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Testimony

For Release
on Delivery
Expected at
9:30 a.m. EDT
Tuesday
June 28, 1988

Competition Between Tax-Exempt
Organizations and Taxable Businesses

Statement of
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Before the
House Committee on Small Business



042556/136189

COMPETITION BETWEEN TAX-EXEMPT
ORGANIZATIONS AND TAXABLE BUSINESSES

Summary Statement of
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Competition has become a major concern to both the taxable business and tax-exempt communities because they are increasingly providing similar services. Tax-exempt organizations are becoming more involved in activities traditionally done by taxable businesses, such as publishing services and tours. On the other hand, tax-exempt organizations see taxable businesses as becoming more involved in activities traditionally dominated by tax-exempt organizations, such as day care and physical fitness.

Complete data do not exist to quantify the exact nature, extent and impact of competition between the tax-exempt and taxable business communities. The tax-exempt community has grown significantly over the years in terms of numbers of organizations and types of activities. It also appears that tax-exempt organizations have become more reliant on income-producing activities and less reliant on charitable and government sources of revenue to fund their activities. The tax-exempt community has attributed this shift in funding sources, in part, to a reduction in government support and the inability of other traditional funding sources, such as contributions, to compensate for this reduction. These income-producing activities may result in competition with taxable businesses. However, because of the lack of data, it is difficult to measure the impact of competition on the business sector.

The business community is voicing increased concern about competition from tax-exempt organizations' income-producing activities. Although some representatives of tax-exempt organizations believe that income-producing activities further their exempt purposes, some representatives of taxable businesses view these activities as exceeding the traditional role of these organizations. Business representatives also view these organizations as having a competitive advantage by virtue of their tax-exempt status and other benefits. Our 1986 survey of businesses in six industries -- audio-visual, racquet sports, research and testing, tour, travel, and veterinarian -- revealed that a substantial number of the businesses reported experiencing competition from one or more tax-exempt competitors. However, the specific types of competitors and the extent and effects of competition that were reported varied from industry to industry.

Mr. Chairman and Members of the Committee:

We are pleased to be here today to assist the Committee in its inquiry into the issue of competition between tax-exempt organizations and taxable businesses. Our statement is based primarily on a 1987 report we issued to the Joint Committee on Taxation on the issue of competition between taxable businesses and tax-exempt organizations (GAO/GGD-87-40BR). This report showed that competition has become a major concern to both the taxable business and tax-exempt communities because they are increasingly providing similar services. Tax-exempt organizations are becoming more involved in activities traditionally done by taxable businesses, such as publishing services and tours. On the other hand, tax-exempt organizations see taxable businesses as becoming more involved in activities traditionally dominated by tax-exempt organizations, such as day care and physical fitness.

I would like to highlight two major points about the competition issue.

First, complete data do not exist to quantify the exact nature, extent and impact of competition between the tax-exempt and taxable business communities. The tax-exempt community has grown significantly over the years in terms of numbers of organizations and types of activities. It also appears that tax-exempt organizations have become more reliant on income-producing

activities and less reliant on charitable and government sources of revenue to fund their activities. These income-producing activities may result in competition with taxable businesses. However, because of the lack of data, it is difficult to measure the impact of competition on the business sector.

Second, the business community is voicing increased concern about competition from tax-exempt organizations' income-producing activities. Although some representatives of tax-exempt organizations believe that income-producing activities further their exempt purposes, representatives of taxable businesses view these activities as exceeding the traditional role of these organizations. Business representatives also view these organizations as having a competitive advantage by virtue of their tax-exempt status and other benefits. Our survey of businesses in six industries -- audio-visual, racquet sports, research and testing, tour, travel, and veterinarian -- revealed that a substantial number of the businesses reported experiencing competition from one or more tax-exempt competitors. However, the specific types of competitors and the extent and effects of competition that were reported seemed to vary from industry to industry.

I would now like to discuss these points in more detail.

LIMITED DATA EXIST ON THE COMPETITION ISSUE

Although there are data bases on segments of the tax-exempt community, such as hospitals and colleges, data on the overall community are limited, especially with regard to its involvement in income-producing activities and competition with taxable businesses. IRS routinely collects tax return and other data on tax-exempt organizations and is generally regarded as having the best data available on these organizations. However, these data do not encompass the entire tax-exempt community. For example, IRS does not compile information on churches because they are not required to file for tax-exempt status. In addition, the data may be unreliable because of inaccurate reporting by tax-exempt organizations when filing returns. Also, the data do not identify the type, specific nature, and extent of income-producing activity of tax-exempt organizations.

