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# **Noncommercial organizations activity economic impact study for the period 1991-2001 in Bulgaria**

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## **Used abbreviations**

**NSI – National Statistic Institute**

**NPO – nonprofit organizations**

**NCO – noncommercial organizations**

**GDP – gross domestic product**

**SNA – system of national accounts**

**EU – European Union**

**NPLE – nonprofit legal entities**

**NPLEA – Nonprofit Legal Entity Act**

## Introduction

The solution of social problems requires joint efforts by the government and third sector. The non-profit organizations are valuable means for achievement of state policy goals (poverty fight<sup>1</sup>, development of the civil society, protection of historical and cultural heritage, etc.). This imposes the necessity of their separation from economic point of view and a special support for their activity. As long as the greater part of the resources of nonprofit organizations are gained through the form of donations, the encouragement of charitable activities is pointed as the main motive<sup>2</sup> for providing them with a privileged status. Most often this status means direct budget subsidies or tax exemptions, i.e. the tax treatment of non-profit organizations represents an instrument for the economic policy goals achievement. At the same time, the tax exemptions are given also to the rest of the economic subjects in their virtue of donors.

The privileges, which the non-profit organizations are given, lead to redistribution in their favor of limited social resources. This imposes the clear understanding of the effect of each measure and the society's gain from the activity of nonprofit organizations. From statistical point of view, the indicators of the sector's importance and efficiency traditionally undervalue its role, because they do not take into consideration the existence of positive outside effects, which results from the execution of most of the non-profit organizations' projects. The sector's development is directly related with the civil society strengthening, which is one of the most important requirements for the EU applicant countries. Non-profit organizations are effective when delivering different services; they are less bureaucratic with regard to the public sector, gain additional support from society in the form of donations or voluntary work.

Many organizations, whose functions and tasks are targeting establishment of civil society values have been created in the last ten years in Bulgaria. Most of these organizations are established to perform charitable, social, cultural, educational, scientific, religious and other activities. By status they are very diverse – foundations, associations, unions, sport unions, political parties, economic chambers, religious organizations and so on. The legal acts, which regulate their activities, are the Non-profit Legal Entities Act, the Law on Political Parties, the Law on People's Chitalishta, etc.

The present analysis is made upon the request of the "Bulgarian Center For Not-for-profit Law" Foundation. The research has two main objectives: first to analyze the activity of noncommercial entities and to value their place and importance for the development of Bulgarian economy in the period 1991-2001 and second to research the tax treatment of non-profit organizations and the effect of a favorable regime of their taxation on the consolidated state budget.

The research comprises of three main parts. In the first one is taken into consideration the nature of noncommercial organizations, a classification of the noncommercial organizations is made on the basis of their institutional affiliation and

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<sup>1</sup> The great inequalities in the incomes and the employment possibilities may be a serious impediment to the economic growth and well-being.

<sup>2</sup> See "General Explanations of the Administration's Fiscal Year 2001 Revenue Proposals", p. 103 and "General Explanations of the Administration's Fiscal Year 2002 Tax Relief Proposals", p. 6.

economical activity. The methodical nature of indicators, which measure their activity, has been clarified. Defined are some of the problems, encountered with regard to the existing information on noncommercial organizations. In part two follows the sector's development in the period 1991-2001 through the prism of the main macroeconomic indicators. The employment in the sector in the period of 1998 – 2001 is analyzed, as well as the income and expenses structure of these organizations on the basis of their income and expenses reports. This is the base, on which in the third part of the research is examined the tax treatment of nonprofit organizations. The effect of some of the proposals for legislative amendments in the Bulgarian legislation with respect to the taxation of nonprofit organizations on the country's economy and mainly on the state budget is made as the calculations are set in a special application. This order and the relatedness of the research as well as the trustworthy information sources presuppose the reliability of the results reached.

A main information source is the data from the National Statistic Institute (NSI) and the Ministry of Finance. Also used are the officially published data of the NSI and some aggregations of original data, made especially for the present study. The consolidated state budget is the primary information basis, which is used for evaluation of the effect of NPO activities and the legislation amendments on the public finances situation.

In the study, the notions noncommercial and non-profitmaking organizations are used as synonymous. The notion nonprofit organizations is used in a narrower sense, as the transition from the aggregation of noncommercial organizations towards non-profit ones is clarified in part one, section I.1.

## **Part one. Noncommercial organizations**

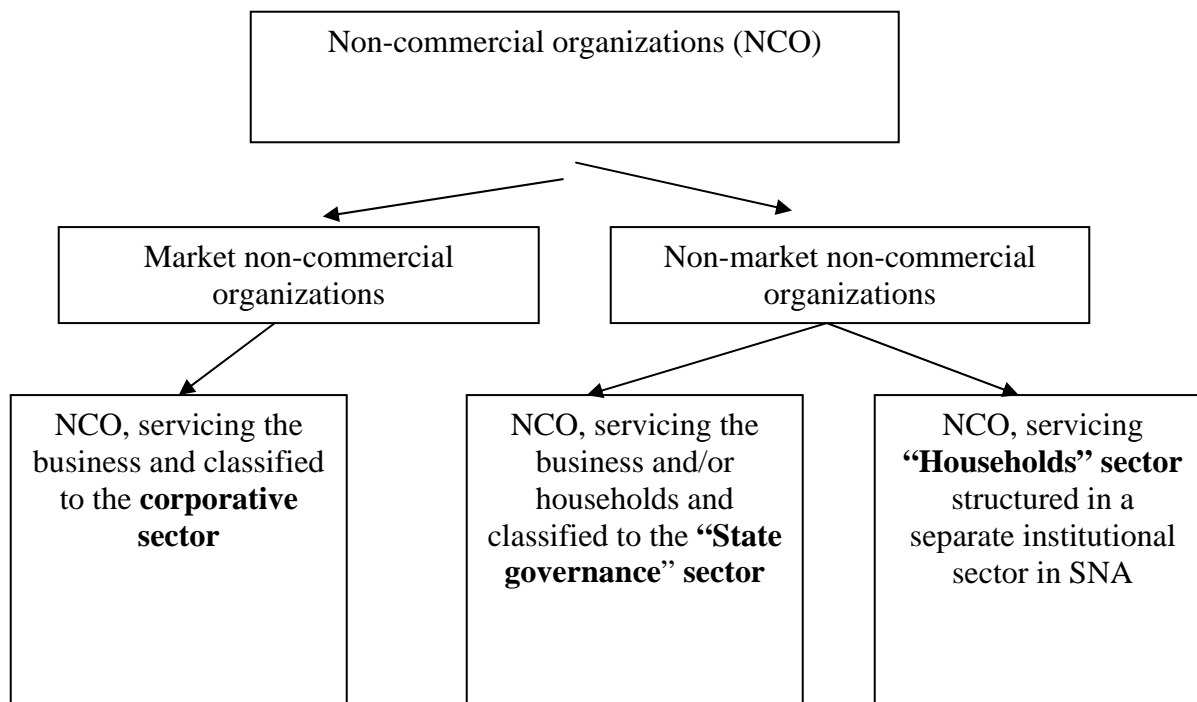
### **I.1. Nature and types of noncommercial organizations**

The system of national accounts (SNA 93 and ESS 95) defines noncommercial (non-profitmaking) institutions as juridical units, established with the aim of goods and services production, whose status does not allow them to be a source of income or other financial profit for those, who establish, control or fund them<sup>3</sup>. In practice their activity generates surpluses or deficits, but other institutional units cannot absorb the surpluses. Due to this reason they are often exempted from different taxes. The notion “non-profitmaking” does not mean that none of the noncommercial organizations cannot have an operating surplus from its activity, but it comes from the fact that, the members of these organizations, who control the NCO are not allowed to gain profit from the NCO activity.

The following scheme shows the **systematization of NCO from the economic institutional structure point of view**.

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<sup>3</sup> System of National Accounts, 1993, p. 94



NCOs are divided into market and non-market producers. The NCO – market producers provide goods and services to other institutional units at economically important prices, i.e. prices which have an important influence over the quality, which the producer wants to offer and the quantity that the buyer wants to buy. Schools, universities, hospitals are market NCO, when they charge fees, which are based on their production expenses and which are high enough to influence the search of their services. While performing their activity the market NCO should generate operating surplus or loss. Each surplus that they generate should stay inside the institutions, because their status forbids them to distribute it among other institutions.

Most market NCOs, servicing business, are created by business associations and are funded by them. Examples of market NCOs, servicing businesses and classified towards the corporate sector are the commercial chambers, agricultural or commercial associations, research labs and other organizations or institutions, performing activity that is profiting the business, which controls and funds them. When NCOs are business servicing (for example commercial chambers and other organizations), but are controlled and financed primary by state, then they are classified as non-market NCOs and are directed towards the state governed sector.

The greater part of NCOs are non-market producers. They are producers, which provide their production free or at economically insignificant prices or fees<sup>4</sup>. Therefore, in order to cover their activity expenses, non-market NCOs rely on other sources such as membership fees and transfers from other economy sectors.

From the point of view of the institutional structure in the economy, the non-market institutions are divided into two parts – ones that are controlled and financed primarily by the Government and service the business and/or households and others, providing not-market services and goods to households, financed primarily by transfers from non-government sources – households, corporations or from foreign sector. Examples for NCOs, classified in the governmental sector are NCOs, which are engaged with researches and are benefiting groups of producers or such NCOs, functioning in the healthcare, ecology, education and other spheres and are of benefit not only to the manufactures, but also to the population. The Government may create such NCOs, and they are part of the government management sector, although they are benefiting some other institutional sectors.

The rest of the NCOs are united in a separate sector in the system of national accounts – noncommercial organizations, servicing households. These are NCOs such as professional unions, political parties, consumers associations, religious communities and social or sports clubs. Not included here are organizations with similar functions, but controlled and financed primarily by the Government,. Other NCOs, servicing households, provide services or goods to the households at non-market prices in case of natural disasters or war. The incomes of these NCOs are gained generally on the base of donations in cash or in-kind provided by the community, corporations or the Government and from foreign sources.

For systematization of NCOs from the point of view of their performed activity, in the NSI practice is used the National Branch Classification (NBC 98). It is compatible with the branches classification and economic activities, adopted in the EU member-states and applicant-states. Up to 1997 for branch economic grouping has been used the branch classification of activities (BCA), which structures the production sphere according to the methodology of the material product system. This creates some difficulties when connecting data in dynamic lines and analysis, especially at the lower levels of aggregation of the functions and activities of non-profitmaking institutions.

