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**A COMPARATIVE ANALYSIS OF THE TAXATION OF  
NON-GOVERNMENTAL ORGANIZATIONS IN CROATIA**

*January 1999*

## Introduction

*There are highly varying forms as to how governments encourage the evolution of the national nongovernmental sector. Besides defining administrative requirements such as registration, reporting standards, etc., governments establish a preferential structure of fiscal regulations for nongovernmental organizations (NGOs) to provide exemption from, or preferential treatment under different tax laws. Taxation, besides serving the central budget, can also assure a better accountability of these organizations, and may provide some control over their operation. The list of NGOs that may benefit from tax exemptions also varies from country to country<sup>1</sup>, and sometimes even the support for specific organizations is regulated by the law, which manifests the considerations and preferences of state policy.*

This paper is designed to provide an overview of the fiscal regulations that influence the operation and activities of NGOs and their donors in Croatia. According to the law<sup>2</sup>, these NGOs are:

- chambers and private citizen associations,
- trusts and other funds organized for charitable, humanitarian, scientific, cultural, and similar purposes,
- other not-for-profit organizations and institutions not corresponding to any of the above not-for-profit organizations and institutions, entitled to that status by a special decision issued by the Tax Administration.

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<sup>1</sup> Tax exempt status may be based on the type of activity realised by the organisation. For example French law, although it does not provide definitions, recognises philanthropic, educational, scientific, social, humanitarian, cultural, and sport activities as qualifying for special treatment. German law recognises the following: The development and well-being of the public at large, including public health care, general welfare, youth welfare, environmental protection, education, culture, sports and scientific purposes; the support of persons unable to care for themselves; church and religious purposes.

<sup>2</sup> By-law on Profit Tax (People's Bulletin no. 7/96, 142/97, and 17/98)

This paper will discuss the taxation of these NGOs and their donors, concerning the availability of exemptions from certain taxes, such as income and profits taxes, property and transfer taxes (on gift and death transfers), excise taxes, value added, sales, employment, and other relevant taxes. In addition, the paper compares the Croatian system to the practices followed by other European countries, in order to draw attention to the possible alternatives of the present NGO taxation system, and to initiate its creative analysis.

This research was conducted with the support of the Budapest Office of the International Center for Not-for-Profit Law (ICNL) in November 1998.<sup>3</sup>

## 1. Taxation of the Income of NGOs

*NGOs usually derive their income from donations received from individual or corporate donors, from governmental agencies, from membership fees, from income on passive profit generating activities, such as interest, dividends, and capital gains earned on assets or the sale of assets, and finally, from economic, business type activities. Economic activity is discussed in Part 3.*

*While donations and membership fees are usually tax-free income in current international practice, dividends and interest and capital gains are sometimes considered taxable. NGOs may benefit from preferential treatment, if not all receipts are considered as income and therefore are exempted from income tax, or if receipts are recognized as income, but NGOs enjoy tax exempt status.*

*Most taxation systems make a clear distinction between public benefit organizations (PBOs) that serve the interests of the public, i.e. where the circle of beneficiaries is open, and mutual benefit organizations (MBOs) that primarily serve the interests of a limited group of people. Most developed countries accept the principle that a PBO may*

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<sup>3</sup> ICNL's document prepared by Kornelija Sirovica and Gojko Bezovan: *Tax and fiscal Laws Relating to Not-for-Profit Organisations in Croatia* has been widely used during the development of present paper.

*also be involved in activities other than those for the public benefit, and they should be provided preferential or exclusive income tax exemptions.*

In *Croatia*, not-for-profit organizations are exempted from income taxation on grants, and donations, whether from a governmental, individual or corporate source. Similarly, membership fees are exempted from taxation. However, these resources are subject to tax if used to finance an economic activity, and are considered as a part of the total revenue generated by that activity.

The *Croatian* regulations are rather strict in stating that income from grants and donations are subject to tax if spent on for-profit activities. Cash donations, for example, are tax free in West European countries, regardless of their further allocation.<sup>4</sup>

As to other forms of income, *Croatian* organizations engaged in profit making activities become tax liable for the profit generated by those activities, and income from dividends and interest is also subject to tax.

