



This document has been provided by the International Center for Not-for-Profit Law (ICNL).

ICNL is the leading source for information on the legal environment for civil society and public participation. Since 1992, ICNL has served as a resource to civil society leaders, government officials, and the donor community in over 90 countries.

Visit ICNL's **Online Library** at
<http://www.icnl.org/knowledge/library/index.php>
for further resources and research from countries all over the world.

Disclaimers

Content. The information provided herein is for general informational and educational purposes only. It is not intended and should not be construed to constitute legal advice. The information contained herein may not be applicable in all situations and may not, after the date of its presentation, even reflect the most current authority. Nothing contained herein should be relied or acted upon without the benefit of legal advice based upon the particular facts and circumstances presented, and nothing herein should be construed otherwise.

Translations. Translations by ICNL of any materials into other languages are intended solely as a convenience. Translation accuracy is not guaranteed nor implied. If any questions arise related to the accuracy of a translation, please refer to the original language official version of the document. Any discrepancies or differences created in the translation are not binding and have no legal effect for compliance or enforcement purposes.

Warranty and Limitation of Liability. Although ICNL uses reasonable efforts to include accurate and up-to-date information herein, ICNL makes no warranties or representations of any kind as to its accuracy, currency or completeness. You agree that access to and use of this document and the content thereof is at your own risk. ICNL disclaims all warranties of any kind, express or implied. Neither ICNL nor any party involved in creating, producing or delivering this document shall be liable for any damages whatsoever arising out of access to, use of or inability to use this document, or any errors or omissions in the content thereof.

About Miracles and Misperceptions - Lessons from the "percentage mechanism" in Hungary

By Nilda Bullain, Program Director, European Center for Not-for-Profit Law

There is an old Hungarian tale about the farmer girl who was very poor but very smart and fulfilled even the most impossible demands of the king that he posed for his future wife. The future wife would have had to bring a present to the king and not; she would have had to wrap it up and not; she would have had to give the gift and not. The poor girl took a white dove, put it in a wire cage, gave it to her little sister to carry and when the king opened the cage, the dove flew away. And the king married her as a reward. This tale presents the possibility that if you are smart you will be able to give and not give at the same time. This principle is more or less what the “percentage philanthropy” solution follows – no wonder it is a Hungarian “invention”.

The so called “one percent law”¹, adopted by the Hungarian Parliament in 1996 introduced a special mechanism in Hungary by which every taxpayer may designate one percent of his or her paid personal income tax to a qualified beneficiary of his or her choice. In this paper first we would like to describe the main characteristics of this mechanism and then assess its impacts to date. Hopefully this analysis will help better understand the nature of the percentage mechanism and therefore contribute to a more effective implementation of such system in Poland.

I. The One Percent Law in Hungary

In this first part, we will examine the designation mechanism as prescribed by the law, as well as how it works in practice and the results of its operation in the past seven years. This part contains a description of legal provisions as well as facts and figures relating to the implementation of the law, that serve as the basis for a more in-depth impact analysis provided in the second part.

I.1. Basic features of the system

In Hungary, individual taxpayers – natural persons – may designate one percent of their income taxes paid to a qualifying nonprofit organization and another one percent to a church. In addition to nonprofits, there is also a list of budgetary institutions; while as an alternative to a church, a special budgetary priority objective is named each year. In this way there are four categories of beneficiaries:

- The first one percent may be designated to associations, foundations and public foundations² (hereinafter: NGOs) conducting public benefit activities, or
- State institutions, such as museums, libraries or the National Opera.

¹ Act CXXXVI of 1996 on the Use of a Specified Portion of the Personal Income Tax

² Foundations established by Parliament, government or local government

- The second one percent may be designated to a registered Hungarian church denomination, or
- An issue of national significance, determined by Parliament annually – e.g. flood relief or emergency medical services.

There are further requirements for the NGOs to be entitled to receive the one percent designations. These relate to ensuring accountability and proper use of the taxpayer's funds and include the following:

- The beneficiary NGO has to be in existence for at least two years prior to the year in which the designation was made (however, in the case of prominently public benefit organizations³ this is only one year).
- NGOs entitled to receive designations have to be carrying out at least one type of public benefit activity (the Law on Public Benefit Organizations, hereinafter: the PBO Law, determines 22 types of these activities⁴).
- NGOs also have to comply with the provision of the PBO Law that prohibits conducting direct political activity to public benefit organizations.⁵

However, NGOs in Hungary do not need to have a public benefit organization (PBO) status to be entitled to receive the one percent designations. In fact, the designations reach a much broader range of NGOs than those that are also PBOs. For example in 2003, 44% of NGOs received designations, while only 36% of NGOs have had a public benefit status.⁶

Furthermore, a beneficiary NGO must be “operating in the interest of domestic population or cross-border Hungarians.” This clause may prohibit some NGOs from collecting one percent designations, namely those that are working in the interest of development in another country, e.g., in South Eastern Europe or Africa.

Finally, the beneficiary NGO may not have a public debt (for example, debt occurred in tax arrears, payments of social security benefits or pension allowance). However, as of 2002, the NGO is actually permitted to have such debt, but must make a statement authorizing the tax authority to pay the debt from the amount of the one percent designations received by the organization.

I.2. Technical workings of the designation mechanism

Taxpayers make the designations on special forms enclosed in the tax return. In order to fill the form they only need to know the tax identification number of the beneficiary (to

³ In Hungary there are two levels of public benefit status. The “prominently public benefit” status entails higher benefits but also higher accountability requirements for NGOs

⁴ Act CLVI of 1997 on public benefit organizations, Art. 26 (a)

⁵ Art. 26 (d) defines direct political activity as “political party activity and nomination of candidates for Parliamentary and local governmental elections at the county level, including the city of Budapest”.

⁶ Based on the 2003 report of the Tax Authority on the use of percentage designations (www.afeh.hu) and the 2001 report of the Statistical Office on the NGO sector, *infra* page 7.

provide the name is optional but may help in identifying the beneficiary in case of doubt). Taxpayers slip the forms into a closed envelope and post it together with the tax return forms.

In Hungary, about 50% of taxpayers submit a tax return sheet through their employers. When the employer files a tax report for the employee, the employee has to hand a sealed envelope containing the designation forms to the employer. This envelope has to bear the signature of the employee over the seal. The employer sends the envelopes along with the report to the tax authority.

The Tax Authority separates the envelopes and the designation forms, thereby ensuring for data protection (the records of designations will not contain the data of the designators).⁷ The system in Hungary needs to be anonymous due to data protection reasons. This has two aspects. Firstly, the designation is considered sensitive information as part of the tax return form (e.g. the annual income of the taxpayer may be calculated based on this information). Secondly, in Hungary the Law on Freedom of Religion prescribes that the state may not keep a record of the religious affiliation of a citizen.⁸ Designations made to churches are classified as such records and it is therefore prohibited to keep the records of designators. The significance and effects of the anonymous system is discussed in this paper (*see pages 18-20*).

Taxpayers must submit the return forms and with them, the designations by March 20 of each year. The tax authority processes the forms and sends a notice to the beneficiary NGOs by September 30. NGOs have 30 days to prove their entitlement and if they are successful, the tax authority transfers the amounts designated by November 30.⁹

I.3. Facts and figures of the last seven years¹⁰

Generally, 30-33% of taxpayers take advantage of this opportunity by making a designation to at least one beneficiary. The majority of taxpayers makes a designation to an NGO beneficiary as opposed to a public institution. The amount of designations directed to public institutions is in fact considerably less than those supporting nongovernmental organizations: the number of designations to public institutions was 20,000 in 2003, compared to 1,338 million designations for nongovernmental organizations. The inclusion of public institutions into this scheme is widely debated.

Hungarians are also less likely to designate to churches: in 2003, churches received about half the number of designations to NGOs (635,000). This reflects the trend of the past years as well.

