

INTRODUCTION

Percentage Philanthropy

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It is now over seven years since **Hungary** adopted a unique piece of legislation in 1996, popularly known as the 1% Law. This instrument allows individual taxpayers to allocate 1% of their previous year's personal income tax to an eligible non-governmental organisation (NGO) of their choice that conducts public benefit activities. Hungary's 1% Law sparked a chain reaction: several other countries in Central and Eastern Europe have adopted percentage laws in different forms and with varying criteria.

From 1999 onwards **Slovakia** incorporated into its tax code a series of provisions introducing a 1% system. Individual taxpayers first used this new option in 2002 to support an eligible organisation of their choice. Further amendments adopted at the end of 2003 mean that individuals – and also companies which join Slovakia's percentage system in 2004 – can now designate up to 2% of paid tax to NGO beneficiaries.

In 2002 **Lithuania** adopted a 2% designation system and from 2004, payers of personal income tax there have the opportunity to use this option. As is the case in Hungary and Slovakia, it is the tax authority in Lithuania that transfers the designated portion of tax to the selected beneficiary according to the taxpayer's instructions.

In the spring of 2003, **Poland** enacted its own version of a percentage system which took effect at the start of 2004. By contrast, it is the taxpayer, not the tax authority that transfers an amount equivalent to up to 1% of their income tax. As for taxpayers in Lithuania and companies in Slovakia, more than one beneficiary that meets the specified requirements can be selected in Poland.

A fifth country, **Romania**, adopted a 1% provision in its new tax code in December 2003. This new measure is due to start operating in 2005.

The Percentage Philanthropy Project

The Percentage Philanthropy Project of the Nonprofit Information and Training Centre (NIOK) seeks to grasp the momentum and generate critical feedback to countries where percentage laws exist while providing information and assistance to those that are interested in considering similar legislation. This means that the project not only collects details of the existing structures but also actively disseminates information so that those interested in similar laws have a better basis on which to make decisions about their effect and usefulness. A further aim is to share best practice regarding implementation so that countries that have such laws already are better equipped to improve or fine-tune their operation. This study, *Percentage Philanthropy*, which presents the experience and practice of the percentage laws in Hungary, Slovakia, Lithuania, Poland and Romania, is the centrepiece of the first phase of the project.

The motivation behind the project stems from NIOK's own involvement in helping implement Hungary's 1% Law. As part of its mission to support and strengthen Hungary's NGO sector, NIOK organises a campaign each year to promote the 1% opportunity and provide information and advice to taxpayers and NGOs. Over the last seven-year period, a steady stream of NGOs, researchers and journalists from numerous countries have sought

information from NIOK on all aspects of the 1% Law. NIOK has also worked closely with partners in Slovakia and Lithuania to help organisations there initiate and implement percentage laws.

The study is a natural extension of this work and co-operation. It also builds on earlier research conducted by the Nonprofit Research Group and NIOK in 1999/2000 to assess the impact of Hungary's 1% Law.¹ Importantly, the papers included in this 2004 volume break new ground by providing information on developments in Slovakia, Lithuania, Poland and Romania.² Despite the newness of the various percentage systems, it has proved to be a useful, if challenging, task to collect this series of papers. The study puts the spotlight on the efforts of the key individuals and organisations, especially in Slovakia and Lithuania, that have worked incredibly hard to make percentage laws in their countries a reality. The study also catches up with and reflects on new developments in Hungary, anticipates how Poland's recently adopted 1% system will work and introduces the recent Romanian experience.

The first phase of the project (April 2003-March 2004) was very lively – new developments frequently occurred as more new countries joined the “Percentage Club” and the old club members adjusted their systems. In 2003 alone there were two new countries – Poland and Romania – that adopted percentage laws, Slovakia made major adjustments to its system, while Hungary added a completely new element in the form of a National Civil Fund.

