

Percentage designations assessed

Redistribution and the idea of the school of philanthropy

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1. Abstract

The percentage tax designation system is a phenomenon in the nexus of public finance allocation, public benefit/civil society realm, philanthropy and taxation. The system has remained to be a popular policy instrument over twenty years, mainly in the Central and Eastern Europe (CEE). Findings in this paper refer to a recent research covering four areas of the system: 1) The system itself, 2) Its role in funding of the non-profit sector, 3) Effects and side effects, 4) Policy assessment.

The percentage mechanism was met with enthusiasm in the transitional phase of post-communist CEE. It has offered a unique way of providing financial support to public benefit, mostly not-for-profit entities based on the decision of the individuals and has often been called wrongly as “percentage philanthropy”, as the resources used are not private resources. In reality it works as a decentralized decision making mechanism where state resources, namely certain percentages of the income tax, are channeled, mostly to not-for-profit organizations (as well as other public and private entities with (mostly) public benefit purposes), based on the decision of the taxpayers and therefore reflecting the societal needs as perceived by taxpayers. The percentage mechanism is estimated to have provided around € 5 billion support to a variety of beneficiaries in Europe over the years.

Still, this source is a small portion of the overall revenues of the non-profit sectors (around 2%). It can not be proven if it has been a school of philanthropy, but at least it has not crowded out private philanthropy, especially when incentives for individual private giving have lessened in most countries after the introduction of the percentage tax designation system.

2. Background

The percentage tax designation system concept emerged in Central and Eastern Europe in the policy debates around the issue of church and civil society funding in the early nineties (1992-1995). First in Hungary (1996), then later on in other countries, newly democratized governments were looking for ways to establish new relationships with these societal actors.

After discussions among stakeholders, a mechanism emerged in Hungary and later on in Slovakia, Romania, Lithuania and Poland, as a public finance innovation that channelled public funds to civil society for public benefit purposes in a decentralized way. Today, it has a slightly different form in each country, but the core principle is the same: the mechanism grants a right to a taxpayer to designate 1%, 2% or 3 % of paid income tax to a non-profit, non-governmental organization or other type of public benefit entity, as well as to a church or a political party.

The main rationale for introducing the mechanism was to support the development of civil society, to develop a philanthropic culture and tradition, as well as to de-politicize the government funding of civil society. The mechanism has had several observed side effects in some countries – such as the abolition of tax incentives for giving, or increasing public awareness of civil society.

Today, twenty years after the introduction of the mechanism in Hungary and ten years after the latest and only comparative research, a need has emerged to evaluate the mechanism in light of its original ambition: to evaluate the role and impact of the percentage tax designation system on civil society based on experience in the Central and Eastern European countries (CEE): Hungary, Lithuania, Poland, Slovakia, Romania and Italy.

The lessons to be learnt from such effort could be instrumental and useful to policy makers, donors and civil society actors not only in the countries that currently use the mechanism, but also in other countries looking for innovative ways to fund civil society.

2.1. *Four hypotheses*

The researchers formulated four hypotheses that the research attempted to test – to challenge or to confirm:

HYPOTHESIS I.

The “percentage systems”, often called “percentage philanthropy mechanisms”, are different but similar. There is no existing definition of what these similar systems really are. As they all bear some

common features, it is assumed that across countries such mechanisms are used to transfer state resources to the non-profit sector in a decentralised manner, reflecting on societal needs as perceived by taxpayers.

HYPOTHESIS II.

Since the implementation of the percentage system, the non-profit sector is believed to be in a financially better position. It is also assumed by many that the percentage tax designation mechanism provides substantial financial contribution to the revenues of the non-profit sector, some believing it to be one of the most important sources of funding.

HYPOTHESIS III.

It is believed that besides providing monetary support to public benefit purposes, the system has had numerous, mostly valuable side effects, some of which are in direct relation with the sustainability of public benefit organizations, especially the non-profit sector, and some that reach beyond it.

HYPOTHESIS IV.

It is hypothesized that the lack of rigorous policy evaluation of the mechanism results in a stagnating system, where changes and adjustments are rare and the results are foreseeably reaching their plateau without using the mechanism to its full potential. The system, that once was an innovative policy solution becomes part of the in-country status quo that the societal actors live with.