For the period from 1998 to 2000 NCOs are classified into the following activities' groups:

- 1. Business organizations and employers' organizations – NCOs, focused on the development of a specific business or towards economic and social development of a particular region such as the Branch union of leather, fur, shoe and haberdashery industry, Federation of bread bakers and confectioners in Bulgaria, Association of Bulgarian factories for international transportation, Agency for small and medium entrepreneur assistance, Association of Bulgarian Book publishers, Bulgarian artisans chamber, Association of Bulgarian insurers;**

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<sup>4</sup> In the sense that they do not have sufficient influence over the quantity, which the producer wants to sell and over the quantity, the buyer wants to buy.

**2.** Professional unions and organizations – organizations, whose members have similar interests in a professional-technical sphere or practice similar professions such as: the Union of Architects in Bulgaria, Scientists' Union in Bulgaria, Chemists' Union in Bulgaria, Pharmaceutical Union – Sofia, Interpreters' Association, Union of mathematicians in Bulgaria, Union of the independent auto - technical experts in Bulgaria, Union of meteorologists in Bulgaria;

**3.** Creative unions – clubs and unions of culture and art activists: writers, artists, painters, movie-makers, TV and radio – workers, journalists and etc. as: Union of national arts masters, Association “World and music”, Union of Bulgarian composers, Union of Bulgarian movie workers, Union of Bulgarian painters, Association of Bulgarian writers, Bulgarian Association for theatre;

**4.** Associations of cooperative organizations – association among co-operatives that are not targeting profit for performance of the common policy, in relation to market, labor salary, social policy such as: National Union of labor-productive co-operatives, Central Union of co-operatives of handicapped;

**5.** Syndicate organizations – organizations of hired employees, which protect their interests in the sphere of labor realization and labor salary as: Syndicate Federation “Metalitzi”, Syndicate of Bulgarian teachers, Federation of independent syndicates of minors, Labor Confederation “Podkrepa”, Union “Promiana”;

**6.** Other NCOs – foundations, associations, clubs, interests societies, related primarily with distribution of sources, products and providing services without profit; fundraising for charitable aims; establishment of social contacts; protection of a particular interests of groups of people; organization of educative activities. In this group are Foundation “Democracy”, Foundation “St. Kiril and Methodius”, Foundation “Vasil Levski”, Foundation “Public Fund Childhood”, “Bulgarian Red Cross”, Association “Center for social practices”, Independent association “Green patrols”;

**7.** Political organizations – political organizations and their associated organizations – for example: political parties' youth organizations;

**8.** Religious organizations such as: the Bulgarian Patriarchy, Union of Seventh day Adventists churches, United God church, Church of Seventh day Adventists, Armenian Evangelists Church;

**9.** Chitalishte.

In addition to the above mentioned NCOs are registered in the following activities, which by rule, are performed also by commercial entities in the market sphere:

**10.** Academic studies – fundamental and applicable scientific studies, experimental researches in the sphere of medical science and public and humanitarian science;

**11.** Education – higher education, out-of-class activity for children and youth, professional qualification and requalification of adults. In this group are

Association “New Bulgarian University”, association “American University in Bulgaria”, Center for human resources development;

**12.** Human healthcare and social services – “Mother and child” homes, social patronage and social care centers, providing accommodation, activities related to providing food and services to elderly and physically and mentally disabled and vulnerable people, family and children related consultations, adoption issues inclusive, professional orientation and displacement of disabled and vulnerable people, selection in connection to providing financial and in kind help; for example Association SOS – child villages Bulgaria;

**13.** Culture, art, science - technical information and documentation – theatric, music and artistic activity, protection and restoration of cultural monuments, library activity; Association “Theatre Flower”, Association “Antract”;

**14.** Physical and sports activity. Tourist association “Aleko Konstantinov”, Riding club – Boyana, Bulgarian School union “Unak”, Sports club “Academicus”, Sport Dances Club “Mladost”, Yacht Club – port Burgas.

The analysis in part two is made as for the activities from 11 to 14 including is separated only the **data for NCOs**, functioning in these spheres.

The terms “noncommercial organizations” and “non-profitmaking organizations” are used in the study as synonymous – for indication of the whole group of noncommercial organizations, despite the type of activity performed. The notion “nonprofit organizations” is used in a narrower sense. Here are included only the noncommercial organizations from group 1, 2, 3, 4, 6, 9, 11, 12, 13 and 14. One additional group non-profit organizations have been considered, from which are excluded chitalishta and NPOs, performing physical culture and sports activity. It is accepted that the Non-profit legal entities act that entered into force on January 1, 2001 regulates the activities of these NPOs.

## **I.2. Indicators for measurement of the NCOs activity**

The activity of NCOs is measured and analyzed more difficultly than the one in the commercial sector due to the nature of services, which they provide and the accountability procedure they have to observe. In the present study for measurement of this activity are used several groups of indicators. First, is the SNA data, characterizing the produced production, the intermediate consumption and the added value in the sector. Second, are the employment data and employees’ salaries, characterizing the labor efficiency. Third, is data from incomes and expenditures reports, which serves as a base for the use of the indicators in the preceding two groups.

The main measures of the NCO activity are the total production, intermediate consumption and the added value. They are counted in observation of the methodological recommendation of SNA for the accounting of the non-market producers.

**The gross production (GP)** is measured on the basis of paid current expenses for the accomplishment of the respective activity, including the consumption of general capital. For NCOs the indicator gross production is a sum of their economic and non-



economic activity production. The one from non-economic activity is equal to the administrative costs, made in the sector for accomplishment of this activity. Here are included the expenses for materials, outside services, salaries, social security and consumption of general capital.

**The intermediate consumption (IC)** generalizes the current production expenses for materials used and paid outside services. Here are not included the expenses for compensation of hired employees, as well as the general capital consumption.

**The added value (AV)** represents the difference between the produced gross production and the intermediate consumption. For NCOs, providing services free of charge or at economically unimportant prices, the added value of their non-economic activity comprises in its structure of compensation of the hired personnel (as initial expenditures for the unit and initial income for the hired persons) and consumption of general capital. While the NCOs perform non-economic activity, the consumption of general capital eliminates the gross operating surplus, as the net operating surplus<sup>5</sup> for them is zero. The net operating surplus for NCOs may be different from zero as a result of the performed by the NCOs economic activity.

**The disposable income (DI)** is indicator, which is formed in the process of distribution and redistribution of incomes. It is used for final consumption and savings, which defines the financial position of the sector: net possibility for financing or net need of financing.

The connection between the listed above NCO sector indicators can be presented generally through the following equations:

- (1)  $AV = GP - IP$  (in the Production account)
- (2)  $OS = AV - (CHP + SSP)$  (in the Generating of incomes account)
- (3)  $DI = II + OS + \text{current transfers (received minus given)}$  (in the Distribution of initial incomes and Secondary distribution of income accounts)
- (4)  $\text{Saving} = DI - \text{expenses for final consumption}$  (in the Use of disposable income account)
- (5)  $\text{Net possibility/need of financing} = \text{saving} + \text{capital transfers (received minus given)} - \text{gross formation of general capital} - \text{alteration of reserves}$  (in the capital account)

AV – added value in the institutional sector

GP – gross production

IC – intermediate consumption

OS – operating surplus

CHP – compensation of hired persons

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<sup>5</sup> The net operating surplus is the balance position in the generating income account. It is counted as from the added value are deducted compensation of the hired personnel and the paid production's taxes and are added the received subsidies.

SSP – social security payments

DI – disposable income

II – initial incomes (net)

The basis for construction of indicators, measuring the NCO activity is the accountancy information, part of the incomes and expenditures report. Up to 1997 accounting standards do not allow the accounting of the specific operations related to the realization of non-profit activity and all units present their financial situation and results from the activity performed in the reports scheme of companies from the sector “Non-financial companies”. Since 1998 significant changes in the NCO accountancy system had been introduced. Two types of incomes and expenditures reports were implemented – for independent accounting of non-economic and economic activity. This created conditions for precision of accounting, prepared on the basis of SNA methodology for the period after 1997, especially with regard to the gross production accounts, added value and operating surplus (in result of the performed economic activity).

It should be noted here that the formation of the dynamic lines for the whole period 1991-2001 r. for the most indicators is impossible due to the transition nature of Bulgarian economy and the often happening methodological changes in the data (as well as in the content of initial data and in the methodology of their aggregation). All this impedes the statistics data administration and its on-time transformation in a comparable shape through the last years of the studied period. Due to those reasons the disposable income data, savings and net financial position towards the institutional sectors is available only up to 1997 including.

The employment and salaries data in the NCO sector is available for the period 1997-2000 and only for these organizations that are classified as performing activities from 1 to 9 including in chapter I.1 of Part one.

Due to the specified above change in accountancy in 1998, the existing and comparable data for NCO incomes and expenditures are for the period 1998-2000. Although the informational limitations narrow down the abilities for shaping the whole picture for the NCO sector dynamics, the available data gives sufficiently clear and trustful idea about the sector development tendencies in the last ten years.