A comparison with other European countries reveals that most taxation systems provide a wider scope of preferences. For example, *French*, *Greek*, or *British* regulations allow preferences for corporate tax, if profit generating activities of the organization are compatible with and necessary for the realization of its objectives, and are of a subsidiary nature. Therefore, in these countries, profit from passive profit making activity is not subject to tax, provided the above conditions are fulfilled. Obviously, even in these countries, some further restraints are present, as in *France*, where only domestic dividend income is exempt, or in *Greece*, where investment income other than bank interest is subject to tax, but at a reduced rate. In *Germany*, investment income is exempt only if it is used for purposes related to the main purpose of the body, but if regular economic activity is maintained in order to support the purposes of the organization, tax exemption is provided. In *Italy*, investment income and gains on assets used exclusively for qualified purposes are exempted.

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<sup>4</sup> Provided the organisation does not engage in profit oriented activities, unless compatible with and necessary for the realisation of its objectives and of a subsidiary nature.

In *the Netherlands* an interesting model is offered, since *Dutch* NGOs do not have to file annual tax returns at all if investment profits for a certain year do not exceed a certain limit,<sup>5</sup> but pay normal tax above that limit. In *Belgium* and in *Spain* all investment income is taxed, at the rate of 25.75% for dividends and 10.30% for interest and royalties in the former, and at 25% for all investment income in the latter.

As the above brief survey shows, interest income tax is applied in a variety of ways in European countries. A few more examples reveal that the regulations may also vary on the types of incomes to be subject to income tax. In *Romania*, interest is not considered to have 'economic character', therefore NGOs are not subject to the profits tax.<sup>6</sup> Corporate tax of *Portuguese* NGOs is exempted, although a ministerial recognition is required on a case-by-case basis for each organization. Finally, income tax of *Czech* NGOs is assessed on income from advertisement and property rentals, while income from membership fees and from state or municipal subsidies is not subject to income tax.

## 2. Tax Deductibility of Donations

*NGO income includes gifts, grants, and scholarships received from corporate or individual donors. Tax preferences, such as deductions, tax credits, or rebates for contributions, are essential incentives for the donors to provide NGOs with assets or services. (Tax deduction reduces the amount of income that is subject to tax, while a tax credit reduces the amount of the tax itself.) In addition, individuals may be allowed similar deductions from, or credits against, (estate and gift) transfer taxes for donations. Sometimes, as the Croatian practice demonstrates, the group of NGOs that may receive tax deductible donations is more reduced than that of tax-exempted NGOs.*

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<sup>5</sup> Qualified organisations are not required to file annual tax returns if profits for the current year are bellow DFI 13,000 or profits for the year and the previous four years are bellow DFI 65,000.

<sup>6</sup> Ministry of Finance Methodological Rules No. 5910 of 1991

*A maximum limit for deductible or creditable contributions is often determined, as is a distinction between donations in cash, and in kind.*

According to the *Croatian Law on Income Tax* and the *By-law on Income Tax*, gifts, grants, and sponsorships result in a tax deduction for donors only if the recipient provides the corporate donor or sponsor with an adequate reciprocal favor in the form of promotional services related to the donor's company, product, or emblem. Thus, donations made must result in a direct gain for the donor, otherwise no tax deduction is available. This option does not apply to individual donors.

However, the legal system provides the possibility of a tax deduction for donors if donations are made to NGOs engaged in creative/artistic activities or to sport associations, institutions, or commercial associations carrying out sports activities. In these cases, the element of reciprocity must not be part of the donation.

A limit for deductible contributions, i.e. for the amount deductible from the income tax base for physical persons and from the profit tax base for legal entities is established: For artistic activities, the limit is 5,000 kuna for individuals, and 15,000 kuna for legal entities. Sports may be supported by up to 50,000 kuna annually by individuals, and by up to 500,000 kuna by legal entities.

Moreover, donors included in the VAT system pay value added tax on donations in goods or services that are subject to tax. The value added tax is to be paid on all deliveries of goods and services (not donations in cash), regardless of the nonprofit or other status of the final recipient.

