NEWH

The Hospitality Industry Network

Tax Exempt . . . What Does It Mean

So many times the question arises "being that NEWH is a tax exempt organization, do we have to pay sales tax?"

We received our tax exempt status from the IRS, a division of the Federal Government. The definition of tax exempt is: Not subject to taxation, as the capital or income of a philanthropic organization. In other words, all income that is derived under and related to our 501(c) (3) status is exempt from being taxed as your personal or business income is taxed. Any unrelated income that NEWH would generate would be taxable.

Being that sales taxes are a state function, our federal status has no relevance as to whether you will be paying taxes on items or services purchased. All chapters must be registered with the state that they are operating in order to have a non-profit status in that state. Once you are registered, you may then apply to the state to receive an exemption from paying state sales taxes.

Can a nonprofit make a profit?

It may sound like an oxymoron, but it is acceptable — even desirable — for a nonprofit to make a profit (although nonprofits usually use the terms ***surplus*** or ***net revenue***). Not everyone understands or agrees with this, and some people believe that nonprofits should spend every penny they generate immediately in pursuit of their charitable mission. Many nonprofits do just that, and many others actually spend more than they take in and operate at a deficit. In a recent NCNB survey of more than a thousand nonprofits, nearly 20 percent reported an operating deficit in their most recent fiscal year.

For many reasons, operating a nonprofit at a deficit is bad policy. The most successful and responsible organizations find ways to generate an annual surplus and build up a reserve fund to insulate the organization from the inevitable ups and downs that any nonprofit faces. Donors sometimes fail to pay up, governments unexpectedly terminate contracts, direct mail solicitations generate far less income than expected and unforeseen events can cause increased demand for programs and services. To survive these unpredictable changes, most nonprofits need a reserve fund, and the easiest way to build such a fund is to operate at an annual surplus, generating net revenue, which can then be added to reserves. A healthy reserve fund also gives a nonprofit the flexibility to research and develop new programs and to respond to sudden opportunities or emergencies.

Determining whether operating to generate a surplus is appropriate is a question nonprofit boards and chief executives answer by looking at the nature of their mission. Although generating a surplus may be wise for organizations that intend to operate over the long haul, it may be inappropriate for organizations with short-range goals or those that have nearly accomplished their missions.

What distinguishes nonprofits is not whether they can make a profit, but what happens to profits. A for-profit company that generates net revenue can choose to distribute those profits to owners and shareholders, executives, and employees. Nonprofit organizations, in contrast, are non-profit-distributing; they do not exist to earn money for owners and shareholders (there are none) or employees. In fact, distribution of profits — termed private inurnment in the nonprofit world — is strictly prohibited. This distinction, not the ability to generate a profit, is a major difference between nonprofits and businesses.