

Tax Policies Affecting Nonprofit Employment

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The ongoing nonprofit workforce shortage crisis¹ is a clear indication that labor market economics are not working for the benefit of people served by charitable organizations throughout the country. Data show that charitable nonprofits often cannot afford to pay wages and benefits that are commensurate with similar jobs in the for-profit and government sectors. The most direct impact frequently manifests in longer waiting lines and reduced services for individuals. All sectors suffer, however, when nonprofit child care providers are unable to pay enough to attract and retain staff to care for the children of employees of for-profit, governmental, and nonprofit employers. Nonprofit workforce shortages, therefore, are not mere inconveniences, but challenges for all residents of the United States. Congress can alleviate some of these challenges by removing existing tax policy impediments and extending to nonprofits many of the tax incentives enjoyed by businesses.

Much More Than a Sector of Volunteers

Contrary to common misperceptions, the charitable sector does not operate with an all-volunteer workforce. Rather, Bureau of Labor Statistics data for 2022 show that more than 300,000 nonprofit establishments accounted for 12.8 million compensated jobs, or 9.9 percent of all private-sector jobs.² In several states, including Maine, Massachusetts, New York, Pennsylvania, Rhode Island, and Vermont, employment at charitable organizations exceeds 15% of the private workforce.³ Nonprofit organizations are involved in all industry sectors, with nearly 2 out of every 3 nonprofit jobs in the health care and social assistance sector (66.3%) and educational services comprising 16.4%. Although nonprofits generally do not pay any income taxes, estimates are that they contribute almost \$65 billion annually in payroll taxes.⁴

¹ [2023 Nonprofit Workforce Survey Results: Communities Suffer as Nonprofit Workforce Shortage Crisis Continues](#), National Council of Nonprofits, August 2023.

² [Nonprofits accounted for 12.8 million jobs, 9.9 percent of private-sector employment, in 2022](#), Bureau of Labor Statistics, Aug. 16, 2024.

³ [State Nonprofit Data & Reports](#), Nonprofit Impact Matters, August 2019.

⁴ Calculation provided by the National Center for Charitable Statistics at the Urban Institute.

Employment Tax Incentives

Congress occasionally gets it right, but more often than not the enthusiasm behind creating employment tax incentives has focused almost exclusively on for-profit employers. This has served as a detriment to nonprofit employers, their employees, and the people they serve.

As Congress revisits many of the provisions of the 2017 tax law set to expire at the end of 2025, it will examine some of the business tax incentives or benefits, often in the form of tax credits, that currently subsidize employment. At present, many of these income-tax based incentives are not available to nonprofit employers since they are generally exempt from federal income taxes.

The following is a list of the most commonly discussed tax credits to which nonprofit access is limited or which charitable organizations cannot utilize:

- **Expenditures to provide access to disabled individuals:** An income tax credit is available for expenditures by small businesses to enable compliance with the requirements of the Americans with Disabilities Act (ADA).⁵
- **Retirement Savings:** Employers may be able to claim an income tax credit of up to \$5,000, for three years, for the ordinary and necessary costs of starting a qualified pension plan. In addition, Code Section 45T provides a three-year tax credit for employers that offer automatic enrollment in pension plans.⁶ We note favorably that legislation introduced in late summer 2024 would extend both of these important tax incentive to small nonprofit employers by applying the tax credit to payroll taxes they pay.⁷
- **Child Care Facilities:** Employers can qualify for an income tax credit up to \$150,000 per year to offset 25% of qualified childcare facility expenditures and 10% of qualified childcare resource and referral expenditures.⁸
- **Family and Medical Leave:** Employers who provide paid family and medical leave to their employees may claim an income tax credit, which is equal to a percentage of wages they pay

⁵ 26 U.S. Code § 44.

⁶ 26 U.S. Code § 45E.

⁷ [S. 4965](#), the Small Nonprofit Retirement Security Act of 2024, introduced Aug. 1, 2024 by Senators James Lankford and Cortez Masto.