In comparing the Croatian legal framework, the very limited character of the group of preferred NGOs to whom tax-deductible gifts may be made is immediately apparent. In most European countries organizations recognized as generally serving the public interest may receive tax-deductible gifts. *Irish* regulations, as another rare example for limiting possible donors' choices, restrict tax-deductible donations to those made to universities or colleges within the country carrying out research or teaching certain sciences, or to human rights organizations.

The amount of donations that may be deducted from the donor's tax base, varies greatly from country to country. Some countries, similarly to *Croatia*, specify the maximum (and possibly the minimum) amount of donations. For example, *Danish* donors receive tax benefits on making donations to approved bodies, and donations in cash for individuals or companies must be between DKK 1,500 and DKK 3,000.

A few European countries apply percentage limits: In *Russia*, individuals can claim deductions of up to only 3% of their income, and business entities are limited to 1%. In *Spain*, individual donations may amount to 10-30% of income depending on the qualification of the donee, while companies may deduct 10% of the taxable profit on donations to qualified bodies, and receive a 10% tax credit for special historical investments.<sup>7</sup> *German* individual donors may deduct up to 5% of taxable income/taxable profit for charitable, church, religious, and other similar purposes, and up to 10% for scientific, and cultural purposes. *German* corporate donors may deduct gifts of up to 0.2% of the sum of the total turnover with salaries and wages paid. Intercontinental differences are also interesting: In some *Asian* countries, no deductions for contributions are allowed, while in the *United States* individuals can deduct amounts up to 50% of their income for contributions to charities. In *Australia*, there is no limit, although the category of charity NGOs to benefit from these donations is very narrow.

Often, the limit of contributions is set by a combination of a percentage and a certain amount: For example, in *Belgium*, the minimum amount for an individual donation to be deductible is BF 1,000, and the maximum deduction is 10% of the taxable income, up to a maximum of BF 10,988,000. For companies the minimum contribution is the same, and the maximum deduction may not exceed 5% or BF 20,000,000.

Regulations become more complex when determining the limits for donations for different categories of donors and donees. *French* regulations make a distinction

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<sup>7</sup> 10% tax credits are provided for investments in assets registered in the General Inventory of Spanish historical heritage.



between public utility foundations/associations<sup>8</sup> and other qualified bodies. To the former group of organizations individuals may deduct donations to a limit of 5% of the gross taxable income, and companies 0.3% of the turnover, while in the case of the latter group the figures are 1.25% and 0.2%. *German* tax law specifies 3 categories on the standards of donations by companies and 3 for individuals, while *Portuguese* law sets 3 categories for individual and 7 categories for company donations, depending on the type of the beneficiary of the donation.

Depending on the priorities of state policy on NGOs, tax deductible donations may be provided without limitation, but usually to a limited group of NGOs: Individuals and companies in *Italy* may donate without limit to organizations that promote study, research, or dissemination of information of noteworthy scientific, cultural, or artistic interest. In *Ireland*, - as already mentioned - only university or human rights related issues may be supported. As an exception in Europe, *Greek* regulations allow deductibility of cash donations to all qualified bodies.

Donations, if a deduction is authorized, may usually be deducted with the full amount from taxable income, or a percentage of the donation from the tax itself. For example, in some countries only a certain percentage may be deducted from tax, such as in *Hungary*, individual donors may deduct 30% of donations made for NGOs from taxable income. Canada has a similar rule. In *Hungary*, legal entities as well as individuals receive extra exemptions for regular support from the second year on, (a so called durable donation".)

Very interestingly, in *Portugal*, 110% of individual donations and 115% of corporate donations may be deducted from income tax or from turnover before tax.

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<sup>8</sup> Foundations and association serving the public interest are granted their status by the Minister of the Interior on advice from the Conseil d'Etat. French law, although providing no definition, recognises philanthropic, educational, scientific, social, humanitarian, cultural, and sports activities as qualifying for special treatment.

There are a few more remarkable examples of support for NGOs through allocations. *Hungarian* taxpayers, in addition to normal donations, may designate for the tax authorities a foundation or association they wish to receive 1% of their personal income tax payment.<sup>9</sup> That 1% percent is sent later by the tax authority to the named NGO. In the *United Kingdom*, tax benefits are not given to the donor, but to the receiving NGO itself, in addition to the cash already received.