⁷ The envelopes and forms are coded and may be realigned only in case of a dispute or if the taxpayer demands information regarding his or her own designation.

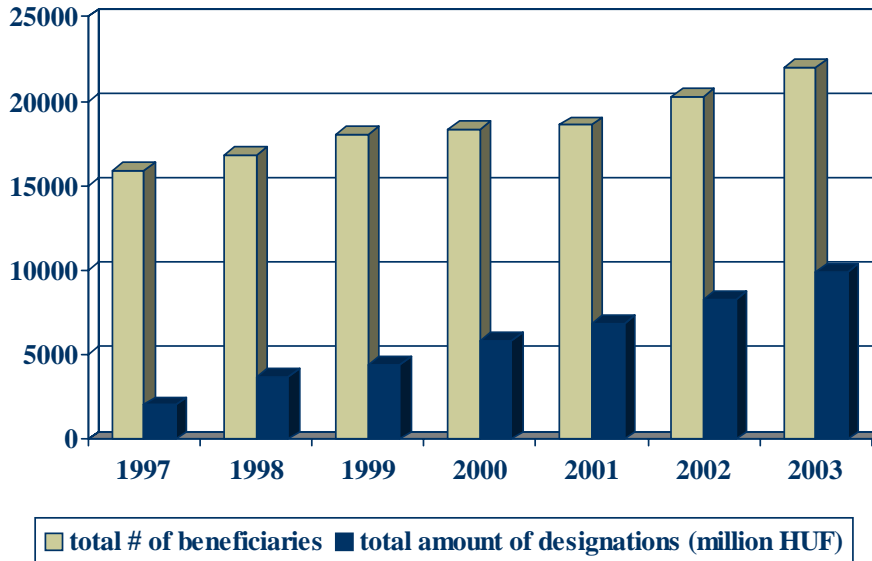
⁸ Act IV of 1990 on the Freedom of Religion, Freedom of Conscience and Churches, Art. 3(2)

⁹ In case the tax authority refuses entitlement to an NGO, there is room for appeal to the court and an expedited procedure takes place. The court has to make a ruling in 15 days.

¹⁰ All data and figures in this and the next section (I.3. and I.4.) are either taken directly from or based on the yearly reports of the Hungarian tax authority on the use of the designations, published on the Internet www.apelh.hu. (unless referenced otherwise).

TABLE 1

**Number of beneficiaries and total amount of 1% designations in Hungary,
1997 – 2003**



As can be seen from the above table, despite the fact that the number of designating taxpayers did not significantly increase, the number of recipient organizations as well as the amount designated shows steady growth over the seven years.

Compared to 12,000 NGO recipients in 1996, over 20,000 NGO recipients were named by the taxpayers in 2003, and thus 44% of NGOs became beneficiaries of the designation scheme. (The table above reflects the overall number of beneficiaries including public institutions and churches as well. This aggregate number grew from 16,000 to 22,000 between 1997-2003.)

The total amount designated almost tripled between 1998 – 2003 (it also doubled from 1997 to 1998 because 1998 was the first year when churches were included). Taxpayers designated a total of 3.7 billion HUF (18.5 million USD) in 1998, of which 1.8 billion HUF (9 million USD) was directed to NGOs. In 2003, the total amount designated was 9.92 billion HUF (50 million USD) and NGOs received 6 billion HUF (30 million USD) from this amount.

This shows two important factors:

- Taxpayers tend to designate to different organizations each year (hence the increased number of beneficiaries).
- It is the higher income taxpayers who are more likely to make designations (hence the increase in the amounts)¹¹.

I.4. Winners and losers?

Most of the funds from the one percent designations are disbursed in small amounts among recipient organizations. In the year 2003, most NGOs (over 9000) received designations of between 100,000 – 1 million HUF (\$450 - 4500). At the same time only 800 NGOs received between 1 –5 million HUF (\$4,500 – 22,000); 80 NGOs received between 5 – 15 million HUF (\$22,500 – 68,000); and a mere 18 organizations were designated more than 20 million HUF (\$90,000).

Therefore, the system provides small amounts of money to most organizations and only a fraction of the NGOs can consider their income from the 1% designations to be significant. However, for many small organizations, even the small amount of designations constitutes a major part of their yearly budget.

It can also be seen that very few organizations manage to attract a high number of designations. In 2003, there were only 95 organizations that received support from more than one thousand taxpayers, and only 8 that were named by more than 10,000 people. The NGO topping the list in this year was a child cancer organization, which received 151 million HUF (\$686,300) from 39,000 taxpayers. On the other end of the spectrum are hundreds of NGOs who received designations from only one or two taxpayers.

In terms of the areas of activity that taxpayer prefer, the most frequently supported issues have been education, social care and health care. Specifically, foundations set up by schools and hospitals receive a major part of the designations. At the same time, among the organizations that repeatedly receive the largest amounts from the largest number of people, we can find two recurrent areas of concern: child cancer and animal rights. (See for example *Table 2*) Interestingly, foundations (as opposed to associations) continually receive about 2/3 of the designations.

TABLE 2

<ul style="list-style-type: none"> ▪ Most frequently requested NGOs in the NIOK telephone hotline in the last 3 years*: ▪ Child Cancer Foundation ▪ Foundation of Heim Pál Children's Hospital ▪ Foundation for Children with Leukemia (Tűzoltó Street Hospital) ▪ Rex Dog Shelter Foundation ▪ Miskolc Special Rescue Team Foundation ▪ White Cross Animal Protection League ▪ Budapest Zoo ▪ Red Cross ▪ Pető Institute Public Foundation for Special Education ▪ Red Nose Clown Doctors Foundation

¹¹ In fact, this finding is also supported by research made in 2000, see *infra* Page 10 Note 21.

*NIOK is a resource center that provides information on NGOs for taxpayers during the 1% campaign period
Source: www.onepercent.hu

I.5. The context of NGO financing

A further piece of information that will help put the one percent scheme into perspective is a short description of the larger context of government financing in Hungary.

Over the last ten years, government financing of the nonprofit sector has more than doubled in volume. (See *Table 3*) This was in part due to the introduction and establishment of a range of quasi-governmental organizations, such as the public foundations and public benefit corporations. These nonprofit organizations are autonomous but founded and financed for the most part by governmental agencies. These, as well as other nonprofit organizations, especially those that have a “prominently public benefit” status have been playing an increasing role in the provision of public services, such as education or social care.

The Hungarian government indeed recognized the role and importance of these organizations and of the nonprofit sector in meeting the needs of Hungarian society during this transition period. Unfortunately, increased support and interest on the government’s part also meant an increased influence of it on the nonprofit sector.

In terms of its structure, state oriented quasi NGOs (public foundations, public benefit corporations) gained a greater proportion than before. Numbers of associations, sports and hobby NGOs, interest representation and advocacy organizations diminished, while the number of institutions of NGOs and those engaged in regional and economic development increased. *“We are witnessing not simply a change in proportions but the actual contraction of the part of the sector that can be considered really ‘civil’, voluntary and nongovernmental”* states the Statistical Yearbook of 2000¹².

