

## **Chapter III**

# **THE PROCESS OF DEVELOPING PERCENTAGE LAWS**

## **Advocacy in favour of 1% tax allocation in Slovakia**

*by Arpád Lőrincz and Helena Woleková*

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## **Advocacy in favour of 1% tax allocation in Slovakia**

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It took a whole parliamentary term – from 1998 to 2002 – for the system of 1% tax allocation to become a part of Slovak tax legislation. There were several phases of advocacy in favour of 1% allocation. According to the general political climate, there were changes in the legal environment and also in the NGO sector regarding the structures and groups who “dealt with” the 1% allocation issue. This process is unfinished and, as this paper will explain, more time as well as more involvement from the NGO side are still needed to ensure that the system of 1% allocation becomes an inseparable part of the Slovak legal system that cannot be abolished by a simple political decision.

### **The political and social climate in the 1990s**

Although the major steps in advocating for a 1% system had been taken by the end of the 1990s, the key element that influenced the success of this initiative happened before 1998, starting in the first years after the Czech and Slovak Federal Republic split (1993). The Prime Minister, Vladimir Meciar and his political party, the Movement for Democratic Slovakia (HZDS) that governed Slovakia from 1992 onwards threatened the democratic development of new state. Political opposition was relatively weak, so it was natural that gradually increasing numbers of people saw the need to be active in defending the democratic institutions that had been set up in 1989. The NGO sector provided the greatest freedom for this kind of activity.

Perhaps to a greater degree than in other neighbouring post-communist countries, Slovak NGOs have influenced politics by issuing critical statements on government decisions and actions. In addition, NGO activists have searched for ways to address the general public and motivate citizens to advocate and defend their rights.

During Vladimir Meciar’s period of administration (1993-98), NGOs also had to defend their own position when the government decided to increase its control and pass strict conditions on foundations. As a reaction to such moves, the first big campaign called “*Third Sector SOS*” was organised in 1996. NGOs showed their considerable potential for co-operation and co-ordination within the sector and, at the same time, that they were capable of winning strong support from both important organisations and personalities in Slovakia and abroad. Although this campaign was only partially successful, it illustrated the effectiveness of civic action.

Later, in 1998, this strength was used in the civic campaign called “*OK’98*” for free and fair parliamentary elections the same year.<sup>1</sup> The media and political scientists agreed that with this campaign, NGOs played a role in bringing about social change. After the elections, a coalition government consisting of four democratic political parties replaced the Meciar government.

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<sup>1</sup> The civic campaign OK’98 was announced on 3 March 1998 by a group of 35 NGOs and later on was supported by additional ones (NonProfit 3-4/98, p. 6).

## NGO sector co-operation and development of the “1%” issue

In 1991 the first joint meeting of NGOs from Czechoslovakia, the so-called 1<sup>st</sup> Stupava conference, took place.<sup>2</sup> After the country divided into two separate states, the importance of co-operation among NGOs increased. Information within the NGO sector was spread by the NGO monthly “*NonProfit*”, and, as part of SAIA (Slovak Academic Information Agency), a special centre offering services to the NGO sector was created.

In 1994 Slovak NGOs met at the 2<sup>nd</sup> Stupava conference and elected several key individuals as NGO sector representatives, a group which came to be called the *Gremium of the Third Sector*.<sup>3</sup> Later, Gremium set up special working groups dealing with specific issues. One of these was a group of people who were interested in improving the legal environment for NGOs and was led by Helena Woleková.<sup>4</sup> The expert base of this kind of body was also used during the SOS campaign. At the international level, assistance to this group was provided by the International Center for Non-for Profit Law (ICNL) based in the US, that was advising NGOs in Central and Eastern Europe.

In October 1997 at the 5<sup>th</sup> Stupava conference, it was agreed that the legal group created by Gremium should concentrate its effort on the revision of all NGO laws and on tax legislation, and within this, on the system of 1% tax allocation. It was assumed that the new government, expected to enter office after the elections in the autumn of 1998, would be more open to negotiation and the power of arguments. It was also expected that, if required, there would be enough support from NGOs and the public in favour of proposals for change put forward by NGOs.

