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A SUMMARY OF THE EVALUATION OF THE ACT ON PUBLIC BENEFIT ORGANIZATIONS BY *PARLAMENTI REFLEKTOR* (WRITTEN BY DÁNIEL CSANÁDY)

Introduction

New legislation was called for due to diminishing governmental undertakings and the resulting increased role of non-profit organizations in fulfilling public tasks. Because not-for-profit organizations also perform public tasks by using public resources, a kind of "social contract" is concluded between the government and the non-profit sector. In return for the performance of public tasks by NGOs, the government provides certain preferences for them. The advantage of NGOs providing public tasks is that they are more responsive in recognizing and meeting local needs of the people and they can provide services with higher quality and at a lower cost than the government.

The purpose of the new Act is to regulate the relationship between the government and the NGO sector. The newly created public benefit legal status provides rights to governmental support on one hand, and obligations concerning operation and management on the other. One of the most important basic principles of the Act is voluntariness. It means that the public benefit legal status is not obligatory, but it is based on a voluntary undertaking. Another important basic principle is accountability: the organizations using public funds have the obligation of filing a public benefit report, which is public and can be examined by anyone.

By adopting the new legislation, notwithstanding its imperfections and deficiencies, the Hungarian Parliament took a big step forward in regulating the NGO sector - the first country in the Central Eastern European region to do so.

Scope of the Law

The scope of the Act extends not only to the types of organizations regulated by the Civil Code, but it covers - with exceptions - all civil-society organizations established under the Freedom of Association Act, as well as foundations, public foundations, public benefit companies and public chambers.

In this regard, one of the debates during the preparation of the bill related to public chambers. Although they are regulated by the Civil Code, public chambers are not classic NGOs because they can be established only by an act of Parliament, not by the initiatives of citizens. They can even have official authority in fulfilling their public tasks. According to the Act, public chambers can be classified as PBOs only if they acquire this legal status by registration, and not based on the act authorizing their establishment.

The Act uses the term "civil-society organization", instead of "association". For that reason insurance associations, political parties and interest groups of employers and employees are explicitly excluded from the scope of the Act.

Scope of Public Benefit Activities

Public benefit activities are defined as follows: "the following activities, which are in accordance with the purpose of the organization as set forth in its founding document, and which are for satisfying the common interests of society and the individual." The Act later sets forth a list of public benefit activities. These activities range from special health

care, social, scientific, cultural and sports activities to the protection of the environment, human rights and public order, the promotion of Euroatlantic integration, etc. However, the placing of this definition with an enumeration of activities among the (final) explanatory provisions and not among the operative articles has been criticised.

In the Government's proposal professional sports was also included in the list of public benefit activities, despite its business character. The Parliament did not accept this approach and in the final version only those sports activities which are not pursued on the basis of employment or commission are regarded as public benefit activities.

Classes of Public Benefit Organizations

The law recognizes two categories of PBOs: public benefit and prominently public benefit organizations. The latter must undertake public tasks of the central or local government. The scope of state responsibilities is not well defined under the present Hungarian legal system. State responsibilities are determined by different laws, but none of them determines clearly which can be provided only by public (law) institutions and which can be undertaken by NGOs. The new Act does not change anything in this respect, but that was not its task. On one hand, it gives only additional preferences to NGOs which undertake state responsibilities, and on the other hand, it does not support the undertaking of public responsibilities which are not on the list of public benefit activities.

Accessibility of Public Benefit Services

In order to be registered as a PBO, an NGO must pursue a public benefit activity - as enumerated in the Act - and must make its public benefit services available to anyone, not only to its members. This is to exclude mutual benefit organizations - including trade unions - from the scope of this legislation.

Prohibition on the Distribution of Profits

The non-profit nature of public benefit organizations can be ensured in two different ways. The first is to prohibit them from pursuing any business activities at all. The second is to permit them to pursue business activity, but their profits cannot be distributed among their members, founders, owners or directors. In Hungary, as far as the financial resources of NGOs are concerned, they rely more heavily on their business activities, than their Western European counterparts. The prohibition of business activity would endanger the viability and development of these organizations.

National and international examples of the distribution of profits disguised as expenses warns us that a single declaration of a prohibition (on the distribution of profits) is not sufficient without adequate safeguards. Unfortunately, the Parliament voted in favour of detailed specification of the public benefit report, but only made a general declaration of the prohibition on profit distribution. Publicity seems likely to be insufficient without detailed provisions for sanctions.

Limits of Business Activity

With regard to the limitation of business activity, the shortcomings of the Act are obvious: its wording is not clear and it does not contain detailed rules. Although it does not prohibit business activity, it fails to differentiate between business activities promoting

the objectives of the organization and unrelated business activities. The Act recognizes only the former, without mentioning the latter. This is rather incomprehensible, since the concept of "activity in accordance with the objective" is defined in the law.

