

The Rationale and Ethics behind Non-Profit Organizations Being Exempt from Tax

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Abstract

The current research paper is prepared to explain the rationale and ethics behind the tax exemption of non-profit organizations. The main purpose of this paper is to explore the understanding of such exemption discussed in various studies. The topic is interesting and attractive to find out the reasons for tax exemption for a non-profit organization to realize its importance. The requirement is to find out the reasons from relevant literature to ensure completeness in this research paper. The overall findings in the current study have clarified that tax exemption for non-profit organizations is essential to mitigate any threat in the future. The research indicates that non-profit organization work according to the welfare policies and rules set by the government. The support of government is mandatory to promote and motivate such welfare practices. Although the revenue budget of the government may face critical issues due to this action, the practices of welfare and well-being should be continued in the same manner. The government authorities should offer further relief to such organizations that they can reduce the financial issues in the long run.

Keywords: Non-profit Organizations, Tax Exempt, Ethics

Jel Codes: M40, H2, L3

1. Introduction

Tax is considered important in today's modern competitive environment. Every organization specifically consider this element in the decision-making process. However, non-profit organizations are exempt from taxes, as their primary objective is not profitability. Although they may earn income which is considered as surplus, the income is not taxable. The main motive of a government is to give relief to such organizations and promote charitable role in society. Non-profit organizations include religious, scientific, or public safety institutions with specific purposes. Therefore, a government provides an exemption to such organizations that they are not liable to pay taxes.

The current research paper is prepared to explain the rationale and ethics behind the tax exemption of non-profit organizations. The main purpose of this paper is to explore the understanding of such exemption discussed in various studies. The topic is interesting and attractive to find out the reasons for tax exemption for a non-profit organization to realize its importance. The requirement is to find out the reasons from relevant literature to ensure completeness in this research paper.

The design of this research paper is simple to extract relevant information from different scholarly sources. The next section of this research paper is a literature review, which consists of findings from various scholarly sources. The methodology adopted for this research paper is to collect and analyze the extracted information. The secondary approach is essential to achieve the objective of this research paper. The third section of this report comprises of the discussion on the findings from the literature review. The last section is the conclusion that summarizes the findings to show a clear and concise view.

2. Literature Review

The current section is the main part of this research paper that comprises of two important discussions. The first portion is definitions of key terms used in this research to make it clear and understandable. The next section comprises of different past studies that discuss various concepts and claims observed and noticed by authors.

Three different key terms are discussed in this section to show a clear and concise view in this literature review section.

2.1. Non-Profit Organizations

Non-profit organizations are non-business entities as they do not work for profit or earnings (Barbara Yasmin Lodge, 2017). It may include hospitals, welfare centers, educational centers, or religious centers, etc. (Ely and Calabrese, 2017). Many non-profit organizations are managed and controlled by a government to ensure the welfare and progress of society (Hojiev, 2017). However, it is not essential that only government authorities can run this type of entity (Feng and Others, 2019). Individuals or group of individuals can run such organizations but not for profit.

2.2. Tax Exemption

Tax exemption refers to entities that are exempt by laws not to pay taxes on any gain or surplus (Basri and Khalid, 2020). A government specifically or generally mentions the category of entities that are not required to pay the proportion of income to the government (Grigsby, 2018). The main reason for such exemption is to appreciate or promote such organizations to work without any hesitation (Zheng, 2018).

2.3. Public Welfare and Interest

The term of public welfare and interest relates to government or state practices to work for citizens (Brescia and Others, 2019). A government is responsible for protecting the interest of the public by preparing policies and rules to facilitate citizens (Hojiev, 2017). It is the main reason that government exempts taxes to non-profit organizations that they work for the welfare of society.

2.4. Past Studies

Baglioni, De Pieri, and Tallarico (2017) explain that the role of non-profit organizations was crucial in achieving the goal of a government in Germany and Italy. The findings of the study showed that the practices of such non-profit organizations resulted in the success of the government. Chaiyachati, Qi, and Werner (2018) also elaborate that spending on hospitals is required to reduce health issues in society. The exemption of tax is based on the health and well-being of citizens to minimize their problems. Barragato (2019) also supports the argument by claiming that the tax exemption of non-profit organizations is essential to ensure the progress of the society. Although the accountability and transparency of such organizations is mandatory, the tax exemption policy should be followed accordingly.

De Los Mozos, Duarte, and Ruiz (2016) explain requirement of tax exemption for non-profit organizations in a different manner. Non-profit organizations mainly raise funds to run their institutions. If such organizations are required to give revenues to the government, it is not possible to achieve the goal of fundraising. Kelley and McLaughlin (2017) also support the argument by claiming that non-profit entities are entitled to get tax exemption. A government promotes fundraising organizations to increase their practices for the welfare of all stakeholders. Khorin, Brovkin, and Potanina (2018) argue that non-profit organizations also contribute substantially to the economy of a country. Government support is mandatory to maintain consistency in their operations, and the authorities exempt taxes to such organizations to appreciate and motivate them.