2.2. *Methodology*

In the initial phase of work, the project leaders identified five groups of countries:

- 1) The so-called “Percentage Club” countries, where some version of the percentage tax designation system is in operation: Hungary, Italy, Lithuania, Poland, Portugal, Romania, Spain and Slovakia.
- 2) The so-called “Potential” countries, where the issue has been seriously discussed by one or more groups of stakeholders: Croatia, Macedonia, Serbia and Ukraine but no decision has been made regarding its implementation.
- 3) The so-called “No” countries, where the issue had been seriously discussed by one or more groups of stakeholders, and it was decided not to implement the mechanism: Czech Republic and Estonia.

- 4) The so-called “Not-in-operation yet” category, where the law of a percentage tax designation system has been passed but it is not in operation yet: Moldova.
- 5) The so-called “Other related countries” where something related to the percentage tax designation system is in operation: Japan.

Project leaders decided to focus on the “Percentage Club” countries in Central and Eastern Europe due to the fact that most countries with the percentage tax designation mechanism are based in this region and the socio-economic developments of these countries are relatively similar and comparable to one another. It was also decided that some attention will be given to Italy, the first country to introduce the mechanism.

The project leaders organized preliminary conversations with researchers, civil society leaders and public administrators in order to determine the key questions of concern and map the available mass of “second hand” information about the various percentage tax designation systems, and to map the potential data sources (as the work did not include direct data collection).

As a result of these conversations, the key issues for the assessment have been identified and explored in three ways:

1. A common questionnaire was developed for the CEE “Percentage Club” countries with a list of qualitative and quantitative questions, which was filled in by the country research associates. It required a lot of research work, including data mining, studying financial and statistical reports, describing legal background, etc.

After the data gathering, the quantitative parts of the questionnaires were processed, and a common database was set up. The database contains various indicators calculated from the basic figures. In order to create a time series, data were drawn from each country in the year when the percentage tax designation system was introduced, as well as the fifth, the tenth and/or the most recent year of operation, respectively. Since sometimes there was no available information for a given year, and the introduction of the systems took place in different years, at the end, the four representative years – called snapshots – were assigned in time series (Table 1). The reference years are in each country as the follows:

Country	Introduction of percentage system	1. snapshot	2. snapshot	3. snapshot	4. snapshot
		first year	fifth year	last/tenth year	last year
Hungary	1997	1997	2001	2006	2013/2014
Slovakia	2002	2002	2007	2012/2014	
Poland	2004	2004/2005	2009/2010	2013/2014	
Lithuania	2004	2004	2009	2014	
Romania	2004	2004	2009	2014	

Table 1: Snapshot in time series in five CEE countries to support "Per Phil Database"

Not all countries could provide all information. In these cases, the missing values were substituted by estimation or remained empty. Figures coming from the common databases are referenced in the background materials as "*Per Phil database*". The original sources and availability of the national data are also listed in the *Appendix*. As no similar endeavor has taken place before, the work has faced serious challenges in data harmonization and even data availability.

The results of this work provide the core of this paper

2. The *Country Reports* contain narrative descriptions of the current state of the percentage tax designation system, with key achievements and challenges. The published version of the work includes some of the country reports while the Internet version is complete with all additional information.

3. Additional papers were commissioned on key cross-cutting issues and challenges of the designation that raise interesting questions about the mechanism, and describe the key questions relevant in the system today, highlighting trends and expressing local researchers' personal view with as much concrete background information as possible, interviews, case studies, references etc.

The final publication was developed as a comprehensive summary and analysis from these different sources in continuous collaboration among authors and the country researchers. The project maintains a website: www.taxdesignation.org that includes the full version of the research reports.

3. What is a “percentage tax designation mechanism”?

As several countries have made their own version of the percentage tax designation mechanism, the arising question is: what can be defined as the “*percentage tax designation mechanism*” (often incorrectly called percentage philanthropy). Is it always true that by this mechanism state resources are transferred to public benefit purposes in decentralised manner, reflecting the societal needs as perceived by taxpayers? The questions, such as who can make use of this mechanism and who are the beneficiaries, what percentage is allocated through this system, and the questions around the process of designation itself are to be discussed in this section. The goal is to figure out a definition of the percentage tax designation system based on the case at hand.

