THE CHRONICLE OF PHILANTHROPY

OPINION

‘Five Alarm Fire': How New Tax Law Could Decimate Nonprofits — and What Can Be Done

Local nonprofit leaders in Republican districts need to speak out against proposed changes and ensure lawmakers understand the consequences.

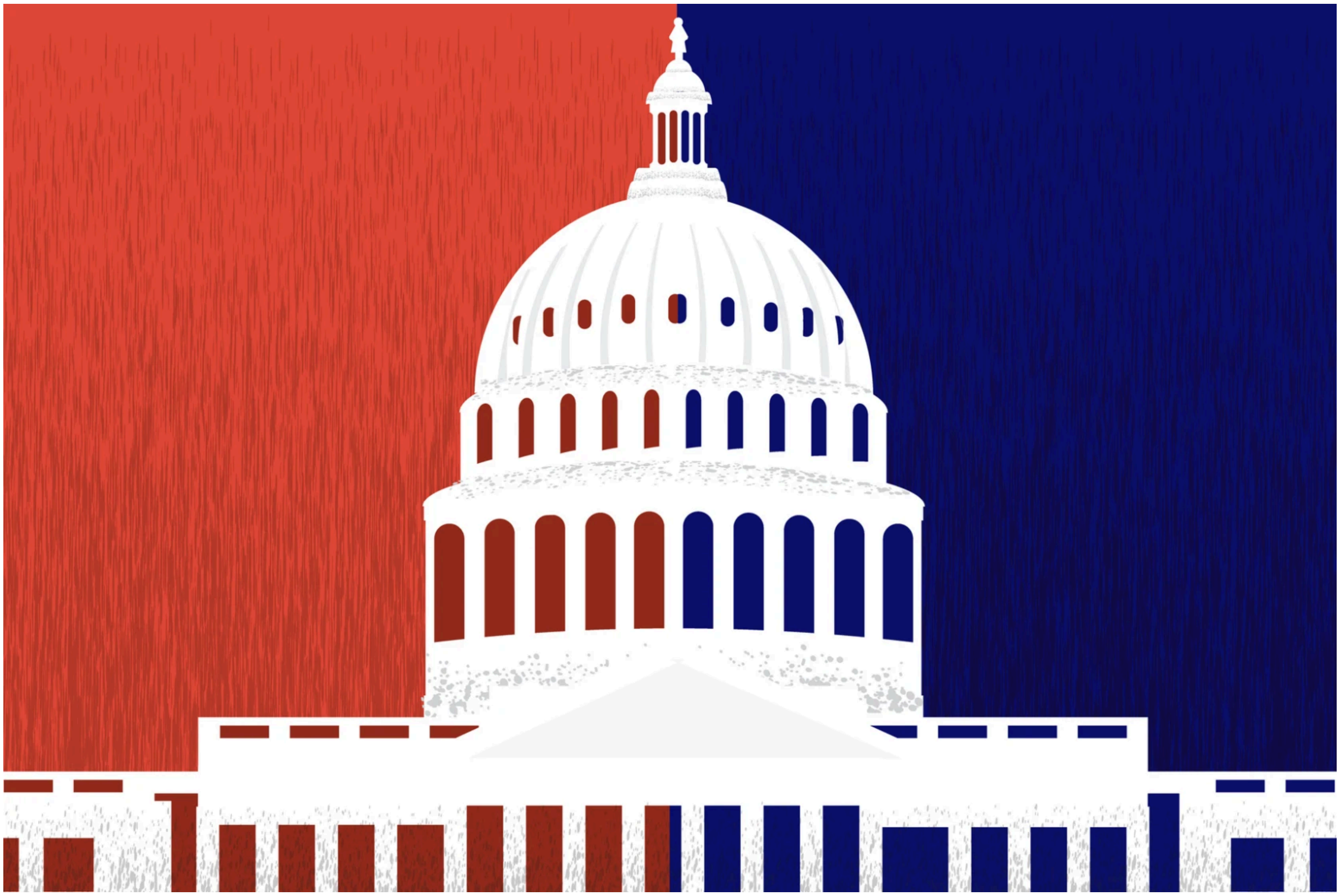
By Steve Taylor

APRIL 23, 2025

ARCHITECT OF THE CAPITOL

The nonprofit world is facing irreparable damage because of actions coming out of Washington. I'm not referring to President Trump and his executive orders. The more lasting danger is emanating from Congress, which could permanently shrink and sharply reshape the nonprofit sector as it prepares new tax reform legislation.

