INDEPENDENT SECTOR

Tax Credit Fairness for Nonprofit Employers

Critical Employers, Unequal Tax Code

Nonprofit organizations are the foundation of American democracy — places where people come together to solve problems, trusted partners for government leaders, and anchors in their local communities. In the course of doing this essential work, they create a massive economic impact.

In fact, over 10 percent of the private workforce in the United States is employed by a nonprofit organization, making it America's third-largest employment sector. And, despite their "tax-exempt" status, nonprofit organizations pay an estimated $65 billion each year in payroll taxes.[1]

Yet, these major employers and economic contributors are excluded from a wide range of employer incentives delivered as tax credits that are made available to for-profit employers — simply because they are tied to the federal income tax.

Proposal: Treat Nonprofit Organizations Fairly

Nonprofit employers who take the same beneficial actions envisioned by Congress to hire and invest in workers should have access to the same tax incentives as their for-profit counterparts. In addition to correcting this fundamental unfairness, giving nonprofits access to these tax credits would boost the underlying policy goals by reaching a new and significant portion of the workforce.[2]

Congress has taken important steps toward recognizing this disparity in recent years. As examples, the Employee Retention Tax Credit in 2020 and 2021 was structured as a credit against payroll taxes, and the R&D tax credit allows qualified small businesses to offset the credit against payroll taxes. In addition, one portion of the Work Opportunity Tax Credit is available as a credit against payroll taxes of nonprofit employers that hire veterans. Policymakers wisely chose to structure these incentives in a way that reaches the broadest swath of employers as possible.

The following federal tax incentives — currently available only to organizations that pay income tax — should be made available to eligible nonprofit organizations:

- Employer-Provided Childcare Credit (Section 45F)
- Work Opportunity Tax Credit (expanded to all hiring categories, Section 51)
- Employer Credit for Paid Family and Medical Leave (Section 45S)
- Indian Employment Credit (Section 45A, expired)
- Small Employer Pension Plan Start-Up Cost and Automatic Enrollment Credits (Sections 45E, 45T)
- Disabled Access Credit (Section 44)

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[1] Calculation provided by the National Center for Charitable Statistics at the Urban Institute.

[2] While this proposal only addresses tax credits, the nonprofit workforce faces other tax fairness issues, including the discrepancy between the standard rate when calculating deductible costs of using an automobile for business purposes (currently 65.5 cents/mile) versus charitable purposes (14 cents/mile).

While there are various ways to accomplish this work legislatively, policymakers would do well to build on the bipartisan model of current incentives by allowing these credits to be applied against payroll tax liability for nonprofit employers. This treatment would recognize that nonprofit employers do pay taxes and can be effective participants in these workforce incentives Congress created to increase hiring and expand benefits for workers. To underscore the power and importance of such an initiative, more detail about each of these credits follows.

Six Key Incentives Enhanced by Nonprofit Employer Participation

Employer-Provided Childcare Credit (Section 45F)

The credit for childcare expenses serves as an incentive for employers to provide childcare for their employees. It is equal to the sum of 25 percent of the qualified childcare expenses to build or operate an onsite childcare facility or contract with a qualified offsite childcare provider, plus 10 percent of the qualified referral costs. The credit is capped at $150,000 per year.[3]

Access to affordable childcare is one of the major issues confronting the nonprofit sector's workforce, of which 67.3 percent are women, compared to 47.1 percent in the overall workforce.[4] Studies continue to show that the lack of adequate childcare for employees, particularly women of color, has been an impediment to the recovery of the workforce after the pandemic. **Nonprofit organizations should be allowed to claim the Employer-Provided Childcare Credit.**

Work Opportunity Tax Credit (Section 51)

The Work Opportunity Tax Credit (WOTC) is available to employers for hiring individuals from targeted groups who have traditionally faced barriers to employment. In general, the WOTC provides up to $2,400 to an employer during the first year they employ an individual who is certified as being a member of a targeted group. Qualified target groups include families receiving TANF benefits, qualified veterans, qualified ex-felons, SNAP recipients, SSI recipients, long-term unemployed, and more. Currently, nonprofit organizations are only eligible to claim WOTC for hiring qualified veterans – one of the 10 targeted groups.

Given their work and missions, nonprofit organizations already engage deeply with individuals in each of the 10 groups targeted by WOTC. Incentives for employment of such individuals could provide yet another powerful way for nonprofits to make a difference. **Nonprofit organizations should be allowed to claim WOTC for all 10 targeted groups, as they also hire individuals from these targeted groups.** Given the small size of many nonprofit organizations, steps to streamline the WOTC certification process may reduce the paperwork burden and improve nonprofit participation.