### How “1%” became a part of tax legislation

The first public discussion on the 1% allocation issue was organised by the legal group created by Gremium and took place on 2 April, 1998 in Bratislava. It was a seminar about tax legislation in Hungary in which representatives from Hungary’s Ministries of Finance and Justice, and a Hungarian NGO, the Nonprofit Information and Training Centre (NIOK)<sup>5</sup> participated. Anybody from a Slovak NGO could take part.<sup>6</sup> After this event, an article on legislation in Hungary was published in *NonProfit*.

Before the parliamentary elections (in September 1998), Gremium presented to political parties a document called “*NGO Requirements*.” Among other proposals made, one was: “*NGOs request an amendment to the tax acts to enable citizens and the business sector to have better conditions for making donations in favour of public benefit purposes. We demand:*

- *the right for citizens to receive a tax allowance for donations made*

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<sup>2</sup> Stupava is the city in western Slovakia where the conference was organised.

<sup>3</sup> NGO sector representatives continued to be elected on a regular basis at the Stupava conferences.

<sup>4</sup> Former Minister of Employment, Social and Family Affairs and one of the authors of this paper.

<sup>5</sup> NIOK was the organisation that organised the public awareness 1% campaign in Hungary.

<sup>6</sup> The information about seminar was also published in the NGO monthly *NonProfit* in an article by Helena Woleková: *Výhody pre neziskové organizácie v Maďarsku*, *NonProfit* 6/98, p. 17, SAIA-SCTS, Bratislava

- *for legal entities to expand or increase their tax allowances (the deduction of the value of donations from the tax base) in favour of long-term support for NGOs*
- *the NGO tax regime to be changed in a way that would ensure NGOs' income could be used as much as possible for the development of their activities.”*<sup>7</sup>

Of all the political parties that took part in the elections just one<sup>8</sup> of them declared in its election manifesto that it was in favour of concrete tools to support NGOs: *“We will guarantee by law that each tax-paying citizen can decide about his/her 1% of paid tax in favour of a foundation, civic association or other NGO.”*<sup>9</sup>

Immediately after the parliamentary elections in December 1998, Gremium offered to cooperate with the Ministry of Finance in the drafting of laws affecting NGOs. As this offer had not been taken up by the Ministry, the following March Gremium presented a proposal for amendments to the lottery and tax laws. In contrast to the way different committees in ministries allocated state money, the key goal was to make more resources available to NGOs that were independent of political influence. However, there was no positive reaction to this proposal by the Ministry of Finance.

A crucial reversal in negotiations occurred in August 1999 when members of Gremium met with Prime Minister Mikulas Dzurinda.<sup>10</sup> The main topic of the meeting was not tax legislation but the lack of transparency in the use of EU pre-accession funds and the absence of any principle of partnership in the preparation of the National Development Plan. In the second part of the meeting, Gremium presented its requests for changes to the Income Taxes Act which included the 1% option. The Prime Minister promised that he would support these suggestions and asked the Ministry of Finance's Deputy State Secretary to take care of this matter.

At that moment the Ministry of Finance had finished its preparation of amendments to the Income Taxes Act, so there was no time for serious negotiations to take place on the legislative proposal. Although the government lawyers understood the main purpose of the proposed 1% allocation option, what actually appeared in the legislative proposal was radically different to the original concept. As there was no time to inform MPs or for a broader campaign to raise public awareness on the 1% issue, Gremium tried to influence the final form of the 1% system by meeting with the chairmen of parliamentary political groups. The argumentation put forward was based on the philosophy that the taxpayer could decide about a portion of his/her tax. This principle was supported by the planned decentralisation from the central state administration to municipalities.<sup>11</sup> On the basis of the experience in Hungary, Gremium calculated that operating the 1% allocation system in Slovakia would influence the state budget by 100 million koruny (about 2.5 million euros) – around one third of 300 million koruny (about 7.5 million euros), the maximum amount the 1% of income tax represented.

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<sup>7</sup> *Gremium of the Third Sector, Requirements of NGOs*, NonProfit – elections '98, p. 26, SAIA-SCTS, Bratislava.

<sup>8</sup> It was the Slovak Democratic Coalition that became a part of the government after the elections.

<sup>8</sup> In the article: *From election programmes of some political parties*, NonProfit – elections '98, p. 27, SAIA-SCTS, Bratislava.

