WHEN TAX-EXEMPT NONPROFITS DETRACT VALUE FROM SOCIETY

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ABSTRACT

Nonprofits receive tax exemptions in return for social value creation and delivery. While the outcomes of these tax exemptions are often positive, there are value detracting situations in which the cost of granting the tax exemption is likely to exceed its benefits. To date, explanations for these value detracting situations remain scattered and discipline centric. Therefore, the purpose of this paper is to clarify the conditions under which tax-exempt nonprofits detract value from society. We survey fifteen years of tax-exempt nonprofit scholarship, across nine disciplines, and identify three value detracting conditions: *policymaking and regulation intemperance, nonprofit management and governance distraction,* and *detection and prosecution inconsistencies*. These three conditions interact and reinforce each other, compounding the value destruction to society. Overall, our findings offer important policy insights regarding the unintended consequences of tax exemptions and our framework can be used to identify negative return situations.

Key words: accountability, governance, nonprofits, regulation, social value, tax exemptions

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INTRODUCTION

Tax-exempt nonprofits are a well-known and growing category of social enterprise that generate positive value for society. They have a long history of responding to social, environmental and economic inequalities (Aftab Hayat, 2014; Felício, Gonçalves & da Conceição Gonçalves, 2013). Their track record of public service and social transformation (Chin, 2018; Smith & Lipsky, 2009) is argued to be essential for a better future (Montgomery, Dacin & Dacin, 2012). Of particular interest in this paper is their tax exemptions (freedom from paying sales, property, and/or federal taxes), which are given in exchange for this value, created and delivered.

Scholars have documented that nonprofit tax exemptions come with several financial and competitive benefits (Felix et al., 2018), such as reduced operational costs (Lecy & Searing, 2014), easier access to capital (Calabrese & Ely, 2015), and millions of hours of free labor (Greenlee et al., 2007). Other scholars have criticized tax-exempt nonprofits for their inefficiencies (Knox et al., 2006), poor governance (Gamble & Christensen, 2019) and misbehaviors (e.g. Archambeault et al., 2015). Thus, instead of creating social returns, some tax-exempt nonprofits may be detracting value from society, i.e. situations where lost revenues from the tax exemptions, exceed the burden relieved (Greenlee et al., 2007). The size of the returns (whether positive or negative) that society gets from tax exemptions remains unknown, while current appraisal mechanisms cannot account for the complexity underlying value detraction. Calculating negative return situations first requires scholars to be clear on what antecedents lead to situations where tax-exempt nonprofits detract value from society. So, as part of the larger return on exemption question, in this paper we ask and then answer, *what are the conditions under which tax-exempt nonprofits detract value from society?*

We argue that answering this question requires breaking down disciplinary silos. *Management* research approaches this question through organizational forms, board composition, managerial acumen. *Law* focuses on the legal underpinnings and case precedents. *Public policy* research centers its attention on those regulatory and policy issues which may trigger behavior. *Psychology* pays attention to the behavior itself, and *Accounting* research searches for explanations in social accountability and reporting. Yet, existing literature does not offer a comprehensive explanation of the conditions that drive value detracting and/or negative returns from tax-exempt nonprofits.

Our integrative approach was to examine 143 studies and legal cases published over the last 15 years across nine disciplines. We identified studies that address the activities associated with value detraction. Our analysis identified twelve enablers of value detraction, highlighting the culpability of policymakers, nonprofits, and enforcing bodies. We aggregated these twelve enablers into three conditions: *policymaking and regulation intemperance, nonprofit management and governance distraction,* and *detection and prosecution inconsistencies*. We also noticed that these three conditions interact and reinforce each other, and thereby likely amplifying negative returns to society. These findings form the basis of our framework.

Our findings contribute to research and policy in a number of ways. First, we introduce to the extant literature three distinct interacting conditions, which represent the foundation for understanding and measuring value detraction in the tax-exempt nonprofit space. These findings and framework lay the groundwork to tackle a bigger challenge, which is the need to have a good, reliable, repeatable calculous to tell what the societal return on exemption is. Second, we introduce a multi-level framework to facilitate analysis of nonprofits and their returns to society.

If policymakers, stakeholders, and scholars can focus on preventing such conditions, then fertile ground for value detracting behavior can be reduced and potentially eliminated.

TAX-EXEMPT NONPROFITS

The origins of nonprofit tax-exemptions

Tax exemptions in the United States date back to the early 1800s. At this point, Americans were observed to collaborate in voluntary activities (Tocqueville, 2003). Early in the United States legislative history, tax exemptions followed three principles: (1) charitable organizations were granted exemption from Federal income tax, (2) income could not benefit an individual related to the organization, and (3) income tax deductions would encourage charitable giving (Arnsberger et al., 2009). Later, The Revenue Act of 1909 was expanded, primarily based on the notion that tax-exempt charitable organizations should be nonprofit. Shortly thereafter, The Revenue Act of 1954 introduced section 501. Today, the current reading of 501(a) and 501(3) of the revenue code include: "corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, for testing for public safety, to foster national or international amateur sports competition, for the prevention of cruelty to children, women, or animals …shall be exempt from taxation" (Lathrope, 2017).

A commendable aspect of nonprofit legislative history was the efforts of lawmakers to tighten regulation as the business environment evolved (Lathrope, 2017). This is likely a result of lawmaker efforts to balance fairness and consistency; to stimulate positive social behaviors; and/or to reduce the occurrences of tax-exemption abuse. Additionally, many of these lawmakers were guided by the logic that: (1) net income cannot be coherently defined for nonprofits, (2)

nonprofits are deliberately being subsidized by government through the exemption, and (3) nonprofits have an historic legacy of being excluded from the tax base (Rushton, 2007).

However, as time has passed, the landscape of charitable activities has changed. New tensions and opportunities have emerged that require a renewed examination of how tax exemptions are being utilized to develop/sustain civil society. More recently, scholars have framed these tensions and opportunities under the banner of 'prosocial logics' (Moroz, et al., 2018; Zhao & Lounsbury, 2016; Zhao & Wry, 2016). A notable example of this is found in a study of aid providers (Ballesteros, Useem, & Wry, 2017). Ballesteros et al. challenged the traditional view that relief is faster, and nations will recover more fully, when nonprofits are playing the dominant role. What they [Ballesteros et al.] find, is that local corporations play a bigger role than nonprofits, when it comes to relief aid.

Difficulties with nonprofit tax-exemptions

Tax exemptions are a defining, arguably central, regulatory feature of this category (Walker & Sipult, 2011). In the United States, for example, tax-exempt nonprofits are recognized by law under section 501(c)(3) of the Internal Revenue Code. In the United Kingdom, charities do not pay tax on most types of income (e.g. donations, profits from trading, rental or investment income) as long as they use the money for charitable purposes. Exemption is granted for charitable companies and trusts under the Corporation Tax Act 2010 and the Income Tax Act 2007, respectively. In Canada, registered charities and nonprofit organizations are also exempted from taxation under paragraph 149(1)(f) and 149(1)(l) of the Income Tax Act, when they are organized and operated solely for social welfare, civic improvement and other forms of charitable purpose. Across the European Union, each member state has its own legislation on this

matter, but most follow a similar logic when it comes to charitable and nonprofit organizations. In all cases, a charitable purpose is understood as one that helps the public or an activity intended for public benefit. The main policy argument behind the variety of tax exemptions (i.e. freedom from paying sales, property, and/or federal/state taxes) concerns the public value nonprofits are assumed to create and deliver. While this is true for a large number of tax-exempt nonprofits, problems still prevail, raising questions about the validity of such argument (Archambeault et al., 2015; Greenlee et al., 2007). Yet, policymakers and regulators continue to award tax exemptions to nonprofits, in the same fashion and at a growing rate.

In this sense, this category is somewhat paradoxical. While some tax-exempt nonprofits play a large role in positive change, others are fraught with organizational problems which amount to wasteful efforts or even duplicitous behavior. Most interestingly, despite any hard evidence of net-positive contributions, many nonprofits continue to receive tax exemptions, which amounts to a substantial financial, operational and competitive benefit (Hines et al., 2010). Rosenbaum et al. (2015) estimated that, for 2011, the nonprofit tax exemption for the health sector alone in the United States was $24.6 billion. Yet, little research has determined whether the tax exemption given to nonprofits is yielding the intended results, and that the benefits outweigh the costs.