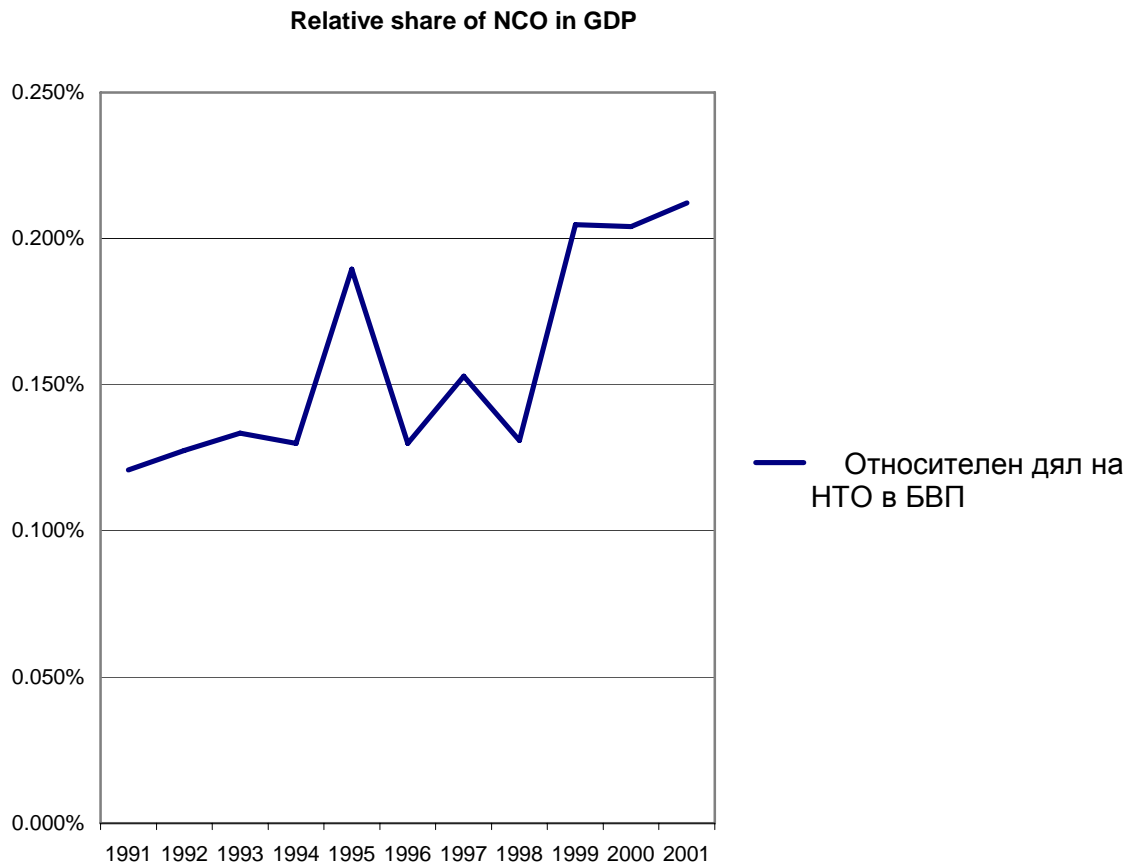
## **Part two. NCO development in Bulgaria during the 90s**

### **II.1. Production and added value**

The statistics show that the NCOs still have insignificant share in the economy of Bulgaria. In 2001 the added value in this sector is 62.8 million BGL and hardly forms 0.21% of the GDP of the country. This is its major relative share for the last ten years. During the period 1991-1998 the sector's share in GDP is comparatively stable (between

0.12 and 0.15%<sup>6</sup>), and in 1999 rose and during the next two years remained at the level of 0.2%<sup>7</sup> (Graphic 1).

Graphic 1

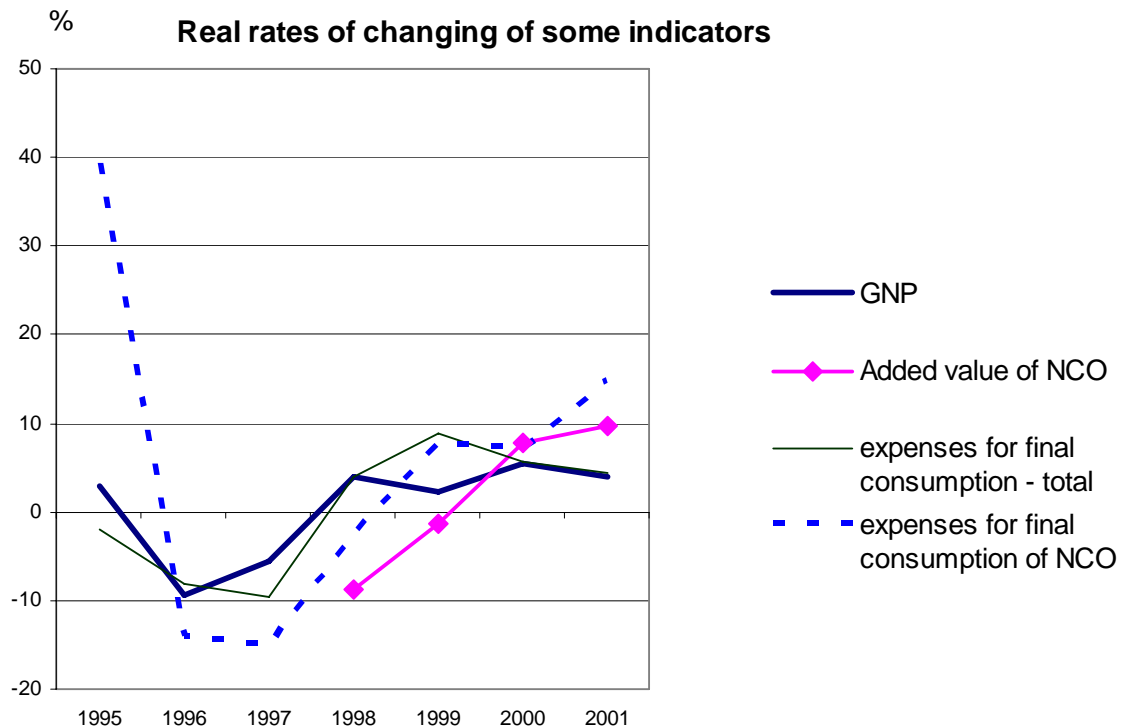


The comparison between the real increase of the above stated indicators is a better sign for NCO development due to the different deflators of added value in NCO and GDP. In 2000 and 2001 the real increase of the added value, created by NCOs is respectively 7.7 and 9.6% and is respectively with 2.3 and 5.6 percents higher than the state GDP increase during these years (Graphic 2). Probably the increased dynamics of NCO during the last years is a result of the improved macro-economic and institutional environment, in which NCOs are functioning.

Graphic 2

<sup>6</sup> Except 1995, when the share of NCO in GDP rose to 0.19%.

<sup>7</sup> For comparison the sector's share in the GDP in Norway and USA is around 4 percent.



In 2000 the added value of NPOs is 31.8 million BGL (58.3% of the added value in the NCO sector) and represents 0.12% of state GDP. If we exclude from the NPO group the Chitalishta and the sports organizations, the added value would be 23.1 million BGL, and the NPO share in GDP goes down to 0.087%. Only the NCOs, performing physical culture and sports activity have produced 1.9 million BGL of added value in 2000.

The disposable income of NCOs systematically and sensitively exceeds the gross added value gained in this sector. In 1997<sup>8</sup> this increase is more than 4 times. The gross added value of these organizations is 26.6 million BGL, and the disposable income of the studied sector is 109,6 million BGL. This is a result of the redistribution processes as a consequence of which net sources flow towards the NCOs. Besides the NCOs, only the sector «State governance» the transfers received exceed the ones given, i.e. the redistribution processes lead to resources transfer from non-financial and financial entities, households and the foreign sector towards the state budget and NCOs. Of course, the size of the received net sources of the non-governmental sector (101 million BGL) is very small (25 times less in 1997) compared to State governance.

In 1997 the net transfers towards the NCO sector represent 92,1% of their disposable income. The rest of the disposable income is formed from initial income and the operating surplus in the sector. From the last two elements of the disposable income

<sup>8</sup> As was noted down in I.2. for the transfers indicators, disposable income, savings, gross formation of general capital and net possibility (need for) financing by economy sectors there is no data for the period after 1997.

in the non-governmental sector a dominant share (96% in 1994 and 74% in 1997) have the initial incomes, which are a result of the specificity of the studied sector as a combination of non-profit making economic units.

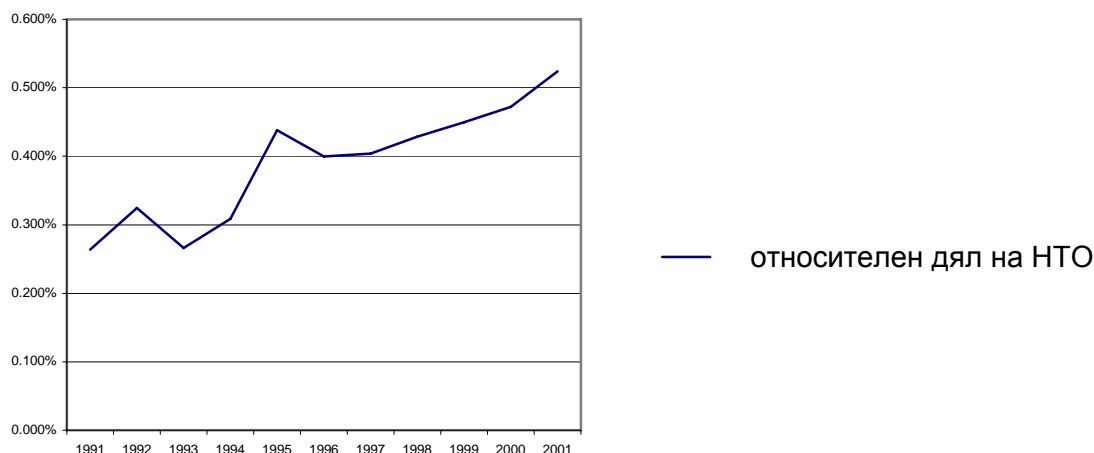
The disposable income is distributed between expenditures for final consumption and savings. For the NCO sector the period 1991-1997 could be divided into two sub-periods. Up to 1996 the expenditures for final consumptions have exceeded the disposable income in the sector, which caused negative savings in the sector, i.e. during that period the sector needed additional resources in order to function. In 1996 and 1997 the situation is radically changed, because the transfers, distributed towards the non-profitmaking sector during these years increased significantly and are far greater than the real possibilities for their absorption by the NCOs that are much undeveloped. Thus, the NCO sector during these years increases its financial assets and occupies the position of net lender in the economy in the period of financial and economical crisis.

The analysis until that point shows that although it was created after the beginning of the transition period, the NCO sector gradually strengthens financially in the conditions of strong budget limitations. That indicates the sector as a possible important factor for a long-run growth in the economy if a favorable model of economic policy for its further development exists.

The final consumption expenditures of NCOs for the economy in general reconfirm the insignificant role of NCOs for the development of Bulgarian economy. Although the fact that during the period 1991-2001 this share rises twice, even its maximum stays very low – hardly 0.52% in 2001 (Graphic 3). The real growth of the final consumption expenditures in the NCO sector since 2000 until now significantly surpasses not only the growth of the final consumption expenditures for the economy in general, but also the growth of GDP for the respective years (Graphic 2). Most clearly it is seen in 2001 when the physical volume index of final consumption expenditures of NCOs, serving households is 114,8, the final consumption expenditures is 104,5, and to GDP – 104. The change in the trend of development of the non-profitmaking sector is probably caused by the far clearer conditions regulating NPOs and as a result of the general macro-economic stability.

Graphic 3

Relative share of final consumer expenses of NCO in the total final consumption



In the gross formation of NCO general capital is also noticed a growing tendency of the absolute share of this indicator as well as of its relation to the gross formation of general capital for the economy as a whole. In 1991 this share is hardly 0.08%, while in 1997 it rises to 0.58%.

