

# TAXATION OF NON-PROFIT ORGANIZATIONS IN THE SELECTED EUROPEAN COUNTRIES: THE PROPOSAL OF THE CHANGES FOR THE CZECH REPUBLIC

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## Abstract

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The paper is focused on the issue of taxation of income of non-profit organizations, especially to associations (clubs) in the Czech Republic, Slovakia and the United Kingdom. This paper is part of research, where the main emphasis is placed on the comparison of the tax benefits which are provided to non-profit organizations in different countries. This paper points to the current situation in the Czech Republic where despite the changes that have occurred in connection with the new Civil Code, there is still missing clear legislation that would regulate the activities of the monitored organizations. Changes in the taxation of income of non-profit organizations are designed with regard to the elimination of deficiencies in order to prevent the abuse of the benefits and the speculative behavior of tax entities.

Keywords: non-profit organization, corporate income tax, civic association, non-profit sector

## INTRODUCTION

Non-profit organizations hold an important position in every society. They are an indicator of the development of civil society and are often the initiators of social changes, as stated Stejskal (2012). The reason for the existence of non-profit organizations is clear from the provision of the Charter of Fundamental Rights and Freedoms. The charter states that everyone has the right to associate in societies, associations, companies and different types of organizations. This association is not limited by age or citizenship. Both natural and legal persons can associate (Kočí *et al.*, 2012). As state Neziskovky. cz (2012), Non-governmental organizations (2014) and the NCVO (2013), altogether 81,720 non-profit organizations were recorded in the Czech Republic, 44,186 in the Slovak Republic and 171,074 in the UK in 2012. Further, as state Third Sector Foresight (2013), the largest growth of the non-profit organizations has been recorded in the UK since 1960. Non-profit organizations are not formed

or established primarily to make profits (however these organizations cannot be necessarily always non-profit). In addition to the main mission of the organization there is often performed secondary (business) activity in order to assess the resources and obtain resources for main activities, i.e. activities resulting from their mission. Secondary activity should always be profitable and serve mainly to cover the loss from main activity. Non-profit organizations are not therefore established for profit, despite this fact they are liable to taxation in the majority of the countries. Afterwards they have some tax benefits in form of tax exemptions, reduction of tax base, deductible items from the tax base, etc. In the Czech Republic there have been long discussions about the taxation of non-profit organizations, especially because of the lack of legal definition and terminology, which would govern the activities of these organizations. This conceptual inadequacy has been partially removed in connection with the validity of the new Civil Code,

which significantly affected the regulation of non-profit organizations and therefore also associations. In this connection there was cancellation of Law No. 83/1990 Coll., on association of citizens. All the citizen associations have been considered since 1. 1. 2014 as associations and are governed according to the Law No. 89/2012 Coll., The Civil Code. The main activities of the association can only be the satisfying and protecting the interests for which the association is based. Business activities or any other gainful activity must not be the main activity. The association may also have the business activity, i.e. business or other gainful activity, its purpose is, of course, to support the main activity. Profit is used solely for the operation of the association or its management.

In the Czech Republic the tax benefits have been granted to all non-profit organizations till the end of 2013 only on the basis of their legal form, which raised some doubts, especially because of possible tax evasions. Since 2014 only those non-profit organizations, which are also beneficial taxpayers, are entitled to tax benefits. However the problem is the lack of definition of this term. The new Civil Code, which became effective on January 1, 2014, defines this term but the definition is very broad. This situation could, to some extent, change the discussed law on the status of public benefit that could bring a greater transparency in the non-profit sector, especially in associations that are the most common form of non-profit organizations in the Czech Republic. However, this law has not passed. Also in terms of the Income Tax Act, it is necessary to mention that its definition is insufficient. AVPO (2014) indicates on this issue that the status of public benefit could obtain the vast majority of currently existing non-profit organizations under the current liberal form of law. Boukal (2009) states that as transparent and efficient non-profit organization can be considered that, which from the perspective of the public has a good reputation, a clear goal, and community focus, has a transparent management, is capable of promotion and media coverage of its activities, has a wide circle of supporters, well-conducted fundraising and ability to raise funds for projects that are consistent with the mission and the objectives of the organization.