<sup>10</sup> He was also the Chairman of the Slovak Democratic Coalition.

<sup>11</sup> The decentralisation reform also expected that citizens would be more active and more involved in decision making (including the use of public money).

Finally the bill was adopted, but as the government had tabled it.

There were several shortcomings in the way the 1% system was initially defined. The recipient of a taxpayer's 1% allocation could be a NGO but also an individual if the money was used for covering the costs connected with education, health care, sports, environmental protection, culture and the reconstruction of cultural monuments. This definition was based on the one for tax allowances also specified in the Income Taxes Act.

A delay was also foreseen in the start-up of the 1% measure. The section of Income Taxes Act that dealt with the 1% system was to take effect only from 2002 onwards. The reason for postponing it from 2000 to 2002 was the expected reduction in state budget income caused by the lowering of corporate income tax from 34% to 29%; the Ministry of Finance was not certain how much this change would influence the income side of the state budget.

In sum, the 1% mechanism, as defined in the law, was not acceptable for NGOs because:

- the range of specified recipients was too broad; it was not just for NGOs
- the range of public benefit activities included sport in general and there was no clear distinction between professional and amateur sport
- it only became valid two years later, from 2002 onwards.

Therefore advocacy activities addressing these issues continued after the 1% allocation system became part of the Income Taxes Act passed in 1999.

### **The advocacy process from 2000 to 2002**

**Amendments to the 1% mechanism.** While it was welcome news that the 1% mechanism had been incorporated into the Income Taxes Act as of 1 January 2000, the advocacy process did not finish. The small group responsible for negotiations and expert analysis on NGO issues did the core work. It was necessary to persuade Ministry officials that the new 1% instrument had to be radically changed.

The Minister of Finance's reaction was to ask NGOs to draft a new section on the 1% allocation system. At this point, the First Slovak Non-profit Service Centre (1.SNSC) took over responsibility for this legislative issue and also for discussions within the NGO sector.<sup>12</sup> Its members were also members of the legal group created by Gremium. Thanks to the support of the Open Society Foundation, a team of experts was formed for this specific topic. The draft section on the 1% allocation mechanism was prepared by experts with the involvement of NGOs. There were several meetings with NGOs at which the key parts of the 1% mechanism were defined, including, among other issues, limiting the group of recipients and the scope of NGO activities. It was also suggested that the 1% of tax should be at least 20 koruny (about 0.5 euros). The reason was to decrease the administrative costs in respect of very small incomes, and was calculated on the basis of the minimum wage valid at that time.

The main principles of 1% allocation included:

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<sup>12</sup> An association of legal experts, economists, etc.

- anonymity of the taxpayer
- trust in the 1% philosophy whereby taxpayers decide on the use of public money in favour of NGOs
- transparency in the use of the transferred 1% funds.

and meant that the 1% mechanism would be different to tax allowances for gifts/donations also regulated in the Income Taxes Act.

The draft amendment to the 1% allocation section proposed by NGOs was accepted by the Ministry of Finance and became a part of the amendment to the Income Taxes Act that went before Parliament in the autumn of 2001. The MPs accepted the suggested amendments and included the Slovak Red Cross as a specific category of 1% beneficiary.

Why were the amendments accepted? The government coalition that was in office from 1998 to 2002 was composed of three centre-right political parties<sup>13</sup> and also one left-of-centre party.<sup>14</sup> In situations where an issue was settled at the government level, then the government's proposals were assured parliamentary support. The crucial person, other than the Prime Minister, was Vladimil Podstransky, the Deputy State Secretary at the Ministry of Finance.<sup>15</sup> He defended the NGO draft within the Ministry of Finance.

### **A Slovak invention: the “1% from companies”**

The success in securing the passing of the amended 1% section in the tax code motivated NGOs to consider new initiatives. During the discussions and negotiations on the 1% issue a basic fact became evident: although NGOs were seen as an important social force, the ruling coalition did not have any programme for supporting NGOs. It was clear that NGOs needed to come up with their own proposals.

A working group created by the Slovak Donors' Forum (SDF) together with the legal group created by Gremium initiated discussions within the NGO sector on “participation of NGOs in privatisation income”, an idea imported from the Czech Republic where income from privatisation was helping create some long-term domestic sources of support for the NGO sector.

