form 4720 may help determine the impact and effectiveness of any changes made or additions to the regulations that govern the activities of nonprofit organizations.

► Summary

The information obtained from SOI statistics, microdata, and research projects can be used in analyses that illuminate a variety of issues faced by legislators,

Table 4. Excise Taxes Reported by Charities, Private Foundations, and Certain Trusts on Form 4720, Calendar Years 2003 and 2004

Internal Revenue Code Section	Item	Calendar Year 2003		Calendar Year 2004	
		Number	Amount	Number	Amount
Section 4942	Tax on Undistributed Income (Schedule B)	1,551	3,539,633	1,482	5,594,073
Sections 4941 & 4958	Taxes on Self-Dealing and Excess Benefit Transactions (Schedule A)	170	730,233	170	659,721
Section 4945	Tax on Taxable Expenditures (Schedule E)	53	277,420	54	1,036,999
Section 4911	Tax on Excess Lobbying Expenditures (Schedule G)	27	75,255	31	136,033
Sections 4943, 4944, 4912, 4955	Additional Excise Taxes[1]	26	191,318	23	276,670
	Total[2]	**1,817**	**4,813,859**	**1,743**	**7,703,496**

[1] Includes reported taxes on Excess Business Holdings, Invesments that Jeopardize Charitable Purposes, Disqualifying Lobbying Expenditures, Political Expenditures, and Personal Benefit Contracts.

[2] Detail adds to more than total because some organizations reported more than one type of activity subject to excise taxes.

the IRS, and nonprofit practitioners; this paper has highlighted three examples. Several research projects, including an analysis of information derived from the Forms 990/990-T integrated sample and the Forms 990 and 990-T allocation studies, have identified apparent problems with the quality of reporting by tax-exempt organizations. SOI microdata and statistics can be an important asset in research involving information where proper line item allocations are imperative, such as balance sheet or income statement information. Data for individual compensation amounts paid to executives and board members can be employed in a variety of analyses and can provide a glimpse into the compensation habits of nonprofit organizations. The recent introduction of the Form 4720 study provides a new opportunity for research into the degree to which nonprofit organizations deviate from their tax-exempt purposes. Clearly, SOI data can be valuable to researchers and analysts in determining an overall picture of the nonprofit sector, identifying potential problems in tax reporting and compliance, and establishing benchmarks for the administration and operation of nonprofit organizations. Such analyses may provide the framework for future oversight procedures, tax legislation, and self-governance guidelines.

► Endnotes

1 This amount was obtained from the Internal Revenue Service Exempt Organizations Business Master File and includes nonprofit organizations not required to file annual returns with the IRS.

2 Data indicated as constant dollars were adjusted based on the 2000 chain-type price index for Gross Domestic Product as reported by the U.S. Department of Commerce, Bureau of Economic Analysis. Tax Year 2002 is used as the base year for these adjustments.

3 For purposes of analysis, "charitable expenditures" is defined as the sum of program service expenses from Form 990 and disbursements for charitable purposes from Form 990-PF.

4 Growth rates were derived from the exponential formula for growth, $y=b*m^x$.

5 For detailed information on Statistics of Income sampling methodology for producing population estimates, see the general appendix, located near the back of the Summer 2005 issue of the *SOI Bulletin*, particularly the Sample Criteria and Selection of Returns section and the Method of Estimation section. The *SOI Bulletin* is available from the Tax Stats section of the IRS Web site, www.irs.gov/taxstats.

6 A business activity is considered unrelated if it does not contribute importantly (other than the production of funds) to accomplishing an organization's charitable, educational, or other purpose that is the basis for the organization's tax exemption. Whether an activity contributes importantly depends in each case on the facts involved. See IRS Publication 598, *Tax on Unrelated Business Income of Exempt Organizations*, for additional information on unrelated business income and tax.

7 Data collected for the Deductions Allocation Study were controlled to provide statistics solely on amounts of itemized deductions allocated from Other deductions. Any SOI adjustments made for reasons other than allocating, such as correcting math errors, are included in both the SOI adjusted amounts and the taxpayer-reported amounts.

8 The actual number of Tax Year 2002 large-income Forms 990-T with allocations was 492. Seven returns could not be located for the study, and data on taxpayer entries of itemized deductions were not available from any other source.

9 Each year, several Form 990 filers report their balance sheet items in thousands of dollars with a note on the return with that information. During IRS Returns Transaction File processing and GuideStar transcription, this note is often missed. SOI processing includes steps to ensure that these returns are transcribed correctly. Consequently, for a certain number of returns each year, SOI balance sheet figures are one thousand times larger than on both the GuideStar file and the Returns Transaction File.

[10] For purposes of analysis, "small" public charities hold less than $1 million in book value of total assets; "small" private foundations hold less than $1 million in fair market value of total assets; "medium" public charities hold from $1 million to less than $50 million in book value of total assets; "medium" private foundations hold from $1 million to less than $50 million in fair value of total assets; "large" public charities hold $50 million or more in book value of total assets; and "large" private foundations hold $50 million or more in fair market value of total assets. Of the returns filed by public charities for Tax Year 2002, some 68 percent were filed by small public charities, 30 percent were filed by medium public charities, and 2 percent were filed by large public charities. Small, medium, and large private foundations represented 70 percent, 29 percent, and 1 percent of returns filed by private foundations for Tax Year 2002, respectively.

[11] For additional information on institutional trustees, see Boris, Elizabeth A.; Renz, Loren; and Hager, Mark A (2005), *Foundation Expenses and Compensation: Interim Report, 2005,* The Urban Institute, The Foundation Center, and Philanthropic Research, Inc.

[12] Organizations identified as "Form 990-PF filers" may be private foundations or section 4947(a)(1) charitable trusts that are treated as private foundations for tax purposes. Generally, private foundations represent more than 90 percent of all Form 990-PF filers.