Restriction on Political Activity

According to the Act, the restriction on political activity extends only to activity within political parties and to registering candidates to the elections. Moreover, the prohibition pertains only to the elections of Parliamentary representatives and the elections of the representatives at a county (metropolitan) level. Accordingly, it does not prohibit the registration of candidates in local (municipal) elections. Similarly, although PBOs can not (financially) support political parties, they can be supported by them.

Establishment and Termination of Public Benefit Status

The new law did not change the system of registration for organizations falling under its scope, but supplemented it by requiring registration of data relating to their public benefit status. Two exceptions exist as to the general rule. Public benefit companies are registered at the Companies Registry, like for-profit companies. In the case of public chambers, the act on their establishment must assign the competent court.

A court decision to abolish an organization from the public benefit registry means the termination of public benefit status. It can be initiated by the public prosecutor, or it must be initiated by the organizations themselves, if they no longer comply with the requirements of public benefit status.

Although this is not the only way by which public benefit status can be terminated, the Act does not mention the other possibilities, such as merger with an organization not having public benefit legal status, termination without successors, dissolution by the court etc.

Preferences and Financial Resources

The Act determines generally the scope of preferences to which PBOs are entitled, while the specification of the conditions and the extent of these preferences is determined by the other relevant laws on tax, fees and customs duties. Employing a person performing civil service obligations gives rise to an additional preference.

The Act is deficient in the following respects:

1. There are no VAT preferences for PBOs. (Preferences of these kinds were proposed both by the Ministry preparing the bill and by the NGOs, but the Ministry of Finance strongly rejected them.)
2. Contributions having the character of taxes (such as cultural or rehabilitional contribution) are not on the "preference-list".
3. The law does not declare the principle that prominently public benefit organizations are entitled to more preferences in comparison to "normal" PBOs. It is important because otherwise, the category of prominently public benefit organizations may become meaningless by the annual amendments of tax laws.

Changes to Tax Laws

The business activities of PBOs were given more preferential treatment than before the amendment.

However, churches and national interest groups were granted the same corporate tax preferences as PBOs, despite the fact that they are not covered by the new law. This is hardly acceptable, because while they do not have to satisfy the mandatory requirements for PBOs, they can receive the same preferential treatment.

The law on personal income tax and the Act are inconsistent. Despite a provision in the Act that the recipient of a public benefit service of a PBO is not subject to personal income tax, the receiver of the service of a public benefit company is not entitled to this exemption. This also applies to payments by foundations and public foundations with the exception of payments serving special educational, research, social or sports purposes.

Donations

According to the Act, natural or legal persons are entitled to tax preferences with respect to donations made to PBOs. PBOs are also entitled to tax preferences with respect of donations made to natural persons, as a part of their public benefit activity.

Like the Civil Code, the new law does not define the concept of donation. Rather, it regards it as equivalent to the concept of support. This approach is inaccurate, since while a donation is gratuitous, support is not. Budgetary support, for example, is very often the "price" of fulfilling some kind of public task.

The Act introduces a new concept, that of durable donation. Durable donation means the annual donation of the same or increasing amount of money or securities based on a contract for at least four years, involving increasing tax preferences.

Fulfilling Public Tasks

The Act also fails to regulate aspects of the direct relationship between governmental (state) institutions and PBOs, such as tenders, contracts, conditions of financing and performance guarantees.

Nevertheless, considerable progress was reached by the new legislation. On one hand, a PBO may receive budgetary support - except for normative support - only on the basis of a written contract, and the extent and conditions of this support are public. On the other hand, the spending of budgetary resources must be accounted for in the public benefit report.

Duties

One of the most important "innovations" of the new law is the introduction of the annual public benefit report. So far, a similar obligation existed only in the case of public foundations under the Civil Code.

This report on public benefit activity is public. However, since the Act does not provide any gurantees of this public access, this provision in itself will hardly be satisfactory. The law did not provide for the establishment of an information center, to which all the reports must be submitted and where anyone can inquire about them. A center of this kind could be created either within the framework of the public prosecutor's office or within the Company Registration and Information Service already operating as a part of the Ministry of Justice.

Conflict of Interest, Internal Control

The Act contains detailed rules in order to prevent the donors from receiving back their donations as public benefit payments. The law also obliges the officers of PBOs to inform the organization about their similar occupation at other PBOs, but no sanctions are imposed for the neglect of this duty.

The Act orders the establishment of a supervisory organ to ensure the internal control of an organization, only if this obligation is otherwise prescribed by law. Rather surprisingly, in the case of prominently public benefit organizations, the establishment of a supervisory organ is not mandatory.

Supervision

The Act does not change the system of general supervision of NGOs, only supplements it in two respects. First, the national and local authorities providing support to PBOs have the obligation to sign a contract about the spending of budgetary resources. Second, the public prosecutor, having powers of general supervision, also controls public benefit operation and spending. The prosecutor may initiate through the court the transfer of the organization to a lower category, or its cancellation from the registry. In the case of public benefit companies, this causes an additional problem, because these organizations were previously supervised by the Registry Court. The creation of a uniform system of supervision is a great achievement of the new law.