The costs associated with tax-exempt nonprofits take many forms. Scholars have documented problems related to performance inefficiencies (Ebrahim & Rangan, 2014), fraudulent activities (Archambeault et al., 2015; Greenlee et al., 2007), mission drift (Ebrahim, Battilana, & Mair, 2014), and/or governance-leadership failures (Fremont-Smith & Kosaras, 2003). Others suggest that questions of legitimacy arise from the lack of overall accountability and tax avoidance practices of organizations that are awarded tax-exempt status (Omer & Yetman, 2007). Kaplan (2001) posits that management control deviation is at the root of much of the criticism directed at

nonprofits. Such criticisms (i.e., accusations of fraud, governance failures, and poor controls) have not been fully weighed by policymakers or scholars. Borek (2005) estimates that the value of uncollected income tax associated with nonprofit exemptions and the charitable tax deduction granted to individuals together far exceed federal social welfare spending.

Alongside these issues, there are a number of recent scandals that are boosting a sense of collective skepticism regarding the role and actual impact of tax-exempt nonprofits. Racism, sexism and bullying have been reported at *Oxfam* (BBC News, 2019). Volunteers from *Medecins Sans Frontieres* were involved in prostitution while working in Africa (Adams, 2018). *Kids Wish Network* channels $110 million in US dollars to its corporate solicitors and $4.8 million to the charity's founder and his own consulting firms, while sick children receive 3 cents on the dollar from donations (Hundley & Taggart, 2013). Several nonprofit foundations have also been accused of misusing funds for personal benefit over multiple years, to support politics or construction (Vandewalker & Lee, 2018). These are not just extreme examples. The list continues as journalists, watchdogs and documentarists dig into the enduring problems within this space (e.g., Hundley & Taggart, 2013). While such criticisms hardly apply to the entire category, their magnitude has increased skepticism regarding the true value and legitimacy of tax-exempt nonprofits. Ultimately, misconduct in this sector has had negative and enduring effects upon the charitable industry as a whole (Jones et al., 2019).

Altogether, existing evidence does raise reasonable doubts as to whether the tax mechanisms for nonprofits are appropriate. Several authors have already hinted at the potential darker side of tax exemptions (Yetman, 2003; Yetman & Yetman, 2009). Given the increasing size of this sector (Milofsky, 1997), and longstanding interest in the role that taxes play in motivating

organizational behavior (Yetman & Yetman, 2009), we aim to examine the conditions under which tax-exempt nonprofits are likely to detract value from society.

VALUE DETRACTION BY TAX-EXEMPT NONPROFITS

Value detracting conditions are antecedents that lead tax-exempt nonprofits to return less to society than the exemptions they are given. In these circumstances the accrued benefits garnered from tax-exempt status are greater than the benefits generated by the nonprofit. Such negative return instances are most often witnessed when the beneficiaries of the charitable good or service do not actually receive the benefits, or the damage and harm caused by the tax-exempt nonprofit is greater than the good performed. To date there is only scattered knowledge of what conditions drive such value detraction.

One reason for this research gap is that prior research on tax-exempt nonprofits is limited to discipline specific conceptualizations of the conditions leading to negative returns. For example, management and ethics scholars would argue that the problem stems from poor oversight and can be solved by improving governance or managerial practices (Gibelman & Gelman, 2001; Harris, Petrovits & Yetman, 2017). Public sector scholars would argue that the problem stems from incorrect resource allocation and inadequate estimations and can therefore be solved by improving resource allocation mechanisms and cost-benefit analyses (Knox, Blankmeyer & Stutzman, 2006). Unfortunately, such siloed research can only provide disciplinary responses and limits the way in which scholars address “real-world problems” (Jeffrey, 2003, p. 539).

In order to explain the conditions under which tax-exempt nonprofits detract value from society, we reviewed and synthesized[1] 143 studies and litigation cases across nine disciplines (accounting, economics, ethics, general management, law, public sector, planning, sector studies and other social sciences), covering a range of value detracting activities. These included: fraud, misconduct, comparative performance, cost-benefit issues, information asymmetries, unfair competition, CEO incentives and overpayments, and operational inefficiencies in tax-exempt nonprofits. In our study, we paid particular attention to empirical studies and evidence reviews focused, for example, on costs and benefits of tax exemptions or effects of regulation upon tax-exempt nonprofit governance. We also looked at a range of evidence-based research notes and/or reflective papers examining litigations and the legal implications of regulatory changes in these organizations. Finally, we examined a selection of qualitative studies on such issues as perceptions of regulatory compliance, or public image of tax-exempt nonprofits and trust in their boards.

The number of studies published in this space remained relatively stable for ten years then grew significantly from 2014 onwards (See Appendix A). The spike in research interest form early 2010 (considering research and publication cycles) may be attributable to factors, such as: 1) the availability of early evidence pertaining to the impact of the Affordable Care Act, accompanied by the need to compare the performance and cost-benefit relationships between alternative service providers; 2) the IRS decision to scrutinize charitable organizations more closely than other organizations seeking tax benefits, as reported by the Treasury Department in 2007, despite several budget cuts affecting oversight capacity within the IRS (Hackney, 2017); and/or 3) the surge of scandals affecting these organizations and news coverage highlighting

[1] A detailed description of our methodological procedure and review analysis can be found in Appendix A.

America's “worst” charities (e.g., Hundley & Taggart, 2013) and other scandals in Europe (e.g. BBC News, 2019). These factors are not only relevant from a methodological point of view, but also show the timeliness of the phenomenon under examination.

The vast majority of studies reviewed examined tax-exempt nonprofits in the United States. We found three arguments supporting this unbalanced distribution. First, while the share of voluntary work is stable across countries, the United States donates more to charity than any other country (through both individuals and corporations). In 2017 Americans donated $410 billion, representing ~2% of the country’s GDP (Osili & Zarins, 2018). In the United States, income tax incentives cover a wide range of donations including more illiquid assets, and the donor can claim large portions of a donation to reduce taxable income. Other countries tend to offer a narrower range of available tax incentives and restrict the number of income tax deductions allowed. Finally, as with many disciplines, a disproportionate number of scholars published in leading journals are based in the United States. We do not see this as problematic, but rather a set of interesting insights that can potentially inform further studies, in other countries, as their social industries evolve (or devolve).

In our integrative review, we first extracted evidence of value detraction, which we then aggregated to twelve enablers of value detraction. They pertain to, for example, expectations of social value return, unjustified performance differentials, managerial misbehavior, accountability and transparency issues, selective public scrutiny and ineffectiveness of stricter regulation. In making sense of these enablers, we observed that they materialize at three different levels, becoming entity specific, distinctively explaining why value detraction might occur within this space. The levels are: 1) policymaking and regulation; 2) nonprofit management and governance; and 3) enforcement and prosecution.

At the policymaking and regulation level, for example, we observed that tax exemption is seen as a unique and defining feature of the nonprofit category. It gives meaning to the charitable work performed by nonprofits (Dal Pont, 2015), despite the fact that tax rules are not clear for some nonprofit types (Colombo, 2010) and the definition of what is charitable lacks uniformity (as it depends mostly on the needs of local governments) (Walker & Sipult, 2011). This is problematic as it creates uneven expectations of social value return over tax exemptions (Herring et al., 2018). Policy and regulation persist in granting tax exemptions despite the many problems – uneven treatment, misleading assumptions and lack of clear evidence regarding social value returns over tax benefits – revealing a state of intemperance.

