

PERCENTAGE PHILANTHROPY PROJECT
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**The system of 1% designation and other forms of
support for NGOs in Hungary**

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I. The “1% Act” in Hungary

The beginnings

The introduction to Act CXXVI of 1996 on the Use of a Specified Portion of Personal Income Tax According to the Designation of the Taxpayer notes that the legal basis for the Act is laid down in Act CXVII of 1995 on personal income tax. After a decade has gone by, it is worth recalling that paragraph 45 of the Act on personal income tax passed on 12 December 1995 states that:

(1) Individuals can dispose of 1% of their consolidated tax base remaining after the deduction of tax allowances (the tax paid) in the tax declaration. The Hungarian Tax Authority (APEH) will transfer this sum to the beneficiary designated in the declaration.

(2) The beneficiary mentioned in paragraph (1) can be an organisation, institution, fund or foundation pursuing or promoting the public good.

(3) A separate Act governs the process of implementing the disposition set forth in this paragraph.

This separate Act was given a rather long-winded name and is generally known as the “1%Act”. The authors of these three short sections of the Personal Income Tax Act may not have realised that they were creating the principles and legal basis of a commendable model for funding non-governmental organisations (NGOs). The Act created a system of regular government funding, gave taxpayers the right to designate part (albeit a symbolic part) of their tax to an eligible recipient, and created a new framework for the relationship between taxpayers and NGOs.

The process of embodying these modern and elevated principles in actual legislation was a complex one. The preliminary drafts were only made available to those concerned (i.e. NGOs) and were mainly discussed at forums organised by Members of Parliament concerned with the NGO sector. Parliament included the matter in its timetable for the autumn 1996 session, and detailed discussions of the Bill at committee stage took place between 28 November and 11 December 1996. It is interesting to study the minutes of these committee sessions, which reveal several surprising contributions from today’s perspective. For instance, on 5 December, the Budget Committee discussed whether sport should be designated an activity of public benefit. On 11 December, there was a proposal that taxpayers should choose their favoured NGO from an official shortlist. The Budget Committee also discussed whether taxpayers should make the designation by filling in an APEH form or by sending a letter. These examples of discussions that took place just before the Act

was passed show how novel the proposed legislation was and how new the subject was to MPs.

It should be noted that funding transferred through the 1% system involves government expenditure. Although taxpayers choose the recipients, the amounts designated do not come from their own pockets but from income tax paid to the state. Paragraph (5) of § 7 of the 1% Act states: "the sums transferred to the beneficiaries are defined as government support, the allocation of which is regulated by the tax authority in accordance with the relevant provisions of Act XCII of 2003. The tax authority is entitled to reclaim any sums not used for public benefit purposes".

The 1% Act was finally passed by Parliament on 19 December 1996. The joyful and enthusiastic welcome given to the Act by NGOs was tempered by the clumsy wording of the Act and also by the fact that sums could also be designated to government funds and government-funded institutions. A particular source of friction was the fact that NGOs had to have been in operation for three years in order to be eligible for support, whereas the "waiting period" for public foundations (which are government-funded) was only one year. It also emerged that the founding statutes of many NGOs failed to meet the legal requirements. Potential beneficiaries had to provide documentary evidence that they had no arrears in their payments of tax, customs duty or social security contributions. (In the first year, several NGOs found that they could not meet this requirement.)

In the first part of 1997, NGOs were getting to know the 1% Act, launching their first fund-raising campaigns and, in some cases, amending their founding statutes. APEH figures for 1997 show that 15,949 organisations received a total of just over HUF 2 billion (approx. EUR 8 million) as a result of 1,058,362 tax designations. These figures indicate that the scheme was a huge initial success with taxpayers and NGOs alike. What was especially striking was the large number of organisations that received support. Furthermore, the figure provided an effective guide to the number of NGOs that were actually active, as against the number that were merely officially registered.

On 15 December 1997, Parliament passed Act CLVI of 1997 on public benefit organisations and the new law came into effect on 1 January 1998. The content, spirit and phraseology of this Act had a major impact on the 1% Act.

Amendments to the 1% Act now defined potential beneficiaries as:

- a) organisations promoting the public good, as defined in Act II of 1989 on the right of assembly (except for political parties, trade unions and employers' organisations), that were officially registered at least two years before the first day of the fiscal year for which the designation is made, and

- b) foundations that were officially registered at least two years before the tax year in question, furthermore
- c) bodies that were officially registered as eminently public benefit organisations or public foundations at least one year before the fiscal year in question or whose founding statutes or articles of association state that they pursue activities of public benefit as defined in point c of § 20 of Act CLVI of 1997 on public benefit organisations at least one year before the first day of the fiscal year in question.

The inclusion of the phrase “pursuing activities of public benefit” in the 1% Act at first led many people to believe that only organisations officially registered as “public benefit” or “eminently public benefit” could receive 1% funding. However, detailed analysis and exhaustive interpretation of the Act made it clear that what was important was not an organisation’s legal status as a “public benefit organisation”, but the fact that an organisation actually carried out activities of public benefit. Thus, many NGOs that were not officially registered as public benefit organisations were in fact eligible for 1% tax designations.

Numerous other items of new or amended legislation had an impact on 1% Act and Parliament also amended the Act itself.

Thereafter

- Under the “1+1%” system introduced at the start of 1998, taxpayers can designate a further 1% to an official church/recognised religion or to one of several special purposes specified in each year’s Budget Act (hereinafter referred to as “target area”). Taxpayers designate the recipient of the second 1% by means of a number published in the Official Gazette. The second designation in aid of a church/recognised religion or target area is separate from the “civil” designation: taxpayers are free to allocate support to only one or both categories.

This was obviously a major change to the original 1% Act, and was motivated by a political desire to find new sources of funding for churches.

- The target areas for the second 1% are specified in the annual budget act and have included areas such as emergency medical treatment, the eradication of ragweed, sport and fitness, forestry protection, crime prevention, etc. There is little logic behind their selection, which is determined mainly by fiscal needs or the influence of pressure groups. The list could easily be extended further : the fight against child poverty is just as worthy a cause as holding the Olympic Games in Hungary.