Taxation of non-profit organizations is still very difficult according to current regulations. The complexity in the field of corporate income tax lies in the liability to classify the incomes into groups and then assign costs to them to achieve, maintain and secure income. In the tax laws there are created conditions for the non-profit entities, which should be favorable for them in comparison with other taxpayers. However, the method that has been selected for the implementation of these provisions seems less convenient and ultimately brings

many complications to non-profit organizations. Corporate income tax is regulated by Act No. 586/1992 Coll. On the Income Tax Act (hereinafter referred to as ITA), as amended, in the Czech Republic. Non-profit organizations with the so-called narrow tax base, where associations belong, must strictly classify their incomes to:

- incomes subject to tax,
- incomes subject to tax, but exempt,
- incomes that are not subject to tax.

Generally incomes from all activities and incomes from management of all property are the subject of corporate income tax. In the case of non-profit organizations, namely in case of association, only those activities from which is reported a profit are subject to income tax with respect to income arising from their mission. In order to determine the tax base it is important to allocate the costs to the individual incomes, because non-profit organizations routinely creates costs that are related simultaneously to taxable and non-taxable income. Process of cost allocation is determined in an internal directive by non-profit organization as states Rektorík (2010). This fact is referred to as "keying of costs." Non-profit organization establishes a rule in the directive according to which are divided the total costs into the individual types of income. Multiplication of the not allocated costs and coefficient<sup>1</sup> is the one of the methods how to key the costs. It is also necessary to respect the other limiting condition, and to divide the costs and incomes to individual activities within a single type of activity, i.e. for individual events within a single type of activity, such as states Pelc (2010). Incomes from advertisement, membership fees, rentals and business activity are always liable to tax. Membership contributions according to directives, statutes or foundation deeds are exempt from tax. Incomes which are not generally liable to income tax and also incomes that are not subject to tax only in non-profit organizations falls into the category of incomes that are not subject to tax. In case of associations, the incomes from activities resulting from their mission are not subject to tax under the condition that costs incurred according to the ITA are higher, incomes from grants, subsidies for operations and other aid provided from the state, county or municipal budget under special legislation and other means specified in the ITA.

Status of public benefit has been discussed for very long period. It has not been defined in any law till the end of 2013 and unprofitability was assessed on the basis of the legal form of the legal person, as stated AVPO (2012). Since 2014 the public benefit has been defined under the new Civil Code. However this definition is very general. At the same there is no law on the status of public benefit, which would set out the conditions for its obtaining. The aim of the status of public benefit is to contribute

1 Proportion of taxable income to total income

to greater transparency and credibility of the non-profit sector in the Czech Republic. Non-profit organization that will apply for the status of public benefit will prove the performance of the public beneficial activities and fulfill other criteria such transparent management. These facts raise the necessity to define the public beneficial services. The non-profit organizations will be able to obtain tax allowances and support from public sources based on their objectives and activities that serve the common good on the basis of provided the status of public benefit. However, this presupposes in connection with the new Civil Code to introduce a new law on public benefit and also preparing changes in the tax laws. Partial changes in the field of income tax for the taxation of non-profit organizations has been valid since 2014, but for the taxation of associations remained unchanged.

## MATERIALS AND METHODS

The aim of this paper is to propose changes in the field of the taxation of non-profit organizations by the corporate income tax in the Czech Republic on the basis of the comparative analysis of the taxation of non-profit organizations in the monitored countries (United Kingdom, Slovakia, and Czech Republic). Changes will be proposed based on the identified advantages and disadvantages within the principles and techniques of taxation of non-profit organizations within the surveyed countries. The selection of the countries was made on the basis of continuation of the research, where Germany and Austria have already been examined, Otavová (2014). Slovakia was chosen because of the direct vicinity with the Czech Republic, and also based on the fact that it has a similar tradition of historical development. United Kingdom was selected with regard to the fact that it belongs to the Anglo-Saxon system. This is a state, which is, in many characteristics, different from the Czech Republic, which is part of the Continental System. Considering the broad definition of the term "non-profit organization", the paper will only deal with