At the management and governance level, we found evidence of problematic expectations of misbehavior within management teams across nonprofits, mostly due to unclear behavioral boundaries (Aprill, 2014) and lack of professionalism in nonprofits (Kummer et al., 2015). This leads to a normalization of poor governance (Dhanani & Connolly, 2015; Lecy & Searing, 2014). When it comes to accountability and reporting, management teams seem too distracted to deliver on what is required. Against intuition, stricter regulation does not change governance behavior (Gilkeson, 2007), nor reduce misconduct (Kerlin & Reid, 2010). This is perhaps reinforced by the fact that the consequences of poor accountability and transparency practices are mostly trivial (e.g. Archambeault & Weber, 2018; Greenlee et al., 2007), which links up with inconsistencies at the level of detection and prosecution. At this level, we observed that the revenue service and prosecutors generally decline to accuse nonprofits that run afoul of the laws on charitable giving, because the associated expenses and reputational risks are too great (Marks & Ugo, 2012). Ultimately, detection and prosecution are seen as inconvenient, non-conducive and mostly ineffective and remain contingent upon perceptions and public scrutiny. Too many

inconsistencies in detection and prosecution seem to aggravate problems in policymaking and managerial practices.

The way enablers combine within each of the levels led us to identify three (entity-specific) value detracting conditions, which we label: *policymaking and regulation intemperance, nonprofit management and governance distraction,* and *detection and prosecution inconsistencies*. Table 1 provides an all-inclusive representation of the key evidence compiled and analyzed. The evidence has been organized thematically according to how it enables value detraction. This informs our conceptualization of the enabling structure underlying value detraction within each condition. In the following section, we discuss the content of Table 1 in detail which is subsequently summarized in Table 2.

---Insert Table 1 about here---

FINDINGS

Conditions under which tax-exempt nonprofits detract value from society

Condition 1: Policymaking and regulation intemperance

Our findings point to a problematic condition, which is that policymakers and regulators have granted tax exemptions in an excessive manner (Archambeault et al., 2015; Greenlee et al., 2007). This stems from counterproductive policy and regulatory assumptions. These assumptions are rooted in a set of unsubstantiated logics of social and financial performance, operational efficiency, cost-benefit relationships, value delivery expectations, complex legal structures, governance and competition. Overall, these assumptions stem from a series of presumed circumstances, including historical influences, regulatory inequities (Colombo, 2010), competitive disadvantages (Owens, 2005), and blurry moral logics (Magill & Prybil, 2011),

which leads to a presumption that tax-exempt nonprofits should have special protection under the law (Hines et al., 2010).

Authors find that a chasm exists between the social value expected of tax-exempted nonprofits, their performance (Knox et al., 2006) and the value they actually deliver (Rubin et al., 2013). First, the size of tax exemption seems to influence public opinion, regarding the size of community benefits provided. This assumption is unsubstantiated because tax exemptions tend to produce distorted community benefit expectations (Owens, 2005). In the case of well-known hospitals, for example, there is a disproportionately high expectation from the public, that tax-exempt organizations should provide more community benefits, simply because they receive a tax exemption (Rosenbaum et al., 2015). Likewise, more social value is expected from faith-based nonprofits in comparison to secular ones (Ferdinand et al. 2014). This is problematic since the pressure applied by stakeholders for nonprofits to deliver high levels of community benefits, in line with the tax-exemptions they receive, may unintentionally encourage misconduct (Owens, 2005).

Conversely, less visible tax-exempt nonprofits continue to receive tax benefits without excessive public scrutiny regarding expectations of performance and social value delivery. Using data from the Texas Department of Human Services' annual cost reports regarding cost-efficiency across three types of nursing homes, Knox et al. (2006) reject the homogeneous performance assumption, showing significant variance across tax-exempt nonprofits. The authors show that, given the same quality of service, faith-related tax-exempt nonprofits are considerably less efficient in terms of costs and allocation of resources than government and private sector organizations. While faith-based nonprofits are more likely to engage in activities that provide significantly higher benefits to their communities (Ferdinand et al., 2014) their inefficiencies

tend to remain hidden from public scrutiny due to the assumed socially superior goals underlying their status (Knox et al. 2006). Furthermore, faith-based organizations can afford to disclose less than their secular counterparts (Tremblay-Boire & Prakash, 2015) and engage in political activity (Backer, 2016) (which is prohibited by law) because the public trusts in the morally of their goals (Tremblay-Boire & Prakash, 2017).

A related finding is an input-output problem. Since tax exemptions are granted based on input activities rather than outcomes, community benefits that exceed the tax-exemption cannot be guaranteed (Rubin et al., 2013). For example, in the health sector, which is the largest recipient of tax benefits, the assumption that tax exemption increases community benefits does not hold (Bloche, 2006). Alternatively, in the education sector tax-exempt nonprofits with little or no social mission, such as National Collegiate Athletic Association (NCAA), can access the exemption benefits if they operate in a charitable way (Colombo, 2010; Leff, 2014). Even marijuana sellers have managed to avoid taxes by registering as 501(c)(3) (Leff, 2014).

We also find problems with misleading assumptions regarding efficiency of social value delivery. We discover that such lenience towards tax-exempt nonprofits may actually foster organizational inefficiencies (Knox et al., 2006). This is supported by empirical evidence suggesting that the costs of tax-exemptions may actually exceed the aggregate benefits (Rosenbaum et al., 2015). In 2018, Herring et al. found that community benefits exceeded the tax exemption for only 62% of hospitals receiving such exemptions. Interestingly though, for-profit hospitals deliver similar social benefits despite their tax obligations (Schlesinger & Gray, 2006). Herring et al. (2018) argued strongly for a re-evaluation of tax-exempt status as an instrument and incentive. Many tax-exempt nonprofits benefit from it, but do not provide equal social value. In other words, taxpayers' investment is not returning enough social benefits.

Another assumption that seems problematic is that tax exemptions are necessary to protect tax-exempt nonprofits from unfair competition. Hines et al. (2010) and Mayer, (2012) argue that competition and consumer demands might undermine the uniqueness of the tax-exempt category. They argue that competition is likely to be detrimental to a charity's pursuit of public benefit (Mayer, 2012) and eventually trigger misbehavior in nonprofits (Hines et al., 2010). However, evidence show that protecting tax-exempt nonprofits from additional competition may not be justified. In his analysis of the 2004 report on competition and health care, by the Federal Trade Commission and Department of Justice, Colombo (2006) shows that exposure to competition is indeed beneficial and not likely to hinder efficient tax-exempt nonprofits from meeting their goals. Both tax-exempt nonprofits and non-tax-exempt social enterprises deliver important social benefits, far exceeding the contributions of tax-exempt nonprofits alone. In the health sector, for example, Bloche's (2006) review reveals that while nonprofits tend to deliver slightly more community benefit than other nonprofits or for-profits, there is no evidence that tax exemption is the cause. Hines et al. (2010) suggest that offering similar tax treatment to for-profits engaging in charity (e.g., L3Cs – which are for-profit structures that have a social mission as their primary goal) might encourage greater charitable entrepreneurship and healthy competition for the whole sector. This is relevant because evidence show that grassroot nonprofits create equal social value when compared to tax-exempt nonprofits, despite having a smaller market share (Kanaya et al. 2015). In Colombo's (2006) view, more competition within social industry would improve the net benefits. Despite the evidence, tax-exempt nonprofit organizations tend to receive excessive attention and benefits, which ultimately undermines the potential contribution of other social enterprises (Til, 2009), stifles competition and potentially destroys social value.

Returning to the introduction, there appears to be policy alignment issues between what tax-exempt nonprofits say they are (mission), and not what they do (behavior). Existing literature examining value detraction across disciplines suggests that many important aspects of prosocial efforts have been overlooked by policymakers and regulators (Bloche, 2006; Colombo, 2006, 2010; Leff, 2014). Appreciating that their initial intention was to grant a small number of organizations tax-exempt status, we see evidence of intemperance. Such excess – in this case granting tax-exempt status to multiple organizational variations – has broadened the category, thereby creating complications, disruptions and abuses that regulators aim to patch with further regulations.