- Organisations receiving 1% contributions only have to declare, and not prove, to the tax authority that they meet the requirements for eligibility, have no tax and social security arrears and are actively involved in public benefit activities.
- The fact that an organisation has arrears in its tax and social security contributions does not exclude it from eligibility for 1% contributions. However, the organisation should use 1% support received to pay off these arrears.
- The limit of HUF 100 (EUR 0.4) for the minimum sum disbursed under the 1% system was scrapped.
- APEH must transfer the amount allocated to a beneficiary within 30 days of receiving a tax declaration, but certainly not later than 30 November of the tax year in question. (The previous deadline was 31 October). This change was criticised by a number of NGOs on the grounds that 'the state wants to use our money for a longer period of time'.
- Beneficiaries are allowed to place sums received under the 1% system in their reserves and use them in the next year. In such cases, the amount reserved should be announced in a press statement by 31 October of the calendar year following receipt of the transferred funds.
- In addition to public foundations, eminently public benefit organisations can also receive 1% contributions if they were registered at least one year before the start of the tax year in question. These organisations were put on an equal footing in this respect after a major scandal concerning the Children's Cancer Foundation. This foundation was established in December 1997 and thus should have had to wait for three years until it was eligible for 1% support. Nevertheless, the foundation carried out effective and successful fund-raising campaigns and received HUF 103 million (EUR 400,000) in 1999 and HUF 134 million (EUR 500,000) in 2000. In the first year, APEH passed the designated amount on to the Children's Cancer Foundation but reclaimed it after a court ruling. In 2000, APEH withheld 1% contributions to the Foundation. The story received extensive media coverage and many of those who supported the foundation felt that they had been cheated. This public discontent created pressure for changes to the Act, as did the claim by the head of the Children's Cancer Foundation that the foundation served a cause at least as important as those supported by public foundations.
- Concurrently, the "waiting period" for all other NGOs was cut from three to two years.

- APEH has to publish online the name and address of all recipients and the total amount each received. Previously, APEH only had to inform the relevant parliamentary committee, the minister responsible for taxation and the minister responsible for liaison with churches.
- New deadlines of dispositions for those choosing tax assessment by the tax authority and those filing their tax returns electronically and the rules of completing electronic forms were amended in § 5 of the Act. The deadlines of making declarations for dispositions in 2007 are quite unusual. It was only decided on 28th December 2006 that employers' accounting that replaced tax returns would not cease to exist, therefore employees can still ask their employers to prepare the tax returns for them. It will only be clear in late 2007 to what extent these changes, effected at the last minute, and the resulting confusion caused, will influence the size and quantity of 1% designations.
- Another change in 2007 is that higher education institutions (listed in Appendix No 1 of the Higher Education Act) can be designated as recipients of 1% support.

The current situation

The Act, although amended several times, still contains a number of contradictions and defects:

- In spite of constant criticism from NGOs, the “civilisation” of the group of organisations eligible for 1% support has not taken place. In addition to NGOs, the list of eligible beneficiaries still includes public bodies (e.g. the Hungarian Academy of Sciences), government-funded institutions (e.g. the Hungarian State Opera House), and government-backed funds (e.g. the Hungarian Scientific Research Fund). Their usefulness is indisputable, but because they receive government funding, their financial management is radically different from that of typical NGOs. The same is true of libraries, archives and museums, which are also eligible beneficiaries and which presumably operate their own foundations or associations to attract additional funding including 1% contributions. The inclusion of higher education institutions has further confused the situation, as a number of NGOs already operate in this field. APEH figures published on 29 November 2006 show that organisations involved in education and research were nominated in 30% of all 1% declarations and received 29% of the total sum disbursed. Obviously, the entire amount does not go to higher education, but given the large number of people working in higher education, the figure is likely to increase. It is true that the APEH figures also show that 96% of the total amount disbursed in 2006 went to organisations such as associations and foundations, but the logic of the Act shows no consistency.

- The situation as regards the second 1% that can go to a target area chosen by the government is even more anomalous. While taxpayers decide on the recipient of the first 1% and the particular religion that receives a second 1%, the government decides how much goes to applicants for support in this category. Although chapter 9 of § 6 of the Act provides that the money donated for special appropriations shall be used by way of tendering, taxpayers making the 1% declaration have no influence whatsoever on the tendering process.
- The fact that APEH now publishes the amount received by each beneficiary obviously helps keeps the general public informed. However, it would be even more useful if the published information included recipients' tax numbers as this would make it simpler for first-time designators to obtain the required details of their chosen beneficiary.
- Ever since the early days of the Act, the most heavily criticised aspect of the 1% system has been the paperwork required of taxpayers and it is true that the current method of making designations is over-complicated. The requirement is that taxpayers have to know the tax number of the organisation they wish to support and enclose this information in an envelope that has their own name, address and tax ID number on it. APEH figures for 1996 show the following breakdown of taxpayers' errors that invalidated 1+1% tax designations:
 - 28.6% failed to pay their personal income tax in time
 - 8.6% offered their 1% contribution to more than one beneficiary in the "civil" category (only one "civil" beneficiary can be selected)
 - 8.3% forgot to add their signature across the seal of the envelope holding their designation request (required when employers submit the requests along with the employees' tax return)
 - 8% gave the wrong tax number for the beneficiary
 - 7.2% forgot to write their own tax ID number on the envelope, 795 taxpayers nominated organisations that were not eligible to receive 1% designations.
- It could be argued that the possibility of making 1% designations would be more obvious to taxpayers if the 1% form was part of the main tax declaration form. At the same time, it must be recognised that the tax authority has no further tools of assistance in the designation process beyond the form offered automatically in case of filing the tax return electronically and the standard size envelope listing the data required to be included for 1% declarations in the tax return package.

Arguments concerning the protection of personal data are only valid in cases where employers deal with their employees' tax returns, and this method is being phased out.