the taxation of the non-profit organizations with the focus on associations (clubs). Based on the description and interpretation of Czech and foreign-language literature and tax laws of the surveyed countries there will be outlined the current state of the investigated issues. This information will be the starting point for a comparative analysis, through which the taxation of associations by the corporate income tax will be compared in these countries. Using the modeling there will be compiled examples and the purpose of modeling and model examples is to show the fundamental differences in the approach to the taxation of associations in the monitored countries in relation to the tax liability. Based on the synthesis the achieved findings will be combined into coherent results and recommendations will be established for the taxation of non-profit organizations in the Czech Republic.

## RESULTS

Based on the analysis of the tax laws of the surveyed countries there was carried out a comparison, which aims to summarize the most important differences in the taxation of associations by the corporate income tax. Comparison was made with regard to the taxation of associations in selected EU countries, particularly in the UK and Slovakia in comparison with the Czech Republic.

The table shows that the above mentioned types of income are not subject to tax or are exempt from tax in the monitored countries. In this respect it should be noted that the tax assignments are introduced only in Slovakia. Tax assignments are therefore additional possibility of funding of non-profit organizations, it is a direct public support. It is necessary to note that tax assignment is not the philanthropy, but it is tax redistribution with a share of direct decision-making by taxpayers. The funds collected will be a form of a state subsidy which is a subject to subsequent control of the state with regard to the using of tax assignment. Tax assignment brings a wide range of positives but also negatives,

I: *Individual types of incomes and their relation to the corporate income tax*

Income	Czech Republic	Slovak Republic	United Kingdom
Donations	Not subject to tax	Not subject to tax	Exempt from tax
Subsidies, contributions to operation	Not subject to tax	Exempt from tax	Exempt from tax
Membership contributions according to regulations	Exempt from tax	Exempt from tax	Exempt from tax
Tax assignments	Not implemented	Not implemented	Not implemented

Source: work of author on the basis of legal regulations

II: *Evaluation of the individual incomes with regard to their taxation*

Income	Czech Republic	Slovak Republic	United Kingdom
Income from advertisement	Yes	Yes	Exempt from tax
Income from rental	Yes	Yes	Exempt from tax
Income from capital asset	Yes	Yes	Exempt from tax

Source: work of author on the basis of legal regulations

## III: Comparison of taxation of the main and business activities of associations

Items	Czech Republic	Slovak Republic	United Kingdom
Taxation of incomes from the main activity	Yes/No	Yes/No	Exempt from tax
Taxation of incomes from business activity	Yes	Yes	Yes/Exempt from tax
Form of tax benefit	Deduction from tax base 10 933 EUR–36 443 EUR <sup>2</sup>	No	Yes in case of business activity
Deduction of tax loss from the tax base	Yes	Yes	Yes
Corporate income tax rate	19%	19%	20%, 23%

Source: work of author on the basis of legal regulations

## IV: Limitations for the exemption of incomes from business activities in UK

Total incomes	Limitations for exemption
Less than 20 000 GBP (25 189 EUR)	5 000 GBP (6 297 EUR)
20 001–200 000 GBP (25 190–251 889 EUR)	25% from the total incomes
More than 200 000 GBP (251 889 EUR)	50 000 GBP (62 972 EUR)

Source: HM Revenue & Customs, 2014

such as states Solík (2009). Incomes obtained in this way are not subject to tax, as stated Zajíčková (2012). The following table shows additional incomes that can be found in the associations. Individual incomes are evaluated whether they are subject to tax and represent taxable income or not to an association.

The table above shows the obvious differences between selected types of incomes. These types of incomes are always subject to tax in the Czech Republic and Slovakia. In the majority of the cases these types of incomes are exempt from tax in the United Kingdom if those incomes are used for charitable purposes. If they are used for other than charitable activities they will be subject to taxation.