Private researchers studying the scope and nature of tax-exempt organizations have also found data sources to be limited or inadequate. For example, two nonprofit groups, the Urban Institute and the Independent Sector, made major studies of charitable and social welfare tax-exempt organizations and noted significant information gaps.

The limited data that do exist indicate that the tax-exempt community has grown significantly in terms of number of

organizations and types of activities. This growth could be part of the cause of the increasing concern of the business community with regard to competition.

Internal Revenue Service statistics showed that as of September 30, 1968, there were 409,789 tax-exempt organizations on IRS's master file; as of July 31, 1987, there were 871,806, an increase of over 100 percent in about 19 years. Accompanying this growth in numbers of organizations has been an expansion of the activities in which they engage. In 1965, IRS listed 90 different tax-exempt activities; currently, IRS lists over 260 such activities. Further, many tax-exempt organizations engage in more than one activity. For example, 1985 IRS data showed 43 percent of tax-exempt organizations were doing one activity, 30 percent were doing two activities, and 27 percent were doing at least three activities. While many of these appear to be traditional charitable-type activities, such as missionary and fund-raising activities, others appear to be more similar to taxable businesses in nature. For example, some tax-exempt organizations offer publishing services and conduct travel tours.

As tax-exempt organizations have evolved over the years in terms of number and activities, many appear to have become more reliant on income-producing activities and less reliant on support from contributions, government grants, and dues. Some organizations are now imposing fees for services related to their

exempt purpose which were previously provided at little or no cost, expanding services to new markets, and operating income-producing activities either related or unrelated to their exempt purpose. The tax-exempt community has attributed this shift in funding sources, in part, to a reduction in government support and the inability of other traditional funding sources, such as contributions, to compensate for this reduction.

The trend toward less reliance upon contributions and dues is particularly evident among those organizations established for charitable, religious, and educational purposes -- the section 501(c)(3) organizations. Contributions as a percent of total revenue for these organizations decreased from 36 percent of total revenue in 1946 to 18 percent in 1982. Other revenue as a percentage of total revenue increased from 59 percent to 81 percent during the same period. The other revenue category includes such items as business receipts, interest, dividends, rents, royalties, and sales of assets.

In sum, the overall statistics show that the tax-exempt community has grown significantly in terms of numbers of organizations and activities and is increasingly reliant on income-producing activities as a source of revenue. This reliance on income-producing activities has led to instances where some tax-exempt organizations are competing with taxable businesses to provide similar services. Instances of competition

between tax-exempt organizations and taxable businesses have become a frequent topic of discussion within these two communities, in the media, and even in Congress. While it is no doubt true that some competition occurs, complete data do not exist to quantify the nature, extent and impact of such competition. Simply put, we do not know how much of a problem this is.

BUSINESSES VIEW COMPETITION FROM TAX-EXEMPT ORGANIZATIONS AS AN INCREASING PROBLEM

Because information on the competition issue is largely fragmented and compiled on an informal basis, we solicited the views of representatives of selected tax-exempt organizations and taxable businesses to get more perspective on the competition issue.

Not unexpectedly, tax-exempt and taxable business representatives have differing views on the issue. Tax-exempt organization representatives believe that income-producing activities further their exempt purposes and are important to generate needed additional revenue to fund their activities. Further, they believe that competition is the result of taxable businesses increasingly entering traditional tax-exempt activities, such as day care or physical fitness. Representatives of taxable businesses, on the other hand, believe that income-producing

activities of tax-exempt organizations exceed the traditional role of these organizations, and that these organizations are afforded a competitive advantage by virtue of their tax-exempt status and other benefits.

In order to obtain more detailed information on the perceptions of competition by taxable businesses, in 1986 we sent a questionnaire to 1,738 randomly selected businesses in six industries -- audio-visual, racquet sports, research and testing, tour, travel, and veterinarian. We selected these industries because representatives from various businesses within these industries had written most often to the Small Business Administration voicing concern about competition. The questionnaire requested background information about the respondent's business and the respondent's perceptions of the extent, if any, of competition with tax-exempt organizations and its effects. More detailed information on our scope and methodology is contained in our 1987 report. Although perceptions on the nature and extent of competition varied by industry, some common themes also emerged.