- When moving the final deadline for paying out 1% designations back from 31 October to 30 November, the government argued that this reflected changes in tax payment deadlines and the introduction of new ways of filling out tax returns. Given that the first deadline for submitting tax returns is 15 February (which, of course, is not the same as the deadline for paying the tax due), this leaves nine months to get the money to the recipient. This delay is a long time now that electronic data processing has become so common. Simplifying the method of making the declaration would certainly help speed up the processing of 1% designations and mean that the money reached NGOs sooner.
- There are two areas of controversy concerning the legal requirement that NGOs publish details of the utilisation of the 1% support. One is that 1% funds must be spent on the activities listed in the organisation's founding statutes and cannot be used to cover operating costs. This is a controversial issue as many NGOs (e.g. those dealing with spiritual problems) can only fulfil their purpose by means of their operations. The other problem area is the definition of publication - for example, should the public announcement on the use made of the 1% support received be made in the local or national press, in a daily or weekly newspaper or in one of the organisation's own publications? Beneficiaries are required to show proof of such announcements so another question is whether publishing the figures on the internet and the keeping of a printed-out version is sufficient to meet legal requirements?
- Although the preceding paragraphs highlight the shortcomings of the 1% Act, its positive impact on the NGO sector must be acknowledged. The HUF 50 billion (approx. 20 million EUR) transferred to NGOs in the past ten years is, in itself, a substantial sum, but the system has also had further positive effects. The 1% system has become a natural way to support NGOs and is now perceived as a "right". Although, as seen above, the original Act has been amended in many aspects, its basic tenet has been left intact. The Act is also one of the few in Hungary that has never been politically contentious. Equally important is the fact that large budget deficits have not threatened the survival of the 1% system; indeed there has been talk of adding a third 1% allocation to trade unions, and giving more organisations (e.g. higher education institutions) access to 1% funding.
- In this respect, the government was due to discuss proposed amendments to the Act in the first half of 2007 and the proposed changes are due to go before Parliament in the second half of the year. Several NGOs submitted their opinions between February and May 2007 and there is widespread consensus between their views and those of the ministries concerned. The main proposals under consideration are:

- use of 1% funding to cover, or partly cover, organisations' operating costs.
 - online publication of the utilisation of 1% funds.
 - publication of more information, specifically recipients' tax numbers, by APEH.
 - simplifying the way in which the designation is made (eg the 1% form as a detachable section of the main tax declaration form) both for the electronic and the paper-based returns.
 - making deadlines for tax declarations as uniform as possible.
 - reducing the number of target areas nominated by the government entitled to receive 1% support.
- It should be noted that these proposed changes do not threaten the existence or the essence of the 1% Act. During the discussion phase, the government representatives were receptive to constructive amendments. However, the idea of allowing a taxpayer to divide his/her 1% designation among several NGO beneficiaries did not win official support.
- In the recent fiscal environment, during which personal income tax allowances for charitable donations have been eroded, the stability of the 1% Act should be appreciated. The Act came into effect on 1 January 1997, by which time the tightening up of tax breaks had already started (taxpayers no longer deducted donations from the tax payable but could decrease their tax base by 30% of the sums donated). Since 1998, only donations to public benefit organisations and eminently public benefit organisations are eligible for tax breaks. The total amount of tax deductible has shrunk continuously: initially taxpayers could deduct 35% of the amount donated to a maximum of 30% of the tax payable in the case of donations to eminently public benefit organisations, and 30% of the amount donated but no more than 15% of the tax payable in the case of donations to public benefit organisations. Later, taxpayers could deduct 30% in both cases with ceilings of HUF 100,000 (EUR 400) for donations to eminently public benefit organisations, and HUF 50,000 (EUR 200) for donations to public benefit organisations. Since 2005, people earning more than HUF 6.5 million (EUR 26,000) a year are not eligible for any tax allowances, and tax allowances to those earning less than this cannot exceed HUF 100,000 (EUR 400).

- In addition to the requirement to be active in the area of their stated mission, NGOs must have their deeds of foundation, accounts and internal records in order if they are to receive 1% support. Over half of all active NGOs have received 1% support and the 1% Act has had a positive effect on the general level of compliance with statutory requirements and accounting discipline in the NGO sector. This – as will be seen in the following chapter – is necessary. Although several attempts have been made, the laws dealing with financial management, reporting requirements, the comprehensibility of tax allowances and incentives to donate have not been made any more “NGO-friendly”.

II. The legal framework of financial management of NGOs and the system of tax allowances

The legal basis of the management of Hungarian not-for-profit organisations is generally acceptable and provides an adequate framework for NGOs to operate in. This general assessment should however be modified in that legislation on financial management reflects:

- regulation
- overregulation
- lack of differentiation.

The legal framework of financial management

Not-for-profit organisations are affected by the following basic Acts:

- Act CXVII of 1995 on personal income tax
- Act LXXXI of 1996 on corporation tax and tax on dividends
- Act LXXIV of 1992 on Value Added Tax
- Act XCI of 1990 on taxation
- Act XCIII of 1990 on duties
- Act C of 1990 on local taxation
- Act CXXI of 1999 on professional organisations
- Act C of 2000 on accounting
- Act CIII of 2000 on customs law, customs procedures, and customs clearance.

Not-for-profit organisations are specifically governed by the following items of legislation::

- Act CLVI of 1997 on public benefit organisations

- Act CXXVI of 1996 on The Use of a Specified Portion of Personal Income Tax According to the Designation of the Taxpayer
- Act CXLII of 1997 on resolving the legal status of state-owned property used by organisations serving the public good
- Statutory Instrument (SI) 224/2000 (19 December) on the special features of annual reports and accountancy requirements in the case of organisations listed as “other organisations” in the Act on accounting
- SI 114/1992 (23 July) on the financial management of organisations serving the public good
- SI 115/1992 (23 July) on the financial management of foundations

Contradictions in the legislation

These key problems are that:

- the legislation treats NGOs in the same way as business organisations;
- the legislation does not usually differentiate in favour of NGOs.

The requirements concerning the registration of NGOs is the first area in which overregulation can be detected.

After being officially registered:

- NGOs must register with the national tax authority (APEH) and receive a tax number;
- NGOs must declare whether they are subject to VAT;
- all NGOs must be registered as organisations liable to pay duty (since 1 January 2007);
- NGOs must be registered with their local council;
- NGOs must be registered with the social security authorities (therefore, in theory, all not-for-profit organisations have social security numbers);
- NGOs have to be registered at the Central Statistics Office.

The requirement to be registered with the national tax authority is not contentious. This is not the case with the need to be registered with the social security authorities and the local council. Most NGOs are not required to pay social security contributions on their revenue and rarely pay local taxes. Very often, NGOs only become aware of this requirement when they need a certificate to prove they have no tax or social security arrears.

NGOs are required to open a bank account and name those who have access to it. Organisations must also notify APEH of all data concerning the bank account.