Kim, Oh, and Kim (2018) present the findings of Korea that the government offers tax benefits to non-profit organizations to transfer the ultimate benefits to the public. The Korean government takes needful steps to benefit its citizens. Lamboy-Ruiz, Cannon, and Watanabe (2019) also support the argument that the government prepares policies to ensure improvement in welfare. The community benefits are considered important in bringing improvement in the overall society or country. Nwabachili and Obi-Ochiabutor (2020) explain the difference in tax exemption laws of Nigeria, the US, and the UK. The appraisal is noticed in the case of each country to give more benefits to non-profit organizations.

Manny (2017) criticizes the argument of tax exemption to non-profit organizations by elaborating that governance issues are common in such organizations. Although governments try to overcome the issues by implementing various policies, tax exemption is the relief to promote welfare services. Martin and Todd (2018) elaborate that tax deduction is allowed in charitable works to promote such activities in the city. The deductions are allowed in the United States and Australia that are considered important in reducing the issues. McMillan (2020) supports the argument of Manny (2017) that non-charitable organizations should not have the facility of tax deduction.

Stratmann (2017) state that sales tax exemption is allowed to various food aid providers in a country or city. Non-profit organizations are entitled to get relief on sales tax and promote welfare services within the territory. It is the prime responsibility of a state or country government to ensure the consistent improvement in welfare and well-being related services. Therefore, non-profit organizations work on this general rule to support the government in achieving its long-term goals. Michalski and Others (2018) claim that accountability is the main issue for the Polish government to promote the practices of non-profit organizations in the country. The increasing issues of governance and management within such organizations have created hurdles for the government to give tax exemptions. The lack of consistency in managing and preparing goal-oriented policies for all organizations is the main reason for increasing issues. Netzer (2020) also supports the claim by explaining that non-profit organizations work according to the culture of a country. The promotion of culture is important to manage the norms, values, and other cultural practices.

Schoenfeld (2017) criticizes the argument by explaining that tax exemptions are allowed to religious organizations. However, few countries or state do not allow such exemptions to religious organizations that create issues and challenges for a government. The promotion of religious organizations is also mandatory to protect the basic right of worship of people living in a country. Verulava, Jorbenadze, and Dangadze (2018) claim that the role of non-profit organizations is essential in a healthcare system to avoid negative impacts on the economy. A government should continue to support the healthcare providers in the city or state that they should work consistently on bringing improvement in the healthcare system.

Basri and Khalid (2020) also claim that accountability issues are common in non-profit organizations. The issues require special treatment from tax authorities to smoothen the operations. The combined efforts of government authorities are also crucial to mitigate the challenges of non-profit organizations. Netzer (2020) also elaborate that the authorities should promote cultural and religious practices within the country to achieve the goal of welfare and well-being of people. Therefore, a government should provide complete support to such organizations that they can contribute their part in the overall progress of a country.

De Los Mozos and Others (2016) state that a government should have potential control over resource utilization. The utilization of resources is workable only when a government gives tax exemption to cultural and religious organizations. They should have proper funding that can be used to acquire new resources for long-term growth. Feng and Others (2019) criticize the findings of De Los Mozos and Others (2016) by claiming that there should be accountability and transparency in all organizations. The tax exemption policy should be well-defined for all non-profit organizations, and they should be accountable for their related practices to claim for such exemption.

Kim and Others (2018) state that non-profit organizations work on behalf of the government to support the public. The tax benefit to them means that the government is improving its activities to fulfil the responsibility towards the public. The benefit should be provided to such organizations that they should continue their welfare practices without any disturbance. The role of government authorities is crucial in reducing the challenges to these non-profit organizations. Lamboy-Ruiz and Others (2019) also supports the argument that community or society benefits should be considered important. The benefits to the non-profit organization will ultimately result in a benefit to the government in achieving the goal of prosperity and growth. The overall productivity of the economy will open in this way, which will open new doors for the government. The ethical dilemma in this activity is that it will become easy for the government to make effective policies and rules regarding the welfare of people. Nwabachili and Obi-Ochiabutor (2020) also support the argument that the role of non-profit organizations is crucial for a government to implement a policy for the welfare of people. Non-profit

organizations work according to the guidelines and rules set by the state authorities to mitigate the challenges for the government.