Condition 2: Nonprofit management and governance distraction

Our findings suggest that, in value detracting tax-exempt nonprofits, lax governance and accountability are allowed and in fact often expected (Alexander et al., 2008). This is characterized by a normalization of managerial irresponsibility (Kummer et al., 2015); an unjustified perpetuation of trust (Felix et al., 2017; Rubin et al., 2013); unclear and fluid behavioral boundaries (Buckles, 2016; Aprill, 2014; Lavarda, 2009); and a misleading over-emphasis on socially superior goals (Knox et al., 2006). These issues become salient when rooted in the board of directors actions. Here, those responsible for setting appropriate limits shield themselves from normal management frustrations under a set of ambiguous yet accepted behavioral boundaries (Tillotson & Tropman, 2014). Metzger (2015) argues that misbehavior in these organizations is no longer surprising and in fact often expected, since there is no expectation of professional managerial behavior or close engagement (Bromley & Orchard, 2016; McGiverin-Bohan et al., 2016). Some authors point to external budget restrictions as a

driver of minor forms of misconduct. After analyzing a sample of 4,000 tax-exempt nonprofits with large assets, Almond and Xia (2017) found that these organizations tend to avoid reporting small negative returns, which instead appear as gains. This accounting pattern is present in a wide range of tax-exempt nonprofits, including faith-based and community organizations. This suggests that tax-exempt nonprofits behave much like for-profit organizations: having incentives to manipulate returns and finding ways to do so (Almond & Xia, 2017). Managerial and supervisory failures are part of a series of governance features that have long been fundamental in shaping how tax-exempt nonprofits operate (Jamail, 2014; 2016; Metzger, 2015).

In the view of Alexander et al. (2008), poor governance leads to poor reporting practices, which are protected by a form of moral self-licensing (Merritt et al., 2010), where misbehavior can be justified as it is outweighed by the all the good things the charity does. This in turn perpetuates a fallacy of trust in nonprofits' charitable behavior (Tremblay-Boire & Prakash, 2017). In these cases, trustworthiness is attributed to the nonprofit's purpose rather than actual behavior, which intensifies in cases of religious bonding (Tremblay-Boire & Prakash, 2015). Tremblay-Boire and Prakash (2017) suggest that the tax-exempt nonprofit category has yet demonstrated that it is worthy of the trust it receives, and this is difficult to achieve in the absence of good governance and reporting practices (Dhanani & Connolly, 2015; Lecy & Searing, 2014).

A related issue in tax-exempt nonprofits is that CEOs and board members tend to prioritize activities that contribute to forming perceptions of higher performance (Kramer & Santerre, 2010), even in situations where this might undermine beneficial (non-measurable) activities for the community. Indeed, evidence show that managers tend to turn to profitable activities when community benefit expectations are met (Vansant, 2016). Felix et al. (2017) show that nonprofits

operating in higher trust areas are more likely to overspend on administrative expenses. Disturbingly, this also occurs in periods of nonprofit starvation (i.e., a debilitating trend of under investment in organizational infrastructure), where tax-exempt nonprofits end up spending more on executive salaries and fundraising and less on staff wages (Lecy & Searing, 2014).

Furthermore, governance oversight issues are highlighted with the still blurry boundary between taxable and non-taxable activities (Yetman & Yetman, 2009), leading to problems of misreporting (Lecy & Searing, 2014). Since interpretation and flexibility is allowed, the line between the taxable and non-taxable activities can be moved based on convenience (e.g., when the taxable activities produce a relatively higher return); when tax-exempt nonprofits are under financial pressure (Foster & Bradach, 2005; Lecy & Searing, 2014; Yetman & Yetman 2009); or when basic community benefit expectations are met (Vansant, 2016). Indeed, Yetman et al. (2009) argue that there is a confirmation bias across the industry whereby taxable activities are often seen as charitable activities. This is interesting since prioritizing taxable over charitable activities under a nonprofit structure does not seem to deliver results. In a cross-industry study of revenue trends (1991-2001), reported on IRS 990 form, Foster and Bradach (2005) found that earned income accounts for only a small share of funding in most nonprofit domains. While complementarities can lower production costs and make it easier for tax-exempt nonprofits to allocate joint costs from tax-exempt to taxable activities (Yetman, 2003), nonprofit expansion into taxable markets might lead to mission drift and distraction from community benefits.

Interestingly, stricter regulation has not produced the expected effects on governance misconduct (Kerlin & Reid, 2010) and has proven insufficient to engage the underlying ethical imperative for boards to provide effective oversight (Magill & Prybil 2011). It also does not lead to higher community benefits (Singh et al. 2018). Even financial scrutiny is perceived as

negative, although it might lead to better performance, because it might have negative effect on the delivery of community benefits (Principe et al., 2012). As Bromley and Orchard (2016) explain, although the development of codes of practice may lead to higher standards of ethical behavior, they tend to be used as a legitimizing symbol in a cultural context of professionalization. Alexander et al. (2008) reinforce this point by showing that while lax governance has led to new mandatory board structures and practices, the evidence points to a modest relationship between stricter regulation and improvements in governance quality. Even seminal pieces of governance regulation, such as California's Nonprofit Integrity Act of 2004, have proven inefficient in improving the quality of financial reporting, only increasing accounting fees and administrative burden (Neely, 2011).

Since punishment for governance infractions tends to be merely symbolic, the immediate consequences are tenuous and mostly linked to a momentary loss of legitimacy and potentially a reluctance of donors to continue supporting the organization if legitimacy is not restored. Expectedly, tax-exempt nonprofits tend to turn their attention to contingent symbolic management (Zott & Huy, 2007) and unquantifiable activities that only contribute to legitimacy (Byrd & Landry, 2012); e.g., unilateral website disclosures (Tremblay-Boire & Prakash, 2015). Bromley and Orchard (2016) show that in those circumstances, tax-exempt nonprofits tend to focus on codes of practice that symbolize their commitment to accountability and self-regulation, thus signaling their legitimacy. Dhanani and Connolly (2015) found that disclosure content is frequently guided by the opportunity to showcase the organization in a way that increases its legitimacy. In a similar vein, tax-exempt nonprofits also tend to engage in efforts to depict a positive view of their financial position, hiding small negative returns (Almond & Xia, 2017) and lobbying efforts (Leech, 2006).

In sum, across disciplines, much of the existing literature suggests that serious governance and oversight issues exist. Kramer and Santerre (2010) suggest that many of these issues have evolved into a generation of bad role models, embedded distraction and normalized immaturity. However, solutions such as increasing compliance and governance may not be a silver bullet solution, and may in fact decrease nonprofit performance (Alam, 2011; Blumenthal & Kalambokidis 2006; Keating & Frumkin, 2003; St. Clair, 2016). Principe et al. (2012) argue that authorities should instead focus on mission nurturing and scrutiny, rather than financial scrutiny only. Bradley (2015) shows that accountability and transparency can indeed improve, not through stricter regulation but rather when the community (Berg, 2010), employees and other stakeholders get actively involved. This moves the locus of the anti-fraud measures from external agents to the employees themselves who, once engaged, are less likely to commit fraud and more likely to dissuade their peers from misbehavior. Interestingly, similar debates around community involvement in social wealth creation have also started in management research (e.g. Lumpkin & Bacq, 2019; Markman et al., 2019). Unfortunately, governments and nonprofits alike still pay disproportionate attention to tax exemptions and competition disregarding the role that employees and beneficiaries can play in the improvement of reporting practices and nonprofit management more broadly (Berg, 2010; Bradley, 2015).

Condition 3: Detection and prosecution inconsistencies

Our examination reveals a tenuous relationship between tax-exempt nonprofit misconduct and external enforcement and prosecution (i.e. by the Internal Revenue Service (IRS) or criminal justice). Evidence suggests that nested within this tenuous relationship is the issue of unintentional avoidance of misconduct detection and prosecution.

First, detection and prosecution are seen as inconvenient and non-conducive for a number of reasons, pertaining to enforcement power, chances of repayment, and ineffectiveness of current mechanisms. Hackney (2017) suggests that the IRS does have the teeth but not the time, effort and energy to have appropriate oversight. As such, it is limited in its ability to prevent misconduct and fraud. This, despite the 1996 and 2002 amendments that gave the IRS further flexibility in pursing nonprofit wrongdoers (Gilkeson, 2007). This is aggravated by the fact that monetary and reputational costs of detecting and prosecuting tax-exempt nonprofits are seen as overshooting the sum of the community benefits provided (Peters, 1995). As Singh et al. (2018) show in their study of community benefit spending, for more than 18,000 hospitals in the United States, stricter oversight alone does not lead to higher community benefits. This is particularly worrisome considering evidence suggesting the chances of repayment, after a successful prosecution, are actually very low (Peters, 1995). Relatedly, evidence points to external oversight inconsistency issues pertaining to the types and uses of fraud detection instruments. In their study of fraud in Australia and New Zealand, Kummer et al. (2015) found that most fraud detection measures do not increase detection. The most effective instruments – fraud control policies, whistle-blower policies and fraud risk registers – are rarely used, and the most commonly used, are not necessarily the most effective.