After registration, NGOs have 90 days to select an accounting method. They have to decide on the way in which the annual report is drawn up and the related accountancy. NGOs have to draw up regulations relating to areas such as money management, inventory and the valuation of assets and liabilities. In general these last few categories are only theoretical obligations as 90% of NGOs do not have an independent accounting policy, and most organisations run by volunteers (school foundations, hobby clubs, etc.) have not even heard of this requirement.

Opportunities to differentiate

The legislation fails to adequately differentiate between various kinds of NGOs in terms of their revenue and financial management.

The few allowances currently made are:

- NGOs that pay corporation tax do not need to pay 90% of the amount due until 20 December;
- extra allowances for public benefit and eminently public benefit organisations are accompanied by stricter requirements concerning record-keeping and accounting;
- public benefit organisations with annual income of less than HUF 5 million (EUR 20,000) do not have to set up an organ of internal supervision;
- only organisations of public benefit pursuing investment activities are required to draw up regulations governing investment.

Although there is some differentiation in the requirements as regards compiling reports, bookkeeping and auditing, this is not really transparent. The dispensation that organisations with annual revenue from basic and business activities of less than HUF 50 million (EUR 200,000 EUR) in two consecutive years can use single-entry

bookkeeping was tightened to include only public benefit organisations. Thus organisations can currently choose one of the following forms of accounting:

- public benefit organisations
 - a simplified report of public benefit
 - a simplified annual report of public benefit
 - annual report as provided for by the Act on accounting
 - simplified annual report as provided for by the Act on accounting

- organisations other than those “of public benefit”
 - a simplified report
 - a simplified annual report
 - annual report as provided for by the Act on accounting
 - simplified annual report as provided for by the Act on accounting

- Public foundations cannot prepare simplified reports, and thus have to use double-entry bookkeeping and employ an auditor regardless of their revenue.

The most comprehensive figures for the NGO sector are those published by the Central Statistics Office in 2003. These show that 14.3% of NGOs (7,573) had annual revenue of more than HUF 5 million (EUR 20,000) and only 3.7% (1,972) had annual revenue of over HUF 50 million (EUR 200,000 EUR), which means that the differentiation does not affect a large number of organisations. The figures also showed that 15.2% of the organisations had annual revenue of less than HUF 50,000 (EUR 200), 30.0% had revenue of between HUF 51,000 and HUF 500,000; (EUR 200 and EUR 2,000) and 36.8% had revenue of between HUF 501,000 and HUF 5,000,000 (EUR 2,000 and EUR 20,000 EUR). Despite vast differences in their size, virtually all NGOs have to obey the same rules of financial management, record-keeping and reporting.

The figures show that 45% of not-for-profit organisations had annual revenue of less than HUF 500,000 (EUR 2,000). If legislators had the courage to set annual revenue of HUF 1 million (EUR 4,000) as a condition for requirements concerning the provision of data, financial management and accounting, they would make life much easier for at least two-thirds of NGOs. This is not to suggest here that the requirements should be totally scrapped, but they could be reasonably reduced.

The system of allowances

§ 6 of Act CLVI of 1997 lists the various types of tax allowance that apply to public benefit organisations, their donors and those using their services. It also lists the relevant legal basis.

When studying the relevant legislation, it becomes clear that most allowances are only available to not-for-profit organisations that are registered as “of public benefit” and very few of them apply to all not-for-profit organisations. It is obvious that only donors to public benefit organisations are entitled to tax allowances.

The allowances are categorised as follows by § 6 of Act CLVI of 1997:

- 1) Allowances are pursuant to Act LXXXI of 1996 on corporate tax and the tax on dividends, Act CXVII of 1995 on personal income tax, Act XCIII of 1990 on duties, Act C of 1990 on local taxes, and Act C of 1995 on customs law, customs procedures, and customs clearance, and governing other statutory instruments
 - a) public benefit organisation
 1. corporation tax exemption on activities performed in line with the purpose set down in the founding statutes;
 2. corporation tax allowance on business activities;
 3. local tax allowance
 4. duty allowance
 5. customs duty allowance
 6. other allowances determined in the relevant legislation
 - b) personal income tax exemption on services received from the organisation if these are in line with its basic activities.
 - c) corporate income tax allowance and personal income tax allowance on sums received to help achieve the objectives listed in the founding statutes of a public benefit organisation (hereinafter: donation).
 - d) in case of long-term donations, donors listed in point c) are entitled to additional allowances from the second year on.
- 2) Public benefit organisations may employ people doing civilian service (the alternative to compulsory military service, since abolished).
- 3) Public benefit organisations that have tax or social security arrears are not eligible for allowances.

The statutory provisions for 2007 contain the following allowances:

Allowances for public benefit organisations

- Income derived from subsidies, grants and charitable donations and from local and central government as a result of contracts, and from membership fees, is exempt from corporate and dividend tax.
(6/A.1. of Act LXXXI of 1996)
- Income derived from bank deposits and securities are exempt from corporate and dividend tax (to an extent proportionate to the public benefit revenue).
(6/A.3. of Act LXXXI of 1996)
- Income derived from the sale of tangible assets, inventory and immaterial assets serving the stated purposes of the organisation are considered preferential revenue as regards corporate and dividend tax.
(6/A.2. of Act LXXXI of 1996)
- Public benefit organisations are not obliged to pay profit tax on revenue derived from business activities if this revenue makes up less than 10% of its total revenue or HUF 20 million. In the case of eminently public benefit organisations, the proportion is 15% of total revenue. (Public benefit organisations that are given tax allowances in proportion to their preferential activities are exceptions.)
(7) of § 9 of Act LXXXI of 1996)
- Those NGOs that did not have to pay profit tax in the previous fiscal year are exempt from paying local taxes.
(2) of § 3 of Act C of 1990)
- County tax authorities can provide VAT refunds to foundations, social organisations and churches that have been officially registered for at least one year, operate in a not-for-profit manner, and do not provide any remuneration, either pecuniary or in kind, to their executive officers. Applications are assessed on an individual basis and VAT is refundable on expenditure related to social, health, educational, cultural, religious, environmental protection, and regional development activities.
(9) of § 71 of Act LXXVI of 1992)