The analysis up to here allows us to make the following conclusions about the NCO activity in Bulgaria and about the environment they are operating in:

First, NCOs contributed insignificantly to the economic development of Bulgaria in the 90s of 20th century and the beginning of 21st century. The comparative analysis shows that their relative share in GDP is much lower in comparison with other countries.

Second, through the years of economic and financial crisis (1996-1997) the NCO sector is in a position of net lender in the economy, but due to its insignificant relative share has not been in a situation to play the role of a buffer and to decrease the crisis level;

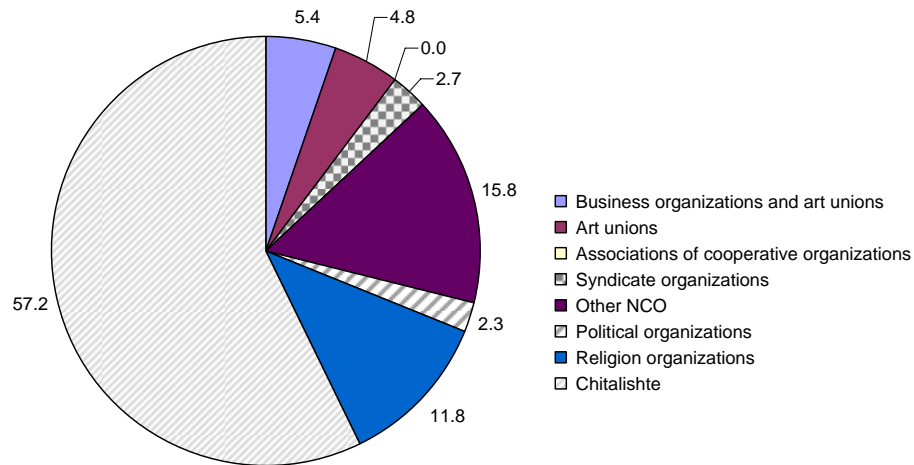
Third, in the last two years have been created more favorable macroeconomic and institutional conditions for the operation of NCOs and as a result they are developing with a faster rate in comparison with the dynamics of the economy as whole.

## II.2. Employment and work salary

In contrast with the growing dynamics of the indicators, characterizing non-profitmaking sector from the added value point of view, in the last years the number of the employed people in NCOs gradually goes down – from 16771 persons in 1996 to

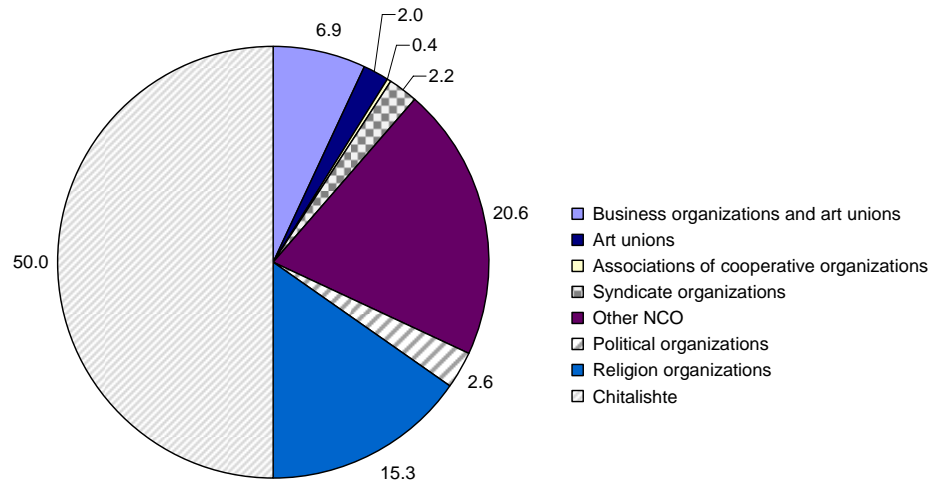
11502 in 2001.<sup>9</sup> This dynamics follows the tendency for decrease of the employment in the economy for the same period. Irrespective of the downward tendency in the number of employed in the non-profitmaking sector, their increase through the last year of the studied period should be noted. For 2001 their share rose from 0.36% to 0.39% due to the increase of employed in NCOs (with 9%) while there was a total decrease of the employed in the economy as a whole (with 0.1%).

**Structure of the employed by NCO in 1997 (%)**



<sup>9</sup> As was noted down in part one, I.2. the employment data for NCOs is available only for activities from 1 to 9, exclusively. By indirect assessments (on the basis of hired persons in the compensations data of all NCOs) the number of all occupied in the NCO sector is around 16 000.

**Structure of the employed by NCO in 2000 (%)**



The chitalishta engaged above one half of the employed in the NCO sector (5280 persons in 2000). Their relative share gradually decreases – from 57.2% in 1997 to 50% in 2000 due to the relatively faster growth of employed mainly in the religious organizations and these from the group «Activity of other NCO». In these two sectors the employed in 2000 are 1619 and 2172 persons.

The dynamics of the employment in the NPOs coincides with the downward tendency with regard to employment in the entire NCO sector. From 10096 persons in 1997 their number decreased to 8433. If we exclude the group of Chitalishta, the employed people in these organizations are 3157 in 1997 and 3153 in 2000.

In the NCO sector work primarily women and they are relatively with regard to men. Women amount to 6748 people in 2000 or 64% of all employed people in NCOs. If we take only the NPOs, the share of women is even higher (74% in 2000 or 6252 women), and if we exclude Chitalishta from the group of NPOs, in 2000 in NPOs have worked 1939 women (61.5% of all occupied in NPO group without chitalishta).

Women have the biggest share in the groups «Chitalishta», «Creative unions activity» and «Activity of business organizations and professional unions, besides the creative ones» - respectively 82%, 69% и 67% in 2000, and the lowest is the relative share in «Religious organizations activity» - 14%.

The analysis shows that the added value of a person employed in the NCO sector is much lower than the added value measured with respect to economy as a whole. In 2001 the proportion between added value in the non-profit sector of an employed person and the added value for the entire economy of one employed person is around 1:1.8. Due to the fact that the data for the employment in non-profitmaking sector is not full, the regarded proportion is even higher. This is explained with NCOs nature as non-profit making economic entities, because of which the level of operating surplus as a component of the added value is insignificant.



The payment in the NCO sector is relatively lower than the average for the economy. In 1990 the average annual salary in NCOs is significantly below the average salary for the country (with 36%), but through the last years it has risen relatively fast and in 2000 it is only 11% less than the average annual salary for the country. The average annual salary in the sector in 2000 is 2433 BGL. The average annual salary of women in NCOs is 75.5% of the men's and 89.8% of the average annual salary, paid in the sector.

The average annual salary in NPOs for 2000 is 2468 BGL, but excluding Chitalishta it rises to the level of 3961 BGL.

According to the classification of the activities groups, included in NCO sector, the highest is the annual salary of the occupied in «Associations of co-operative organizations» (6548 BGL in 2000). This salary exceeds 2.5 times the average salary in the sector, and the lowest is the annual salary of the occupied in the chitalishta (1576 BGL). The payment differentiation among NCOs on the basis of activity performed is 4.2 times.

In summary, the employment in the non-profit sector analysis shows that through the last years the number of employed in NCOs falls down parallel with the increase in the unemployment indicator for the country. Irrespective of this tendency, in 2001 together with the increase of added value in the NCO sector, an increase of the number of employed persons in it is observed as well. The payment in the sector is significantly below the average for the economy, but gradually the difference between the average annual salary for the country and the average annual salary in the NCO sector will be eliminated. The change in the employment tendency and the approximation of the payment level in the studied sector and the average for the economy can be regarded as a result of the more favorable conditions, in which NCOs are acting in the last two years.

### **II.3. Incomes and expenditures of NCO for the period 1998-2000**

The nominal incomes of NCOs by both economic and non-economic activity are 180 274 000 BGL and 238 426 000 BGL respectively for 1998 and 2000. They increase from 0.8% of the GDP of the country for 1998 to 0.89% in 2000. The incomes only of non-profit organizations are respectively 134 755 BGL (0.6% from GDP) in 1998 and 175 567 BGL (0.66% from GDP) in 2000. Excluding the Chitalishta and sports organizations, the income of NPOs in 1998 and 2000 is respectively 113 629 BGL and 149 160 BGL (0.5% and 0.56% from GDP).

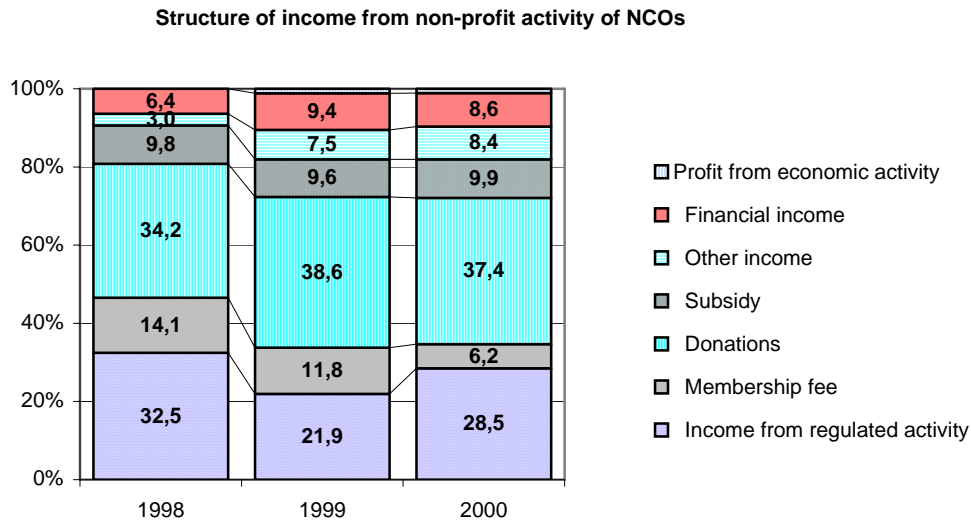
Throughout the studied period the incomes from non-economic activity constitute almost 85% of the incomes of NCOs. The remaining 15% incomes from economic activity are primarily (around 90% of them) incomes from sale of production<sup>10</sup>. The tax legislation in force does not stimulate NCOs to perform economic activity, with which to facilitate the achievement of their goals due to the taxation of their profit, formed as a result of their economic activity.

