The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*

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Introduction

Although most types of nonprofit corporations have been exempted from the federal corporate income tax since that tax was first adopted,[1] we continue to lack a clear rationale for the exemption. This was perhaps understandable and acceptable when the nonprofit sector was small and nonprofit organizations were engaged largely in activities of a traditionally charitable nature. Today, however, the nonprofit sector represents a substantial and growing share of the national economy.[2] Large concentrations of nonprofits can be found in a number of vital and expanding service industries, including education, health care, research, the media, and the arts. Nonprofit firms now commonly provide goods and services in direct competition with profit-seeking firms, and in many cases increasingly resemble their for-profit competitors in their manner of organization and operation.[3] The traditional criteria for applying the exemption are, as a result, being stretched beyond recognition, so that the absence of an underlying rationale for those criteria, and indeed for the exemption in general, is becoming increasingly conspicuous. To be sure, various efforts to

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1. *See* Bittker & Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J. 299, 301 (1976).

2. The best data available, which are not very good, suggest that the nonprofit sector today accounts for roughly 3% of GNP, compared to just over 1% fifty years ago. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 835 n.1 (1980).

3. This is true, in particular, of "commercial" nonprofits, such as nursing homes, day care centers, hospitals, and publications, which are discussed at p. 59 *infra*. *See* Hansmann, *supra* note 2, at 862-68.