Against to the general principle that is applied in many countries where incomes from main activities are not taxed, the incomes from main activity exceeding related costs become the part of the tax base in the Czech Republic and Slovakia. As it can be seen from the Tab. III, incomes from main activity belong to the category of exempt income in the UK. For this method speaks the fact that in this country there are legally defined public beneficial services that may be carried out within the main activities. At the same time the non-profit organizations in the UK are characteristic for the so called charitable status<sup>3</sup> under which they receive tax relief (Salamon, Anheier, 1993). In addition to the main activity, which is consistent with the charitable objectives, the non-profit organization can also operate an business activity (Hudcová, 2007; Blade, 2003). If the business activity is carried out within the framework

of charitable goals, then these incomes are exempt from tax. Also the business activity associated with the operation of lotteries and fundraising activities is exempt from tax in the UK. On the contrary the business activity that is not performed within the charity objective is considered as taxable activity. However under certain circumstances it also may be exempt. For the scope of the exemption there are defined limitations which are shown in the following table. All subsequently amounts are converted to euros by rate from 11. 7. 2014 in the amount of 0.794 GBP / EUR. The amounts are then mathematically rounded to whole euro.

The business activity is always taxed in the Czech Republic and Slovakia. Regarding the tax benefits that are provided to associations – the associations may apply the deduction from the tax base, in the amount of 10 933 EUR<sup>4</sup>, in the case of the Czech Republic. Tax benefits are not provided to associations in the Slovakia. The situation is different in the UK. Any income from main activities, which is intended for charitable purposes, is exempt from tax. If these incomes would be used for other than charitable goals, so then they will be taxed. The business activity is, as already mentioned above, distinguished to more types. Business activities that are consistent with the charitable objectives, or income from lotteries, which will be subsequently used for charitable goals, are exempt from tax. As regards incomes from business activities that cannot be classified into the previous types of exemptions

<sup>2</sup> The amounts are converted by the rate of the Czech National Bank from 11. 7. 2014 (27.44 CZK/EUR) and mathematically rounded to whole Euros.

<sup>3</sup> Analogy of the status of public benefit. Tax office in the UK distinguishes different taxation for charities and other non-profit organizations, which are for example registered amateur sports clubs. It is important to distinguish between these two entities. Charity is always non-profit organizations, while non-profit organization may not always be charity.

<sup>4</sup> More precisely, the associations can reduce the tax base by 30%, to maximum of 1 million CZK (36 443 EUR). In the case that the 30% reduction is less than CZK 300 000 (10 933 EUR), you can deduct the amount of CZK 300 000 (10 933 EUR). Reduction can be applied up to the amount of the tax base.



there are apply limitations for exemptions, which have been mentioned above.

The association is allowed to deduct the tax loss in all countries. In the Czech Republic it is possible to deduct the tax loss in the five tax periods, in the Slovakia in seven tax periods that follow immediately after the tax period for which the tax loss has been assessed. In the UK it is possible to apply the tax loss in subsequent tax periods with no time restrictions. However it is possible to apply it only to income in the same category, i.e., the resulting loss will be deducted from the income from the same kind of trading (Global Individual Tax Handbook 2013 and Global Corporate Tax Handbook 2013).

With respect to the corporate income tax rate there is not established a special rate for non-profit organization in any of these states. It should also be pointed out to the regulation of the tax rate in the UK, where the basic and reduced tax rate is applied depending on the extent of income for the tax period. If the taxable income is up to 300 000 GBP, then the tax rate is 20%. In the case when this amount is exceeded, the basic rate in amount of 23% is used. If a non-profit organization is subject to taxation, and its annual taxable income is between 300 001 GBP and 1 500 000 GBP, it is possible to apply the relief in the form of so-called marginal tax relief<sup>5</sup>, on which basis the tax liability of the taxpayer is reduced.

Certain specificity represents tax allowance when employing disabled people in the Czech Republic. These tax allowances do not occur in other selected countries.

### Model Example

Comparative analysis of the taxation of associations by the corporate income tax in theory will now be transferred to the practical level using a model example, where the base point for the model will be association. With regard to the proper interpretation of the results, all calculations will be converted to a single currency, which will be the euro.