Based on the original Hungarian model, there are several variations of the percentage system operating in the different countries. This project focuses on **legal mechanisms** which allow **individual taxpayers** to allocate **a certain percentage** of their previous year's paid **personal income tax to NGO beneficiaries** entitled to receive such funds. The study refers to other beneficiaries involved for example, public institutions such as schools and hospitals in Lithuania, named public cultural institutions in Hungary, the churches in Hungary that have their separate percentage scheme, and also the forthcoming involvement of corporate taxpayers in Slovakia. These issues – important as they are – are not the main focus of this particular study. The study also refers to, but does not cover in detail, the registration requirements for establishing NGOs. Tax incentives such as tax-deductible donations are discussed in general terms. More detailed descriptions of these subjects can be found in other studies and sources.

Partners, participants and patrons

NIOK, an NGO based in Budapest, managed the first phase of the Percentage Philanthropy Project with two main partners: the Forum Information Centre (FIC) in Slovakia and the Non-Governmental Organisation Information and Support Centre (NISC) in Lithuania who provided know-how and practical assistance to the project. Special thanks go to all 16 authors, other individuals and organisations from 7 countries that have contributed to the project thus far.

Everyone involved in this truly Central and Eastern European project has been highly motivated. There has not only been the chance to share our experiences but also a strong

¹ See Ágnes Vajda and Éva Kuti “1%” *Forint votes for civil society organisations*, Nonprofit Research Group, 2000 at: <http://www.onepercent.hu/Dokumentumok/1percentaspen.doc>

² Three papers from Poland and one from Romania were added to take account of developments in these countries in 2003.

feeling that we are helping to shape policies to better the working environment of civil society organisations in the region.

NIOK plans to continue this project in 2004 and 2005 by providing assistance to countries interested in developing percentage systems. NIOK is grateful to the Sasakawa Peace Foundation's Central Europe Fund for its support for the Percentage Philanthropy Project, including the development of a website, www.onepercent.hu that is devoted to this topic. The international conference held in Budapest on 19-20 January 2004, that closed the first phase of the project, was also supported by the East-East program: Partnership Beyond Borders through Soros Foundation-Hungary; the Hungarian Prime Minister's Office (MEH) and Orpheus Network of the European Foundation Centre.

The countries involved

It is worth reminding readers of the common heritage and challenges of the countries included in this study, namely Hungary, Lithuania, Poland, Slovakia and Romania. It is generally true for all the countries of the "Percentage Club" that they:

- have only recently emerged from forty years of communist rule
- established democratic institutions after 1989 and in the early 1990s
- still face multiple challenges in developing just and prosperous societies
- have rates of GDP per capita still considerable lower than EU levels, for example 52% in Hungary and 40% in Poland
- have low but growing personal income levels
- have relatively new personal income tax systems; income tax levels have tended to be high and the tax-paying culture is somewhat ambivalent.

Other common features are:

- the heritage of reduced levels of social responsibility during the communist era
- a low but growing awareness of social issues and NGOs' role in society
- the relatively young NGO sector
- an ambivalent public view of NGOs
- scarce resources available to NGOs
- limited incentives available to stimulate private giving.

Views on the percentage system

It is against this background that percentage laws have emerged as a new idea to contribute to the funding needs of NGOs. **Percentage laws offer a new method of providing revenues to the NGO sector.** These laws offer several attractive solutions to addressing challenges of post communist countries as they:

- allow populations a direct say in how a portion of their income tax is used
- also mean that people in the low income countries of this region are offered the means of giving to charitable causes at little or no extra cost to themselves
- are a welcome new source of income to NGOs

- raise public interest in supporting NGOs with the result that the public profile of NGOs and the work they do has noticeably increased
- decentralise decision making to individual taxpayers in the allocation of state revenues to NGOs
- provide a legitimacy measurement or “public acceptance test” for NGOs
- may function as “schools” of private giving and social responsibility (a much debated argument)
- develop marketing know-how among NGOs
- broaden the public network around NGOs
- highlight transparency issues for NGOs and tax authorities
- may give governments that accept such laws a positive image

and so on.

Some may be tempted to seize upon this new exciting percentage system as a means of solving every problem faced by NGOs; the realisation that it cannot will cause frustration among NGOs, state actors as well as the public. As salaries are low in these countries the financial gains may not reach the level some expect. Meanwhile there is an obvious worry about the “crowding out” effect, that is, about the danger that private donations or government funding may fall as a result of the percentage system.