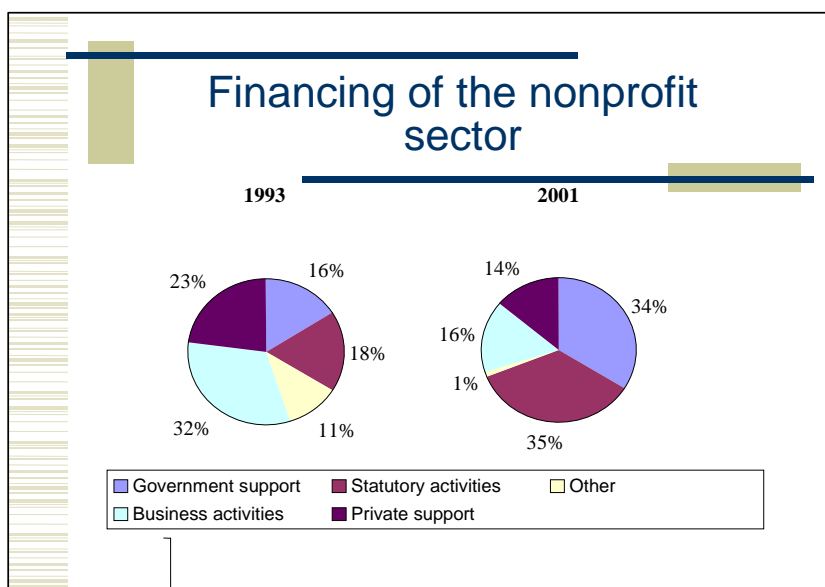
State financing for NGOs today is available through a range of central and local channels and it amounts to 150 billion HUF (\$750 million) a year, constituting more than 1/3 of sector income. (See *Table 4*) However, the revenues from the one percent designations account for only 0.8% of the total income of the nonprofit sector in Hungary. This equals 3.3% of total governmental support for the sector.

The significance of the 1% scheme in this context is that it represents a small portion of public funds that are provided to NGOs without the political strings attached. In the case of the one percent mechanism, access to public funding depends not on the ability of the NGO to write “winning” proposals and lobby decision-makers in the Parliament or ministries; but on their ability to reach out to their constituencies and communicate about

¹² Kuti Éva, Bocz János, Mészáros Geyza, Sebestény István, Emri Istvánné: Nonprofit Organizations in Hungary (Nonprofit Szervezetek Magyarországon), 2000, KSH (Report of the Central Statistical Office), page 25.

themselves convincingly to the average citizen in Hungary. These characteristics have differing impacts on the development of NGOs and on the effectiveness of public spending (see Analysis of potential impacts below).

TABLE 3



Source: Kuti Éva, Bocz János, Mészáros Geyza, Sebestény István, Emri Istvánné: Nonprofit Organizations in Hungary (Nonprofit Szervezetek Magyarországon), 1993 and 2001, KSH (Reports of the Central Statistical Office)

TABLE 4

Channels of Support for Public Financing of Nonprofit Sector in Hungary Total financing in 2001: 150 billion HUF (\$750 million)*	
Centrally (77%)	Locally (20%)
<ul style="list-style-type: none"> ▪ Parliament ▪ Government ▪ Ministries ▪ Public Foundations ▪ Central Funds ▪ Normative Support** 	<ul style="list-style-type: none"> ▪ Local Council ▪ Local Council Committees ▪ Mayor ▪ Public Foundations ▪ Local tax designation of companies***

*VAT refunds account for 2.2% and the one percent designations for 0.8% of government support.

**Per capita support to nongovernmental social service providers

***In some localities companies may designate 1% of their local business tax to an NGO based on the laws of the local government

Source: Kuti Éva, Bocz János, Mészáros Geyza, Sebestény István, Emri Istvánné: Nonprofit Organizations in Hungary (Nonprofit Szervezetek Magyarországon), 2001, KSH (Report of the Central Statistical Office)

II. Role and impact the One Percent Law in Hungary¹³

The percentage designation system is a “special animal”. This designation is not a donation, a tax benefit or a tax incentive in the strict sense of these concepts¹⁴; and yet legislators have had the assumption that it may nevertheless have a significant effect on philanthropic behavior in transitional societies. At the same time, the percentage designation in the legal sense is a special form of tax allocation and therefore has an effect on the redistribution of public funds as well as on the understanding of citizen responsibilities.

In fact, it is this multifunctional nature of the percentage mechanism that makes it rather unique – and quite unpredictable. Its intended impacts are severalfold and there are a range of reasons governments and NGOs have used in campaigning for its adoption. In the following we will examine this idea in the light of the possible rationales that support it. All of the following four rationales were in some way mentioned during the political debate that preceded the adoption of the law in Hungary.

II.1. Policy rationales that support the introduction of the law

One rationale is that of what one author calls “*taxation self-determination*”¹⁵, i.e. the possibility that tax paying citizens make autonomous decisions on the use of a – whatever small – portion of their income tax, thereby exercising direct democracy. Hungarian researchers examining the impact of the law entitled their book “*Citizen’s Votes*”¹⁶ reflecting this principle. In the context of this rationale, the mechanism is actually a tool of strengthening democratic values (in this case, citizen participation and taxpayer control of spending public funds) in transition societies.

Another rationale is that of “*civil society development*”, i.e. the role this mechanism can play in strengthening civil society by (a) providing new resources to the NGOs, (b) raising awareness about NGOs, and (c) increasing the skills of NGOs in communication and community outreach. In light of this argument, the mechanism actually helps educate the general public about the role and importance of NGOs and at the same time it motivates NGOs to communicate with the public. These functions are crucial in societies that are ignorant or hostile with NGOs. Also, importantly, the one percent provides

¹³ Some parts of this Section II are also elaborated on in a paper by this author (N.B.) entitled “Percentage Philanthropy and Law” and presented at the Percentage Philanthropy Conference, January 19-20, 2004 in Budapest, Hungary

¹⁴ A donation is given from the donor’s own property, while in this case, it is given from public funds. A tax benefit or a tax incentive means a financial (economic) benefit to the donor as s/he will have to pay less taxes. This is not the case with the percentage designation where taxpayers have to pay the same amount of tax whether they make a designation or not.

¹⁵ Erzsébet Fazekas, *The 1% Law in Hungary: Private Donation from Public Funds to the Civil Sphere*, The Journal of East European Law Vol.7, Nos 3-4, Columbia University (2000), e.g. on page 447

¹⁶ Eva Kuti and Agnes Vajda, *Citizen’s Votes for Nonprofit Activities in Hungary*, Nonprofit Information and Training Center – Nonprofit Research Group (2000); available at <http://www.niok.hu/1/indexe.htm>, or at <http://www.onepercent.hu/documents.htm#SIStudies>

another income source for these organizations that they can use with relative freedom to further their cause (as opposed to project funding, the use of which is restricted).

A third rationale is that of “*development of a philanthropic culture*”. This focuses on the importance of citizen support to NGO endeavors. According to those emphasizing this rationale, in transition societies there is no tradition of philanthropy (private giving) and this mechanism may be a good first step in developing such culture, as it encourages the individuals to think about reasons to support an NGO. In addition, it serves as an indicator of the level of public support to NGOs.

A fourth rationale is “*government outsourcing*”, in that the method can serve the purpose of providing decentralized and depoliticized government support to activities that benefit the public. In Hungary, government funding is generally viewed as too centralized, politicized and akin to favoritism. In fact, recent reports revealed that 80% of government funding to NGOs is provided by the central government¹⁷ and 80% of this central government funding is being distributed via sole source solicitation (i.e. without a tender procedure).¹⁸ According to the arguments of the “government outsourcing” rationale, because the beneficiary organizations are conducting public benefit activities the government is subsidizing important public tasks, but in a decentralized and depoliticized way, which is a much needed alternative to centralized and bureaucratic decision making.

II.2. Analysis of potential impacts

It is quite difficult to assess the impacts of the One Percent Law in Hungary, even though seven years have passed since its introduction. The main reason for this difficulty is the lack of relevant data. While there have been a limited number of research studies conducted around 2000, these do not provide enough basis to draw definitive conclusions.

However, it is not our mandate to draw definitive conclusions about the effects of the percentage legislation in this paper. Rather, we would like to point out a few potential relations between the law and the way it has been implemented and the effects that can be observed, focusing mainly on Hungary and drawing upon the information from Slovakia as well.¹⁹

In the following, we are going to examine

- The potential impacts related the above described rationales, i.e. is it realistic to expect such outcomes at all?
- The actual outcomes related to each rationale, i.e. to what extent has this potential been realized to date?