- The remuneration of executive officers is not an excluding factor in the case of VAT refunds requested by foundations or organisations registered as eminently public benefit organisations that operate in the fields of social or health care. (10) of § 71 of Act LXXVI of 1992)
- The tax authority will accept a VAT refund upon justifiable requests of the beneficiary with the strict conditions provided for by provisions a, b and c of paragraph 8 of § 71 of the VAT Act when donations from abroad are used if the donor states that the beneficiaries of the donation should be exempted from paying VAT with respect to expenditures related to fulfilling their tasks. (3) of § 72 of Act LXXVI of 1992)
- Duty allowances are available to public benefit organisations (except for public benefit companies) and NGOs not registered as public benefit organisations when they are officially registered or when they amend their deeds of foundation. Duty allowances also apply to court and state administrative procedures involving organisations that did not have to pay profit tax in the previous financial year. (§ 5 of Act XCIII of 1990)
- Upon the request of public benefit organisations, the customs authorities can grant customs duty exemption to goods that have no value and that assist the fulfilment of community tasks benefiting a significant section of society. (1) of § 72 of Act LXXVI of 1992)
- No customs duty is payable on objects serving educational, scientific or health-care needs received by foundations, public foundations and public bodies as gifts or as barter if the head of the organisation can prove registration. These customs goods can only be alienated within five years of receipt upon the payment of the customs duty currently in effect. (§ 114 of Act C of 1995)
- A number of further allowances are provided by legislation pertaining to public benefit organisations. For example, under the Act on personal income tax, the owner of a car is not obliged to pay personal income tax if the car is used by a foundation, public foundation, social organisation or public body dealing with medical prevention or cure, or assistance to handicapped, if the car is really used for these purposes. (9) c) of § 70 of Act CXVII of 1995)

Allowances available to donors

- Taxpayers can reclaim 30% of the amount paid to public benefit organisations and eminently public benefit organisations. The amount reclaimed cannot exceed HUF 100,000 (EUR 400) in the case of organisations of eminently public benefit and HUF 50,000 (EUR 200) in the case of public benefit organisations.
(1-4) of § 41 of Act CXVII of 1995)
- Taxpayers can reclaim a further 5% if their donations are stipulated by a written contract covering a period of at least four years irrespective of whether the donations are in equal instalments or grow annually.
(5) of § 41 of Act CXVII of 1995)
- The naming of a donor is not classified as a material advantage (it is not considered an advertisement).
(6) of § 41 of Act CXVII of 1995 and (1/b) of 4§ of Act LXXXI of 1996)
- Provisions 1-5 of §44 of the Act on personal income tax limit the total amount that can be refunded from tax paid – including the allowance on charitable donations – and cannot exceed HUF 100,000 (EUR 400). A further limit is the maximum HUF 6 million (EUR 24,000) annual income, above which all tax allowances cease, combined with the number of dependents.
- Organisations liable for corporation and dividend tax can decrease their tax base by 150% of the value of donations given to eminently public benefit organisations and by 100% of donations given to public benefit organisations. There is a further 20% allowance for long-term donations (of at least 4 years). The allowance cannot exceed 20% of the company's pre-tax profit, or 25% in the case of donations to public benefit and eminently public benefit organisations.
(5-6) of §7 of Act LXXXI of 1996)
- As regards business organisations, the Act on taxation uses the term "donation" in a wide sense to include all pecuniary and non-pecuniary contributions. Non-pecuniary contributions include objects with an asset value, intellectual property, and the right to use property or services free of charge.
(4/1/a-b of §26 of Act CLVI of 1997 and 1/a of §4 of Act LXXXI of 1996)
- In order to receive tax allowances, donors must present a certificate provided to them by the recipient public benefit organisation. The certificate must state the name, address and tax number of the organisation and the donor, the size of the donation, the cause supported, and the degree of public benefit.
(7) of §7 of Act LXXXI of 1996 and 52 of §43of Act CXVII of 1995)

Allowances due to the users of services provided by public benefit organisations

- No personal income tax is payable on scholarships provided by public foundations and public benefit foundations and eminently public benefit foundations. Sums given as financial support to those in need and amounts up to HUF 500 (EUR 2) given to those taking part in sporting activities are also exempt from personal income tax.
(3.1. of Appendix No 1 of Act CXVII of 1995)
- No personal income tax is payable on amounts given to individuals by foundations and public foundations that were established using entirely foreign funding before 1 January 1993, and whose subsequent donors have not benefited from tax allowances.
(3.2.1. of appendix No 1 of Act CXVII of 1995)
- The same income tax exemption applies to amounts received by individuals from foundations, public foundations or associations not conducting business activities if the founders of, and donors to, these organisations have not received certificates entitling them to tax allowances.
(3.2.2. of appendix No 1 of Act CXVII of 1995)
- No personal income tax is payable on items received by individuals for carrying out public benefit activities on behalf of public benefit organisations or eminently public benefit organisations, foundations or public foundations.
(3.3. of appendix No 1 of Act CXVII of 1995)
- Tax allowances are not available to individuals who are founders of, or donors to, the organisation, individuals employed by the organisation, individuals with a legal relationship concerning work, or individuals with any other contractual relationship as defined in the Civil Code.
(3.4. of appendix No 1 of Act CXVII of 1995)

Changes to the tax allowances

As the scale of allowances depends on government policy and fiscal needs, there have hardly been two consecutive years in which the legislation on taxation has remained unchanged. The percentage of donations that is tax-deductible has steadily been cut to the current “symbolic” levels of 5% in the case of “long-term support” and 20% in the case of long-term donations. At the same time, the limits of the amounts that are tax-deductible have not changed, and the restrictions mentioned above were introduced in 2005. This happened in spite of a document entitled “The

Government's Civil Strategy" published on 7 May 2003, which put forward the possibility of increased tax allowances on charitable donations.

In addition to analysing the situation of the NGO sector in Hungary, "The Government's Civil Strategy" examined the relationship between the government and NGOs and contained a number of concrete proposals. The most important of these as regards the present study was the promise to set up a National Civil Fund, into which would go the amount equivalent to the 1% of the income tax paid by those who did not allocate the sum to a specific recipient. This was the first time that the government had responded positively to NGOs' demands that they should receive 1% of the total income tax paid by all taxpayers. This initiative was in keeping with the spirit of the government programme announced in 2002

III. Follow-up to the “1% Act”: the National Civil Fund

The second chapter of the government programme announced in 2002 entitled “The state’s acceptance of autonomous civil society as its partner” defined the goals and tasks required to encourage the creation of independent decision-making organs involving NGOs and to expand NGO funding. The first draft of the Government’s Civil Strategy was widely circulated for discussion. In the course of these discussions, NGOs expressed their preference for the creation of a more transparent system of co-operation and support that is better adapted to the activities, problems and needs of NGOs.