While *Croatian* regulations make no distinction between donations in cash and in kind, donations in kind are often not deductible. In *Greece* and *Denmark* no donations made in kind may be deducted, while in *France* and *Germany* such donations - if appreciated - are deductible, according to the regulations on donations in cash. In *Belgium*, only artistic works in kind are deductible, and in *Italy*, an individual's donations must be in cash, while company donations may be in cash or in kind.

### 3. Taxation of Economic Activities

*The taxation of NGOs on their profits made by economic activity may largely vary from country to country. Rarely, NGOs are prohibited from performing economic activities at all, while in other cases they are restricted to economic activities strictly related to their own statutory purposes. Profits on economic activities may be fully exempted from, or, on the contrary, fully subjected to income taxation. The provision of an exemption may depend on whether profits are spent on the not-for-profit purposes of the organization ("destination of income" test, or whether the activity relates directly to the NGO's statutory goals ("relatedness" test) - i.e. a nonprofit hospital charging admission fees. Finally, another alternative is tax exempt from tax a modest amount of profits from economic activities, and tax fully amounts above that limit.*

*Croatian* regulations related to the registration procedure are not clear on the permitted economic activities. There is some evidence from official registration practices, that

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<sup>9</sup> This law was revised in 1998 to permit the designation of an additional 1% to a church or religious organisation.

*Croatian* NGOs seeking to include in their funding documents the fact that economic type activities are to be undertaken, are denied registration until they revise their documents to eliminate the economic activities. Later, they are restricted from performing economic activities that may be necessary for the accomplishment of the goals defined in their constitution on the grounds that such activities are not included in their statutes.<sup>10</sup>

In principle, profits, if generated by regular economic activity,<sup>11</sup> realized besides the principal activity of an NGO, are subject to tax. Before January 1, 1998, not-for-profit organizations and institutions had been tax exempted for the profit made on their economic activities below 50,000 kuna, and had to pay profit tax only for profits exceeding that limit. Since that date, the 50,000 kuna allowance is eliminated, and, NGOs, if they regularly engage in profit generating economic activities, are taxed for the total profit earned.

For entertainment and sports shows as economic activities, the law sets a clear standard: NGOs that organize such events within the limits of their purposes pay 5% tax on the income made on tickets.

Most European countries allow NGOs to perform economic activities, though they may tax them. Regulations do not concentrate on the frequency of the economic activity, but on the character of the operation of the NGO. Public benefit organizations benefit from exemptions in *Austria, Switzerland, Spain, France*, and with certain limits, in the *United Kingdom* and *Germany* as well. In most of these countries, namely in *Austria, Switzerland, France* and the *United Kingdom*, these exemptions are granted on the consideration that economic activities are indispensable for the operation of a public

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<sup>10</sup> This is based on conclusions commented by Dr. Gojko Bezovan in a paper 'Tax and Fiscal Laws Relating to Not-for-Profit Organizations in Croatia' prepared for the International Center for Not-for-Profit Law, 1998.

<sup>11</sup> By-law on Profit Tax of January 1, 1998 does not define the criteria for regularity.

benefit organization. In these countries, profits from business are exempted from tax, provided the activity supports the primary purpose of the organization.

The *Netherlands* is a rare example where economic activities by public benefit organizations are subject to normal taxation above a certain limit<sup>12</sup> if competing with other organizations themselves subject to tax, unless the public benefit organization performs activities mainly directed to public welfare.

The taxation of economic activities may be exempt up to a certain amount, as in *Denmark*, where foundations and associations pay tax on business income in excess of DKK 250,000. *French* public benefit foundations and associations are granted a 50% tax credit on distributions against any corporate tax on business income. In other countries, an NGO may get full exemption from tax on income from economic activity, as in *Poland*, where foundations may directly engage in business activity and be exempt on such income.

In *Hungary*, registered public benefit organizations have full tax exemptions for the activities described in their founding documents and receive company tax allowances for entrepreneurial activities. At the same time, the law makes no distinction between the different forms of entrepreneurial activities. (The only restriction is that public benefit organizations may not issue bills of exchange or any bonds, and may not borrow credits for economic activities to such an extent that would endanger their public benefit activities.)