Basri and Khalid (2020) criticize the claim that tax exemption should be based on performances of non-profit organizations. The factor of accountability and transparency is important to determine whether the tax should be exempted or not. The deduction should be allowed on the past performance of an organization. The taxation authority should keep in view the track record of the organization to make the decision of exemption. Netzer (2020) criticize the previous findings by claiming that tax exemption is based on the rules and laws prepared by the government. In simple words, the taxation authorities should carefully review and assess whether the exemption is according to the defined rules, and suits to the long-term objectives of the country.

Manny (2017) elaborates that non-profit organizations should consider governance issues to prepare accounts for tax exemption. The main requirement is to assess whether the governance issues are attributed to the policies and rules set by the government or not. The decision of tax exemption should be based on evaluating all legal aspects in a specific context to grant a tax exemption or reduction. Martin and Todd (2018) also claim that tax credits should be given to non-profit organization based on their performances in reducing the issues of the government. The main concern of these organizations should be like that they act as an agent of the country's authority to remain consistent on their mission and objectives.

3. The Rationale and Ethics behind Non-Profit Organizations Being Exempt from Tax

Non-profit organizations work according to the guidelines set by the state or country authority. The primary objective of these organizations is to protect the interest of all stakeholders without creating any discrimination. The requirement is to promote such organizations in a way that the government should ensure a backup for them (Chaiyachati, Qi and Werner, 2018). The concept of ethics arises in this situation that such organizations should have the leverage to work for the betterment of society. The reason is to give motivation to such organizations that they should continue working for the welfare of the public (Feng, Neely and Slatten, 2019). Three important benefits in support of the argument of tax exemption of non-profit organization is presented in this section.

3.1. Monetary Benefits

Tax exemption creates easiness for a non-profit organization to utilize the income uniformly. In the case of a surplus, the tax relief to such organizations increases the funds of such organizations to further utilize them (Kelley and McLaughlin, 2017). The monetary benefits are important to reutilize the excess of funds for the welfare of people. Therefore, monetary benefits have a high value for a government to maintain stability in welfare practices. The increasing monetary benefits enable the leaders of non-profit organizations to strengthen their operations and support the government.

The benefits of tax exemption are not limited to income taxes, but the government also offers tax relief for food aid organizations. The government is responsible for providing basic rights to its citizens (Manny, 2017). Non-profit organizations give exclusive supports to the government in reducing the issues of poverty and inflation in the country. The monetary benefit provides financial support to such organizations in mitigating the challenges and issues that may come forward in their routine operations.

3.2. The motivation for Non-Profit Organizations

The motivation and appreciation of non-profit organizations are essential to increase the morale of employees (Khorin, Brovkin and Potanina, 2018). The employees should have financial and moral support from the leaders of their organizations to mitigate the challenges of life. Most of the workers in a non-profit organization work voluntarily or for the sake of humanity. They receive salary that they may be proud of, and they should have such appreciation. Therefore, the motivation and appreciation of such hardworking employees are essential that they should remain proud of their work.

The talented and experienced workers in a non-profit organization require recognition and award to bring improvement in their respective jobs. The employees working at different levels maintain consistency in their operational activities if they receive full support from the management of their organizations. The management also looks for such support from the government to give a tax relief that they can be efficient and productive in their work (Lamboy-Ruiz, Cannon and Watanabe, 2019). The support and backup of a government requirement to reduce the issues and challenges for all non-profit organizations working in return for appreciation and recognition.

3.3. Promotion of Welfare Practices

A government work for the welfare and well-being of people living in a city or state. It is the implied ethical duty and responsibility of an organization to promote such practices (Khorin, Brovkin and Potanina, 2018). The promotion of such practices is essential to reduce the challenges faced by various citizens. The promotion of welfare practices has a high significance in the world to work for the sake of humanity (Barragato, 2019). A government requires the support of such welfare organizations to overcome the economic and social challenges in the city or state.

Non-profit organizations act as an agent of a government to protect the interest of all stakeholders. A government prepares policies and guidelines for welfare organizations that they should follow them in the same sense (Grigsby, 2018). The leaders of non-profit organizations are required to prepare a strategic framework to promote such welfare practices. The non-availability of tax credit creates issues for such organizations to continue welfare practices. Therefore, the requirement is to manage the operations in such non-profit organizations. The leaders of a non-profit organization should manage and control the operations in a systematic manner to reduce future challenges.

4. Conclusion

The overall findings in the current study have clarified that tax exemption for non-profit organizations is essential to mitigate any threat in the future. The research indicates that non-profit organization work according to the welfare policies and rules set by the government. The support of government is mandatory to promote and motivate such welfare practices. Although the revenue budget of the government may face critical issues due to this action, the practices of welfare and well-being should be continued in the same manner. The government authorities should offer further relief to such organizations that they can reduce the financial issues in the long run.

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