After a lengthy debate, Parliament passed Act L on the National Civil Fund on 23 June 2003 (hereinafter NFC Act) and its implementation was governed by Statutory Instrument (SI) 160/2003 of 7 October. The purpose of the Fund is to empower civil society and help its self-organisation through its participation in the delivery of important public and social services. The creation of an appropriate system of support was expected to encourage a more efficient and successful NGO contribution in such areas as social care, rehabilitation, disability, the elderly, education, child and youth protection, environmental protection, culture and heritage, legal protection, and the preparation of Hungarian society for EU membership.

As regards its financing, the original aim was that the National Civil Fund should receive all of the remaining part of the 1% of the tax paid that is not allocated by taxpayers. This was a substantial amount of money as only a part of taxpayers actually allocate 1% of their paid tax.

Although this would have greatly benefited civil society, it would have led to inevitable conflicts of interest. On the one hand, NGOs would have liked to get the 1% support directly from growing numbers of taxpayers, on the other hand, every forint they got would have been one less that went into the Fund. Furthermore, NGOs that were awarded support from the Fund would spend less effort on attracting direct 1% support. The legislators found a solution that would encourage NGOs to raise funds and also resolve the conflict of interest mentioned. Under the terms of the Act, the Government gives the Fund an amount equal to the amount allocated as 1% of tax paid in the previous fiscal year. The amount of support transferred to the Fund cannot be less than 0.5 % of the total personal income tax paid in the previous fiscal year.

The National Civil Fund operates as a transparent system of support based on the automatic allocation of government funding that is free of party politics and is mainly aimed at helping NGOs cover their operating costs. The Fund strengthens the NGO sector and helps it take over an increasing number of tasks from the government.

The NCF Act was of further significance: it was the first time that experts, lay people and NGO representatives and activists had a chance to give their opinions on the draft from its very inception.

The Fund's management and financial sources

As laid down in the NCF, Act a member of the Government is charged with responsibility for the "National Civil Fund". However, NGOs play an important role in the management of the Fund. Representatives are elected by the NGO sector to serve on the boards that distribute NCF grants. NGO representatives also form the majority of delegates that sit on the Council that governs the Fund's operation.

The NCF Act defines the revenues of the Fund as follows:

- a) an amount equal to the amount transferred to the beneficiaries designated by taxpayers as 1% of their income tax actually paid pursuant to § 4 of Act CXXVI of 1996 on The Use of a Specified Portion of Personal Income Tax According to the Designation of the Taxpayer in the fiscal year preceding the given year. The amount of support transferred to the Fund cannot be less than 0.5 % of the personal income tax paid by individuals in the fiscal year preceding the year in question;
- b) Voluntary contributions and donations of legal entities, organisations without legal entity and individuals;
- c) Support from the central budget;
- d) Other revenue.

The NCF Act contains the following regulation concerning budget support to the Fund:

" A time-proportionate part of the source provided for in provision a) of paragraph (2) is provided for the Fund by the Treasury quarterly, by the 20th of the first month of each quarter. In the first, second and third quarters the Treasury of Hungary provides the time-proportionate part of the income tax actually transferred to the beneficiaries designated in § 4 of Act CXXVI of 1996 on The Use of a Specified Portion of Personal Income Tax According to the Designation of the Taxpayer in the previous fiscal year. In the fourth quarter, it provides a time-proportionate part of the amount calculated in point a) of paragraph (2) modified by the differences of the sources for the first, second and third quarters and the time-proportionate amount calculated pursuant to point a) of paragraph (2)."

Voluntary contributions from individuals, companies and other organisations provide the Fund with additional funding. These donors receive all the benefits and allowances available as in the case of supporting public benefit organisations (listed above).

The NCF Act allows the Fund to receive further automatic central budget funding in the future.

The beneficiaries of the Fund

The following organisations can apply for support from the Fund:

- a) organisations (except for political parties, trade unions and employers' associations, insurance associations and churches) that were officially registered at least one year before the first day of the year in question and that actually pursue the activities laid down in their articles of association;
- b) foundations (excluding public foundations) that were officially registered at least one year before the first day of the year in question and that actually pursue the activities laid down in their deeds of foundation.

It follows that not all NGOs are eligible to receive support from the Fund. One requirement is that the organisation has to be registered in Hungary. Another is that it must have been in operation for at least one year prior to the announcement of the Fund's application rounds. This was intended to exclude organisations being set up with the sole purpose of applying for support from the Fund. One year is also considered to be long enough for an organisation to show that it can function effectively. Additionally, it would not be fair to long-established organisations if others receive supported as soon as they are founded.

It has been a question among NGOs whether individual sections of national organisations can apply for support from the Fund. Yes, they can, and furthermore, organisations that are not legal entities but are "derivative" legal entities can also apply for support. A derivative legal entity is a unit of an organisation which has legal entity. It has independent management and representative organs and has an independent budget.

Certain types of organisation are not eligible for support from the Fund: political parties, insurance associations, trade unions and employers' associations and churches cannot be beneficiaries of the Fund because they are not the "classic" NGOs that constitute the Fund's key target group. In addition, these organisations have access to other sources of government funding, and in line with the Act on public benefit organisations, this group of organisations are not regarded as NGOs. Public foundations are also ineligible as they receive substantial government support and already receive 40% of all revenue in the NGO sector.

These exclusions reflect the desire to "civilise" the group of beneficiaries of the 1% Act. The situation is slightly odd in that the legislators did not amend the Act itself, but drew up the NCF Act to reflect earlier criticisms from the NGO sector.

The NCF Act and related SIs also contain some provisions which exclude or limit eligibility to receive support from the Fund.

For instance, NGOs are not eligible for support to cover their operating costs if they receive direct government funding. The rationale behind this provision is that the Fund should target the most needy small organisations. This, however, only excludes

them from applying for support for their operations, government-funded organisations can apply for other types of NCF support if they are registered as a public benefit organisation. Furthermore, members' organisations that are (independent or derivative) parts of government-funded organisations can apply for support for their operations.

Political parties cannot apply to the Fund for support. The Act on public benefit organisations defines a political party as any organisation that fields candidates at national or local elections.