First, a substantial number of businesses in each industry reported experiencing competition from one or more tax-exempt competitors during the period 1980 to 1985. This ranged from a low of 45 percent of travel businesses reporting competition to a high of 90 percent of racquet sports businesses reporting

competition. (The attachment to this statement provides more detailed results by industry group.)

Second, a majority of those businesses that reported experiencing competition thought that it was increasing. A majority of businesses in four of the six industries thought that the actual number of tax-exempt competitors had increased, while majorities in all six industries responded that the extent of competitive activities from tax-exempt organizations had increased.

Third, the primary type of tax-exempt competitor varied by industry. Audio-visual and research and testing businesses reported the most competition from public universities. Travel and tour businesses reported the most competition from religious organizations, with public universities a close second in each case. Predictably, veterinarians reported the most competition from humane societies, and racquet sports businesses reported the most competition from YM/YWCAs.

Fourth, representatives of the taxable business community said that tax-exempt organizations have an advantage when competing with taxable businesses. These representatives cited the following as contributing to this advantage: certain exemptions from federal, state, and local taxes; the availability of grants and free facilities; reduced mailing rates; volunteer labor; and the erroneous belief of some taxpayers that amounts remitted to

tax-exempt organizations for goods and services are fully deductible as charitable contributions. The extent to which these various factors are considered to contribute to an advantage varied among the six industries we surveyed. For example, our survey results show that subsidy through government grants and facilities was seen as contributing to an advantage to a moderate, great or very great extent by 89 percent of the estimated 177 research businesses who said they were experiencing competition, and 47 percent of the estimated 10,540 veterinarians who said they were experiencing competition.

Fifth, over half the taxable businesses in each of the six industries reported that the presence of tax-exempt competitors decreased profits for their businesses and reduced a current or potential market. Many businesses in each industry also cited tax-exempt competition as necessitating price reductions on their part in order to remain competitive. A smaller number of businesses reported that tax-exempt competition resulted in layoffs or other curtailment of activities.

It should be noted that the responses I just discussed represent the views and perceptions of the businesses in the six industries and not necessarily those of the entire taxable business community. While we have no reason to doubt the sincerity of these particular respondents, we did not have the time or resources necessary to verify the existence of alleged

competition or document the validity of the effects reported by the respondents.

In any event, it seems clear from these data that businesses are becoming increasingly concerned about competition from the tax-exempt community. The increasing variety of activities of tax-exempt organizations and their increasing reliance on income-producing activities may be primary sources of this concern. However, in specific terms, there is no complete data to quantify the nature, extent and effects of competition between the tax-exempt and taxable business communities. For example, what and how many businesses are affected by tax-exempt competition? Is it a local or a national problem? What are the actual effects on the businesses? Without such detailed information, it is difficult to determine whether legislative or regulatory changes are needed to address the competition issue.

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Mr. Chairman, this concludes my statement. I would be pleased to answer questions.

Number of Perceived Tax-Exempt
Competitors by Businesses Within
Selected Industries^a

<u>Industry</u>	<u>Projected respondents</u>	<u>No competitors</u>		<u>One competitor</u>		<u>More than one competitor</u>		<u>Top three types of tax-exempt competitors^b</u>	
		<u>number</u>	<u>percent</u>	<u>number</u>	<u>percent</u>	<u>number</u>	<u>percent</u>	<u>organizations</u>	<u>percentage of respondents</u>
Audio-visual	356	128	36	25	7	203	57	University or college - public	63
								Government - state or local	52
								University or college - private	43
Racquet sports	462	47	10	89	19	326	71	YM/YWCA or YM/YMHA	85
								Recreational/health/sports/ fitness club	65
								Hospital	41
Research and testing	215	34	16	4	2	177	82	University or college - public	79
								Government - state or local	60
								Research organizations	56
Tour	28	16	57	1	6	11	39	Religious organizations	60
								University or college - public	56
								Business or professional association	55
Travel agent	7,349	4,016	55	472	6	2,861	39	Religious organizations	67
								University or college - public	63
								Social/fraternal organization	60
Veterinarian	18,444	7,191	39	3,733	20	7,520	41	Human or animal welfare organization	60
								Government - state or local	24
								University or college - public	15

Source: GAO questionnaire data

^aPercentage have been rounded to the nearest whole number.

^bTypes of tax-exempt organizations perceived to compete to a moderate, great, or very great extent with questionnaire respondents over past 6 years (1980 - 1985).