Association during the tax period within the main activities carried out activities during the tax period:

- a) All of them were profitable. Association showed profit from main operations in the amount of 10 400 EUR. In addition it reported profit from advertisement in the amount of 15 500 EUR and income from rental in amount of 2 500 EUR<sup>6</sup>. Within the business activity there was showed a profit of 11 000 EUR for the tax period that is not subject to tax (these activities were carried out in relation to the objectives of the main mission of the association or they have been exempt on the basis of limitations resulting from the Tab. IV).
- b) All of them were unprofitable (loss), association showed a loss from the main activities in amount of EUR 1 900 EUR for the tax period. In addition it reported profit from advertisement in the amount of 15 500 EUR, income from rental in amount of 2 500 EUR and profit from the business activities in amount of 11 000 EUR, which is not subject to tax (these activities were carried out in relation to the objectives of the main mission of the association or they have been exempt under limitations resulting from the Tab. IV).
- c) This option only applies to the UK and it is the same as instructions for the variant a), it applies only that business activity is liable to the taxation.

V: Comparison of the taxation of the association by corporate tax in the surveyed countries

Item	CR a	CR b	SR a	SR b	UK a	UK b	UK c	UK d
Main activity	10 400	-1 900	10 400	-1 900	10 400	-1 900	10 400	-1 900
Advertisement	15 500	15 500	15 500	15 500	15 500	15 500	15 500	15 500
Rental	2 500	2 500	2 500	2 500	2 500	2 500	2 500	2 500
Business activity	11 000	11 000	11 000	11 000	11 000	11 000	11 000	11 000
Tax base	39 400	29 000	39 400	29 000	0	0	11 000	11 000
Deduction	-10 933	-10 933	0	0	0	0	0	0
Reduced tax base rounded	28 467	18 067	39 400	29 000	0	0	11 000	11 000
Tax rate	19	19	19	19	20	20	20	20
Tax	5 408	3 433	7 486	5 510	0	0	2 200	2 200

Source: work of author

5 Calculation of the marginal tax relief is based on the basic tax rate of 23%, from which is calculated tax liability of non-profit organization. From the upper limit of £ 1.5 million are deducted taxable profits, and this sum is multiplied by a factor of 3/400. The final amount is tax relief, which is then deducted from the tax liability. Tax liability is then lower and depends on the amount of annual taxable income within given limits.

6 Incomes from advertisements are part of business activity in all selected countries. Profit from its realization is there for included in tax base. Incomes from rental are always subject to tax in the case of associations in the Czech Republic and Slovakia. Rental belongs to property management in Austria and Germany. Property management is exempt from tax.

## VI: Comparison of the taxation of business activity of association in the surveyed countries

Item	CR a	SR a	UK a	UK b	UK c	UK d	UK e	UK f
Income from main activity	110 000	110 000	110 000	110 000	11 000	11 000	200 000	200 000
Income from business activity	60 000	60 000	60 000	60 000	10 000	10 000	100 000	100 000
Business activity	11 000	11 000	11 000	50 000	7 000	5 000	50 000	70 000
Taxation of the income from business activity	Yes <sup>7</sup>	Yes	Exempt <sup>8</sup>	Yes <sup>9</sup>	Yes <sup>10</sup>	Exempt <sup>11</sup>	Exempt <sup>12</sup>	Yes

Source: work of author

d) This option only applies to the UK and it is the same as instructions for the variant a), it applies only that business activity is liable to the taxation.

For the calculation of corporate tax in the UK it was needed to complete the instructions with other aspects of the model (variant c and d) in connection with the performance of the business activity. If we assume that the performance of the business activity will not be consistent with the charitable objectives of the organization and at the same time it is not possible to apply the exemption of income from economic activities. In the case of the Czech Republic and Slovakia there are listed only option a) and b), as it applies that income from business activities is always taxed.