¹⁷ Központi Statisztikai Hivatal: Nonprofit szervezetek Magyarországon, 2000 (Central Statistical Office, *Nonprofit Organizations in Hungary*, 2000); page 105

¹⁸ Állami Számvevőszék: Jelentés a társadalmi szervezeteknek és köztestületeknek juttatott költségvetési támogatások ellenőrzéséről (State Audit Bureau, *Report on the Control of Budget Support to Social Organizations and Public Societies*), September 2002; page 9

¹⁹ A similar one percent designation system has been operational in Slovakia since 2002.

We have also made a summary chart of the conclusions (again, subjective and tentative ones to help orient thinking rather than decisive ones) to provide an overview of the effects. (See *Table 5*)

TABLE 5

Assessment of Potential and Actual Impacts of the 1% Law*

Rationale / Impact	Potential	Results
Taxation self-determination	3/4	3
Civil society development	4	4
Developing philanthropy	2/3	2
Government outsourcing	2	1

1=Poor 2=Questionable 3=Limited 4=High

*based on data from Hungary 1997-2002 and Slovakia 2001-2002

II.3. Taxation self-determination

According to this rationale the intended effect would be to strengthen the democratic values in society by increasing citizen participation and taxpayer awareness. The questions are then, what is the potential of the law in contributing to these effects; how and to what extent the law has contributed to these in Hungary?

Based on the Hungarian experience, the potential effect in raising citizen awareness and participation is definitely there, but to date the ability of NGOs to fully harness this potential has proved to be rather limited. Since the first year of the 1% designations, the number of taxpayers who used the opportunity of tax designation has hardly increased. The proportion of such taxpayers has been stagnating between 30-34% of all taxpayers throughout the seven years. “Nonprofit organizations made a major breakthrough in 1997 when they managed to acquire almost half of the 1% designation potentially available to them, but their performance in convincing taxpayers has not been significantly improved since then.” – say Kuti and Vajda in the most comprehensive study on the impact of the 1% law to date.²⁰

Research both in Hungary and Slovakia clearly indicates that taxpayers with higher education, higher income levels and those who are engaged in philanthropic activities (i.e. volunteer or donate to an NGO) are the ones more inclined to take advantage of this opportunity.²¹ In other words, these cca. 30% of the taxpayers are the ones who will take

²⁰ *Supra* note 16, page 10.

²¹ E.g. in Hungary 43.6% of taxpayers with monthly income in the highest tax bracket, 52.9% of taxpayers with a university degree and 49.6% of taxpayers who are on the board of a foundation, exercised their right to designate the 1% in all three years between 1997-1999. See Vajda-Kuti *supra* note 16, pages 16-20; and

advantage the opportunity created by the law because they are citizens who already have an awareness of democracy, a sense of social responsibility and participate in public decision-making anyway. While informing them about the one percent as an opportunity is important, they do not need to be particularly persuaded to use the opportunity. Therefore, at least in Hungary, the 30% “turnout” could be viewed as a baseline rather than a result – and in the light of this approach, the aim of increasing citizen participation in this form of democratic decision-making has not really been achieved.

Another reason to be doubtful about the extent to which this impact has been achieved is the fact that many people think about their 1% designations as “donations” rather than “tax allocations”. In the research referenced above, the top reasons people named as to why they made their one percent designations were echoing reasons of philanthropic behavior: “The two most frequent assumptions are that taxpayers intend to *help people in need*, including mainly the poor, sick and disabled persons, and victims of disasters (22.8 percent), or to *support concrete fields or activities*, mainly health care, social services, and education (22.6 percent) when they designate the recipient of their 1%.”²² However, although to a lesser extent we can also find the indications of citizen consciousness: “As one of them said, people want to promote the notion that ‘*numerous highly cultivated citizens be able to better themselves and the lot of the nation*’.”²³

The fact that the notion of the designation is often mixed with that of a donation is natural and understandable, but only underlines the importance of the development of a truly philanthropic culture. (See below.)

Tax return by employers

Another aspect of the taxation self-determination is a problem that all CEE countries introducing the one percent will have to face, i.e. the issue of employer-provided tax returns. In these countries where taxation was abolished for decades and the culture of tax evasion is still very high²⁴ there is a general custom of employers filing tax returns for their employees. In Hungary, for example, this is the case when the employee has no other income than the salary received from the employer. About 50% of taxpayers chose this way of fulfilling their tax reporting obligations.

In these cases, the taxpayers are discouraged from making the 1% designations as they do not even fill in their tax forms themselves. In addition, many self-employed entrepreneurs in Hungary who are liable to file their own tax returns simply leave this task to their accountants. It could be expected that in such cases the taxpayers will either not make a designation or make a “surrendered” decision (i.e. they let another person make the decision for them, such as their bookkeeper or the payroll clerk of their employer). As for the extent of people not making a designation because of this reason,

for Slovakia: Outcomes of research after the first-year implementation of assignment of 1% of paid tax, available at <http://www.onepercent.hu/documents.htm#SIStudies>.

²² *Supra* note 16, page 7.

²³ *Id.*

²⁴ *Supra* note 16, page 11

in the research made in 2000, 25% of those whose forms were filled by their employers reported that the employer did not inform them of this opportunity. This is not good but also not impossible to decrease in the future.²⁵ Even more encouraging is data showing that only 3.2% of all taxpayers who exercised their right to make a designation report “haphazard or surrendered” decisions.²⁶ This is also the case in Slovakia, where 2.5% reported employer instructed designations.²⁷ Even if we count the “conformity” phenomena (respondents wanting to conform with perceived expectations, i.e. in this case they are ashamed to admit the truth), the volume of this phenomena is pleasingly low.

A last point about the employers tax return is that in this case, administrative procedural considerations may play a bigger role. Moreover, in this case, administrative procedural considerations may play a bigger role, e.g. when completing the designation forms for the employees is more difficult than for those who file their own returns. This will be the case in Slovakia as of 2004.²⁸

This leads us to the following conclusions:

- (a) the fact that employers fill tax returns of employees is likely to be a deterring factor in making the designation, but not a significant one in itself;
- (b) this is even more true if the administrative procedure is not too burdensome for the employees who want to make a designation;
- (c) once the employees decide to make the designation, the employers preferences will influence only a small portion of taxpayers.

Finally, in relation to the taxation self-determination argument we would also like to point out another obstacle in the fulfillment of the impact of this principle. This is the fact that usually the taxpayer cannot or cannot easily check whether the designation was delivered as intended. There is a tension between the privacy protection considerations and the need for public accounting, which may be resolved in different ways. In Poland, however, the designations are not anonymous and the taxpayer has to transfer the given amount him- or herself to the chosen NGO, thereby exercising full control over the tax designation process.

In conclusion, we suggest that the percentage mechanism has a good potential for an impact that is aimed at increasing citizen participation and taxpayer control over public funds. It has some limitations, especially related to the employers’ tax return and the ability of citizens to control the execution of their designations by the tax authority; nonetheless, this potential is significant and important for transition societies. Still, in order to fully utilize this potential, at least two things are needed:

²⁵ There is, however, a greater “danger” looming in Hungary where the government plans to deliver pre-completed tax returns to citizens as of 2005. The Tax Office will prepare a tax return for a taxpayer based on data it has, sends it to the taxpayer, and unless it receives an objection, will consider the tax agreed to. It is as yet unresolved how the 1% designations will be included in this scheme.

²⁶ *Supra* note 16, pages 23-25

²⁷ *Supra* note 20

²⁸ In Slovakia, “regular” taxpayers will have the opportunity to make a declaration in their tax forms, while those submitting tax returns via employers will still need to post the declaration separately.

