

Key Elements of the U.S. Tax System

TAXES AND CHARITABLE GIVING

What entities are tax-exempt?

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A. Nonprofit organizations that do not distribute profits can be exempt from federal income tax if organized expressly for public purposes.

Tax-exempt organizations (including charities) include many diverse entities. The National Taxonomy of Exempt Entities—developed by the National Center for Charitable Statistics at the Urban Institute and used by the Internal Revenue Service—classifies them into 9 major groups, 26 categories, and over 600 subcategories. The major groups are as follows:

1. Arts, culture, and humanities (e.g., art museums, historical societies)
2. Education (e.g., private schools, universities, parent-teacher associations)
3. Environment and animals (e.g., humane societies, the Chesapeake Bay Foundation)
4. Health (e.g., nonprofit hospitals, the American Lung Association)
5. Human services (e.g., the Girl Scouts, the YMCA, food banks, homeless shelters)
6. International and foreign affairs (e.g., CARE, the Asia Society, the International Committee of the Red Cross)
7. Public society benefit (e.g., the Rockefeller Foundation, the Urban Institute, civil rights groups, the United Way)
8. Religion-related (e.g., interfaith coalitions, religious societies)
9. Mutual membership or benefit (e.g., nonprofit credit unions, labor unions, fraternal organizations)

Although tax exemption requires that owners do not receive profits from the organization, employees and contractors with a nonprofit still earn private benefits, creating potential conflicts over such issues as defining when compensation is excessive. Also, many types of mutual benefit organizations qualify for tax exemption, though not usually deductibility of charitable contributions to them.

In 2020, approximately 1.74 million tax-exempt organizations were registered with the Internal Revenue Service. These nonprofits accounted for approximately 5.5 percent of US gross domestic product in 2019. About 35 percent of registered nonprofits are required to file annual returns (Form 990, 990-EZ, or 990-PF); other organizations with gross receipts between \$25,000 and \$50,000 must file a simpler information return known as the 990-N (e-postcard). Religious congregations, as well as organizations with less than \$25,000 in gross receipts, are exempted from the annual filing requirement. All private foundations are required to file the 990-PF.

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Tax-exempt status confers exemption from federal tax on earnings from income-producing assets and activities (other than those that generate unrelated business income). States generally follow the federal precedent if they impose state income taxes and often exempt charities from state and local property taxes and sales taxes. Charities also sometimes qualify to issue tax-exempt bonds.

Although many nonprofits qualify for tax exemption, only about two-thirds also qualify to be “charities” and receive contributions that donors can deduct on their tax returns. “Charitable purpose” is defined under section 501(c)(3) of the tax code as “religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition [or] the prevention of cruelty to children or animals.” This definition covers both public charities and private foundations; the latter organizations are created to distribute funds for charitable purposes to other charities or individuals.

Updated May 2020

Data Sources

Bureau of Economic Analysis. [“Table 1.3.5. Gross Value added by Sector.”](#) National Income and Product Accounts. Accessed February 17, 2020.

Internal Revenue Service. [“Exempt Organization Business Master File Extract \(EO BMF\).”](#) Accessed February 17, 2020.

Further Reading

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McKeever, Brice S., Nathan E. Dietz, and Saunji D. Fyffe. 2016. *The Nonprofit Almanac*, 9th ed. Lanham, MD: Rowman & Littlefield.

McKeever, Brice S. 2019. [“The Nonprofit Sector in Brief 2018: Public Charities, Giving, and Volunteering.”](#) National Center for Charitable Statistics. Washington, DC: Urban Institute.

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