### ***Related and Unrelated Economic Activity***

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<sup>12</sup> Qualified bodies are not required to file annual tax returns unless profits for the year exceed Dfl 13,000, or profits for that year and the previous four years, exceed DFl 65,000. - Data from 1993.

While *Croatian* regulations do not make a difference between related and unrelated business activity, regulations in most other European countries do. Wherever a distinction is made, more tax exemptions are provided for related economic activities.

The underlying question is how to avoid an NGOs becoming excessively involved in unrelated economic activities, instead of focusing on its primary mission. A related issue is unfair competition with for-profit business engaged in similar activities, who are fully taxed. One solution is the full taxation of all unrelated economic activities. As already mentioned, such practice is widespread and applied, for example, in *Germany* and in *France*, where profits from business are exempt from tax only if the activity supports the primary purpose of the organization.

Taxation of income from unrelated business activities above a certain limit offers another alternative. In *Hungary*, NGOs are exempt on the net profits from economic activities if the annual unrelated business income does not exceed the lesser of 10 million Forints or 10% of the total revenue. However, in *Hungary*, taxes have to be paid on all related and unrelated business income if the threshold is exceeded, since in that case the organization is presumably considered to be a business organization rather than solely a not-for-profit organization.

A few countries, for example *Britain* and *Poland*, apply a logical solution which, on one hand, protects the public benefit organization from being involved in economic activities above its capabilities while, on the other hand, preserves a stable means for funding: If the unrelated business activity is carried out through a subsidiary, and the subsidiary transfers all its profits to the NGO, then no taxes on those profits are to be paid by the NGO or its subsidiary.

#### **4. Value Added Tax**

*Legal regulations may, or may not, exclude NGOs from the VAT system. Exclusion means that the organization pays VAT on goods and services purchased, since the tax is built into the price (input VAT), and there is no refund. Inclusion in the VAT system means that the NGO, although paying VAT on the goods and services it buys, gets the*

*input VAT back. However, services of the NGO include VAT, making their prices higher. Sometimes NGOs are included in the VAT system with a zero or reduced rate, which means that they do not pay output VAT, or pay less, but receive VAT refund for all goods and services purchased.*

*Inclusion in the VAT system is favorable for NGOs, and obviously, the zero rated status is the most preferential one. Only smaller NGOs with limited turnover may wish to opt for exclusion, because limited organizational capacity handles with difficulty the administration of VAT.*

Croatian NGOs are, in principle, included in the VAT system if they perform taxable deliveries worth over 50,000 kuna a year, or if they apply for VAT status. NGOs must calculate 22% VAT on the total value of their deliveries. However, religious societies are tax exempted for their services and deliveries.

Some humanitarian associations are also exempted, as it happens in the case of the national Red Cross. It has the status of a final consumer and is not included in the VAT system, but it pays no VAT on final import of humanitarian aid.

International humanitarian organizations, such as UNHCR, receive special treatment similar to that of diplomatic bodies. They do not pay VAT for the goods and services purchased for official use and private use of the staff, if a special agreement is signed with the government. International humanitarian organizations may also benefit from tax exemption on the purchase of goods if these goods are purchased and distributed within Croatia.<sup>13</sup> Moreover, even services provided by these organizations can be free of VAT, if specified by the agreement.

In *Belgium, France, Greece, Italy, the Netherlands, and Spain*, qualified organizations are generally exempt from output tax, but liable for to input tax on purchases.

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<sup>13</sup> This is apparently accomplished through the preparation of customs tax documents indicating the goods left and then returned to the country, according to Dr. Gojko Bezovan's report.

In most *West European* countries, a number of goods and services, independent of their volume, are exempted from output tax for qualified organizations, while input tax is payable at the appropriate rate. The exempted goods usually include a wide selection of medical and health care materials, such as human organs, human blood, and mother's milk. New buildings or rented premises are also frequently exempted. For example, in *Germany*, there is no output tax on transport of the sick, services of the blind, certain welfare activities, services by youth and scientific institutions, as well as on services by theaters, orchestras, choirs, museums, libraries, and on cultural and sports events by qualified organizations. For other activities, these organizations are subject to a reduced output tax rate of 7%. Input tax is similarly at the 7% reduced rate in *Germany*.