Ad a) Association reported only profitable activities for the tax period. During the tax period there were reported the profit from advertisement, income from rental and profits from the sale of refreshments. Sale of refreshments belongs to business activities in all selected countries. The table shows that profit from business activity caused the creation of tax liability in all countries. We can suppose that in Germany the sum of income from taxable business activity exceeded 35 000 EUR, then the association may deduct non taxable amount of 5 000 EUR. In Austria the deduction was applied in amount of 7 300 EUR. The Czech Republic applies deduction in the amount of 300 000 CZK (the equivalent of 11 733 EUR), this is the highest deduction within the surveyed countries. Slovak Association cannot reduce the tax base under the current legislation. Tax rates differ in the individual countries, the highest corporate income tax rate has been determined in Austria, on the other hand, Austria has the lowest reduced tax base compared to the other countries.

Ad b) Reported loss from the main activity caused a change in the tax base of the Czech and Slovak taxpayer. The tax base is the same as in the previous model due to non taxation of the profitable main activity in the case of Germany and Austria. Although the reduced tax base is the lowest in

Austria, due to the high tax rate, that associations face higher tax liability in comparison with Germany.

Ad c and d) These options are intended only for the UK, because the taxation of business activity is always applied in the case of Czech Republic and Slovakia. Performance of the business activity in the UK, which is not performed in the context of the main objectives of the mission of the association or is not exempt under the limitations resulting from the Tab. IV, caused a change in the tax base of the association. Despite the taxation of business activity in the UK, the total taxation of the association is the lowest in this country.

Exemptions that are listed in the Tab. IV apply in relation to the taxation of income from business activities in the UK. However, if such income is subject to taxation, so it is a taxation of the entire amount, not just the amount that is given above this limit.

From the above performed comparison of the corporate income tax it was found out a significant difference with regard to the taxation of the main and business activities of the association. In the Czech Republic and Slovakia the profitable main activity is subject to taxation, in the UK it is not, which is related to the definition of public beneficial services. The results of the comparative analysis in the field of taxation of corporate income can be summarized into six basic situations.

- *The Association carries out only the main activity from which it reports a loss.*

The tax base will be zero in all selected countries. The association will not be subject to income tax.

- *The Association carries out only the main activity from which it reports a profit.*

The association is not subject to income tax in the UK. In the Czech Republic, using the possibility of deduction, the association is subject to income tax only if the tax base is higher than 300 000 CZK. Association is subject to income tax in the Slovakia.

7 It is possible to apply 30% deduction.

8 Total Income 170 000 EUR, limit for exemption 25% of the total income, till 42 500 EUR.

9 Limit for exemption is exceeded, 50 000 EUR will be taxed.

10 Income exceeds the limit, 6 297 EUR, total of 7 000 EUR will be taxed.

11 Total income in amount of 21 000 EUR, limit for exemption 6 297 EUR.

12 Total income in amount of 300 000 EUR, limit for exemption 62 972 EUR.

- *Association carries out the main activity from which it reports a loss and business activity from which it reports a profit. In the UK applies that the business activity is carried out in relation to the objectives of the main mission of the association or it is exempt under the limitations based on the Tab. IV.*
- The tax base in this case is the same for associations in the Czech Republic and Slovakia. Advantageous situation in relation to the possibility of a tax deduction is in the Czech Republic. Incomes are not taxed in UK.
- *Association carries out the main and business activity and it reports profit from both activities. In the UK applies that the business activity is carried out in relation to the objectives of the main mission of the association or is exempt under the limitations based on Tab. IV.*

Under this assumption, the association will pay the highest income tax in the Slovakia. Profitable main activity will subject to taxation in the Czech Republic and Slovakia. Rental belongs to the taxable activity in the Czech Republic and Slovakia, in the UK this income is not liable to taxation. Also the income earned from business activities will not be subject to taxation.