- Much more effort on part of the NGOs (and the government) aimed at a significantly higher level of involving citizens in this scheme (to go beyond the “30% baseline”);
- More efforts to develop philanthropy as distinct from this form of tax allocation and raise awareness among citizens of the difference between the two.

So far, the implementation of the law has not addressed these aspects and therefore, the level of achievement in the field of tax-self-determination can be described as “limited”.

II.4. Civil society development

There are three aspects that we suggest examining under this rationale, i.e. the level of resources; the level of citizen awareness of civil society and the relationship between the general public and NGOs; and the level of the development of individual organizations participating in this process.

Increasing resources

The potential amount of the percentage of all taxes that may be brought into the resource base of the NGO sector can be relatively easily calculated. A realistic picture implies that initially about 30% and within a few years, about 50% of the total potential percentage contributions may be expected as additional resources for the sector. The question then becomes, what is the significance of this amount in the whole of the sector’s income; both in volume and in quality.

In Hungary, the total amount designated to civil organizations (excluding churches) has grown from 2 billion to 6.1 billion HUF between 1997 – 2003.²⁹ However, this amount has not reached 1% of the income of the nonprofit sector in any given year; it represents 0.8% of its total income in 2003. As described above, the share of the “1% income” within government support for the sector is 3.3%.³⁰

In other words, this income is not significant in terms of volume of new resources coming to the nonprofit sector. It is however, significant in terms of the kind of organizations and activities it supports. Firstly, the 1% reaches out to a wide range of organizations (in 2003, for example, 44% of NGOs received this kind of income); and while not significant for the sector as a whole, such support may be very significant for the individual organizations. It seems to be especially important for smaller NGOs: only 4% of the income of large organisations is from 1% donations, while the smaller ones get approximately 25% of their income from this source.³¹ Second, this support is different in its quality from the general governmental support because it may be used essentially as unrestricted income (the only condition of its use being that it is spent to advance the

²⁹ APEH reports on the 1% income, available at www.onepercent.hu

³⁰ See pages 6-7 of this paper.

³¹ *Large* meaning a budget of above 10 million HUF, while *small* meaning a budget of under 100 thousand HUF. In: *Effectiveness of Hungary’s 1% Law – Survey of NGOs*, prepared by NIOK, 1999, page 11. Available at http://www.onepercent.hu/Dokumentumok/NGO_Report_and_Evaluation_revised.doc

statutory public benefit activity). Most government funding in Hungary is restricted for project spending. Third, this support reaches organizations different from those generally receiving state support. This is actually emphasized as a major conclusion of the study conducted by Eva Kuti and Agnes Vajda in 2000 as well: “In contrast with governmental redistribution, which concentrates on supporting a relatively small number of voluntary organizations, citizens’ preferences are much more diverse.”³² We will look into these differences in more detail below in analyzing the fourth rationale (government outsourcing).

Therefore, while the one percent income did not mean a major source of funding for the sector as a whole, it has played an important developmental role in the composition of the sector. It has increased access to unrestricted funding and channeled public support for organizations that would otherwise have little or no chances to gain such access.

Increasing awareness

The one percent mechanism has also helped in raising awareness about the civil sector among the general public, which is a critical element in the development of civil society. The relevance and strength of voluntary organizations depends largely on the level of recognition and support they receive from the public. The one percent provision has the potential to raise awareness about these organizations in almost every household in the country.

As discussed above, only 30-35% of taxpayers take advantage of the opportunity to make a designation. However, many more citizens actually know of the opportunity and form opinions on the organizations and the sector involved. According to a study made in Hungary in 1999, 94 percent of the adult population and 98 percent of the taxpayers had already heard about the 1% opportunity.³³ In Slovakia, after the first year of implementation of the law, already 71 percent of the respondents of a representative sample of the population were aware of the opportunity. This suggests that – probably in part due to the simple fact that it is a tax-related issue and people are likely to want to find out about it, and in part due to the effective information campaigns conducted by organizations such as NIOK – the one percent opportunity brings the concept of NGOs into the lives of people to a greater extent than any previous method in post-socialist countries.

Moreover, not only had people heard of the opportunity but they also approved of its purpose. Only 14% of all respondents and 10% of taxpayers did not approve of the law. “Our findings seem to prove that the 1% provision has been generally welcomed by the overwhelming majority of the adult population. (...) (They) reveal a deeply positive opinion on the taxpayers’ behavior and suggest that the majority of Hungarians believe in citizens’ virtues.” – says the referenced report.³⁴

³² *Supra* note 16, page 13.

³³ *Supra* note 16, pages 5-6

³⁴ *Supra* note 16, page 8.

This is an unprecedented opportunity and probably one of the biggest benefits of the law. It takes decades of education and several generations to change culture and attitudes in a society. The one percent law offers a unique chance to accelerate such change in relation to nonprofit organizations and their importance to the lives of people.

Unfortunately, Hungary has also witnessed a number of scandals related to nonprofit organizations including a major one about a foundation that was not entitled to collect designations. This is reflected in the fact that almost half of those who disapproved of the system in Hungary indicated moral and accountability problems on the side of the potential beneficiaries as their reason.³⁵ It seems, however, that in the long run these perceptions do not have a significant impact on the overall inclination of Hungarians to support NGOs through the one percent scheme. The number of beneficiary organizations increases year by year; and it is intriguing to note that the foundation mentioned above actually collected the largest amount of designations in 2002 – only a couple of years after the scandal.

Organizational outreach and skill development

As the third aspect of the civil society development perspective, it is important to note the impact of the system on the level of organizational development of the NGOs. The law has great potential to increase the ability of NGOs to communicate about themselves to the public and to their stakeholders. Unlike any other government funding measure, this law provides a strong incentive for organizations to reach out to their members, clients, communities and the public at large – in other words, to reach out to the people that they were supposed to serve in the first place. In Hungary, NGOs have been extremely focused on proposal writing as the main technique of raising funds and this culture lead to mutual isolation and ignorance between the NGOs and the communities in which they had worked. With the exception of the limited circles of their clients and (institutional) donors, NGOs did not make the effort to communicate about their existence and seek for support. The opportunity of the 1% designations opened up a new avenue to raise funds that involves a much more open and inevitably more transparent and more accountable way of operation.

The level to which NGOs lived up to the challenge, of course, varied. In any case, it was a telling fact that from the beginning, foundations had acquired a higher share of the “one percent cake” than associations. It was expected that associations that were supposed to have a strong membership base would be in a better starting position in collecting designations. However, associations did not perform very well. They collected hardly 15% of all designations. “It wasn’t even the small local associations but the big national organizations that failed. It seems that to have the members in the register and hold one

³⁵ Statements like “*There are lots of bogus foundations*”; “*They embezzle money and carry out a number of frauds. If I only mention the cases we hear about...*” seem to suggest that highly publicized scandals have an important impact on the image of nonprofit organizations. Media influence is easily detectable in the attitude of most respondents who believe that charities are not sufficiently accountable to the public for how their money is spent. On the other hand, very few of them reported that they had come to this conclusion on the basis of personal experience. See Supra note 16, page 8.

yearly assembly is not enough – unless the relationship is live and strong, the one percent will not arrive automatically on the accounts.”³⁶ - concludes a report that inquired about the reception of this law by the NGOs.

For these associations, as well as for all NGOs, the results of the one percent campaigns held a mirror showing how well they were known and supported among their stakeholders and the public. As a consequence some lost motivation to pursue this type of support; but those who took it well and used it to further develop relationships to their communities, gained tremendous benefits – and not only financially. “We decided to build membership intensively. We held regular meetings, managed the volunteers, conducted joint projects and joint parties – our income from the one percent grew from 50 to 350 thousand in a year.” – reported an environmental association from Veszprém.³⁷ Other NGOs decided to “play it big” and embarked on professional national PR campaigns using methods (such as billboards or TV ads) never tackled by NGOs before. They created models of successful professional communication that will be followed by many – not only in the one percent campaigns but also in other fundraising and even advocacy work.