The largest incomes from economic activity have the NCOs from the «Activity of business organizations and employers' organizations» group. The economic activity

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<sup>10</sup> The differentiation between economic and non-economic activity of NCOs is very important due to their different tax treatment, which is discussed in detail in part III of the study.

incomes of these NCOs form over 60% of all the incomes from economic activity of NCOs. The economic activity incomes of the NCOs from «Activity of business organizations and employers' organizations» and «Activity of professional unions and organizations, without creative ones» groups are larger than these from non-economic activity. This is logical, considering the fact that these NCOs are tightly connected with the business and probably a large part of them are market NCOs. Chitalishta have insignificant incomes from economic activity, while political parties do not have such incomes.

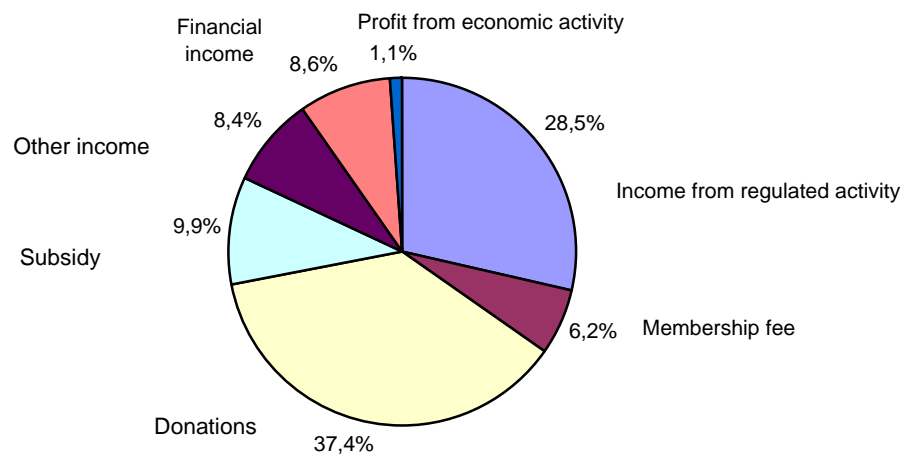


The main source of income for the non-economic activity of NCOs are donations, followed by incomes from regulated non-economic activity<sup>11</sup>. For the period 1998-2000 in the structure of incomes from non-economic activity the share of donations gradually increases (from 34.2% to 37.4%) basically as a result of the relative decrease of membership fees (from 14.1% to 6.2%).

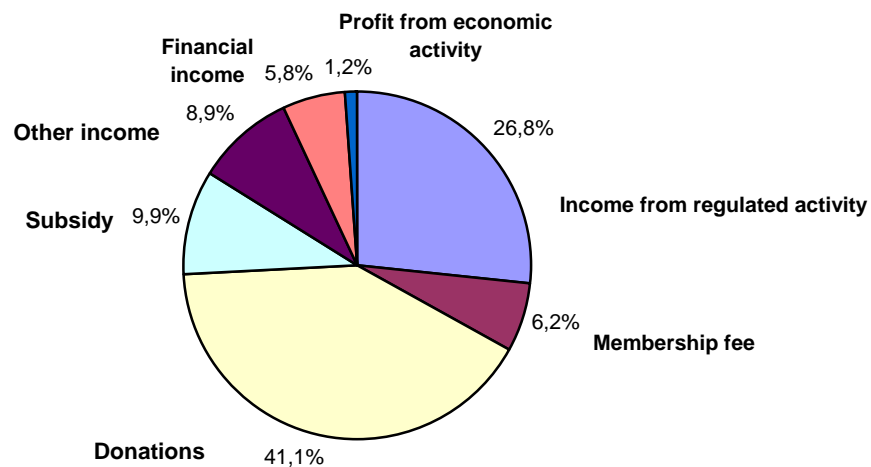
More than 1/3 of the subsidies, which NCOs received in 2000 are directed towards Chitalishta. Due to this fact, if we exclude the Chitalishta and sports clubs from the group of NPOs, the subsidies share in the structure of incomes from non-economic activity of NPOs goes down with 5.1 percents with respect to the whole group of NCOs (from 9.9% for NCOs to 4.8% for NPOs without Chitalishta and sports organizations).

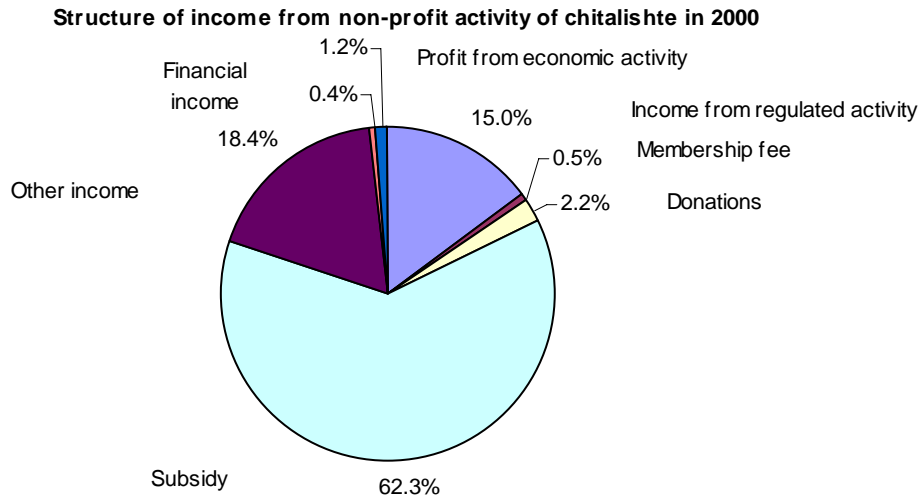
<sup>11</sup> The regulated activity is set forth in the Statute of NCOs and incomes from it are related with the activities performed according to this Statute. For example for the Architectures Union in Bulgaria incomes from regulated activity are the incomes from organization of competitions, exhibitions, distribution of surveys, reports, related to the Union activity etc.

**Structure of income from non-profit activity of NCOs in 2000**

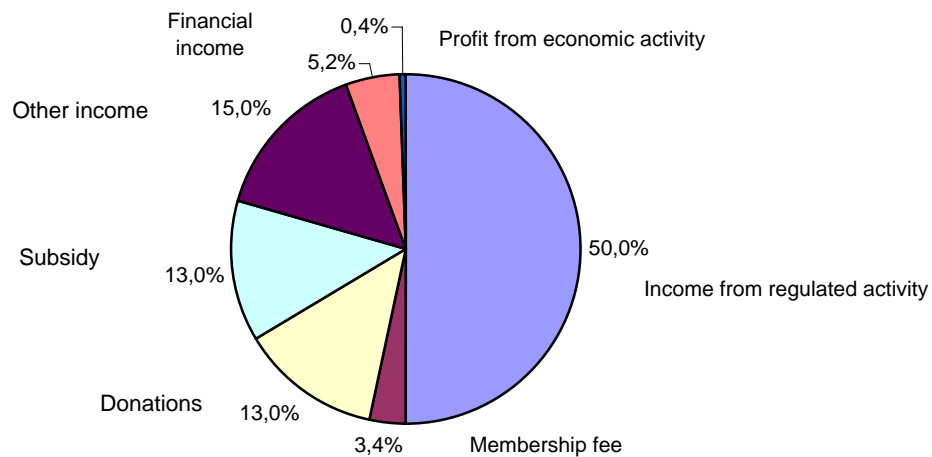


**Structure of income from non-profit activity of NCOs in 2000**





**Structure of income from non-profit activity of NPOs, in the sphere of physical culture and sports in 2000**



Very essential differences between the structures of the incomes of the separate NCO groups could be noticed. The analysis shows that in the group «Activity of business and employers' organizations» the biggest relative share in the incomes from non-economic activity have the incomes from regulated activity (35.7% in 2000) and membership fees (26.5%), in the group «Activity of professional unions and organizations, besides creative ones» and «Activity of syndicate organizations» – the membership fee (respectively 38.4% and 62.3%), and in the associations of co-operative organizations – the membership fee (48.6%) and the subsidies (27%).

Incomes from non-economic activity in the groups «Education and qualification», «Other NCOs» and «Activity of political organizations» is formed primarily of donations

(respectively 33.8%, 53.9% and 61.4%), in the healthcare and social services – subsidies (92.7%), in the chitalishta and cultural activity – also subsidies (respectively 62.3% and 58.1%).

**Distribution of subsidies and donations between the separate groups of NCOs in 2000**

	Donations (thousand.lev.)	Structure
Other NCOs (gr. 6 от I.1)	56675	75,9%
Education and qualification	11197	15,0%
Physical culture and sport activity	1855	2,5%
Activity of political organizations	1973	2,6%
Activity of religious organizations	1851	2,5%
Remaining NCOs	1128	1,5%
<b>Total</b>	<b>74679</b>	<b>100,0%</b>

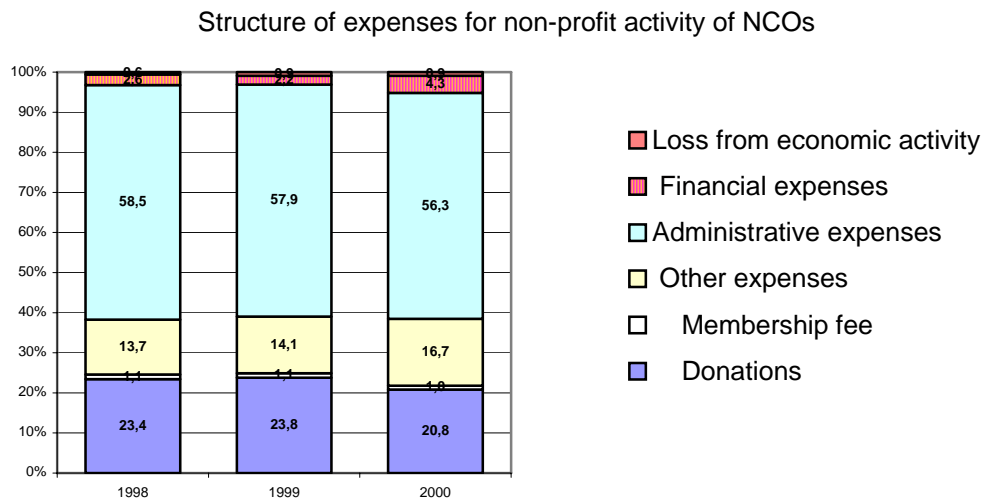
	Subsidies (thousand.lev.)	Structure
Chitalishte activity	6738	34,2%
Healthcare and social care	1717	8,7%
Education and qualification	2561	13,0%
Physical culture and sport activity	1860	9,4%
Other NCOs (gr. 6 от I.1)	5057	25,6%
Remaining NCOs	1797	9,1%
<b>Total</b>	<b>19730</b>	<b>100,0%</b>

The largest incomes from donations are observed in NCOs working in the field of education and qualification and those in the «Other NCOs» group. The state budget subsidies are directed primarily towards NCOs, performing chitalishte activity, education and qualification and for the group «Other NCOs». If from all NCOs these pursuing religious, political and syndicate activity are excluded, the donations for the remaining part of the NCOs will form 79.2% of all donations for 2000, and the subsidies would be – 72.3%. If from the NCOs group we exclude chitalishta and sports clubs the donations share will decrease to 76.4%, and in regard to subsidies – to 28.7%.