- *Association carries out the main activity from which it reports a loss and business activity from which it reports a profit. Business activity is not exempt either is not connected to charitable objectives of the association in UK.*  
In this case the tax base is equal for associations in all selected countries. The situation from the perspective of tax deduction is most favorable for associations in the Czech Republic.
- *The Association carries out main and business activity and it reports profit from both activities. Business activity is not exempt either is not connected to charitable objectives of the association.*

Under this assumption, the association will pay the highest income tax in the Slovakia. Profitable main activity will subject to taxation in the Czech Republic and Slovakia. Rental belongs to the taxable activity in the Czech Republic and Slovakia, in the UK this income is not liable to taxation. It can generally be said that within the surveyed countries, the tax treatment for associations is the least advantageous in the Slovakia, while in the UK the taxation for associations seems to be advantageous, which is related to the charitable mission of the association.

From the previous text it can be concluded that the tax laws in the Czech Republic are favoring especially those associations which report a loss from main activities and at the same time they are carrying out the business activity. The main objective of this paper is a proposal for changes in the field of the taxation of non-profit organizations. Based on comparative analysis, following recommendations are proposed for the taxation of non-profit organizations in the Czech Republic.

- *Classification of non-profit organizations*

Tax benefits in the Czech Republic there are provided to entities mainly based on legal form

rather than based on purpose as it is in the case of UK. Although since 2014 the Civil Code has defined the public benefit, this definition is insufficient and non-profit sector is still not sufficiently transparent. The introduction of the status of public benefit in the Czech legislation would be accompanied by a precise definition of services that would be considered as public beneficial services. Non-profit organizations could be subsequently classified precisely with regard to the status of public benefit, which should have tighten the conditions for the entitlement to tax benefits and possibly to obtain subsidies from public sources. In the context of the associations it would certainly be appropriate to distinguish mutually beneficial associations and public beneficial associations.

- *Classification of associations*

In the context of the associations it would certainly be appropriate to distinguish mutually beneficial associations and public beneficial associations. Mutually beneficial associations are those that are focused on associations' activities, they often work on a volunteer basis and they are not significantly economically active. Public beneficial association is often a non-profit organization having economic activity, it is mainly for those which perform public beneficial service at prices unmatched with the commercial sector.

Following the tightening of conditions for the entitlement to the tax advantages, following changes could be implemented to tax laws:

- *Exemption of main activity from corporate income tax*

Introduced proposal could be implemented for non-profit organizations in relation to the definition of the status of public benefit and public beneficial services. This exemption would be granted only to those which are designated as public beneficial. Nonprofit organizations could thus compensate profits and losses within individual activities arising from their mission (main activity). In the case that the main activity would be exempt from corporate income tax there would be achieved a significant simplification in the context of accounting and subsequently also simplification with respect to the taxation of non-profit organizations.

- *Determination of the limit of exemption in connection with the exercise of business activity*

Another proposal aims to establish the exemption from the income from business activity based on the limit of the achieved profit within the business activity to the overall incomes of the nonprofit organizations. This proposal is based on the tax treatment of non-profit organizations in the UK. Similar model could be valid for the Czech Republic on the basis of this regulation.

- *Reduction of deduction (30%)*

Another option, in the case when the main activity would be exempt from corporate income tax, would be to reduce this deduction because it could represent a significant advantage in comparison with business entities. Intended reduction of this

deduction would therefore be from 30% to about 15%.

- *Graduation of deduction*

Division of tax benefits into two levels could also be used in connection with the proposed *classification of non-profit organizations and associations*. The first level would include only those non-profit organizations which unconditionally fulfill all the conditions for obtaining the status of public benefit and perform public beneficial services (e.g. public beneficial associations). Those could draw maximum benefits. The second level would include other non-profit organizations that would meet only the most general features of public benefit (e.g. mutually beneficial associations). These organizations could take advantage of tax benefits only at reduced rate.

*In connection with the regulation of the taxation of non-profit organizations, the least benefits have been observed in the Slovakia. However, this is related to the fact that Slovakia, as the only one from the surveyed countries, has introduced the tax assignment. The introduction of the tax assignment within the proposed measures for the Czech Republic has not been considered. The main disadvantage is seen in the impact on the reduction in income of state treasury, and also in relation to the increase in expenditure of the state budget, i.e. costs associated with the administration and control of the used means. A second challenge is from the perspective of economic theory the risk of inefficient allocation of funds and then probably less interest of citizens and companies to provide gifts.*

The above proposed recommendations could be applied only after the approval of the law on public

benefit and a clear definition of public beneficial services. A similar conclusion and recommendation were also observed when compared the taxation of non-profit organizations, Czech Republic with Austria and Germany within the previous paper, which is part of the research.