3.1. *The concept*

The “*otto per mille system*” is a mechanism through which Italian taxpayers can elect to assign a per mille of their annual personal income tax intended for social services to one of the country’s religious organizations or to the state (Allen, 2007, old.: 173) (Tremonti, 2015, old.: 231-234). The purposes of the designation in this system are primarily religious (the exact use is laid down in agreements between the government and the churches). In case of the Catholic Church, the purposes are specified in article 48 of the 1985 law: “worship needs support of the people, support of the clergy, and charitable activities in favor of Italian society and the Third World”¹.

The idea of the percentage tax designation system emerged in the policy debates beyond Italy. In some countries, the option to implement the system is still debated; in others, such as the Czech Republic and Estonia, it was discussed and decided not to adopt a similar mechanism. Some form of a percentage system was discussed and has materialised not only in Italy, but also in Hungary, Japan, Lithuania, Slovakia, Spain, Poland, Portugal, Romania, and most recently in Moldova. In Portugal, initially discussing the system for religious purposes only, one can now allocate a share of the income tax to both public (charities) and private organizations (public utility institution of benevolence, assistance or humanitarian purposes or private social welfare institutions). In Spain, taxpayers can transfer 7% of their income tax to Church or to “other social purposes” (usually these are projects related to social issues such as poverty, social exclusion, seniors, immigration, and also projects directly related to quality of life). In case of Portugal and Spain, one can not directly choose the beneficiary (Montedore & Marucci, 2011, pp. 59-74). In Spain, if the “Church” box is marked on the declaration, the money will be allocated to the liturgy expenses while the money collected

¹ <http://www.8xmille.it/rendiconti/ripartizione2012.pdf>

through “the social causes” box is used to finance social projects selected by the Ministries of Social and Foreign Affairs. Similarly, in Portugal since 2001, a 5/1000 can be transferred, but taxpayers cannot choose a concrete beneficiary entity. Percentage allocations are part of state support that is the most important financial source for voluntary organizations in Portugal, followed by self-generated income from member contributions (Franco, 2006).

These examples can be considered to be a broad interpretation of the percentage model. The Ichikawa city government in Chiba prefecture of Japan² operates with a broad variation of the model as well. It has opted for a model where the idea is based on the percentage system but it is on a local government level and not on the state government level. It is also worth to note a most exciting variation introduced in Slovakia that enables corporate bodies to participate in the tax percentage system and allocate a given percentage of their taxes that has had important positive consequences on the financial well-being of not-for-profit organizations in Slovakia.

The percentage designation mechanism, as a broadly understood concept, is a mechanism that channels public resources (collected from taxes) in a decentralized way to public benefit purposes. **The essence of the percentage designation mechanism is that it grants the right to a taxpayer to designate some part of paid income tax to public benefit purposes.**

Different countries have introduced different systems. For example, in the original Italian *otto per mille* model, the beneficiaries are churches. Later, Italy used the same model to benefit other entities as well, such as the not-for-profit organizations and political parties. In other countries, beneficiaries can be non-profit, non-governmental organizations, or other types of public benefit entities, churches, and political parties.

Our attention in this assessment is paid to the effect of the percentage mechanism on the development of the non-profit sectors and its organizations in the CEE countries.

3.2. *The Designator “donor”*

Delegating the decision-making power to a taxpayer to distribute a portion of her/his taxes is an essential feature of the mechanism, and it is an innovative policy solution. Such a solution is unprecedented in the post-communist region and can be considered to be a unique form

² The Ichikawa city government in Chiba prefecture, according to their website, has been running a system based on the percentage mechanism for ten years. (Special thanks to Junko Chano, President of the Sasakawa Peace Foundation for providing this information).

of a participatory budgeting rather than philanthropy. Generally, individual taxpayers can use this opportunity, and in Slovakia, corporations also have the option to designate a certain percentage of their taxes.

In the percentage mechanism system examined here, individual taxpayers are making their own autonomous decisions (without any political or economic influence) that are respected and not challenged by any entity (for other than formal reasons). The individual aims to support the public good, to relieve the pains of social problems and to improve quality of life for people, as in the case of does philanthropy and charity. Still, there is a major difference between percentage designations and philanthropy. In the case of philanthropy, private resources are used while in the case of the percentage mechanism, the allocated resources are related to personal earnings, but they are taxes that the individual would pay anyway. This is why this mechanism should not be considered philanthropy and the allocated resources are not donations. This also means that the percentage designation option is only available to taxpayers, unlike philanthropy, that is open to anyone. It is generally true that the law is applicable to all taxpaying individuals³ (with minor limitations in some countries).