In summary, the 1% Law has helped increase the responsiveness, transparency and accountability of the NPO sector. Efforts by NPOs to convince citizens that they should support them strengthened communication between the nonprofit sector and society. By receiving contributions from their stakeholders, NPOs became directly accountable to them in terms of how funds were spent. In addition, because the law subjects NPOs to reporting requirements, it increased the transparency of NPOs and decreased possibilities for the misuse of funds. Essentially, as a result of the 1% Law, NPOs in Hungary have become more accountable, professional and transparent.

II.5. Development of philanthropy

A fundamental question to address is whether this form of tax designation qualifies as philanthropy. This depends on what we understand as “philanthropy”.

A commonly accepted definition of philanthropy is “voluntary private giving for public purposes”³⁸. According to this definition, philanthropy is:

- “Voluntary: is intended (with the purpose of making a gift) and uncoerced (rules out legal penalties for not giving).”³⁹

³⁶ Balázs Gerencsér and Lajos Bíró: Opinion of civil organizations on the 1% law (*Az 1%-os törvény végrehajtásával és megítélésével kapcsolatos vélemények a civil szervezetek körében*), Nonprofit Information and Training Center, 1999, available in Hungarian at <http://www.nonprofit.hu/kiadvanyok/tanulmanyok.html>

³⁷ *Id.* Page 13.

³⁸ Martin, Mike W.: *Virtuous Giving – Philanthropy, Voluntary Service, and Caring*, Indiana University Press, Bloomington and Indianapolis, 1994. Page 8.

³⁹ Voluntarily is not a synonym for “willingly”. Loyal citizens may pay taxes willingly – but taxes are not voluntary. *Id.*

- “Private: means giving own money and time, as opposed to government spending that means giving public money.
- “Giving: means donating resources without expectation to achieve comparable economic compensation.⁴⁰
- “For the public: is intended for public purposes – virtually all social aims, beyond helping one’s family and friends.”⁴¹

The act of tax designation in the percentage mechanism would not satisfy all of the above criteria. Most of all, it is not giving of one’s own money and time – instead it is disposing of money that belongs to the public. In addition, the question of whether it is given voluntarily may be debatable. It is true that there is no legal penalty for not making the designations; however, in this case people only “give” because they have to pay the taxes anyway.⁴² On the other hand, the designation mechanism also meets several elements of philanthropy as understood above. The designations are made for a public purpose and making them leads to no economic advantage to the “giver”.

In any case, there is not one authoritative interpretation of philanthropy. For example, the Indiana University Center on Philanthropy takes a far-reaching approach when it provides “the Center’s working definition of philanthropy” as “voluntary action for the public good, which includes community service, voluntary giving, voluntary association, nonprofit administration, fundraising, grant making, and stewardship”.⁴³ Here we can see a wide range of activities that come within the scope of philanthropy, not all of them meeting all of the above-described criteria. (E.g., fundraising or nonprofit administration is often a paid activity involving no “sacrifice” of own resources but gaining economic advantages.)

A further interpretation of philanthropy makes a distinction between charity and philanthropy. In this understanding, philanthropy is more than mere charity. It considers charity as an ad-hoc, accidental or incidental activity that we conduct because we feel compassion or because it is a customary thing to do. In contrast, philanthropy would be defined as a conscious and ongoing effort to increase the well being of our community by both financial support and active involvement in the community. “A planned effort to improve our society. To make this world a little better place in which to live.”⁴⁴

⁴⁰ However, some engage in philanthropy to acquiring economic benefit – such as in the case of corporate philanthropy (which expects PR and marketing). *Id.*

⁴¹ However, philanthropy and friendship overlap – you may give to organization, which your friends belong to; as long as other people benefit it is philanthropy. Public purposes refers to either (i) the purposes of the givers (give to promote public good regardless if it will be successful) and (ii) the ends actually promoted by the gift (successful promotion of public good, regardless of motivation). *Id.*

⁴² Robert Payton also argues that critics of the idea of “public altruism” claim – if funds are not voluntary given but collected, their transfer to someone else is not voluntary, therefore not philanthropic (missing voluntary dimension in mobilizing resources). See Payton, Robert L.: *Philanthropy – Voluntary Action for the Public Good*, American Council on Education / Macmillan Publishing Company, New York, 1988. Page 47.

⁴³ <http://www.indiana.edu/~rugs/ctrdir/cp.html>

⁴⁴ Philanthropy Is Not A Taxing Issue, <http://www.globalgiftfund.org/pdf/library/article/art-Philanthropy.pdf>, See also Payton, *supra* note 41. Page 44: Philanthropy is the manifestation of two values:

Deleted:
Formatted

It is a widespread culture of this kind of conscious, planned and ongoing philanthropic behavior that has been missing from the countries in CEE, where the “1%” system was introduced. In these countries the culture of philanthropy is as yet underdeveloped and few have the wealth that would allow them to exercise philanthropy. With the individual tax allocation the government enables people to act as though they were exercising philanthropy. In fact many people consider it as philanthropy, which can be seen from the fact that the designations are often – incorrectly - called donations.

The above examples illustrate that the designation mechanism is not philanthropy as understood in its traditional form, based on a “classic” definition, but at the same time it shows a range of similar elements to philanthropy. Since there is no single definition of philanthropy, it may even be considered a philanthropic activity. However, this is a special form of philanthropy, we may call it “transitional philanthropy” or philanthropy in transitional countries.⁴⁵ If we accept this argument, we may conclude that along with volunteering and giving, a new form of philanthropy has emerged in CEE through the “percentage legislation”.

The percentage designations and development of philanthropy

The hybrid nature of the percentage mechanism makes it limited in its potential to develop a philanthropic culture. The main reason is, that it “costs nothing” to the donor except for the time and effort needed to make the designation. Eva Kuti and Agnes Vajda in their referenced book “Citizen’s Votes” see this characteristic as a positive one from the point of view of examining philanthropy “*In some sense, the 1% law has created ideal conditions for a ‘laboratory experiment’: we can examine how citizens would behave if financial constraints on private donations were completely removed.*”⁴⁶ From another perspective, this is a false basis for comparison and may lead to misleading results if we accept that philanthropy involves a personal stake and some form of private investment in the public good. Taxes as such are not considered philanthropy but a civic obligation and therefore not a voluntary choice of the individual. As seen from the above, the one percent is a hybrid construct that *can* be considered a peculiar form of philanthropy (“transitional philanthropy”) but whether and to what extent it helps “true philanthropy” to develop is not clear at all.

There is no recent and clear data on the tendencies of philanthropic giving in Hungary. On the one hand, the total amount of private individual donations as well as the number of NGOs that received such donations had been increasing year-by-year since the introduction of the One Percent Law (until 2000, which is the most recent data available). (See *Table 6*)

compassion (charity) and community (philanthropy); and Ostrower, Francie: *Why the Wealthy Give – The Culture of Elite Philanthropy*, Princeton University Press, Princeton, New Jersey, 1997. page 4.

⁴⁵ Based on input from Kuba Wagnanski.

⁴⁶ *Supra* note 16, page 1.