Another measure that could effectively deal with the abuse of legal forms of non-profit organizations, appears to be tightening the conditions for the use of funds raised through tax savings, which arises from applied tax deduction (§ 20 para. 7 ITA). Currently, it is necessary to reinvest the tax savings from the deduction no later than 3 years after its formation, which leads to a space for a particular manipulation. Here it would be appropriate to propose an obligation to use these funds no later than in the following tax period to cover costs related to the activities resulting from the mission of non-profit organizations, and only in the case that income from operation from the main activity would be a loss in this period.

Currently the non-profit sector in the Czech Republic has certain signs related to lack of transparency and credibility. In this field there can also be found tax evasions which are caused by abusing the legal status of non-profit organizations. It was expected that this situation will be changed by the new Civil Code and the related laws. Certain beneficial changes have already been carried out, however, there is still missing law on public benefit and a clear definition of community services.

## CONCLUSION

The aim of this paper was to propose changes to the taxation of non-profit organizations by the corporate income tax in the Czech Republic. Given the broad definition of the term "Non-profit organization", the paper dealt only with the taxation of non-profit organizations with the focus on associations. There were compared the taxation of the associations in selected EU countries, namely in the Slovakia and in the UK compared to the Czech Republic. The selection of countries was made on the basis of the continuation of the research, which has already examined Germany and Austria. Slovakia was chosen because of the direct vicinity with the Czech Republic, and also based on the fact that it has a similar tradition of historical development. United Kingdom was selected with regard to the fact that it belongs to the Anglo-Saxon system. This is a state, which is, in many characteristics, different from the Czech Republic, which is part of the Continental System. To fulfill the aim of this paper there was used comparative analysis, which revealed fundamental differences between taxation of the associations in the Czech Republic and taxation of these entities in the UK. In UK there are clearly defined the public beneficial services, concepts as public benefit, charity and church purposes, rather than the legal form of the organization have a major impact for tax laws. Although there have been in the Czech Republic in 2014 newly defined public beneficial taxpayer, this is very insufficient definition and the legal status of the organization continues to play important role for the application of tax benefits.

Although the paper only dealt with the issue of taxation of associations, a proposal for changes in taxation cannot be applied only to one legal form. Within the synthesis of findings from comparative analysis there were therefore suggested recommendations that could be possible to apply for the taxation of the entire non-profit sector in the Czech Republic. The most serious shortcoming of current legislation has been spotted in providing tax benefits. This corresponds to the proposed recommendations – with the need for classification of non-profit organizations and also for division of associations to mutually beneficial and public beneficial. The classification should be primarily based on the definition of public beneficial service, as it is in the case of UK. In the case of the provision of public beneficial services there has been proposed exemption of the main activity from the corporate income tax.



Two types of non-profit organizations: with the status of public benefit and those that have not fulfilled the requirements to obtain the status of public benefit is the result of the classification according to the proposed criteria. Other proposed recommendation, which is the division of the tax benefits into two levels, is built on this structure. Another proposal aims to establish the exemption of income from business activity based on the limit of the achieved profit within the business activity to the total incomes of the non-profit organization. This proposal is based on the tax treatment of the non-profit organizations in the UK.

The proposed recommendations for non-profit organizations would have a positive impact on the state budget due to the regulation of provided tax benefits. This claim is based on the fact that according to the proposed recommendation there would be a limitation for the pumping of tax benefits by organizations that only abuse the legal form of non-profit organizations. At the same time, the classification of non-profit organizations could also bring a change in the field of provision of subsidies with respect to the efficient and transparent use of funds from the state budget, with the possibility of providing resources to those organizations that are truly dedicated to public beneficial activities.

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