Any organisation that provides false or misleading data in the system of choosing NGO candidates to NCF management bodies cannot apply for support for a period of two years. Organisations that use the support received from the Fund in breach of contract are also excluded. Tax and social security arrears are further excluding factors, although organisations will be entitled to continue to receive support if they clear their debts.

IV. Voluntary work

Preliminaries

In November 1997, the General Assembly of the United Nations declared 2001 the International Year of Volunteers. In response to the General Assembly's call on member countries to carry out related national programmes, Hungarian NGOs and government bodies launched programmes to promote voluntary work in Hungary. The objectives of the programmes of the International Year of Volunteers in Hungary were defined with the co-operation of some 70 NGOs, five churches, the Office of the Prime Minister, and six government departments. The objectives included the setting up of a task force aimed at gaining recognition for voluntary work, and creating a positive legal environment. The work of the task force provided a useful basis for debate and also for the first draft of the Act on voluntary work.

The government's civil strategy of 2002 included the aim of increasing the social recognition of voluntary work and creating an appropriate legal framework. These objectives were seen as meeting a widespread need in the NGO sector. The government also realised that a number of European countries have separate legislation governing voluntary work that is designed to reflect its culture, traditions and special needs.

The Act was vital in that it increased public recognition of voluntary work and helped it achieve higher social status. The same factors have led to the adoption of similar legislation in Poland, the Czech Republic and Lithuania in recent years, and Croatia is also preparing a similar Act. These existing laws provided valuable background material for the preparatory work in Hungary.

Unusually, the first draft was not drawn up by government officials but by representatives of the NGO sector. The National Volunteer Centre and other organisations involved in voluntary work organised preliminary discussions. In the spirit of open legislature, people exchanged opinions on internet forums. The main themes and outcomes of the discussions were posted on the National Volunteer Centre's website. The draft was then further refined at regional conferences held in late 2003 and early 2004. The draft was finally presented to the Government Office for Equal Opportunities in the summer of 2004. In autumn 2004, the Ministry for Youth, Family, Social Affairs and Equal Opportunities was set up and the minister submitted the Bill to Parliament.

The social status of voluntary work

Voluntary work is a natural human activity and is motivated by the basic value of solidarity. The wealth and power of civil society is not based entirely on material

assets, donations and financial contributions, but also from people's active participation, that is, the amount and efficiency of the work they do voluntarily. Voluntary work is one of the purest and most basic characteristics of a social being, a gift that anyone can give. That is why legislation in this area forms part of this paper. Before the Act on Voluntary Work came into being, voluntary work was only formally recognised in relation to membership of associations. In the case of voluntary work not carried out by a member of an association, volunteers had to prove that the activity was genuine and that the person was not merely avoiding the payment of tax or social security contributions. Sums received to cover volunteer's travel, clothing, food and equipment expenses were classified as taxable income. The new act remedied this injustice.

The benefits available to volunteers

The Hungarian definition of voluntary work is in line with the internationally accepted definition: work done without compulsion and without remuneration for the benefit of others. In line with the concept of "public interest", the Act complements this definition by listing the range of possible activities and the entities allowed to receive them. Activities carried out for remuneration or for oneself or a close relative, are not considered public interest activities, nor are those activities that have been ordered by a public authority or a court of law.

By law, any remuneration received by volunteers or their immediate family is classified as income. However, volunteers cannot be expected to cover costs incurred while carrying out their activities.

Contributions in kind required for voluntary work and related costs are not classified as income, as they do not improve the financial position of volunteers, but merely prevent it from deteriorating. The only exceptions are prizes (for example, books) to a maximum annual value of HUF 5,700 (EUR 23), the prohibition of which would be unrealistic.

Other benefits provided by the law include the cost of long-distance travel, accommodation, meals, keeping rescue dogs, vaccinations required for third-world countries, petrol used by members of neighbourhood watch schemes, and tuition fees for courses required to work as a volunteer in social institutions. It is important to note that, except for prizes, a general condition is that benefits are only provided for costs if they are necessary for pursuing voluntary work of public interest, that is to say, without them the voluntary activities cannot be carried out or can only be carried out with serious difficulty.

Under the law, the following benefits are due to volunteers:

- uniforms, protective clothing and protective materials
- travel and living, meals or covering the cost thereof (proved by means of a receipt) and sums paid for the use of volunteers' own cars. The conditions of the latter include: pursuant to the provisions relating to business travel section

of Act CXVII of 1995 on personal income tax, volunteers shall be sent on the basis of a business trip order, they shall use their own cars in the interest of the organisation that receives them, and the amount paid shall not exceed one reimbursable in case of using own cars in the interest of employers without presenting a receipt [Provision 6 of Chapter 2 of Appendix 3 of the Personal Income Tax Act: Expenses reimbursable without presenting invoices]

- vaccinations, medical check-ups and other preventative medical treatment provided to volunteers in the interest of pursuing their activities safely
- the cost of relevant training
- feeding, training and taking care of animals owned by volunteers, if the animals are required in order to pursue voluntary public interest activities, and also the reimbursement of these expenses if they are proved by receipts
- equipment owned or used by the volunteers while carrying out voluntary public interest activities, and also the reimbursement of these expenses if they are proved with receipts
- life, health and accident insurance policies taken out to cover death, injury and illness sustained while carrying out voluntary public interest activities and the premiums paid for these policies, and also liability insurance policies taken out to cover damage caused by volunteers and the premiums paid for these policies
- a daily allowance for voluntary public interest activities carried out abroad or by volunteers in Hungary who are foreign citizens not resident in Hungary, provided the amount paid per month is less than 20% of the current compulsory minimum monthly wage
- gifts or rewards given to volunteers for voluntary public interest activities if the amount per month is less than 20% of the current compulsory minimum monthly wage.

The daily allowance covers ancillary expenses related to voluntary work carried out abroad or by foreign citizens in Hungary. Misuse of benefits is prevented by a regulation that states that a volunteer who works for several host institutions can only receive a daily allowance from one of them.

In the case of voluntary work carried out abroad and voluntary work carried out in Hungary by foreign citizens not domiciled in Hungary, organisations based outside Hungary can undertake to provide benefits through a contract concluded with the host organisation. In this case, the host organisation and the organisation based outside Hungary are jointly responsible for providing the benefits laid down in paragraph (3).