Both the incomes, and the expenditures of NCOs outgrow the nominal GDP and their proportion in regard to GDP rises from 0.6% in 1998 to 0.8% in the next years. In nominal figures the expenditures of NCOs in 1998 and 2000 are respectively 133 114 000 BGL and 215 562 000 BGL. The proportion of NCO expenditures to the GDP in 2000 is 0.57% and 0.47% in 1998. If from all NCOs we exclude Chitalishta and sports organizations, their share decreases to 0.37% in 1998 and 0.48% in 2000.

The NCO expenditures are formed from the expenditures for economic and non-economic activity of these organizations. The non-economic activity expenditures

represent around 85% of all NCO expenses and comprise of regulated activity expenses, administrative and financial expenses. Relatively the largest share have the administrative costs, which in 1998 are 58.5% from all NCO expenses, and in 2000 – 56.3%. The salary and outside service expenses are the main components of the administrative costs of NCOs. The salary and the social security expenses paid by the employer form the major part of the added value in this sector – about 86% in 2000<sup>12</sup>.



The main component of the regulated non-economic activity expenses are the donations. Almost all the expenses in the form of donations are made by NCOs, included in the group “Other NCOs” – 98% in 2000. The comparison between received and given donations shows that NCOs donate about one half of the received by them donations. Only for the NCOs from the group “Others” this proportion is 66% for 2000. In that way NCOs perform a redistribution function, but contrary to the state budget, the flow of resources towards NCOs does not have an obligatory, but rather a voluntary nature. Sources of donations for NCOs are the foreign sector, the non-financial sector and households, and the resources collected are directed towards the sphere of activity, the respective NCO is registered for.

Analogically to the incomes situation, the economic activity expenses of NCOs from the group «Activity of business and employers’ organizations » exceed their non-economic activity expenditures and represent about 70% of the general size of the expenses of these NCOs.

With regard to incomes and expenditures of NCOs the following conclusions could be outlined:

<sup>12</sup> The remaining part of the added value in the non-profitmaking sector represents consumption of general capital and operating surplus in result of economic activity, performed by the NCOs.

First, the gradual, but not significant expansion of the NCO sector, defined in the previous two points, finds expression in the ratio of their incomes and expenditures towards GDP. As a whole the economic activity incomes are insignificant with respect to the general incomes of the non-profitmaking organizations.

Second, the income structure of NCOs is in a close dependence with the respective NCO activity specificity. While some of them attract significant in size donations and membership fees, others rely primarily on state subsidies.

Third, NCOs play a redistributing function, but contrary to the state budget, the resources that flow towards NCOs does not have an obligatory, but rather a voluntary nature. Sources of donations to NCOs are the foreign sector, the non-financial sector and the households, and the raised money is directed towards the activity sphere that the respective NCO is registered for.

### **Part three. Tax treatment of NCOs**

Troughout the last two years the institutional environment in which the NPOs work has been sufficiently improved. Since the beginning of 2001 the Law on non-profit legal entities (LNPLE) entered into force and were adopted new tax concessions for their activity, i.e. there are indications for the increase of the economic importance of the sector.

The tax deductions relate to both NPOs<sup>13</sup> and the other economic subjects, in their virtue of donors. NPOs may perform economic activity, which raises the question how they should be taxed in this case. The size and the structure of the tax deductions provided in the respective countries are different – a variety of possible alternatives exists in the different states, and they depend on the level, on which the governments want to facilitate the NPOs and the state bodies are concerned with respect to the competition positions of the separate subjects. Due to the fact that NPOs in Bulgaria work in a state with a developing market economy, they need additional stimuli for their development.

The tax treatment of NPOs depends on the type of performed activity and is regulated as follows in the different tax laws:

#### *Law on Corporate Income Taxation*

When the economic activity of NPOs is analyzed usually arise two questions between which a distinction should be made – should the NPOs be allowed to perform economic activity<sup>14</sup> and whether the profit from this activity should be taxable. According to the current legislation in Bulgaria, the non-profit organizations may perform supplementary economic activity only if it is related to the main activity the NPOs are registered for (Art. 3, sub-art.3 of LNPLE). The incomes from this activity may

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<sup>13</sup> Translator's note: In Part three of the analysis the term NPOs refers to legal entities with nonprofit purposes as defined by the LNPLE.

<sup>14</sup> There are at least three variants: a total ban for performing economic activity; the economic activity is permitted only if it is related to the scope of main activity of the organization; the performance of economic activity is entirely permitted (directly or indirectly - by an affiliate).

be used solely for achievement of the defined in their statute goals. This definition of the LNPLE according to which the economic activity is partially allowed, raises the question for separation of the economic activity that is targeting profit from the one that is related to the main activity of a respective organization. It is not always so easy to make such a distinction. The productive activity of a certain cooperative, in which disabled are involved, will more probably have as a main goal providing employment to people in a vulnerable social position, than increasing the profit.

Irrespective of the real goal of the economic activity performed, its existence makes the NPOs tax subjects, according to Art.6, par.1 in connection to Art.4, par.1 from LCIT. This legal requirement is very limitative, having in mind that according to art.3, par.3 and par.6 of LNPLE the nonprofit legal entities do not distribute profit and are obliged to use the income from their economic activity for pursuing their non-profit goals. The taxation of these funds diminishes the NPO resources and does not correlate to the latest amendments of art.23, par.3, 1 of LCIT, with which was increased from 5% to 10% the allowed tax deduction before the tax transformation of the financial result of donations to NPOs performing public benefit activity.

According to LCIT a hypothesis exists, according to which the NPOs are not taxable under art.6, par.1, point 2 when for the realization of activities, related to their main activity are collected fees, which cover only the expenses for organizing them. When fees are determined on a market basis it is considered that there is an economic activity performed and the hypothesis above is inapplicable. The membership fees are not recognized as income from economic activity and are not taxable under LCIT. The law should explicitly state that the sale of assets, used in the non-economic activity, including sale of donated objects is not an economic activity (and therefore is not taxable).

With respect to the taxes, due at the income source, regardless of the fact whether the NPLEs perform economic activity or not they are taxed with 20% under art.36, par.1 and par.4. When they do not perform economic activity, respectively they are not tax subjects under LCIT; they do not pay the tax under art. 25 (25%) and art.36, par.2 (20%). The latter are due only when economic activity is performed. The tax on dividends and liquidations shares, paid by local entities to NPOs under art.34, par.1 is 15% and is also due at the source.

The tax treatment of NPOs under LCIT is very controversial, because on one hand it stimulates charitable activity (before tax modification the financial result is decreased with up to 10% with the amount of the donations), and on the other hand – the profit formed as a result of the economic activity of the public benefit NPOs is taxed with municipality and profit tax. Among the Central and Eastern Europe states, only in Bulgaria, Albania and Romania the economic activities of NPOs are taxed. The international practice is tax exemption for these incomes, for which different rules are used – according to the use of the incomes (Poland), based on the type of economic activity (Latvia, Estonia) and other more-complicated tests<sup>15</sup> (Hungary, Czech Republic, Slovak, Croatia).

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<sup>15</sup> See ICNL, “NPOs in Central and Eastern Europe tax regime”, p. 13-20.



In case the whole profit should be used for public benefit goals according to LNPLE, its taxation is not economically effective and rational. The profit and municipality taxes for public benefit NPOs may be fully remised<sup>16</sup> and the income from passive investments (incomes from bank deposits interest and government securities) should not be considered economic activity. The remised resources will be accounted as reserves, and their transfer will be valid when they are used for accomplishment of the defined goals in the Statute or the Articles of Incorporation. This mechanism will provide security with regard to legal use of the remised resources and will have at least two aspects. First, it will directly increase the resource, disposable for the accomplishment of the NPO activity. The remise will increase the stimuli for NPOs to perform economic activity that is directly related to their main activity, and will have an indirect support for the achievement of their goals as well. Second, an important aspect that should be taken into consideration is to what loss of budget incomes will lead that action<sup>17</sup>. For that purpose we will use the data of the annual reports for the realization of consolidated fiscal program (see table). The profit and municipality tax incomes from NPOs (including mutual benefit ones) form about 0.1% of the total incomes from this tax and about 0.0068% of the consolidated budget incomes<sup>18</sup>. The distribution of the loss from these incomes between the municipalities' and the republican budget is not important for the current analysis, because based on the planned changes in the tax policy is probably in average term all profit tax incomes to flow in the republican budget.

The minimal budget loss shows that there is no direct risk for the stability of public finances from the decision not to tax NPOs. There could appear some indirect risks for this stability, if the NPO activity is directed towards self-profiting of the related to the organizations individuals, but not towards accomplishing of their nonprofit goals. This is a problem of control on the side of the tax administration, the Minister of Justice and the fair NPOs for observance of LNPLE and should not be a motive for limitation of the tax policy for the whole sector.

**Income from tax on profit and tax for municipality from non-profit organizations \***

	1997	1998	1999	2000	2001	2002
In thousand BGN**	1 351.8	1 289.7	1 135.8	792.0	980.8	848.7
in % from the total income from tax on profit and tax for municipality	0.124	0.154	0.161	0.116	0.092	0.115
In % from the total income for the consolidated budget	0.021	0.014	0.012	0.007	0.008	0.007

\*before 2001 this position has been "income from organizations with non-profit purpose"

\*\*The data is in denominated; for 2002 the data is approximate

<sup>16</sup> Translator's note: "remised" should be understood as calculated but not taken by the state and re-invested in the operations

<sup>17</sup> In a special Application are valued the consolidated budget incomes loss from each proposal in the tax treatment of public benefit NPLE.

<sup>18</sup> The part of these incomes in the consolidated budget will decrease in the midterm, because the governmental tax policy is oriented towards diminishing direct taxes, including the profit tax. In the current moment it is foreseen that the effective tax size will decrease from 25% to 20% in 2004 and from 20% to 15% in 2005.