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[3] This credit requires that at least 30 percent of enrollees are dependents of employees if the facility is the "principal trade or business" of the taxpayer. This is likely inapplicable to most nonprofit providers, given their diverse missions, but may need clarification.

[4] https://independentsector.org/resource/health-of-the-u-s-nonprofit-sector

Employer Credit for Paid Family and Medical Leave (Section 45S)

Employers that provide paid leave can claim a credit of up to 25 percent of wages paid to qualifying employees while they are on a qualifying family or medical leave for up to 12 weeks. Qualifying employees must earn less than a certain salary ($81,000 in 2022) and have worked for the employer for at least a year. Qualifying employers must have a written family and medical leave policy in effect and may only claim the credit for leave provided above state or local legal requirements.

Attracting and retaining employees is a longstanding challenge for nonprofit employers, and it is made more challenging when only the leave policies of for-profit counterparts are subsidized through the tax code. In a workforce that is over two-thirds female, paid leave has even greater importance. **Nonprofit organizations should be allowed to claim the employer paid family and medical leave credit.**

Indian Employment Credit (Section 45A, expired)

The Indian employment credit provides up to $4,000 annually to employers who hire enrolled members of an Indian tribe or their spouses who work on an Indian reservation and live on or near a reservation. It can only be claimed for employees earning less than $50,000 annually.

This credit expired at the end of 2021 along with numerous other tax extenders, but could be restored through future legislation. **Nonprofit organizations should be allowed to claim the Indian Employment Credit.** Additionally, we stand with the National Congress of American Indians and others in calling for tribal government employers to be eligible for this credit.[5]

Small Employer Pension Plan Start-Up Cost and Automatic Enrollment Credit (Sections 45E and 45T)

Employers with generally fewer than 100 employees can receive a tax credit for start-up costs of establishing new retirement plans, including plan administration and employee education. These employers can claim a credit for 50-100 percent of pension plan start-up costs, up to $5,000 annually for three years. These employers can also claim a credit of $500 annually for the first three years in which they include an automatic enrollment feature to their plan.

Attracting and retaining employees is a longstanding challenge for nonprofit organizations, and it is made more challenging when only the retirement plan start-up costs of for-profit employers are subsidized through the tax code. The Government Accountability Office finds that small employers cite high start-up costs as a deterrent to establishing retirement plans[6]. This observation is likely disproportionately true in the nonprofit sector, where 90 percent of nonprofits employ fewer than 100 workers[7]. **Nonprofit organizations should be allowed to claim the Small Employer Pension Plan Start-Up Cost Credit and the Automatic Enrollment Credit.**

[5] https://archive.ncai.org/resources/resolutions/equitable-treatment-for-tribal-nations-in-congressional-tax-reform
[6] https://www.gao.gov/products/gao-15-556
[7] https://www.bls.gov/bdm/nonprofits/nonprofits.htm

<u>Disabled Access Credit (Section 44)</u>

The Disabled Access Credit provides 50 percent reimbursement up to $5,000 each year for small employers that incur expenditures providing access to persons with disabilities. An eligible organization must have less than $1 million in annual gross receipts or fewer than 30 employees. Expenses for complying with the Americans with Disabilities Act (ADA) are eligible, including the cost of removing physical barriers and providing audio- or visual-assistance materials.

As organizations whose missions depend on serving the public, nonprofits have a special responsibility to be accessible to all. For organizations that occupy older buildings, or for those with ongoing accessibility costs for their audiences, the cost of ADA compliance can be significant. **Nonprofit organizations should be allowed to claim the Disabled Access Credit.**

Conclusion

Every day, nonprofits provide housing, health care, nutrition, workforce development, education, disaster relief, cultural inspiration, spiritual guidance, environmental conservation, and any number of other essential services in their community. Yet, while their mission may be their focus, the economic and employment impact of nonprofits is undeniable.

Nonprofits face significant hiring, employee benefits, and worker training and retention issues and bear substantial costs as employers, but are unfairly excluded from various employment and worker incentives. Recognition of this simple fact through the tax code is long overdue.

Both workers and the nonprofit sector would greatly benefit if Congress extended these key employment-related tax credits to nonprofit employers to better meet their goals. These incentives could be easily extended to nonprofit employers through a payroll tax credit to level the playing field and enhance these incentives.