To deal with this problem, Hielscher et al. (2017) suggest that detection and prosecution agencies should transfer or at least share oversight responsibilities with the tax-exempt nonprofits, focusing on collective self-regulation instead. However, this takes us back to the problem of expected unprofessional managerial behavior. Professionalization promotes self-regulation (AbouAssi & Bies, 2017), but there are little expectations of this becoming a norm in tax-exempted nonprofit world (Kummer et al., 2015).

Another source of inconsistency relates to reputational risks for detection and prosecution agencies (Marks & Ugo, 2012). If prosecution of tax-exempt nonprofits is unsuccessful, the IRS may be placed under the spotlight as a tormentor of do-gooders, who become victims in the process (Gilkeson, 2007). The problem of external oversight prevails when the IRS is criticized as misaligned with the intended benefits of tax-exempt nonprofits, which occurs when they target a 'few bad apples' (Mead, 2008). Aprill (2014) attributes this to a fundamental problem with the IRS's enforcing power highlighted above. It is not surprising then that detection and prosecution end up focusing on damage control rather than on fraud detection measures that can actually reduce damage (Kummer et al., 2015).

We also find that inconsistencies in the role of public scrutiny in impacting detection and prosecution. After analyzing ~2,000 regulatory investigations in the UK between 2006-2014, the authors conclude that investigations are most likely to be triggered by complaints from members of the public, particularly around issues concerning governance and misappropriation of resources. However, the effect of public scrutiny varies inconsistently. When it comes to fraud, public scrutiny increases in line with amount of tax exemption received, not with the severity of the fraud itself. In the best-case scenario, it varies with the nonprofit category involved, the type of victims and the perpetrators (Greenlee et al., 2007). This is problematic since size of tax benefit tends to influence public perception regarding community benefits delivered (Rosenbaum et al., 2015). So, when it comes to the effect of public scrutiny on detection and prosecution, it all becomes a game of perceptions.

Finally, stricter regulatory compliance tends to trigger the development of more complex nonprofit structures. After observing five environmental nonprofit groups in the United States, Kerlin and Reid (2010) found that instead of improving reporting practices, stricter regulation

incentivizes nonprofit to combine organizational structures, finances, and programming and form additional, related tax-exempt entities. Others argue that stricter regulatory compliance ends up suffocating nonprofits as it leads to unnecessary burden (Alam, 2011) and costs (Blumenthal & Kalambokidis, 2006). In a study of 30,841 public charities in New York, St. Clair (2016) found that the burden and costs associated with financial regulations further increase avoidance behavior. High revenue tax-exempt nonprofits either forego or fail to report in avoidance of the requirements. This becomes paradoxical, since stricter regulation ends up decreasing the efficiency of the misconduct reduction measure. In their study of environmental tax-exempt nonprofits, Kerlin and Reid (2010) show that changes in regulatory policy compounds complexity – such as reshaping the organizational structures, finances and programming – without effectively reducing wrongdoing. In light of this, lack of prosecution either gives tax-exempt nonprofits leeway or overlooks misconduct until the problem reaches the media, if ever (McDonnell & Rutherford, 2017). This problem is also linked to issues with the application of tax rules. As seen in the NCAA and Marijuana sellers, tax rules are not entirely clear for several sub-categories (Colombo 2010). In the case of some taxable activities, the creation of joint ventures and sub-organizations within the extant tax-exempt nonprofit structure, makes it difficult for the IRS to decouple activities. This makes oversight more complex and fraud detection and prosecution highly inconvenient. Compounding this are occasional breaches in scope of activities clarity. After studying a sample of 110 nonprofits receiving tax exemptions, the IRS found that in 2004 75% of them had violated tax law by engaging in political campaign activities that year. Many of these organizations simply did not understand the scope of prohibition. Instead of lobbying in their personal capacities, their leaders mistakenly spoke on behalf of their organizations (Lavarda, 2009).

In sum, we can observe an emerging cross-disciplinary agreement in terms of problems with external oversight. Perhaps, as Singh et al. (2018) suggest, instead of devoting efforts in ineffective and counterproductive external prosecution, regulation should focus on bringing beneficiaries closer to the service providers, their mission, and reporting mechanisms. They [Singh et al.] propose allocating more resources on understanding community needs, which would in turn trigger more extensive and accurate community benefit spending.

Self-reinforcing conditions and the emergence of value detracting triad

In Table 2, we offer a summarized view of conditions and respective enablers, which collective explain value detraction.

---Insert Table 2 about here---

Examining the table above, we noticed that they interact and reinforce each other. Our findings suggest that policy and regulatory intemperance enables and nurtures negative behavior in some tax-exempt nonprofits, which is sustained over time through oversight distractions, rooted in frail management and governance structures. Such distraction leads to normalizing misbehavior ranging from lax governance to fraud, which is problematic for tax-exempt nonprofits, their beneficiaries, and the category as a whole. Simultaneously, regulators and other enforcing agencies face additional complications due to the inherent regulatory complexity and the reputational and financial risks associated with prosecution. Consequently, prosecution is seen as inconvenient and avoided when possible. This amplifies the problem of policy intemperance, as tax-exempt nonprofits are seen as requiring continuous protection in the form of exclusive incentives and unsophisticated enforcement.

Interactions and self-reinforcing mechanisms form a value detracting triad, which forms the basis of a framework for spotting negative return situations. We argue that in the presence of three of these conditions, negative returns to society are likely to be sustained and encouraged. Even more disturbingly, they will likely escalate over time. Figure 1 provides a visual representation of how the conditions interact and reinforce each other, leading to varying levels of value detraction.

--- Insert Figure 1 about here ---

DISCUSSION

A unique and underexplored aspect of nonprofits are the tax exemptions they receive, which are given in exchange for the value they delivered to communities (Buckles, 2005; Walker & Sipult, 2011). Even though this community benefit principle is a widely used logic for granting tax exemptions, there is far too much room for interpretation and manipulation. Tax-exempt nonprofit value detraction is a big problem that cuts across policy, management and prosecution domains. Scholars and policymakers need to step up to this research challenge because not all tax-exempt nonprofits deserve the tax exemption they receive. To determine the value that each tax-exempt nonprofit is creating for society (both positive and negative), a good, reliable, and repeatable calculous for return on tax exemption is needed. This is particularly relevant in situations of detraction and requires a clear understanding of the antecedents leading to value detraction. Therefore, in this paper we focus on the conditions under which tax-exempt nonprofits detract value from society.

Grounded in 15 years of cross-disciplinary research, we identify three main conditions that drive negative returns to society: *policymaking and regulation intemperance, nonprofit*

management and governance distraction, and *detection and prosecution inconsistencies*. We blame three entities – policymakers, nonprofits, and enforcing bodies – for the these three conditions, which account for the complexity of the value detracting problem. Overall our finding can be used to inform future scholarship and policymaking. We proceed by focusing on the implications of each of our three findings, more specifically, the types of research questions that scholars should be trying to answer and the implications for policymakers, i.e. what they should be asking themselves right now.

Research implications

Advancing management research on tax-exempt nonprofit policymaking and regulation. Tax exemptions continue to be granted in a broad and unreflective manner, despite the evidence of negative returns, uneven expectations, and confusing assumptions. Two areas of scholarship worth expanding are: category membership and competition.