In the *United Kingdom*, various goods and services are output tax exempted, while others are of zero output tax. In the latter case, input tax is payable, but reclaimable if goods and services are sold. These goods and services include basic and processed food, medical equipment and products, children's clothing, aid for handicapped people, charges paid for fund raising in the media, and services such as repair and maintenance for the handicapped.

## **5. Customs Duties**

*Customs duties can have a large impact on the cost of an NGO's operation. Several NGOs, such as humanitarian relief organizations, use imported goods. To avoid abuse, it must be ensured that imported duty free goods are used for the operations of a genuine NGO and not sold to a third party. Strict regulations are needed to filter tax evaders out.*

In *Croatia*, institutions, associations and other not-for-profit legal persons are exempted from duties on goods received from abroad free of charge for scientific, cultural, religious, humanitarian, and welfare purposes. Humanitarian organizations, associations of the blind and persons with impaired hearing or with muscular and

neurological disorders are exempted from duties on the import of specific devices and equipment, if these goods are not produced in the country. International NGOs are also entitled to customs exemption on items used for their official needs.<sup>14</sup> These goods are not to be alienated to a third party. The import of books is also tax exempt.

*Central and East European* practice varies greatly, as far as preferences are concerned. In some countries only the list of exempted goods is defined by regulation, and NGOs receive no special treatment. In other countries, NGOs may import a very limited number of duty free goods, as in the *Czech Republic*, where nonprofit organizations are exempted only for goods used for an educational purpose. In this respect, the *Croatian* system seems to be supportive of the NGO sector, leaving a much wider scope of purposes free from customs duties. In *Hungary*, the customs system provides no general preferences for associations at all, with preferences granted on a case by case basis.

The provision of preferences may lead to a simple evasion of paying customs duties, if imported goods are resold, therefore strict control is frequently applied. Moreover, the resale of goods is usually prohibited, or prohibited for a certain period of time. For the latter, *Hungary* is again a good example, where goods imported with preferences are not to be sold within three years, and may not be used for entrepreneurial purposes.<sup>15</sup>

## 6. Other Taxes

*In addition to the above described income tax, value added tax and customs duties, NGOs may be obliged to pay capital transfer tax after the acquisitions of real estate property, and inheritance and gift tax after donated or inherited cash or movables.*

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<sup>14</sup> Customs Law - People's Bulletin No. 53A/91 to 92/94.

<sup>15</sup> Hungarian examples are taken from: Dániel Csanády: A nonprofit szervezetek általános jellemzése (The general introduction to non-profit organisations) Budapest: CO-NEX Training Rt. 1997. P.7.



### ***Capital transfer tax***

In *Croatia*, the capital transfer tax rate for land is 5%.<sup>16</sup> For buildings completed, constructed and delivered after 31 December 1997, value added tax applies instead. For previously delivered or completed buildings the capital transfer tax rate is equally 5%. NGOs not in the value added system pay 5% capital transfer tax for buildings completed, constructed and delivered after the above date, too. Capital transfer tax is always paid by the acquirer. At the same time, specific groups of NGOs like foundations, the Red Cross, and similar humanitarian associations are exempted from capital transfer tax.

Regulations in different European countries, here again, vary considerably. In *France*, foundations and associations serving the public interest with social assistance enjoy reduced duty, while in Greece all NGOs are subject to tax. *German* nonprofit organizations pay no capital transfer tax. While there is no clear common standard for capital tax, most *Central and East European* countries apply a reduced or zero rate.

### ***Inheritance and gift tax***

In *Croatia*, the gift and inheritance tax rate is 5% imposed on the recipients for all transfers of cash and movables exceeding the actual equivalent of 2,000 DEM. Similarly to capital transfer tax, foundations, the Red Cross, and similar humanitarian associations are exempted from inheritance and gift tax.