In the five “Central- Eastern European Percentage Club/CEE Percentage Club” countries (Hungary, Lithuania, Poland, Romania and Slovakia), almost half of the population, around 17 million of all individual taxpayers (out of 40 million individual taxpayers, Table 2), use this designation mechanism.

An additional 16,7 million taxpayers (Montedore & Marucci, 2011), use the mechanism in Italy totalling 34 million people a year in Europe.

	Population (millions)	Taxpayers (millions)	Designators (millions)
Hungary	9,9	4,6	1,9
Poland	38,5	24,4	12,0
Slovakia	5,4	1,9	0,6

³ A minor variation on the basic mechanism operates in Hungary and in Slovakia, for example, that excludes those individual taxpayers whose taxes are so low that transferring their percentage makes no financial sense.

	Lithuania	2,9	1,0	0,5
	Romania	20,0	7,6	1,7
	<i>“Percentage Club” total:</i>	<i>77</i>	<i>40</i>	<i>17</i>

Table 2 Population, number of taxpayers and designators in the CEE Percentage countries based “Per Phil database” based on national data sources

3.3. Beneficiaries of the Percentage Laws

The percentage tax designation system is often viewed as a financial support mechanism for the non-profit sector/ civil society organizations. This section will provide evidence that this claim does not fully hold true for three reasons.

1. Firstly, in the broadly understood percentage tax designation mechanism, beneficiary groups can be churches as well as political parties and civil society-based not-for-profits in some countries (Figure 2). In Italy, for example, there are three different percentage mechanisms targeting different beneficiaries: there is a percentage mechanism for churches, another for political parties and another for not-for-profit entities. In the five CEE countries, there is a maximum of two separate mechanisms, mostly a mechanism for not-for-profits and another one for churches (e.g. Hungary), or a mechanism for not-for-profits and another one for political parties (e.g. Lithuania). In Poland, Slovakia and Romania, there is “only” one percentage mechanism for not-for-profit and other public benefit entities.

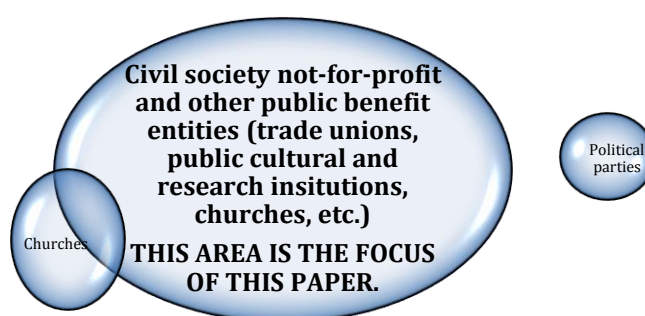


Figure 1 : Potential beneficiaries of broadly understood percentage tax designation legislations

This means that the broadly understood percentage mechanism can benefit entities that are not-profit making, such as churches and political parties, but may not necessarily be civil

society-based not-for-profit ones, as is the case in most of the countries (such as cultural or research institutions).

2. Secondly, one needs to note that even in the narrowly understood percentage mechanism of this research, where the primary beneficiary group is civil society based not-for-profit entities, other types of legal entities (from the public or private sector) are often included in the same group as eligible entities for the given percentage designation. While the mechanism is often perceived to benefit “grass-root” not-for-profits only, in some countries, churches, public entities, trade unions, and even needy individuals can be beneficiaries of this system.

3.3.1 *Not-for-profit entities as primary beneficiaries*

The intent to support not-for-profit organizations as entities of public benefit purposes⁴ is evident in all the six European countries.

In Poland, beneficiaries of the percentage mechanism include only NGOs that have obtained the public benefit status; in Lithuania the beneficiaries of the original law were entities that possess the right to receive charitable donations; in Romania the beneficiaries of the original law were “non-profit entities”; NGOs established under law 21/1924 (associations, foundations and federations) and religious entities were added in 2007; in Slovakia the original legal definition explicitly provided a list of potential recipients combining “grassroots” NGOs with other types of NGOs with various special characteristics, such as church-based and international organizations. There is no information available as to which public benefit sector receives most of the 2% designations in Lithuania. Similar to Lithuania, the number of public entities among the percentage beneficiaries, and their share of allocated resources is small in Hungary (receiving around 1% of the percentage allocations).