TAX POLICY



LEGISLATION

Nonprofits Oppose Bill That Would Give Treasury Unilateral Power to Revoke Tax-Exempt Status

LEGISLATION

Coalition Will Fight New Taxes on Nonprofits

OPINION

5 Conservative Proposals That Could Reshape Philanthropy — and How to Prepare

GIVING DATA

Donors Likely Giving $16 Billion Less Each Year After Tax Law Change, Report Finds

OPINION

Expiring Tax Breaks, Charitable Giving, and What's at Stake for Philanthropy

Congress is working with stunning speed to pass a massive federal tax bill before the 2017 Tax Cuts and Jobs Act expires later this year. In response, nonprofits must act with equal swiftness to prevent sweeping changes to the tax laws that have governed nonprofits for generations.

I raise this alarm as a lifelong Republican who worked for Republican senators for more than a decade, followed by nearly 20 years as a policy advocate for charitable organizations, including as the head of government relations for United Way. I was also engaged in federal tax reform efforts starting in 2014 when Republican Representative Dave Camp of Michigan, then chairman of the Ways and Means Committee, released the "Camp Draft," which went on to become the 2017 tax law.

The current extreme risk to the charitable world results from a convergence of factors, including congressional Republicans' commitment to fast-tracking major tax legislation through the budget reconciliation process, the $36 trillion federal debt, and an unusually vulnerable nonprofit sector.

Among President Trump's campaign promises was extending the individual tax provisions of the 2017 tax legislation beyond their expiration date and a series of additional tax cuts, including eliminating taxes on tips and Social Security benefits.

Such tax cuts, however, are projected to balloon the federal debt even further beyond Republican lawmakers' comfort level. As a result, both the Senate and the House are turning over every stone in search of spending cuts or increases in other tax revenue to partially offset or pay for the tax cut legislation's potential federal debt increase. Nonprofits are the ideal target.

Five-Alarm Fire

In January, a leaked tax committee document showed some of the potential offsets identified by congressional staff, including raising the excise tax on a small number of universities from 1.4 percent to 14 percent and eliminating nonprofit status for hospitals. But the offsets listed aren't enough to cover the needed revenue and are likely a fraction of what is now under consideration. That should set off alarms for the entire charitable sector.

During the 2017 tax legislation negotiations, lawmakers promised not to change the charitable deduction. They largely stuck to that promise, even though the bill ultimately reduced by nearly 20 million the number of taxpayers eligible for the deduction. The House and Senate have introduced freestanding bipartisan charitable deduction bills for taxpayers who don't itemize. But no Republicans are making assurances about what will or will not be in the tax legislation, according to conversations I've had with multiple participants of recent nonprofit advocacy gatherings on Capitol Hill.

Meanwhile, influential conservative tax policy experts argue that the nonprofit world could be a significant source of tax revenue. In a recent opinion piece in the *Washington Examiner*, Scott Hodge, a respected former president of the mainstream conservative Tax Foundation, and his coauthors, argue for changes to the sector that could generate up to $40 billion a year in tax revenue. They cite nonprofit credit unions, hospitals, and elite universities as examples, but the proposed reforms could be applied to all nonprofits. He made a similar case in the *Wall Street Journal* and in an academic paper published in February.

The proposed reforms go far beyond universities and hospitals, calling on Congress to use the following means to eviscerate section 501(c) of the federal tax code, which gives tax-exempt status to nonprofits:

Rigorous requirements to qualify for exempt status. On the extreme end, only nonprofits such as churches and basic needs organizations that fit a narrow Dickensian view of charity — using donated dollars to aid the poor — would be tax exempt. A June 2024 Tax Foundation paper proposes that to qualify as a public charity, 80 percent of an organization's income must come from private individuals and private foundation grants. Entities that would no longer qualify would be taxed as for-profits. Under a much less harmful scenario, Congress could opt to eliminate tax exempt status only for nonprofit hospitals and credit unions, which on their own would generate significant tax revenue.

Redefining what constitutes nonprofit income. Under current law, any nonprofit income related to missions is tax exempt, while unrelated business income is taxable. Many nonprofits have diverse sources of income, such as donations, grants, membership fees, and investment income, all of which are "related." Examples of taxable "unrelated" business income include rental fees paid by tenants of a building owned by a nonprofit or revenue from businesses advertising in a nonprofit's periodical. Hodge and his coauthors suggest that unrelated taxable income could be expanded to include membership fees, program service fees, and some government contracts and grants.

Applying excise taxes or the corporate tax rate to all nonprofits. Currently, private foundations are subject to a 1.39 percent federal excise tax on net investment income, but a 14 percent excise tax on some private colleges and universities was on the list leaked in January. The Tax Foundation, however, goes much further and argues that all 501(c) net income should be taxed at the 21 percent corporate tax rate.

Why Nonprofits?

Tax policy experts working in and for Congress are certainly aware of these options, and their motivations for considering them are clear. The question is: Why go after America's charitable sector?