*Croatian* practice is similar to that of the Netherlands, where regulations apply limits. Any gift under Dfl 7,272 and any inheritance under the he value of Dfl 14,544 is tax exempt, while, above these limits, the tax rate is 11% in both categories.

Several European countries do apply taxation: *Belgian* non-profit organizations pay 8.8% and foundations 6.6%, while in *Luxembourg* the tax rate is 6%, with the exemption

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<sup>16</sup> Law on Capital Transfer Tax - People's Bulletin No. 69/97.

of specified bodies. In *Denmark*, there is no taxation category for gifts, and the general income tax rules for qualified bodies are applied.

At the same time, major European countries do not oblige organizations qualified for exempt status to pay these taxes: *French, German, Greek, Irish, Spanish, and British* qualified bodies pay no taxes on inheritance and gifts. With restrictions, the same applies to *Italian and Portuguese* organizations, too.

## 7. Employment Taxes

*It is unusual for NGOs to be given exemptions or preferential treatment under employment or payroll taxes. As with any other form of preference, NGOs may be authorized to pay a reduced or no social security or other employment taxes, and their employees to pay a reduced or no income tax on their salaries.*

There are a limited number of international examples for preferential treatment under payroll taxes. Australian NGOs involved in social welfare work, if their payroll is over a month, pay a reduced payroll tax. Similar preferences are available for some Brazilian social welfare NGOs.

In *Croatia*, there are no specific employment tax preferences for NGOs, which is in accordance with the practice of other European states.

## 8. Governmental Funding

*State funding is different in character from the so far introduced types of tax treatment, because these are public expenditures, not preferences. Government funding is a clear revelation of state policies. Funding on the one hand is a very positive phenomena, since it reveals the state's appreciation of the performed activities. On the other hand, government funding may lead to the control of activities, which is especially of high concern in the case of NGOs carrying out research on state policy, or realizing public awareness raising activities.*

In *Croatia*, health and welfare activities of private institutions may be funded by the government on the basis of agreements on certain fields of activity, or according to specific regulations. These organizations, if meeting some particular criteria, can become contractual parties to the corresponding ministry.

The law regulates state funding for other private organizations.<sup>17</sup> Associations promoting the highest constitutional values, such as freedom, equality, national equality, peace keeping, social justice, human rights, etc., with membership in some international organization may be also supported if their assessment reveals a beneficial influence on *Croatia*. A Government Commission is set up to assess the activities of these organizations, and according to the suggestion of that Commission, the Government of *Croatia* sets up the amount of budget funds for their support.

Municipal, city, and county budgets also offer support for associations. Although there are contests for the distribution of funds occasionally, most of the time these funds are allocated at the discretion of local decision makers.

There is a similar practice in other countries, too. In *Hungary*, NGOs may qualify for the 'organization of exceptional public benefit' status, and if requirements are met, special preferences are granted.

However, there is no stable picture of the exact financial contents of legal regulations on government funding. Moreover, there is frequently no specific law on state funding for NGOs, so Ministries and state funds distribute grants and donations as current restrictive or interventionist policy dictates. In the *Czech Republic*, each ministry has a budget to support NGOs, and no law on NGO funding has been created.

Changes of ruling parties lead to fast changes of donations made to NGOs, but the trend of state involvement in NGO financing shows that economic development results in greater state support. In *Hungary* state support is around 21% of all income of PBOs,

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<sup>17</sup> Peoples Gazette No. 86/98. - *Decision on Criteria Required to Establish Eligibility to State Funding for Associations Carrying out Activities to the Benefit of the Republic of Croatia.*

and that ratio is even less in other *Central European* countries.<sup>18</sup> The same ratio is 43% on average in the seven most developed countries of the world.

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ICNL *Handbook on Good Practices for Laws Relating to Non-Governmental Organizations* May 1997

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<sup>18</sup> Additional information on the distribution of state funds in Hungary: Out of the 44,176 PBOs registered in Hungary in 1996, 28.3% were based in Budapest and received 70% of all revenues. Approximately 90% of decisions regarding fund distribution for PBOs are made by Budapest based organizations and government bodies. Furthermore, state support for the public benefit sector is very selective - 10% of PBOs receive 90% of the state funds while 70% of PBOs receive no state funds at all.