Tax-exempt nonprofits are granted tax-exempt status because of what they say they are (charitable purpose and mission), and not because of what they do (behavior and outcomes). This is a serious issue, deserving attention, as it impacts organizational legitimacy, performance and accountability. So far, tax exemptions have been viewed as a distinctive feature of nonprofit organizations, acting as a powerful classification mechanism for nonprofits. Such distinctions are important because they act as a valuable mechanism in market efficiency (Vergne & Wry, 2014), define boundaries for competition (Colombo, 2006), regulate market size (Kanaya et al., 2015) and ultimately reflect nonprofit's efforts to fit in and stand out (Hannan, Pólos & Carroll, 2007; Hsu, Hannan & Pólos, 2011; Negro, Hannan & Rao, 2010). The profits made by the NCAA and Marijuana sellers, the fact that grassroot organizations are excluded from the category (despite

their purpose and value created), and the incongruences between the value of tax exemptions and perceptions of community benefits are clear signs of category conflicts, both in terms of membership and cross-boundary competition. This paper highlights a category dogma and reveals a problematic gap in our understanding of whether and how this classification mechanism works, what it actually delivers and if the value exceeds the costs associated.

Scholars ought to engage in research that reveals additional insights into the tax-exempt nonprofit category, such as who they are, what they do, whether and how they compete and what commensurable value they create. Answering questions about the actual prosocial value created and the impacts of broadening competition, to include non-exempt social organizations, would help advance policymaking in this space. For example, by tracking a set of prosocial organizations (some that have tax-exemptions and some that do not) we might be able to assess the true value and impacts that organizations create in communities, the cost-benefits of changing the existing exemption structures, and the advantages/disadvantages of modifying accountability approaches. Overall, this may yield interesting insights into tax-exempt nonprofit misconceptions, such as their lack of distinctiveness, societal trust, true legitimacy, and membership as a critical first responder to issues of inequality and other grand challenges.

Advancing management research on tax-exempt nonprofit governance. Another finding is that tax exemptions are not matched with appropriate boundaries or expectations, and the neglect of accountability structures and poor governance are met with trivial consequences. In this context, two scholarly arenas may provide new and interesting insights: engaged governance and behavioral aspects of nonprofit management.

Firstly, the positive effect of volunteers and beneficiaries on accountability and governance practices has been largely overlooked by management scholarship and policymaking. Our

findings situate this issue at the intersection of these two realms and sheds light on two problems needing answers: how, why and with what consequences are volunteers and beneficiaries neglected by nonprofits and policymakers, and what new management knowledge and tools, at the intersection of taxation and governance, are required to effectively engage them as part of a more cohesive governance structures. Public administration scholarship has contributed to our understanding of collaborative public management and collaborative governance within governmental institutions (e.g. Leach, 2006. McGuire, 2006. Kapucu et al. 2009). Management research and organization studies are yet to provide answers to these thorny questions. We provide scholars with an enhanced platform upon which to understand and further examine these two critical areas.

Secondly, the value destroying triad we present here, highlights the need for more research that investigates the behavioral problems at the intersection of tax policy, governance in prosocial organizations, and oversight. Taxation regulation, as a motivator for desired behavior, has been traditionally taken for granted, especially in the field of management (Hanlon & Heitzman, 2010; Markman, Caton, & Gamble, 2020; Rupert & Wright, 1998). This includes productive and counterproductive effects of taxation on managerial decisions and actions (Hanlon & Heitzman, 2010; Rupert & Wright, 1998). Our evidence suggests that regulators and prosecutors may be perpetuating normalized improper managerial behavioral; failing to enforce category-appropriate limits; or shielding tax-exempt nonprofits from normal everyday business frustrations. As seen in other areas of human development (McIntosh, 1989), the conditions we identify can eventually escalate through the triad toward excessiveness, self-interest, and widespread immature conduct (Gupta, 1999), which turn a solvable managerial problem into an intractable one. Cognitive development research argues that overindulgent behavior leads to

unrealistic worldviews and diminishes skills such as perseverance, coping with failure in effective ways, and collaborating with others (Bredehoft et al., 1998). Management researchers interested in behavioral aspects of nonprofit governance could investigate, in experimental settings, the decision characteristics (Spicer & Becker, 1980; Stinson et al., 2017) of donors, nonprofits' managers, and recipients when tax and governance variations are used simultaneously to motivate or hinder behaviors. Our findings reveal that the explanation for misbehavior are more complex than originally thought, as it involves multiple levels, numerous causes, reinforcing cycles and intricate consequences.

Advancing management research on tax-exempt nonprofit detection and prosecution. Our last finding is that detection and prosecution of tax-exempt nonprofits is largely deemed inconvenient and non-conducive, which is matched with inconsistent fluctuations in public scrutiny. To advance management research, three areas should be considered. First, there is an opportunity for scholars to investigate ways to develop a deeper appreciation for nonprofit value destroying detection and prosecution. This means that it is essential that management scholars be well versed in political and legal discourse, integrating key legal cases into their contextual formulations. Academic activism in social sciences (Choudry, 2020), a renewed emphasis on public intellectualism (Dallyn et al., 2015; Marks, 2017) and the growing interest in academic engagement (Boa et al., 2010) and impact (Elangovan & Hoffman, 2019; Tihanyi 2020) can shed light on possible roads ahead.

The second area pertains to the counterproductive tendency of tax-exempt nonprofits expanding into taxable markets. the growing trend of hybrid business modeling in nonprofits has gone unanswered, under the assumption that an expansion into taxable markets can improve financial prospects and create more competitive (hybrid) charitable organizations (Haigh et al.

2015). Our findings show that the exploitation of complementarities is creating extremely blurry boundaries between taxable and non-taxable activities, not delivering economic value and affecting the capacity of government agencies to decouple complementary activities and detect and prosecute wrongdoers. more critical research on hybridity is needed. The double-edged sword of becoming a hybrid organization (with taxable and non-taxable activities), and the consequences thereof, have been largely explored at the level of logics and performance (Muñoz et al. 2018; Parker et al. 2018), but many questions are yet to be answered around the decoupling of hybrid logics, wrongdoing in hybrids as a result of entering taxable markets and the relationship between hybridity and detection and prosecution.

A third area pertains to the effect of political and religious orientation on detection and prosecution. As in the case of hybridity, research has largely overlooked the role and effect of political views, political campaigning and belief systems in organizations, beyond ethics, decision-making and strategizing (Gundolf & Filser, 2013). Our findings bring to light problematic situations at the intersection of tax rules, governance and prosecution, which yield unjustified asymmetries across sub-categories. This, in terms of how different tax-exempt nonprofits receive alternative prosecution treatments as a result of what they profess and advocate for, rather than what they do.

Policy implications

Policymaking and regulation. Policymakers should reconsider the relatively easy path that an organization can take to join the tax-exempt nonprofit category and how, and with what effects, they are being protected from competition. In general, this exemption status is granted when religious, educational, scientific, cultural, environmental, health, or human service organizations

meet the IRS's modest exemption criteria. This involves declaring a charitable purpose and a clear limitation of power. Alongside avoiding political activity, maintaining tax exempt status requires filling in an annual tax return (e.g. IRS Form 990) and adopting a series of approved practices: e.g. paying reasonable salaries, accounting for unrelated income, and maintaining basic governance formalities, among others. This simple set of requirements creates a series of knock-on effects within nonprofit markets and competition, which unintendedly leads to value detraction. One area that requires further attention is tax-exempt nonprofit reporting. The absence of thoughtful reporting mechanisms, such as a three-year integrated dashboard, overlooks a need to share insights on the return on exemptions. Simply put, more transparent modalities or tools where everyone can tell the extent to which every tax-exempt nonprofit is contributing to society would be helpful. Taken together, reducing the number of nonprofit tax exemptions, pushing for improved reporting mechanisms, and reconsidering why and how tax-exempt nonprofits are protected from competition are necessary steps. The high level of intemperance needs to be halted immediately.

Nonprofit management and governance. Policymakers need to engage with nonprofit leaders, so they are constantly focusing on the relationship between their exemptions, performance, and value created. As evidenced in this paper, exemptions may inadvertently encourage suboptimal performance – or worse, be used for nefarious purposes (Harris et al., 2017). Policymakers should be asking if more and clearer behavioral boundaries and expectations of the nonprofit management team are required. Most of the explanations so far have been focused on efficient causes and immediate consequences (i.e., the effect of stricter regulation on regulatory compliance). We see room for improvement which would require policymakers to expand their repertoire and consider also the material, formal and final causal

structures. Our research offers insights into alternative causes, such as, the interconnected effects of the physical properties of the tax exemption problem (e.g., role of the IRS Form 990); the tax-exemption blueprint (e.g., alterative mixtures of state and federal laws); and the ultimate purpose of the tax-exemption (e.g., community benefits).