First, because those of us in the nonprofit world have for years failed to sufficiently explain who we are and what we do. This is especially true of local nonprofits, many of which have retreated from engaging in advocacy at a crucial moment, according to the Independent Sector's 2023 nonprofit advocacy survey. The problem is most evident among nonprofits located in red states and districts. Over the years, I've talked with thousands of local nonprofit board members in middle America who do not understand that 501(c)(3) charities are permitted to engage in issue advocacy, or that even private foundations are permitted to advocate in defense of their organizations. Heightened partisanship exacerbates the underlying wariness. Additionally, since enactment of the 2017 tax law, many new lawmakers have been elected to Congress. Without regular contact from the nonprofit leaders in their districts, they have limited understanding of why the work nonprofits do matters to their constituents.

There is no evidence of personal animus against nonprofits by conservative tax experts like Hodge, who are motivated by a particular ideological approach to federal tax policy. But the failure of nonprofits to sufficiently engage over time with members of Congress means too few understand the importance of nonprofit work and why the sector's tax treatment is justified.

Second, nonprofits are a casualty of today's toxic politics, increasingly defined by click-bait controversies and political caricature. In a heightened partisan environment, organizations focused on helping immigrants are accused of facilitating illegal migration. The practices of a small number of nonprofits receive outsize attention, such as protests on college campuses over the war in Gaza, donations from foreign entities, and wealthy donors' funneling dollars into political campaigns through nonprofits. The Trump administration has fed these narratives by claiming that large "left-leaning" foundations are drivers of "illegal" DEI policies.

This political environment, combined with the lack of consistent and compelling information about the value of the services provided by nonprofits in red states and districts has resulted in growing antipathy toward the sector. It isn't too late to intervene before Republicans in Congress enact a massive new tax bill. But those interventions can't come soon enough.

Senate and House Republican leadership staff have told me that the tax committees have been working on their respective draft bills since the House budget resolution passed on February 25. Now that both chambers have passed the final budget resolution, the committee is likely to work at breakneck speed to craft the tax legislation. Once an official draft is released, getting changes made will be almost impossible — something I saw firsthand while working on the 2017 tax law. In that case, asking to remove a provision that raised revenue was met with a demand for a viable alternative source of revenue. Similarly, if this year's Republican-negotiated draft bill includes massive changes to section 501(c) of the tax code, it will likely be too late to get them removed.

Local Voices Needed

That's why local nonprofit leaders in Republican districts need to speak up immediately. Lawmakers can dismiss hired lobbyists or representatives from national organizations. But if approached by a beloved local charitable organization, lawmakers will listen and act to protect it from harm. Most people who get elected to Congress have been active in their communities and have served on boards, donated to, or collaborated with local nonprofits. They grew up going to nonprofit camps, community centers, religious organizations, and youth programs.

This type of locally driven advocacy has a strong track record of success. That includes the removal of what was known as the "parking lot" tax from the 2017 tax law. The provision had resulted in a 21 percent tax on parking and transportation benefits for nonprofit employees and was widely opposed by the sector. Congress repealed it in 2019 following an outcry from local nonprofits, including church leaders and board members of local groups.

This type of engagement can overcome a lawmaker's skepticism about the sector or disagreements with the activities of some faraway nonprofit. But many local nonprofit leaders are not aware of the looming risk or equipped for quick, informed action.

National charities with local affiliates or state nonprofit associations can expedite identifying local leaders who have relationships with congressional representatives and could be persuaded to meet with them. Experienced nonprofit advocates can also provide local leaders with the information, tools, and resources needed to ensure the meetings happen, including helping them get to Washington if necessary. This is the type of defensive advocacy that foundations can and should fund and is unlikely to happen otherwise.

The gravity of these circumstances requires a new level of engagement with Congress, especially with Republicans. A catastrophic outcome can be prevented only if lawmakers understand the true cost of decimating, or eliminating altogether, the nonprofit sector. And at this moment, that message will only be effective if delivered by local leaders who have lawmakers' ears — and trust.

We welcome your thoughts and questions about this article. Please email the editors or submit a letter for publication.

GOVERNMENT AND REGULATION | FINANCE AND REVENUE

Steve Taylor

Steve Taylor, the former head of government relations for United Way Worldwide, is currently a senior adviser to the Charitable Independence Initiative and a nonprofit consultant in Washington, D.C.

TRENDING ARTICLES

FUNDRAISING
Want to Connect With DAF Donors? New Research Offers Insights

NONPROFITS & FUNDERS
How a Single Instagram Post Cost One Nonprofit a Quarter of Its Budget

GRANT MAKING
Nearly 90 Foundations 'Meet the Moment' and Pledge to Increase Their Grants

RECOMMENDED WEBINARS FOR YOU

1255 23rd Street, N.W. Washington, D.C. 20037