The percentage system is at an experimental stage – the version adopted in Poland and Lithuania only start operating in 2004. The laws regulating the procedures involved in all countries are imperfect and are likely to be further adjusted. It goes without saying that the real and long term effects of percentage laws are not yet clear. What is certain is that, after several years in Hungary and Slovakia, around one third of tax-paying citizens make use of the opportunity to allocate a portion of their income tax to a cause they consider worthy. Some might consider one third a low figure and perhaps it is, but it can also be regarded as quite high. Encouragingly, a majority of people, whether they use this giving option or not, think positively about concept of a percentage system. In the case of Hungary, it is also clear that the revenue the 1% system generates for the overall NGO sector income is very limited; it hardly reaches 1% of the sector’s official financial income.

There are several clear direct gains but also some question marks around the percentage system. Additionally the system has produced some important side effects in the countries that have advocated for the implementation of such legislation. In certain cases, as part of the advocacy and/or drafting process, informal or formal state-NGO consultative bodies have formed that did not exist before. (In one case even an official adjustment mechanism was designed whereby the first round results were to be officially evaluated by a parliamentary committee.) NGOs have also gained experience in influencing policies affecting the sector and setting an agenda. In several instances, NGO coalitions have been built for this single cause or with a general NGO sector development mission. Often clear leadership has emerged that can be beneficial in the long run. These side effects may prove to be significant in the longer term sectoral development of these countries.

It is still too early to give a verdict about the long term gains and losses of the processes involved and of the percentage system itself. For this reason one may seriously consider if it is not wiser for other countries interested in joining to wait some time to see the outcomes and outputs of the system in the initial countries before pushing their governments to draft and implement such laws. At the same time, countries who have them may need to continue to

battle both to make these laws work more effectively and for other policies that encourage private giving in these post communist countries to ensure the well being of an independent third sector.

The papers in *Percentage Philanthropy*

Many of the papers that appear in this study were presented by their authors at the Percentage Philanthropy Conference held in Budapest on 19-20 January, 2004 with 160 participants from over 20 countries. Some papers have been revised, updated or adjusted to reflect the discussion and feedback received.

The purpose of this study to give the reader a better understanding of the current state of affairs regarding percentage laws. In the papers that follow an effort has been made to provide a balanced picture. Not all the questions raised are answered, but the identification of a number of issues suggests careful or further consideration is required. As this study shows, percentage laws offer many benefits but they do not necessarily come free-of-charge or solve the pressing financial situations of so many in the NGO sector.

This compilation of papers, arranged in seven chapters, describes the origins and nature of this exciting experiment, the processes that have led to the spread of such laws, the types of legislation involved, how procedures work in practice, the complementary measures undertaken by NGOs to publicise the opportunity taxpayers have, and the results achieved so far. Many of the legal texts and documents referred to can be found on www.onepercent.hu.

My role as editor has been to keep the content coherent and the message of the work clear. Luckily, the project co-ordinator was much more than a co-ordinator and a linguistic editor. Deborah Moss became the vehicle behind the scenes and special thanks are due to her for the success of the first phase of the project. Special thanks also go to Laurie M Naumann who made an immense voluntary contribution by taking on the role of the outside expert reader for all the incoming papers. Additional thanks to Myrtil Nagy for her comments on the papers from Slovakia. Their contribution has been invaluable.

The editor, the co-ordinator and the authors are glad to share the enclosed compilation of papers with the reader as we all find it important and timely to provide a basis for understanding how the different models of such laws operate, and their significance for NGOs and the third sector in general. The business of introducing and developing percentage laws is unfinished; the discussion and questions will continue.

As the list of contributors shows, the study combines the knowledge and experience of a former minister, present and former Members of Parliament, NGO practitioners, academics, lawyers and a civil servant. They have done their utmost to contribute to the mission of this project. Their papers are often personal accounts of their stories and I, as editor, have respected the views expressed in individual papers. We remain grateful to all the authors for their heroic efforts to complete their contributions on top of their many other priorities and tasks.

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Editor

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