TABLE 6
**Individual donations in Hungary since the introduction of the one-percent law
 1997-2000**

<i>Year</i>	<i>Amount of individual donations reported by NGOs (million HUF)</i>	<i>Increase compared to previous year (%)</i>	<i>Share of individual donations in the total income of the sector (%)</i>
1997	6,568.8	109.0	2.3
1998	7,272.6	110.7	2.0
1999	9,089.7	125.0	2.2
2000	11,168.7	122.9	2.3

Source: Reports of the Statistical Office 1997-2000

On the other hand, the share of these contributions in the total sector income have been stagnating around 2.3 percent over the last ten years. The share of private individual and corporate contributions in the total income of the NGO sector has decreased by almost 10 percent over the last decade (from 23% in 1993 to 14% in 2001).⁴⁷ The growth of private support of the sector in real terms approached 27%, which, however, lags behind the 70% growth in real terms of government support. Corporate philanthropy performed worst, with its share in the total income of the sector declining from 10% in 1993 to 5% in 2000.⁴⁸

As a result, the picture is mixed. The level of individual giving seems to be gradually increasing but the significance of private philanthropy decreasing overall. The role of the percentage mechanism in these tendencies has not been assessed. Kuti and Vajda refer to this relationship as a potential “crowding out effect”⁴⁹, i.e. that the designations may replace individual donations. In their interpretation, based on data until 2000 this seems not to have happened. We can certainly conclude that the introduction of the one percent mechanism did not result in a decline in philanthropic giving of individuals, but we cannot tell whether it had a positive effect on it.

In lack of recent data to show a clear relationship, all we can do is explore the potential positive and negative effects of the one percent law on philanthropy. There are some characteristics of the system that theoretically help philanthropy and others that theoretically are a hindering factor. Some empirical evidence support both sides.

Positive and negative effects

On the positive side, we have already mentioned that the opportunity created by the law raised awareness about NGOs and facilitated the understanding of civil society in an unprecedented way. In this manner, it has made a great contribution to the development of philanthropy, which is unimaginable without such basic understanding.

⁴⁷ See Table 3 on page 7.

⁴⁸ Based on data from Bocz János et al, Nonprofit Organizations in Hungary (*Nonprofit szervezetek Magyarországon*), 1993, 2000 and 2001 Reports of the Central Statistical Office (KSH), Hungary

⁴⁹ *Supra* note 16, page 32

Another important effect of the law was that it taught people to think of reasons why to support a cause and a concrete organization. Each year when taxpayers are making choices, they go through a thought process that is in fact very similar to that of giving. This process implies the questions about what is important for the individual, what are his or her values, what problems does s/he see in society and how he or she thinks an organization can contribute to solving these problems. In the first years, taxpayers were more interested in supporting a specific cause important to them than a certain organization.⁵⁰ This tendency is slowly changing as people are getting to know more and more the NGOs themselves.

There are also negative impacts. The main one is perhaps, that because of the mixing of the concepts of giving a donation or a designation, the understanding of real philanthropy – in the sense discussed above, i.e. a planned and ongoing contribution of one's own property or time to a public purpose – is being delayed. Many people think that by "giving" the one percent they have accomplished their philanthropic duties and do not understand or approve of further fundraising efforts on part of the NGOs. While we haven't found any recent data on the volume of such behavior, it has been reported several times by NGOs as empirical evidence.

The truth is, while the one percent mechanism has been widely popularized, no one advocated as fiercely to develop other forms of philanthropy. There are no champions of private philanthropy today in Hungary and while many NGOs try to enter the emerging donor-market with various techniques of fundraising, few have brought about the level of success as did the one percent. It seems that while there is a good potential of developing philanthropy in the one percent mechanism, it is by far not enough in itself to address the lack of a philanthropic culture.

Anonymity and administrative procedures

Another issue to look at in relation to philanthropy is the procedure of the mechanism. In Hungary (and the other countries, with the exception of Poland), the designations are anonymous. The NGO does not know who made the designation, how many donors it had or where from. Obviously, this system works against the development of private philanthropy, which is based on trust, more than anything else, between the donor and the NGO. The lack of a personal relationship is something that can be overcome with some effort (by now slick organizations have various methods to get the data of their one percent supporters), but it is a built-in obstacle for most NGOs in taking their fundraising techniques to a new level with the help of this mechanism.

The impersonal approach that anonymity suggests (reflecting also that the taxpayer is actually a decision maker over public funds) results in patterns that work against philanthropy in the macro level as well. E.g. while the number of designating taxpayers is not increasing, the number of beneficiaries is growing (even if slowly), which confirms the empirical experience that people tend to give to different organizations each year. (There are of course "loyal" supporters of NGOs, e.g. probably those who are in touch

⁵⁰ Reports on 1% campaigns by NIOK 1998-99

with the NGO during the year in other forms as well.) With an anonymous system, it is hard to show the value of a long-term relationship between the donor and the NGO.

Interestingly, in Poland the procedure has been altered and the taxpayers make the transfer of the funds themselves. According to a Polish government official, this was a decision based on the above-described critique of the system seen in other countries, with the aim to encourage philanthropic behavior.⁵¹ This, however commendable, raises another set of questions.

According to the tax authorities in Hungary, the reason for anonymity is related to data protection. As part of the tax return, the designation represents an individual choice that is to be respected and not abused. The question of what cause or organization an individual supports belongs to his or her private sphere which should not be public without the consent of the individual. When a person supports an NGO working with AIDS patients or Alcoholics Anonymous, he or she might not want this to be known by his or her colleagues, for example. Therefore this information has to be handled privately, just like the question of whether he or she receives a tax allowance for a private insurance or not. In addition, in Hungary the whole annual income of an individual could be calculated from the one percent amount. There is a clear tension arising from the hybrid nature of the law, between treating it as a tax allocation or treating it as a form of philanthropy.

While the Polish case may succeed in addressing the question of anonymity (the taxpayer makes the transfer privately and only the beneficiary NGO and the tax authority will know whom s/he supported), it might still not succeed in fully respecting both principles. Another problem emerges, this time related to the administrative effort and burden placed on the taxpayer in the execution of the designation.

Because of the philanthropic nature of the action, the golden rule “giving made easy is giving more” applies to the one percent law as well. The process one has to undertake to make a designation is the only and therefore decisive cost of the transaction for the taxpayer. In other words, the more difficult it is to make the designation, the less likely that people will make it. All evidence to date from Hungary and Slovakia show that the ease of administrative burdens increases the likelihood of making the designation.

It is indicative, for example, that in Hungary, where procedural rules have been eased repeatedly in subsequent amendments of the law, only 5.1% of those who did not make a designation cited “technical and administrative problems” as a reason.⁵² In comparison in Slovakia, where such rules are more demanding, 20% of “non-designators” reported that “the process of assignment was very difficult”.⁵³

⁵¹ Contribution of Krzysztof Wieckiewicz at the conference of the Institute of Public Affairs on the one percent legislation, Warsaw, November 2003.

⁵² *Supra* note 16, page 25

⁵³ Outcomes of research after the first-year implementation of assignment of 1% of paid tax, available at <http://www.onepercent.hu/documents.htm#SIStudies>.

In Poland, the abolition of anonymity lead to a more complicated method of making the designation and therefore it may lead to a lesser number of citizens undertaking it, at least initially.

Unwanted impacts: curbing traditional incentives for philanthropy

A final point on the relation between the one percent legislation and philanthropy. It has become a trend that governments view this piece of legislation as one that satisfies the demands for both public and private support to the sector. As a result, traditional tax incentives (tax deductible donations) have been abolished in Lithuania⁵⁴ and in Slovakia and the same has been planned in Poland following the adoption of the one percent legislation. This is regrettable and also extremely dangerous. The multifaceted purpose of the law has become a double-edged sword: it seems as though philanthropic support could be substituted with the percentage legislation.

Whether as a direct “exchange”, like in Lithuania, or as part of a larger tax reform, like in Slovakia, governments have been keen on curbing traditional tax incentives based on fiscal arguments. However, NGOs lose a great deal with such an “exchange”. To illustrate this, let’s take the example of a fictive country where the tax regime is progressive and a person can deduct charitable donations up to 10% of its tax base. An annual income of 1000 monetary units (let’s call them crowns) will fall into the tax bracket of a 30% tax liability, which would be 300 crowns without any deductions. When a person with an annual income of 1000 crowns donates 10 crowns, an NGO receives 10 crowns and the tax office “loses” 3 crowns as a result of deducting the donation from the tax base (30% of 990 crowns is 297 as opposed to 300). In contrast when the same person makes the tax designation of 1% of his/her tax liability, the tax office will “lose” the same 3 crowns (1% of 300), but the NGO will receive only 3 crowns as well.