SDF prepared a suggestion along these lines but this did not prove politically acceptable because there were other demands that the government wanted to fulfil from privatisation income.<sup>16</sup> It was, in fact, the politicians who suggested an alternative option – to extend the 1% of tax from individuals to a similar arrangement for companies. This offer was unofficial and NGO representatives, who had very little time to consider the details<sup>17</sup>, decided to accept it. The process of preparing and passing the “1% from companies” proposal was the quickest legislative action within NGO advocacy history. It took two weeks.

The mechanism for companies allocating 1% of tax was specified in a special section of the Income Taxes Act and is based on the same principles as the 1% of tax from individuals. The

<sup>13</sup> They were the Slovak Democratic Coalition, Hungarian Coalition Party and Party of Civic Understanding.

<sup>14</sup> The Party of the Democratic Left.

<sup>15</sup> He was nominated by the Hungarian Coalition Party.

<sup>16</sup> For covering the state deficit.

<sup>17</sup> Parliament was at that time discussing amendments to the Income Taxes Act.

main difference is in regard to the number of beneficiaries: whereas individual taxpayers could allocate 1% of tax to just one NGO, companies were to be allowed to select one or more NGOs as recipients.

Negotiations on the draft proposal for the “1% from companies” were led by I.SNSC. Because the draft Income Taxes Act had already been sent to Parliament, the only option for tabling the “1% from companies” measure was to find an MP who was willing to present such an amendment in Parliament. Finally, Roman Sipos MP (who in the past had co-operated with NGOs in the fields of regional development and in the use of EU pre-accession funds) tabled the proposed amendment and in April 2002 the Parliament passed the “1% from companies” measure. The measure was due to take effect from January 2003 onwards, with the first allocations by companies to NGOs possible in 2004 (from their previous year’s corporate tax). When the vote took place, it helped that some MPs had previously thought about a “1% from companies” measure in the autumn of 2001 when the amended “1% from individuals” mechanism was adopted.

### **Developments in 2003 surrounding the Income Taxes Act**

In the spring of 2003 the government confirmed that its tax reform concept involved simplifying tax legislation in Slovakia. It proposed that the income tax for individuals and also for companies plus VAT should be cut to a flat rate of 19%. At the same time, it was announced that any benefits or exceptions in deductions from the tax base in tax system would be cancelled. As part of the package of proposals, it was planned to exclude the 1% allocation system from the new tax legislation as one of the “irrelevant elements in the law”.

Thanks to the efforts of NGO platforms and the support of the media, the 1% mechanism was saved and has been included as a part of the new concept for the tax system. Unfortunately the tax allowances, whereby the value of gifts might be deducted from the tax base, were cancelled (from 2004 onwards) and “replaced” by an increase of the percentage in tax allocations to NGOs from 1% to 2 % of personal and corporate tax (from 2004 onwards).

Although there were some NGO efforts to this end, it was impossible to prevent the tax allowances for donations from not being a part of the new Income Taxes Act that was adopted in December 2003. Regarding the 2% allocation mechanism, the new Act included some simplifications to the percentage system.<sup>18</sup>

### **Lessons learned**

The experience of NGOs in Slovakia shows that no Slovak government has had any programme of support for NGO activities. This is true for all ruling governments – for those that were in open conflict with NGOs, but also for those which declared their willingness to co-operate with the sector. The government has usually taken a wait-and-see position.

At the same time, during this period Slovak NGOs have not had any agreed concept for the long-term sustainability of the sector (although they are relatively well organised and structures for co-operation exist). As this paper has shown, when advocating in favour of a

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<sup>18</sup> The changes are described by Arpád Lőrincz and Peter Hańdiak in *Slovakia’s system of 1% tax allocation* in Chapter IV of this study.

1% system in Slovakia, NGOs used models from abroad; the fact such instruments were operating in other countries was used as an important element in the advocacy campaign.

Although the 1% (and 2 %) allocation system is a result of intensive work by a team of experts in the NGO sector, the 1% mechanism would not have been passed if politicians had not personally identified with its philosophy: that citizens, not only politicians or the state, can decide about the use of public money.

The events of 2003 highlight that benefits won by NGOs can be lost when the economic or political situation becomes less favourable. The lesson is that NGOs need to be more vigilant in defending their existing benefits.