It is possible that some public benefit NPLE own shares in local legal entities or non-personified associations, which pay to them dividends or liquidation shares. In that case a 15% tax based on art.34, par.1 of LCIT is due at the income source. The designation of these incomes for NPOs is not different from that of incomes from donations or from related economic activity. The shares may be a result of passive actions – received as a donation, or active actions, related to the accomplishment of the non-profit goals of these entities. The price of the shares is generally calculated as a net present value of the future income from them (dividends and liquidation shares), i.e. the taxation of these incomes of NPOs by its virtue represents taxation of donations or income from economic activity, depending on the way of receiving the shares.

If Art.34, par.1 text is amended in a way that public benefit NPOs are excluded from its scope, there will be no big loss of budget income. The precise amount cannot be defined, because for these incomes, information for the amounts received from this tax is not collected, but an indirect assessment could be made on the basis of the data from the income statements of NPOs, the national accounts and the reports for the consolidated fiscal program. We will assume that the share of the created added value by NPOs in the gross added value for the economy, is approximately equal to the share of the income from the tax on dividends and liquidation shares paid to NPOs, in the total income from this tax. In this situation the loss of income for the consolidated budget resulting from the amendment of art.34, par.1, namely that the dividends and liquidation shares paid to public benefit NPOs will be tax-exempt, will be equal to about 0.04 million BGL annually (as a basis is year 2002) or 0.0003% of all incomes.

Tax benefits for public benefit NPOs might be directed either towards encouraging charity or to increasing disposable income, resulting from the organizations' activity. The presented here proposals for amendments of LCIT were based on the idea not to tax the income from their activities. If the government is willing to support an increase in the stimuli for charitable activity, this might be realized by means of changes in the taxation policy towards donations. As the different tax subjects have different opportunities and willingness to donate, law provides for a limit for tax-exempt donations of up to 10% of the generated profit before tax transformation. The donations, accounted as expenses, are taxed with a 25% tax at the income source, and this tax is accepted as an activity expense and is not included in the transformation of the financial result under Part two of LCIT. This tax basis limits the possibility to make donations in an amount higher than the defined level of 10% or in case when profit has not been generated, because it will lead to increase of the tax obligations. In that way the greater willingness to donate is taxed more than the lesser willingness. If the contrary taxation philosophy is preferred, according to which the greater willingness to donate is taxed less, the tax size in art.48, par.1 in connection with art.35 should be decreased (parting its part concerning donations). One possible solution could be a tax size of 15%. If this tax is introduced, the possible loss of income for the budget is difficult to be assessed, because there is a high probability for a change in the economic agents' motivation for increasing the donations, which they make. If we presume that their motivation will stay unchanged, the maximum loss of income for the consolidated budget (basis 2002) will be 0.6 millions BGL or 0.0045% from the total incomes. Another possibility for stimulating charitable activity in which a greater foreseeability of the budget expenditures would exist, is the amendment

of art.23, par.3, point 1 by increasing the acceptable limit from 10% to 15% for deductions from the financial result of donations, made from the capital reserves, respectively from the account of the owner. This approach is not related to the variation of the willingness to donate and is less effective than the previous one. The increase of this limit may be gradual through the years, because if the change is made at once, the maximum loss of income for the budget will be about 36.7 millions BGL (0.29% from all consolidated budget incomes, basis 2002). The relatively huge incomes' loss in this case is supporting the gradual decrease of the limit or diminishing the tax size in art.48, par.1 with respect to public benefit NPOs.

According to art.4 of LNPLE the government may support and stimulate the registered in the Central register<sup>19</sup> public benefit NPOs through tax, credit, interest, customs and other financial and economic benefits, as well as funding under conditions and regime defined in the respective laws. The current benefits under the LCIT, which the NPOs can use, show that the government of Bulgaria has estimated for beneficial to facilitate their activity through tax benefits. Their structure is insufficiently effective and has to be changed in order to eliminate the controversies in the law. The changes should be in consideration of the fact that irrespective of the sources of their incomes, NPOs are obliged to use them for the accomplishment of the defined in the Statute or Charter of Incorporation goals. This supposes that the tax treatment of these incomes should be equal, i.e. the profit and municipality tax of public benefit NPLE should be fully remised, and the calculated in their benefit dividends and liquidations assets should not be taxed under art.34, par.2 of LCIT. If we accept the idea, according to which the greater willingness to donate should be taxed less, the tax size under art.48, par.1 in connection to art.35 (in the part concerning donations) may be diminished to 15%. As a result of all the proposed amendments of LCIT the maximum loss of income for the consolidated budget will be roughly 1.4 million BGL or 0.01% from all incomes, i.e. it would not destabilize the public finances.

The proposed amendments to LCIT will give a competitive advantage of public benefit NPOs with respect to the rest of the economic subjects. The power of this advantage is limited by the LNPLE provisions, according to which the economic activity of NPOs should be related to the subject of their main activity. NPOs are facing some others limitations such as the absence of sufficient access to the capital market and financing, which to use for development and modernization of their economic activity. Therefore the used by them tax exemptions should not lead to serious changes of the competing environment, and will balance the competing positions of the separate subjects.

#### *Law on physical persons income taxation*

In the Law on physical persons income taxation (LPPIT) is provided a benefit for donations made to public benefit NPOs. The scope of individuals that are eligible for it is limited (notaries; persons, performing medical practice under the Law on healthcare

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<sup>19</sup> Central registry of NPOs for public benefit activity at the Ministry of Justice. There are 223 NPLE for public benefit activity towards the end of May 2002.

institutions and other activities and services based on non-employment relationships; individuals performing paid management and control; individuals receiving incomes from rent or lease). According to art.22, par.1, 3 of LPPIT the benefit amounts to up to 10% from the taxable income upon deduction under items 1 and 2 from the same paragraph. The tax benefit might be used in case the individuals that make the donation, do not have declared unpaid state obligations or obligations, defined with a tax revision act at the moment of the donation making (art.28, par.1, 2 of LPPIT).

The size of the given tax benefit in case of donations to public benefit NPOs is equal under LPPIT and LCIT, but the scope of tax subjects that are eligible for this benefit is limited under LPPIT. The individuals receiving incomes under labour or other equal to labour contracts form their tax basis in observance of the rules in Part 7 of LPPIT, where there is no deduction from the taxable income of the donations. In that way a big part of the economically active population is placed in an adequate position regarding the stimuli for making the donations<sup>20</sup>. This decreases the community well-being, because it limits the economic agents' choice and the disclosure of their real preferences with respect to the distribution and use of their incomes.

Based on preliminary NSI data the individuals employed on labour contracts at the end of March 2002 are 1 905 647. The expected average monthly wage in 2002 is 278.2 BGL. If the taxable income is decreased with the donations made by these individuals<sup>21</sup> (only to public benefit NPOs<sup>22</sup>), (upon deduction of personal social security tax), the loss of income for the consolidated budget from the total income from the tax will be equal to 2.5 million BGL (0.29% from the revenue from the income tax paid by physical persons having labour and equal to them contracts or 0.02% from the income in the consolidated budget), which is distributed almost equally between the republican and municipality budgets. The income loss is relatively small, due to the low incomes of the population, which presuppose low ability to donate<sup>23</sup>.

#### *Law on VAT*

According to art.59, sub-par.6 of the Law on VAT (LVAT) the import of gratuitous aid is exempt from import tax, except the excise goods when given to public benefit NPOs, registered in the Central register of the Ministry of Justice. Donations of goods, except for the excise ones, or services, and gratuitous disposal of donations are an

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<sup>20</sup> In 2001 the occupied in employment relationships represents 39.9% from the population in work active age.

<sup>21</sup> For the calculation is used the average ability to make donations - 6 %. For comparison the average ability to make donations of the individuals with free professions according art.21, par.3 of LCIT for 2000 is 3.99%.

<sup>22</sup> This presupposes that NPOs will attract around 30% from these donations.

<sup>23</sup> Upon making a donation (10% from the taxable income after deduction of the personal social security tax) the tax burden over the average wage will decrease with 2.15 %, the total revenue from income tax – with 6.0 BGL, and the disposable income of the donor will decrease with 18.9 BGL or 8.70 %. If the average willingness to donate is taken into consideration (6% of the maximum amount of the donation, with which could be decreased the taxable income) the tax burden over the average wage falls with 0.13%, total revenue from income tax – with 0.4 BGL, and the disposable income of donor – with 1.1 BGL or 0.52 %.

exempted delivery under art.49 of LVAT. In the list of individuals, in whose benefit a donation may be made (exempted delivery) are not included public benefit NPOs, i.e. donations of goods and services in their benefit are taxable, if they are not considered import or do not fall in the category of exempted transactions. With this provision are stimulated cash donations rather than in-kind and goods donations.

#### *Laws on excises*

There are not tax concessions for NPOs or for the donations made in their favor in the Law on Excises.

#### *Law on Local Taxes and Fees*

In the Law on local taxes and fees (LLTF) is envisaged an exemption from inheritance tax for properties, inherited by legal entities that are not commercial, excluding mutual benefit NPOs (art.38, par.1, point 2). According to art.48, par.1, point 4 public benefit NPOs are tax exempted for the received and given property (in-kind) donations. In case it is proven that the transfer of property, received under the article above, given to third parties is not connected with the accomplishment of the main goals, for which the particular organization has been created, the tax becomes due.

Besides its tax policy, the government may support public benefit NPOs by giving them direct budget subsidies. Each year with the Law on State Budget of the Republic of Bulgaria are distributed funds for the NPOs (see table). Since 1997 the number of organizations receiving subsidies is continuously increasing, but the amount of the funds received is insignificant. The minimum state subsidies probably will stay constant in the short run due to the enormous financing need of almost all public services and the plans for decreasing of the consolidated state budget expenditures as a percentage from GDP. The low state subsidies are a stimulus for competition growth between public benefit NPOs in fundraising activities from other sources, which presuppose greater transparency and efficiency of their work.