Naturally, there is the argument that the percentage mechanism in our post-communist countries is likely to be exercised by more people than traditional philanthropy. Initially, this may be true. However, in the long run and assuming that it is an important goal for the nonprofit sectors in CEE to increase the personal involvement of citizens in their communities, it is desirable to maintain traditional tax incentives, as much from a financial as from a moral point of view.

II. 6. Government outsourcing

The last rationale that was emphasized in deliberations concerning the one percent law in Hungary (and which played an equally important role in Poland) has been the notion of providing public funds in a decentralized way to NGOs that conduct public benefit activities.

⁵⁴ Lithuania passed the legislation on a percentage designation system in 2002, which is operational as of 2004.

This is perhaps the weakest justification in terms of its potential. So as not to misunderstand this statement we have to affirm that the mechanism itself guarantees for decentralized and non-political decision-making by the taxpayers. The problem, at least in Hungary, has been simply that the funds involved are not significant enough to alter the culture of government funding. The portion of public funds distributed in this way are minuscule compared to the scale of un-transparent and political subsidies. Additionally, the very question of who receives the support may effect whether this is an appropriate way to ensure for public support of NGOs.

Let's look at the positive outcomes first. As described above⁵⁵, the distribution of the one percent support differed considerably from the distribution of other state support in Hungary. Some of the findings of the Kuti-Vajda study in this respect are summarized below:

- The introduction of the 1% scheme more than doubled the number of voluntary organizations which receive support from the central budget.
- Organizations operating in the field of education, or performing health care and social services receive 75 % of the income coming from the 1 % designations - and only half of the budgetary support traditionally distributed.
- Small local not-for-profit organizations receive 16 % of the 1% income – they are more successful in persuading citizens to support them than in raising other state support.
- While 95 % of the direct central government support goes to the largest not-for-profit organizations, they receive only one third of the 1 % designations.
- Regional distribution of the 1 % income is somewhat more even than that of other public support. For example, Budapest receives almost 75% of all budgetary support, and “only” 41 % of the 1 % income, villages gain almost three times more funding from the 1 % designations than from central budgetary supports.

This was the good news. However, the conclusion as stated: “...that the system of government funding has become slightly more equitable and significantly more democratic by the introduction of the 1% scheme”⁵⁶ could be an overstatement. In Hungary, the 1% represents a mere 3% of all government funding (and as the aim is to increase state support this will even be less).⁵⁷ Grant funding, discretionary subsidies, contracts and other forms of support dominate the public funding of the nonprofit sector. The “democratization” effects, while brought notable results for individual NGOs and from the point of view of civil sector development, are not significant in terms of government funding as a whole.

Public benefit activities

⁵⁵ See page 6 of this Study.

⁵⁶ Supra note 16, page 16.

⁵⁷ The situation might be quite different in Slovakia, where government funding for the sector, based on data from the Johns Hopkins University Comparative Nonprofit Sector Project, available at <http://www.jhu.edu/~cnp/pdf/comptable4.pdf>, is three times less than the amount designated in 2002.

Here we have to mention another important factor related to the one percent legislation. Initially in Hungary and consequently in the other countries as well, this legislation was in some way tied to the so-called public benefit laws. These are laws that prescribe and determine when an NGO can be considered being of public benefit and thereby gain access to a wider range of tax benefits than nonprofits in general.

Being of public benefit involves two interrelated aspects. It means on the one hand that an NGO provides services and activities that benefit the public at large or a special group in need; and on the other, that the state provides special recognition for these activities through direct or indirect support.⁵⁸ What activities are of public benefit is defined differently in every country where such legislation exists; usually there is a list of these activities (e.g. in Hungary, a list of 22 types of activities including, among others, education, social services provision, preservation of cultural heritage or protection of the environment). The type of government support available to the NGOs with a public benefit status (called in short public benefit organizations - PBOs) also varies. In Hungary, for example only PBOs may receive tax deductible donations; in Poland there was an intention to provide a corporate income tax exemption to PBOs only. The entitlement to the 1% support is another benefit that can be made available to PBOs only or to a wider circle of NGOs, depending on the government policy.

NGOs that aspire to receive a status of public benefit and the tax advantages that accompany it have to satisfy additional criteria. Most of all, they have to comply with higher levels of transparency and accountability so as to ensure proper spending of public money. For example, they have to prepare a yearly report or establish a supervisory board.

In Hungary an NGO does not have to have a PBO status to be entitled to the one percent designations. As a result, a good part of the one percent support reaches NGOs that government would not necessarily support – e.g. a village association with the aim to maintain local traditions; animal shelters; or the Alfa Romeo Club Society of Hungary. While it is great for these organizations to be supported by citizens, one might argue that taxpayer funds should not be provided for organizations with such particular interests. It might be more appropriate to fund them by charitable contributions of the same individuals who now designate taxes to their benefit.

On the other hand, the one percent support also reaches NGOs that the government would support anyway – e.g. foundations of major hospitals, the renowned Peto Institute for Disabled Children, or the Red Cross. For these institutions, the one percent represents a minor part of their budget, which is highly subsidized by government already. In other words, irrespective of taxpayers' intentions, the government will fund these organizations and the one percent only adds to such funding to the extent of their popularity with the public.

⁵⁸ See more on this in the Handbook on Good Practices for Laws Relating to Non-governmental Organizations, prepared for the World Bank by the International Center for Not-for-Profit Law (ICNL), Discussion Draft , 2000; pages 24-25.

There could be more examples cited. The point is that in Hungary the one percent support can hardly be justified solely or primarily by the intent to “democratize” government support: if government finds it important to fund certain NGOs (e.g. because they are providing a task that would be the responsibility of the state), they should fund those organizations in any case; while on the other hand, it should not provide public funds for others that are not meeting certain accountability criteria.

Erzsebet Fazekas puts the same argument in a different way: “The state was not fully successful in realizing its other purpose: to ease the negative outcomes of transformation to a market economy through a citizen-headed redistribution of wealth. (...) A major portion of the donations went to purposes that do not respond to the most acute and pressing social needs.”⁵⁹

Even if the one percent could be directed to public benefit organizations only (which will be the case in Poland), the tension between deciding on social priorities centrally or in a decentralized way remains. There is a contradiction between “social justice” and the philanthropic, “market based” nature of the one percent designations. Inevitably, the latter results in a competition for the attention of taxpayers, and those more skilled or equipped to obtain this attention will prevail. The one percent does not serve well NGOs not intent on gaining wide social support or having an “unpopular” cause, however important those may be in solving pressing social issues. This is not a problem, however, unless there is a presumption that through the one percent designations taxpayers will make effective decisions on where to allocate government support.

Conclusions

As an overall conclusion we may say that the One Percent Law only partly fulfilled the expectations it had created in Hungary. It proved to be very effective in developing civil society organizations and raising awareness about NGOs among the general public. However, its effects on philanthropic behavior are unclear and it did not fulfill the expectations related to decentralized and depoliticized government support for NGOs.

From the Hungarian experience it can also be concluded that while several policy rationales support the enactment of such legislation, this multifunctional nature of the law results in several tensions in its implementation. The key reasons for the tensions are the conflicting principles of the policy areas that may be pursued by the legislation. Some of these tensions include, e.g. the contradiction between the anonymous nature of the system and the need for direct interaction between the taxpayer and the NGO in order to enhance the philanthropic effect of the law; or the counter-effects of addressing the need of direct interaction, thereby increasing the administrative burden on the taxpayer. As a result, governments have to be clear as to why they want to introduce the law, otherwise they may end up expecting too much and achieving too little in each policy area.

⁵⁹ *Supra* note 16, page 502