Detection and prosecution. In terms of political and religious orientation, the fact that many churches are exempt from filing a form 990 should be a strong enough signal to policymakers (and the general public), interested in improving detection and prosecution mechanisms, that audit and assurance standards need to be raised. For example, places of religious worship should have to file returns, undergo audits, and at a minimum be required to pay land taxes. Not doing perpetuates the politicized nature of the benefit and assumed social value delivered by nonprofits. The reality is that tax exemptions are a taken-for-granted benefit and need to be thoroughly understood. To avoid further value detracting situations government actors must revisit their long-held belief that tax-exemptions, particularly the associated controls, should continue along the same path. Answering some of the questions raised above can aid agencies toward this end. National and local criticisms of the IRS's over-supply of tax exemptions continue, especially in cases of Ivey league schools with multi-billion-dollar endowments and institutions garnering exemptions based on religious grounds. This evidence should be another signal that building stronger alignment across tax-exempt nonprofit entities – through policy, governance, and detection and prosecution – is needed.

CONCLUSIONS

This paper advances an understanding of the darker side of nonprofit tax exemptions, by clarifying the interacting conditions under which tax-exempt nonprofits detract value from

society: *policymaking and regulation intemperance*, *nonprofit management and governance distraction*, and *detection and prosecution inconsistencies*. In doing so, we show how a siloed understanding of value detraction is problematic. We shed light on ways forward, by describing key antecedents of value detraction. Through our findings, and recommendations, we hope to inspire more research in this space and also move the needle on much needed policy change.

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TABLE AND FIGURE

Table 1. Value detraction in tax-exempt nonprofits: conditions, enablers and evidence

Condition 1. Policy and regulation intemperance

Enabler 1.1

- Value of tax exemptions is contingent upon perceptions of community benefits, not actual value delivered (Herring et al., 2018). As such, expectations of social value return increases with amount of tax exemptions (Owens, 2005).
- Tax rules are not entirely clear for several nonprofit sub-categories. Regulator struggle to decouple non-taxable organizations with taxable activities (Colombo, 2010).
- For secular nonprofits, there are high expectations of social value creation over tax exemptions, social value needs to be proven and they are more likely to be held accountable for it (Knox et al., 2006). For faith-based nonprofits, there are high expectations of social value creation over tax exemptions (Kearns et al., 2005) and they are more likely provide services to vulnerable people (White et al. 2010), but there is no need for this to be demonstrated and they are less likely to be accountable for it (Knox et al. 2006).
- Definition of charitable is contingent on needs of local governments (Walker & Sipult, 2011). However, in the USA where States allow for the emergence of nonprofit organizations, tax exemption can only be granted by federal law. This, since federal law has taken over the law of charity, undermining State law (Jamail, 2014).
- Tax exemption is justified based on input activities, not outcomes. Instruments cannot capture benefits against which tax status is granted (Rubin et al., 2013). Tax exemptions can be even justified in cases with clear negative outcomes (e.g. marijuana industry) but concrete charitable purpose (Leff, 2014).

Enabler 1.2

- Tax-exempt nonprofits provide more community benefits than the financial support they receive (Turner et al. 2016), yet there is no differential financial performance (Colombo, 2006), given tax exemptions.
- Nonprofits deliver more social value than for-profits, but mandatory community benefits - due to tax exemptions - undermines mission and social outcomes (Horwitz, 2006).
- Faith-based tax-exempt nonprofits provide more community benefits than secular tax-exempt nonprofits. Yet, growth rates are the same and benefits level off under crisis (Ferdinand et al. 2014).
- While for-profit organizations and social enterprises (e.g. L3Cs) tend to be more efficient than tax-exempt nonprofits (Hines et al., 2010), it is unclear whether tax-exempt nonprofits are more efficient than grassroot nonprofits in the social sector (Til, 2009).
- Likewise, while secular tax-exempt nonprofits tend to be more efficient than faith-based tax-exempt nonprofits it is unclear whether the former create more social value than the latter (Knox et al. 2006),
- In healthcare, there are differences in the performance of nonprofit and for-profit hospitals, however it is unclear whether these differences are large enough to justify a sizable subsidy (Hyman & Sage, 2006).

Enabler 1.3

- Tax-exempt nonprofits are perceived to be more valuable than other social organizations (Til, 2009) , yet L3Cs, tax-exempt nonprofits and grassroot nonprofits provide equal social value (Cram et al., 2010).
- Grassroot organizations create equal social value than tax-exempt nonprofits, but they have smaller market share (Kanaya et al., 2015) and are normally neglected by policy and regulation (Til, 2009).
- Tax exemptions do not lead to greater community benefits. Tax-exempt nonprofits provide marginally more value, but tax exemption is not the cause (Bloche, 2006)
- While tax-exempt nonprofits tend to provide more community benefits than the financial support they receive, there is no evidence of differential financial performance (Colombo, 2006) to justify unfair competition.
- Exposure to competition seems beneficial (Colombo, 2006), yet more competition can eventually trigger misbehavior in nonprofits (Hines et al., 2010). Also, small tax-exempt nonprofits tend to struggle when it comes to accessing capital markets (Calabrese & Ely, 2015). Hence competition is avoided.

Enabler 1.4

- Tax-exemption is a constitutive element of tax-exempt nonprofits, creating a distinct category (Mayer, 2012)

and meaning of charity (Dal Pont, 2015), and it is considered central to building nonprofit sector (Hu, 2015).

- Competition and consumer demands might undermine tax-exempt nonprofits' inner characteristics and uniqueness (Hines et al., 2010; Mayer, 2012).
- Opening tax exemption to others is too complex to regulate and too complex to govern, and if other social enterprises want tax exemption, they should enter the tax-exempt nonprofit category (Hines et al. 2010).
- Changes in charity law might change the meaning of charity (Dal Pont, 2015).
- Collaboration is counterproductive. In healthcare, joint venturing between tax-exempt nonprofits improves collaboration and efficiency, but it threatens tax-exempt status (Smith, 2004).

Condition 2. Nonprofit management and governance distraction

Enabler 2.1

- Public policy doctrine fails to provide fair notice to nonprofits as to what behavior is and is not consistent with maintaining tax exemptions (Buckles, 2016).
- There is an assumption that the actions of managerial teams are to be trusted given the orientation and input activities of tax-exempt nonprofits (Felix et al., 2017; Rubin et al., 2013; Tremblay-Boire & Prakash, 2017). Trust is particularly assumed in religious nonprofits, despite low levels of disclosure (Tremblay-Boire & Prakash, 2015). This is problematic since in the absence of effective enforcement mechanisms, trust can be exploited, e.g. overspending (Felix et al., 2017)
- Behavioral boundaries are unclear as to what management and board members are not allowed to do, e.g. engage in political activity (Aprill, 2014; Lavarda, 2009).
- There are little expectations of professional behavior across in tax-exempted nonprofits - weaker internal controls and lack business and financial expertise (Kummer et al., 2015). Misbehavior is not surprising, it is oftentimes justified and even expected (Metzger, 2015).
- Distracted boards in pursuit of socially-superior goals may diverge from efficiency (Knox et al. 2006) and allow nonprofit CEOs to create and exploit informational asymmetries (Tillotson & Tropman, 2014).
- Taxable activities can lower production costs and increase returns (Yetman, 2003) and CEOs prioritize activities that contribute to their performance and pay (Kramer & Santerre, 2010).
- Managers turn to profitable activities when community benefit expectations are met (Vansant, 2016), when under pressure or is convenient to do so (Yetman, & Yetman, 2009) and there is a tendency to see taxable activities as charitable - non-taxable (Yetman et al., 2009).