#### **Subsidies for organizations with non-profit purpose\***

	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
Provided from the consolidated budget	0.2867%	0.2722%	0.2793%	0.1764%	0.1895%
Provided from the central republican budget	0.0176%	0.0178%	0.0160%	0.0242%	0.0233%
Provided from municipalities	0.1940%	0.1489%	0.1237%	0.1208%	0.1572%
Provided from ministries and institutions	0.0036%	0.1022%	0.1288%	0.0081%	0.0089%
Provided from external budget accounts and funds	0.0715%	0.0033%	0.0108%	0.0233%	-

\*in % from the total expenses of the consolidated budget; the data fro 2002 is approximate

#### **Nom-profit legal entities getting subsidy from the central budget \***

	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
Bulgarian Red cross - National committee	899.3	966.8	993.8	1 129.1	1 168.6

Rila Holy place - Rila monastery	179.0	200.5	320.0	380.0	393.3
Bulgarian tourist union	35.0	37.6	39.0	42.3	38.8
Union of Bulgarian drivers	82.1	88.2	90.7	97.7	86.1
Union of handicaps in Bulgaria	84.9	95.8	71.7	215.0	222.5
Union of war veterans and the affected from the wars and in peaceful time**	35.7	38.4	39.4	62.0	64.2
Union of war veteran cooperatives in Bulgaria of war	12.5	13.4	13.8	22.0	22.8
Union of the blind in Bulgaria	23.2	107.0	25.7	550.0	155.3
Bulgarian association of people with intellectual problems***	22.2	23.8	24.5	50.0	51.8
Union of the deaf in Bulgaria	27.3	29.4	30.2	120.0	124.2
National union of production cooperatives****	39.6	42.6	43.8	110.0	113.9
Representative associations of consumers in Bulgaria*****	12.1	13.0	12.0	50.0	51.8
Central union of the cooperatives of handicaps	17.4	28.8	29.6	90.0	93.2
National centre for social rehabilitation	13.5	14.6	15.0	120.0	124.2
Българска асоциация "Диабет" Bulgarian association "Diabetic"	24.2	26.0	26.7	117.0	121.1
Association of parents of children with affected sight	9.9	10.6	10.9	30.0	31.1
Association of parents of children with affected sight hearing	9.9	10.6	10.9	22.0	22.8
National organization "Young Bulgarian people"	3.0	3.2	3.3	12.0	12.4
National association of blind-deaf in Bulgaria	-	10.0	10.3	25.0	25.9
National consumer cooperative of the deaf in Bulgaria	-	-	-	10.0	10.4
Union of the war veterans in Bulgaria	-	-	-	-	12.0
Union of national chitalishte	-	-	-	-	20.0

\*in thousand denominated BGN; the data for 2002 is approximate

\*\* before 2001 the position is " Union of war veterans an affected by the wars in Bulgaria"

\*\*\* before 2001 the position is " National association fro support to people with mental disorders"

\*\*\*\* before 2001 the position is "Central union of production cooperatives"

\*\*\*\*\* before 1999 the position is "Federation for protection of the consumers in Bulgaria"

The lack of sufficiently full statistical information about the sector impedes the precise analysis of its activity and the impact of some tax regime changes. With regard to the public benefit NPOs, registered in the Central register of the Ministry of Justice, it is possible in a short-term to collect detailed information about the amount of taxes paid by them, type of employment and activities, for which is needs to be created a better organization on the part of the Register.

## Conclusion

If some conclusions should be made regarding the further NPO development and their tax treatment, it is necessary these conclusions to be bound with the reasons for support of their activity, the means for financing it and the limitations on it.

### *Reasons for supporting public benefit NPOs*

- Perform public benefit activity
- Accomplish an important socializing role and facilitate the replacement of political with civic structures
- Replace and supplement state in providing some public goods
- They are efficient in providing certain public goods and in their local work with municipalities<sup>24</sup>
- Facilitate the fiscal decentralization
- Draw in additional support for their activity in the form of donations and voluntary work

The listed reasons impose that the further development of the NPO sector should be stimulated, having in mind the insignificant contribution of NCOs in the state economy at the moment.

### *Means for NPOs financing*

- Domestic and foreign donations
- Subsidies
- Economic activity profit
- Main activity profit, including membership fees
- Income from dividends and liquidation shares
- Interest income
- income from exchange rate differences
- Others

NCOs perform important redistribution functions in the economy. Attracting resources from other economy sectors, they direct them towards realization of public benefit activity, and with the attraction of foreign resources in the form of donations they facilitate and stimulate the state economic growth.

### *Limitations and control over the NPOs activity according to the current legislation*

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<sup>24</sup> An indicator for the fact that municipalities give from one half to two thirds of the subsidy from the consolidated budget, planned for the NPOs.

- May perform additional economic activity only if it is related to the subject of main activity they are registered for
- May use the additional economic activity income only for accomplishment of the defined in the statute goals
- Do not distribute profit
- NPOs face difficulties while financing their additional economic activity
- Public benefit NPOs are entered in a Ministry of justice register
- Public benefit NPOs are subjected to independent audit, if the amount of balance assets from the previous year is bigger than 0.5 million BGL or the amount of the income from their activity and net amount of sales, and the financial incomes for the previous year exceed 1 million BGL
- Public benefit NPOs are obliged to prepare an annual activity report, which should provide data on: 1) performed activity, spent resources, connection with goal and organization programs and the results achieved; 2) amount of the gratuitously received property and other income from fundraising activities; 3) financial result. The report is public, and the announcement for its availability as well as the place, time and way for acquainting with it, is published in the Central register bulletin
- Public benefit NPOs are obliged to apply for entry and to submit in the Central register: copies of the court decisions registering changes in their status; list of individuals that have been in their governance bodies; information on their main activity; certified annual accounting report; declaration for the due taxes, customs and other public claims; Statute or Foundation act amendments
- Public benefit NPOs are subject to constant control on behalf of the Ministry of Justice

*Motives for the necessary amendments in the tax treatment of public benefit NPOs*

- Equalizing the tax treatment of the different income sources, as they all should be used for accomplishment of the public benefit goals of the organizations
- Widening and equalizing the stimuli for donations, as in the scope of persons, eligible for tax preferences in case of donations are included the ones receiving incomes under labor contracts.
- Change of the donations taxation philosophy – donors with higher willingness to donate to be taxed less
- Real elimination of the taxation of donations in the form of share participations in domestic legal entities or non-personified association



The stated above reasons for non-profit sector development stimulation and the motives for NPOs tax treatment changes, their insignificant influence over the realization of the consolidated state budget gives a clear basis to think that the general effect from the realization of the proposed legislative amendments will be positive.

## Appendix:

*Calculating the income loss for the consolidated budget based on the proposed changes in the tax treatment of NPOs in public benefit.*

### Proposal 1

Adoption of additional paragraphs in art.61 of LCIT with which to remise the profit tax and municipality tax of NPOs performing public benefit activity. The transferred sources to be accounted as reserves and the transfer will be valid, if they are used for the accomplishment of the regulated in the Statute goals.

The income loss resulted from this amendment of LCIT will be equal to annual incomes from profit tax and municipality tax, paid by NPOs performing public benefit activity. Due to the lack of precise information on these incomes, the closest indicator will be used – profit tax and municipality tax incomes by NPOs (including organizations in mutual benefit as well), which will overvalue the loss size. For 2002 these incomes are expected to be **848.7 thousand BGL** or **0.0068%** from the total incomes and aids in the consolidated budget.

### Proposal 2

Dividends and liquidation shares, paid to public benefit NPOs to be placed outside of the scope of art.34, par.1 of LCIT.

The dividends and liquidations assets tax is final and due at the income source. There is no information in the Ministry of Finance of on the income from this tax, levied on dividends and liquidation shares paid to public benefit NPOs. The loss for the consolidated budget might be assessed indirectly. For that purpose we will accept that the part of the income, which is a result of the dividends and liquidation shares paid to public benefit NPOs, is equal to the percentage in GDP, formed by NPOs. The value of this indicator for 2000 is 0.087%. Its stability gives us a reason to use its value for 2000 while calculating the loss of income, using the expected level of income from the tax on dividends paid by local and foreign legal entities for 2002 – 47.9 million BGL.

$Loss = 0.00087 * 47887.3 = \mathbf{41.662\ 000\ BGL}$  (**0.0003%** of the expected incomes and aids in the consolidated budget)

### Proposal 3

The decrease of the rate of tax under art.48, par.1 LCIT in connection with art.35 to 15%, for donations to public benefit NPOs, accounted as expenditures.

The expected revenue from the tax on donations and the tax on sponsorship in the consolidated budget is 4.628 million BGL in 2002 , which at the tax size of 25% forms the total size of donations, accounted as expenditures 18.512 million BGL. About 30% of the donations are directed towards organizations with charitable, social, environmental and other activity, which are close to definition for public benefit NPOs. The decrease in the tax rate with 10 % up to 15 % under art. 48, par. 1 in the case of donations to public benefit NPOs will lead to a loss of income for the consolidated budget of **555.360** thousands BGL (**0.0045%** from the expected incomes and aids in the consolidated budget).

$Loss = 0.3 * 18512 * 0.1 = 555.360$  thousands BGL (**0.0045%** of the expected incomes and aids on the consolidated budget)

### Proposal 4

Including in the scope of taxable subjects under LPPIT, who have right to use the given tax deduction in case of donation to public benefit NPOs persons, receiving income under labour or equal to labour contracts.

Based on preliminary data of NSI, the individuals employed on labour contracts at the end of March 2002, were 1 905 647. The expected average monthly wage in 2002 is 278.2 BGL. Upon making a donation (10% of the taxable income after deduction of the personal social security tax), the tax burden over the average monthly income goes down with 2.15 percents, the revenue from the income tax – with 6.0 BGL, and the disposable income of donor decreases with 18.9 BGL or 8.70 percents. Due to the low population income and the great decrease of the disposable income, the donations' size is very small with respect to the taxable income. In 2000, for self-employed individuals, the donations made are about 4% from the total size of donations, with which the taxable income can be decreased. Therefore for 2002 with respect to persons having labor relationship we will accept an average ability to donate – about 6%<sup>25</sup> from the maximum amount of the donations, with which the taxable income can be diminished. In accounting this ability, the tax burden over the average wage decreases with 0.13 percents, the total income tax – with 0.4 BGL, and the disposable income of donor decreases with 1.1 BGL or 0.52 percents. If we use again the assessment that public benefit NPOs attract

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<sup>25</sup> The average willingness to donate is presumed to be higher on purpose

about 30% from the donations, the total maximum loss of income for the consolidated budget (basis 2002) will be:

$Loss = 1905.647 * 0.4 * 12 * 0.3 = 2\,459.466$  thousands BGL (**0.0197%** from the incomes and aids in the consolidated budget).

The total maximum loss from the proposed amendments in the legislation, dealing with public benefit NPLE on basis 2002 will be: loss = **848.700 + 41.662 + 555.360 + 2 459.466 = 3 905.188** thousands BGL (**0.0313%** from the total incomes and aids on the consolidated budget).

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