Determining the range of benefits for volunteers made it necessary to amend a number of related acts. For instance, the amendment of Act CXVII of 1995 on

personal income tax allowed volunteers to receive benefits that are not otherwise classified as tax-free. In this way, the act promotes voluntary work and does not prevent host organisations from providing work for volunteers as the benefits for volunteers are grouped expenditures subtracted from the tax base if the volunteers were employed by self-employed entrepreneurs in business-related and entrepreneurial activities.

A supplement to appendix No 3 of Act LXXXI of 1996 on corporation tax and dividend tax classifies amounts paid by taxpayers to volunteers accounted as other personal payments as expenses incurred in the interest of entrepreneurial activities if the volunteers were employed by self-employed entrepreneurs in business-related and entrepreneurial activities. It was necessary to amend Act IV of 1991 on job creation and the care of homeless people and Act III of 1993 on social administration and social care in order to make it clear and unambiguous that when establishing the social benefits paid to homeless people working as volunteers, sums received for voluntary work cannot be taken into consideration as they are reimbursement of expenses. Although volunteers are not classified as insured within the framework of the social security system, they are entitled to receive free medical treatment for accidents occurring in the course of carrying out voluntary work by virtue of the amendment of Act LXXX of 1997.

The effect on the state budget of these benefits is minimal, as the legislators were very cautious in their approach.

V. Concluding remarks

The opportunity to donate 1% of the tax paid created by the 1% Act has become an organic part of the culture of donations in Hungary and is also a model for other countries. It is also significant because it led to the passing of other acts (such as the Act on the National Civil Fund). In addition, NGOs can use PR techniques learnt during 1% campaigns for other fund-raising campaigns. Despite this, the 1% Act has not “broken the mould” of Hungary’s social and economic environment or the culture of donations. The reasons for this are as follows:

- Even though the three-sector model of society (the market, the state and the NGO sphere) has long been widely accepted, the social and economic reforms reflecting this awareness are only now being carried out. A central element is the reinterpretation of the role of the state in the fields of public services (including education, health and social care) and also in the area of state administration. These reforms focus on NGO participation in carrying out public responsibilities, an area where the legal framework is largely outmoded and is therefore an obstacle to any genuine and efficient sharing and allocation of social responsibilities.

The essence of the above mentioned problem is reflected in differences in terminology. Act XXXVIII of 1992 on the Central Budget, the SI 217/1998 (30 December) on the implementation of the central budget and the Accounting Act C of 2000 describe all government funding for the different categories of not-for-profit organisations as “support” and regulate it accordingly. Regular government funding, government grants, sums paid for contracted services, and even allowances (duty, customs duty and tax allowances) all appear as “support”. By contrast, legislation on the central budget and business sector clearly demarcates the concepts of “support” and “payment for services”. However, NGOs can conclude contracts in areas such as social care, education, child protection and waste management. It follows that the statutory provisions relating to the management of the central budget should also define the concept of support clearly and regulate how it is used. That is important in terms of seeing and interpreting the facts clearly and from an appropriate perspective. Furthermore, as there are certain limits on the size of “support” (e.g. the government can only support a foundation to the tune of HUF 5 million (EUR 20,000) this also raises the need to redefine the concept of “payment for services”. It is especially important in terms of the present topic that sums received from the government to undertake public responsibilities should not be described in legislation as “support” or “donations”.

- In spite of some positive changes, the partnership between the state (local government) and the NGO sector has not really taken root in Hungary, and the validity and efficiency of the partnership is not obvious in legislation or in

everyday life. The System of Norms of Social Agreement recently compiled by the Nonprofit Information and Training Centre (NIOK), the National Society of Conservationists, and the Reflex Environmental Protection Association, analyses the current situation in Hungary and contrasts it with the expectations of the European Union and the Aarhus Treaty (that Hungary has ratified). The analysis, which is multi-faceted, comprehensive and perhaps overly cautious and diplomatic, clearly shows that spheres of responsibility are often misunderstood and that laws are not properly applied or are not followed (notably Act XI of 1987 on Legislation and Act XC of 2005 on the freedom of electronic information). Moreover, the two sides are often unprepared, and the central government and local councils often fulfil their obligations as if they were performing *ex gratia* services. Almost all the report's conclusions reflect the lack of democratic deficit that currently characterises Hungarian society.

- This democratic deficit is also reflected in the low level of social cohesion and solidarity. Although wages rises have outstripped economic growth in the past five years (this is the main reason for the budget deficit), this has not led to an increased propensity to save or to a nationwide increase in long-term thinking. On the contrary: the population is increasingly becoming a debtor to the central budget (this has led to a situation where Hungary's international balance has deteriorated because the state can no longer borrow from domestic sources, and the convergence programme is aimed at remedying this dual effect). It is clear that the income gap has widened, and it has not become the norm for rich people to acknowledge their social responsibilities, partly because some of their income is illegal.
- One of the reasons for the lack of social cohesion could be Hungarians' passion for politics, which often leads to deep political divisions in society. This is also reflected in the polarisation of civil society. Although there was always division within the NGO sector, more intense political influence has widened the gap. Almost all political parties represented in Parliament underline the importance of civil society, but they often do so mainly for positive reasons and in order to broaden their political base and win votes. Paradoxically, this is useful for civil society, as no party dares to trim back any rights gained, including the 1% designation.
- It should be noted that, when speaking in interviews, MPs and government officials usually refer to the 1% designation as an "acquired right" and seem open to reasonable improvements in its operation. Despite this, all proposals concerning increased preferences (e.g. tax allowances for charitable donations) have been rejected point-blank. Individual MPs have made proposals, such as using the unallocated portion of the 1% tax paid to set up a civil bank to grant loans to NGOs that have temporary liquidity problems or that need "matching

funds" in order to receive a grant. The Government gives these proposals only minimal backing, as all new benefits and allowances – in its opinion – would involve "dilution" of the convergence programme.

- If the 1% Act is not politically contentious, each year sees a battle to preserve the National Civil Fund. One reason is that the HUF 7 billion (EUR 28 million) that goes to the NCF each year is a significant sum at a time of fiscal restraint. Another factor is that the Fund, unlike the designation option, does not lie close to the voters' hearts and so cannot be exploited for political gain. NGOs, with the help of the minister responsible for the Fund and also with other political support, have fought off attempts to scrap the 0.5% guarantee. The only cut-back that has occurred so far is that the amount going to the NCF has been capped at HUF 6.8 billion (EUR 27.2 million) in 2007 and 2008 irrespective of the total amount of 1% designations made by taxpayers.