Enabler 2.2

- Poor accountability and reporting practices are common across tax-exempt nonprofits (Lecy & Searing, 2014; Dhanani & Connolly, 2015). Misreporting worsens as competition for resources increases. In addition, tax-exempt nonprofits make efforts to depict a positive view of their financial position. Tax-exempt nonprofits manipulate reported investment returns, avoid reporting small negative returns which instead appear as gains (Almond & Xia, 2017).
- Input activities and spending remain to be an inadequate proxy for social value (Rubin et al., 2013). While enhancing financial rewards for measurable outcomes is positive, it undermines providers' commitment to non-measurable community benefits (Schlesinger & Gray, 2016).
- Fraud in tax-exempt nonprofits remains largely anecdotal, it mostly damages reputation and legitimacy (Archambeault et al., 2015). It does not affect current status of tax-exempt nonprofits. It only reduces their chances of getting funding next period (Greenlee et al., 2007; Petrovits et al., 2011).

Enabler 2.3

- Lax governance has led to new mandatory board structures and practices. Yet, strict regulation does not change practice (Gilkeson, 2007), trigger ethical imperatives (Magill & Prybil, 2011) nor avoid misconduct (Kerlin & Reid, 2010).
- Increasing financial oversight is perceived as negative as it might have a detrimental effect on the provision of community benefits (Principe et al., 2012).
- Stricter law and guidelines do not change management toward delivering better community benefits (Coyne et al., 2014)

Enabler 2.4

- Accountability and transparency improve and fraud decreases in tax-exempt nonprofits when employees and/or beneficiaries are involved (Pennel et al., 2017), so are community benefits (Singh et al., 2018). Yet, they are oftentimes neglected as agents (Berg, 2010; Bradley, 2015).
- Governments and nonprofits tend to pay instead excessive attention to tax exemptions and competition (Berg, 2010).
- Accountability and financial transparency regulations increase burden for tax-exempt nonprofits, which results in accountability and transparency being avoided, i.e. avoidance behavior (St. Clair, 2016)

Condition 3: Detection and prosecution inconsistencies

Enabler 3.1

- Misleading justification for no prosecution: Lack of enforcement power and low chances of repayment if prosecution is successful (Hackney, 2017), charitable purpose can disguise fraud (Webber & Archambeault, 2019), problem is not sufficiently serious in the context of overall tax fraud and fraud detection measures are not effective (Kummer et al. 2015).
- Generalized lack of criticism regarding problems in revenue service oversight, including failure to enforce the tax law equitably (Blank, 2017).
- Commonly used fraud detection instruments tend to be ineffective (Kummer et al., 2015). Fraud detection and prosecution are inconsistent as they fluctuate depending on the characteristics of nonprofit category, type of victims and perpetrators (Greenlee et al., 2007).
- If administrative and political costs are greater than benefits of revenue, local officials are more likely to solicit voluntary payments from tax-exempt nonprofits (Longoria, 2014).

Enabler 3.2

- There are reputation risks for IRS if prosecution of tax-exempt nonprofits is unsuccessful, since enforcement from revenue service agencies can be seen as excessive facing unprotected tax-exempt nonprofits (Marks & Ugo, 2012)
- While fraud detection measures can reduce damage, detection and prosecution focus is rather placed on damage control (Kummer et al. 2015).

Enabler 3.3

- Size of tax exempted influence public opinion regarding community benefits provided. The higher the tax exemption, the higher the expectation (Rosenbaum et al., 2015).
- Media exposure influences disclosure, but level of disclosure depends on regulatory incentives (Tremblay-Boire & Prakash, 2015).
- Public scrutiny regarding fraudulent activities increases in line with amount of tax exemption and is contingent on nonprofit category and the type of victims and perpetrators (Greenlee et al., 2007)
- Lobbying increases in line with level of engagement and tax exemptions (Leech, 2006).

Enabler 3.4

- If misconduct is detected, punishment tends to be symbolic. Disclosure of internal control problems over financial reporting leads to fewer contributions in the subsequent year (Petrovits et al., 2011).
- Current instruments are insufficient to capture the already underlying complexity of tax-exempt nonprofit activity (Colombo, 2010).
- Stricter enforcement increases regulatory complexity further and triggers the development of more complex non-profit structures (Kerlin & Reid, 2010) leading to accountability concerns (McDonnell, 2017).
- Stricter compliance and enforcement create unnecessary burden (Alam, 2011) and costs (Blumenthal & Kalambokidis, 2006) and might lead to avoidance behavior, further misconduct (St. Clair, 2016) and less community benefits (Alam, 2011; Singh et al., 2018).

Table 2. Summary of conditions leading to value detraction

Policy and regulation intemperance	**Enabler 1.1 Uneven expectations of social value return over tax exemptions:** Policy and regulation are inconsistent in their expectations of community benefits and accountability over the amount of tax exemption benefit and type of charitable activity. This results from conflicting, oftentimes counterproductive, law structure and unclear definitions over what social value is, how it is created and reported.
	Enabler 1.2 Misleading assumptions efficiency-social value relationship: Policy and regulation persist in granting tax exemptions, misleadingly, as a way of off-setting the assumed performance differentials across the social sector, which results from social value creation. The higher the perception of social value, the lower the expectation of efficacy, the more the tax exemption is justified. However, evidence does not support the premise of efficiency differentials or that lower efficiency results from higher value creation.
	Enabler 1.3 Misleading assumption protection from competition: Policy and regulation persist in granting tax exemptions, as a way of protecting tax-exempt nonprofits from unfair competition across social sector. This, under the assumption that tax-exempt nonprofits are less competitive than other social organizations, given their orientation and that unfair competition can trigger misbehavior. So that, when tax-exempt nonprofits are protected more social value can be created and fraud avoided. Evidence supports differences in expectations, yet there are no differences in actual social performance given tax-exemptions.
	Enabler 1.4 Unsubstantiated obstruction of other social organizations: Policy and regulation are reluctant to open tax exemptions to other social organizations as it might create unnecessary regulatory and governance complexity and undermine uniqueness of tax-exempt nonprofit category. This under the assumption that tax-exemption is a constitutive and non-separable element of tax-exempt nonprofits Evidence does not support increments in regulatory complexity.
Nonprofit management and governance distraction	**Enabler 2.1 Unclear behavioral boundaries and expectations of misbehavior in management teams:** Unclear behavioral boundaries and distraction allow for managerial misconduct, which has become normalized in and across managerial teams. Fuzzy boundaries between taxable and non-taxable activities influence (mis)behavior of management teams and decisions regarding tax payments are contingent upon circumstances.
	Enabler 2.2 Trivial consequences of poor governance practices: Poor accountability and transparency are common across tax-exempt nonprofits. The effects of wrongdoing tend to be seen as inconsequential. Most of the damage is solely reputational and there is little effect on current funding or likelihood of criminal prosecution.
	Enabler 2.3 No changes in management and governance under stricter rules: Management teams and managerial behavior are frequently unresponsive to stricter regulation and compliance. It can create counterproductive effects, impacting both ethical behavior and social value creation.
	Enabler 2.4 Neglect of positive influencers of accountability and governance: Direct engagement with key stakeholders (beneficiaries, employees and volunteers) increases accountability and transparency across tax-exempt nonprofits, yet they are frequently neglected by management teams and their potential influence on accountability and governance tends to be neutralized.
Detection and prosecution inconsistencies	**Enabler 3.1 Stricter detection and prosecution are seen as inconvenient and non-conducive:** Costs of detection and prosecution tend to overshoot benefits. This is particularly problematic when detection and prosecution agencies lack sufficient resources and face reputational risks. Detection and prosecution tend to be avoided.
	Enabler 3.2 Reputational risks in stricter detection and prosecution: Given the nature and assumed value of tax-exempt nonprofits, detection and prosecution mechanisms weight in the reputational risks in case of prosecution failure. Detection and prosecution tend to get distracted focusing on secondary aspects, such as damage control or reputation.
	Enabler 3.3 Inconsistent fluctuations in public scrutiny affects action of detection and prosecution: Public scrutiny has a positive effect on reducing misconduct, as it influences behavior of nonprofit and detection and prosecution agencies. However, public scrutiny is largely skewed, influenced by amount of exemption, size and type of nonprofit involved. This creates distortions in detection and prosecution.
	Enabler 3.4 More detection and prosecution is perceived as ineffective: Stricter and more sophisticated detection and prosecution instruments increase regulatory complexity and do not change governance behavior or reduce fraud. Regulatory complexity is avoided.

Figure 1. The tax-exempt nonprofit triad: A framework for identifying value detracting situations