Politics & Policy

Tax the Wealthy and Their Charities Will Suffer

Nonprofit organizations would probably get more donations but become less efficient.

By Tyler Cowen
November 21, 2019, 2:00 PM GMT+1

Pre-wealth-tax art lovers. *Photographer: Nicholas Hunt/Getty Images North America*

America's corporate economy has long been divided between a taxed, for-profit sector and a non-taxed, not-for-profit sector. This division has significant implications for tax policy: To wit, if the wealth gained from for-profits is penalized, the nonprofit sector will also suffer.

Consider the wealth taxes that have been proposed by Elizabeth Warren and Bernie Sanders. Even an apparently modest annual wealth tax of 2% could, applied cumulatively, erode most of the value of an asset over a few decades. In response, billionaires won't be so keen to hold those assets in their personal portfolios; they may decide to place more of them in their personal foundations and in donor trusts.

If those institutions are taxed as well, billionaires can simply give more money to nonprofits. Either way, significantly more resources will end up in nonprofits. The size of the nonprofit sector will dramatically increase.

So far, so good, right? Not necessarily. Many nonprofits are inefficient, have poorly defined goals and lack accountability. In this new world, they also would be spending more time and money chasing after donor dollars.

Nonprofit institutions already receive significant subsidies through the tax system: Not only are donations tax-deductible for many donors, but nonprofits do not typically pay tax on net income or property taxes on land. Applying confiscatory tax rates to capital asset values would make the value of that subsidy far greater.

As someone who has worked his entire life in the nonprofit sector, I appreciate (and benefit from) the tax deductibility of donations. But I don't think the subsidy should be extended beyond that.

The effects of pushing wealth out of the for-profit sector would be far-ranging. Wealthy donors might be more likely to pressure nonprofits for luxury consumption experiences, for example. Many nonprofits sponsor cruises to Alaska or the Caribbean for their donors, as a method of fundraising and also for building good will and networking. There's nothing inherently wrong with that. But the pressures would rise for those cruise experiences to be much more luxurious – think freshly caught sushi, Rolling Stones concerts and private butlers.

In essence, the nonprofits would be used to re-create private consumption experiences, but in non-taxable form. This is not a healthy scenario for America's nonprofit institutions.

One response, of course, could be for the government to regulate nonprofit institutions more stringently to limit such abuses. Maybe that would happen, but such regulation would inevitably become absurdly complex, if not downright absurd. How would it be defined and enforced – in other words, just how much is that sushi worth? What would happen to anonymous donations? What would be the costs of compliance for nonprofits? There is also the danger that such regulation would be enforced in a partisan manner, depending on the ideological stance of the nonprofits in question. Again, it seems better simply not to go down this path.

Or imagine how art markets might be affected by a wealth tax. Rather than keeping their art collections private, many more billionaires would donate that art to museums and other nonprofits. This appears to be a good outcome. But it would exacerbate one of the art world's worst problems, which is inflated appraisals for tax purposes. At any rate, America's museums do not have the space or resources to display and look after all of these paintings and sculptures; it is already common for a museum to display no more than 5% or 10% of its collection.

Essentially, a lot of art would be removed from circulation, stored in warehouses largely for tax reasons. Along the way, Christie's and Sotheby's might go bankrupt, as well as many art galleries, as the demand to buy art would plummet. You may think that the demise of a few galleries and auction houses is a small price to pay to reduce wealth inequality. But consider that artists, too, need to make a living.

And all of this is considering only the wealth tax and its particularly striking effects. There are other tax-law decisions that affect the nonprofit sector. If the U.S. restores the corporate income tax rate to what it was before 2018, for example, it could induce more hospitals to switch back to a nonprofit status – to lower their tax burden. That might not be good for patients, since over time for-profit hospitals have proved to be more effective competitors, while nonprofits do not do a significantly better job caring for the poor.

The U.S. has created the most dynamic and effective nonprofit sector in the world. It rests on a delicate balance of private support and some indirect (not too much) government subsidy. America interferes with that balance at its peril.

This column does not necessarily reflect the opinion of the editorial board or Bloomberg LP and its owners.

To contact the author of this story:
Tyler Cowen at tcowen2@bloomberg.net

To contact the editor responsible for this story:
Michael Newman at mnewman43@bloomberg.net

Tyler Cowen is a Bloomberg Opinion columnist. He is a professor of economics at George Mason University and writes for the blog Marginal Revolution. His books include "The Complacent Class: The Self-Defeating Quest for the American Dream."