⁸ 26 U.S. Code § 45F.

to qualifying employees while they're on family and medical leave. This tax credit is scheduled to expire at the end of 2025.⁹

- **The Work Opportunity Tax Credit** (WOTC) is available for employers who hire individuals who are members of “targeted groups.” An employer must obtain certification that an individual is a member of a targeted group before it may claim the income tax credit of up to \$2,400. WOTC targeted groups include: 1) Qualified IV-A ("TANF") recipient; 2) Qualified Veteran; 3) Qualified Ex-Felon; 4) Designated Community Resident; 5) Vocational Rehabilitation Referral; 6) Summer Youth Employee; 7) Supplemental Nutrition Assistance Program (SNAP or "food stamps") recipient; 8) Supplemental Security Income (SSI) recipient; 9) Long-term Family Assistance (Long-term TANF) recipient; and 10) Qualified Long-term Unemployment recipient.¹⁰

All of these tax incentives advance policy priorities deemed important by Congress for the U.S. economy and society. Yet, the sector most dedicated to improving lives and communities – the charitable nonprofit sector – is excluded from utilizing the incentives. The result is that it actually costs more for nonprofit employers to hire and retain staff – leading to their inability to compete with for-profit employers on an equal basis. The current exclusionary policy must be corrected.

Emerging Solutions

Over the past 15 years, Congress has turned to tax credits applied to payroll taxes as a means for providing tax supports for nonprofits. For example, the Affordable Care Act contains a tax credit against payroll taxes for small nonprofits that provide health insurance to their employees.³ More recently, the CARES Act provided a refundable tax credit to both for-profit and nonprofit employers against payroll taxes equal to qualified wages.⁴ And perhaps most significantly, the Inflation Reduction Act of 2022 (IRA) made numerous energy-saving related tax credits available to nonprofits through a reimbursement system. Under the IRA nonprofit and other tax-exempt entities can benefit from the energy tax credits through so-called “elective pay” in which the organization can receive the full value of the credit in the form of a direct payment from the IRS. Alternatively, organizations can transfer all or a portion of the tax credit to a third-party buyer in exchange for cash or an adjustment on the contract price of the property.⁵

⁹ 26 U.S. Code § 45S.

¹⁰ 26 U.S. Code § 51; Rules for Computing Work Opportunity Credit.

Recommendation: Enable tax-exempt employers to utilize employment tax incentives by converting income tax credits to direct pay or transferability.

The Internal Revenue Service has provided extensive guidance in the form of regulations and other guidance regarding both elective pay and transferability. Information on eligibility and election requirements as well as filing requirements is readily available and includes procedures regarding registration to receive direct payments from the federal government.⁶ Congress should consider adapting either the elective pay or credit transfer mechanisms so that several income tax credits currently available to for-profit employers could also be made available to nonprofits.

Employment Excise Tax on Nonprofit Employers

Effective for taxable years beginning after December 31, 2017, the 2017 tax law imposes an excise tax at the corporate tax rate (currently at 21%) on certain remuneration in excess of \$1 million and on certain separation pay (“excess parachute payments”). Separation pay to covered employees can trigger the “parachute payment” tax even if the individual’s compensation never reaches \$1 million. In general, the parachute tax is triggered if separation pay equals or exceeds 3 times a covered employee’s “base amount. The excise tax is extended to “applicable tax-exempt entities” (“ATEOs”) and related organizations. The stated intent at the time of passage was to impose the same economic effect as a for-profit corporation losing a tax deduction.

We challenge the rationale for the excise tax given the nature of work at charitable nonprofits and existing regulatory structures. Nonprofit executive compensation is already on top of the list of issues the IRS scrutinizes effectively. Recent statistical data released by the IRS show that 516 tax-exempt organizations filed and paid excise taxes of approximately \$210 million cumulatively during the calendar year 2021 for providing compensation that the IRS deemed excessive. In 2020, 302 tax-exempt organizations filed and paid excise tax of approximately \$96 million. The IRS states that there continues to be a high volume of exempt organizations that paid compensation of over \$1 million to at least one covered employee but did not report an excise tax on Form 4720, Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code.

The IRS’s Tax Exempt & Government Entities (TE/GE) Division released its compliance and priorities for fiscal year 2024 and supporting examinations of exempt organization executive compensation was among them.¹¹ In fiscal year 2022, the IRS commenced 842 compliance checks with respect to

¹¹ [Tax Exempt & Government Entities – Compliance Program and Priorities](#), Internal Revenue Service.

compliance with the excise tax; of those checks, approximately 100 of those cases were referred for examination.⁷

Recommendation: Congress should allow Section 13602 of the 2017 tax law (IRC Section 4960) to sunset, as scheduled on December 31, 2025.