NONPROFIT REVENUE

Donation Cannibalization

When nonprofits earn taxable income, private donors give less

Revenues from taxable sales activities are the fastest-growing percentage of nonprofits' income. A recent study, however, suggests that income from such sales discourages private donations, thus significantly reducing the net gain.

"If a nonprofit thinks it's going to earn [additional income] through taxable activities, it needs to be very careful," said Robert Yetman, co-author of "The Effect of Nonprofits' Taxable Activities on the Supply of Private Donations," published last March in the *National Tax Journal*.

He and fellow researcher Michelle Yetman, both with the University of California, Davis Graduate School of Management, found that profits on taxable sales – sales outside the nonprofit's primary mission – to a significant extent cannibalized revenues from donations. (Examples of taxable sales include advertising revenues tied to nonprofits' publications and hospital pharmacy sales to nonpatients.) The researchers analyzed the 1995 Internal Revenue Service data of donations and taxable sales from a sample of 1,750 nonprofits. These nonprofits had reported taxable income in 1995 to the National Center for Charitable Statistics (NCCS), whose database includes all nonprofits with assets of at least $10 million, and a sampling of smaller organizations.

Looking at the effect of taxable sales income on subsequent donations, the authors found that every dollar earned by arts, culture, and humanities organizations crowds out 59 cents in donations. Every dollar earned by human services and public benefit organizations crowds out 55 cents in donations.

Prior research offers a mixed picture on the relationship between private donations and alternative funding sources, such as government grants and income from sales. If donors believe that these alternative sources are substitutes for their own gifts, it may crowd out donations; if donors believe that their gifts will complement these alternative sources, it may encourage donations.

Sure enough, the researchers found no crowding-out effect for educational or medical nonprofits. It is possible that donors believe that their gifts complement these sales revenues, or that the donors to these organizations are less sensitive to taxable activities. It may also be that the donors' likelihood of giving is not based upon an organization's financial resources. For instance, donors may contribute to a hospital based upon treatment they experienced there, rather than a review of financial data.

On average, donations comprise more than 30 percent of total revenues for arts, culture, and humanities organizations, while taxable revenues make up only 3 percent. Human services and public benefit organizations earn more than 20 percent of total revenues from donations and 4 percent from taxable sales. Medical nonprofits, in contrast, rely primarily on tax-exempt sales, while donations make up 3 percent of total revenues and taxable sales make up 1 percent.

The negative impact on donations was particularly striking for certain types of nonprofit activities. For arts, culture, and humanities organizations, there is a particularly large negative relationship between donations and advertising revenues: For every dollar earned by a nonprofit through taxable sales of advertising, donations drop by $1.74. –*Andrew Nelson*

LOSS IN DONATIONS DUE TO TAXABLE SALES

(Loss for every $1 in taxable sales)

	Donations
Arts/Culture/Humanities Organizations	$0.59
Human Services/Public Benefit	$0.50
Medical nonprofits	No change

DONATIONS GREATLY OUTWEIGH TAXABLE SALES

(Percent contribution to total revenues)

	Donations	Taxable Sales
Arts/Culture/Humanities Organizations	30%	3%
Human Services/Public Benefit	20%	4%
Medical nonprofits	3%	1%