Irrespective of whether the state public entities are formally included in the legislation or not, an interesting debate resonates in the region regarding the mechanism being a channel of additional resources to public institutions that are traditionally financed by state and/or local government resources. The phenomenon is observed in all CEE countries, even in the countries where public entities are not formally included among the beneficiaries. In this part of the world, public kindergartens, public schools, or state hospitals are traditionally

⁴ Note that „public benefit” is not used as a legal term and is understood in its common meaning of public serving. Also note that public benefit law regulations tend to be different from percentage regulations, the treatment of the percentage system as a policy mechanism that can support purposes of public benefit are universal in all of the countries using the percentage mechanism.

expected to be fully financed by public resources from taxes and used by the vast majority of population. As the public resources are dry, donations as well as percentage designations are being sought as additional resources beyond state and local government revenues. To be able to channel percentage resources, many state entities or people around those entities have set up not-for-profits (e.g. numerous parent-teacher associations in Hungary or Slovakia) or work with intermediary not-for-profits for a certain brokerage fee (e.g. in Poland, Slovakia) to benefit the given public entity⁵.

Finding data on the extent of this rechanneling was found to be impossible, as in most of the countries, these entities are formally independent not-for-profit organizations (civic associations) and therefore they fall into classic catch-all not-for-profit clusters, even when they are not true functioning organizations but simple revenue channels for public entities.

Interpretations of this phenomenon vary. Some find this alarming because they believe the percentage allocation is meant to make independent not-for-profit entities better off, and rechanneling is not in line with this mission. Others argue that the purpose of the mechanism is to finance goods of public benefit based on citizens' decision and whether the end beneficiaries are not-for-profits or public entities is secondary as they all fund the public good.

3.3.2 *Individuals as beneficiaries*

Another debated issue is when individual people become beneficiaries of the percentage mechanism and compete with not-for-profits for the same percentage designation resources, as is the case in some countries.

In Slovakia, the law on tax designation (Demeš, 2001), adopted in 1999, specified that any physical or legal person can be a beneficiary of the tax designation as long as the designation will be used for the public benefit purpose. This changed through an amendment of the law in 2001 before the tax designation came into implementation (which was 2002) and only not-for-profit organizations as legal entities could be beneficiaries (Demeš, 2001).

A law was introduced in Romania (2007), where private persons as recipients of private scholarships can be beneficiaries of the percentage mechanism. The rationale behind this was to create a new income stream for either merit- or need-based scholarships and low income students, but it ended up to be rarely used.

⁵ Or private entity – see discussion below on individuals as beneficiaries

On December 17, 2015, the Lithuanian Parliament passed two amendments allowing Lithuanian residents to allocate up to 2% of their income tax to “natural persons who have art creator status” (artists). This amendment comes into effect on January 1, 2017 and therefore no results can be discussed yet.

In Poland, private persons in need as a category has not been legislated, still, some key leaders in the Polish non-profit sector, such as Kuba Wygnanski, argue that *“the mechanism was somehow privatized (and it was meant to serve public benefit). Quite often the role of the organization is limited to the role of a collector and a mechanical intermediary ... to...obtain profit... The resources from the percentage designations are ... transferred to an individual (often in health and social needs) or to other institutions such as schools or kindergartens) (Conference presentation).* A few people question the whole mechanism and whether it serves its intended purpose and if it should be used at all, while others argue that the general policy is still valid but change in the mechanism is needed to reflect the original policy intention.

3. The third and last point regarding the assumption that the non-profit sector is the beneficiary of this mechanism, one needs to note that not the whole non-profit sector benefits from it (Figure 2). In the CEE region where the mechanism is used, around 35% of the non-profit sector benefits from the mechanism.

The argument for it is, that based on the non-profit sector demography, looks only at the the non-profit sector benefitting from the mechanism vs. the whole non-profit sector. Lithuania leads with the highest proportion of designated organizations at 80%, followed by 35% in Hungary, and 30% in Romania, 24% in Slovakia, while in Poland it is only 7%. **In Italy, 12,5 % of the sector is benefiting, the second lowest after Poland, of the seven countries examined.** This means that on average in these six countries, every third organizations benefits from the system; in the CEE the percentage is slightly higher at 34%.

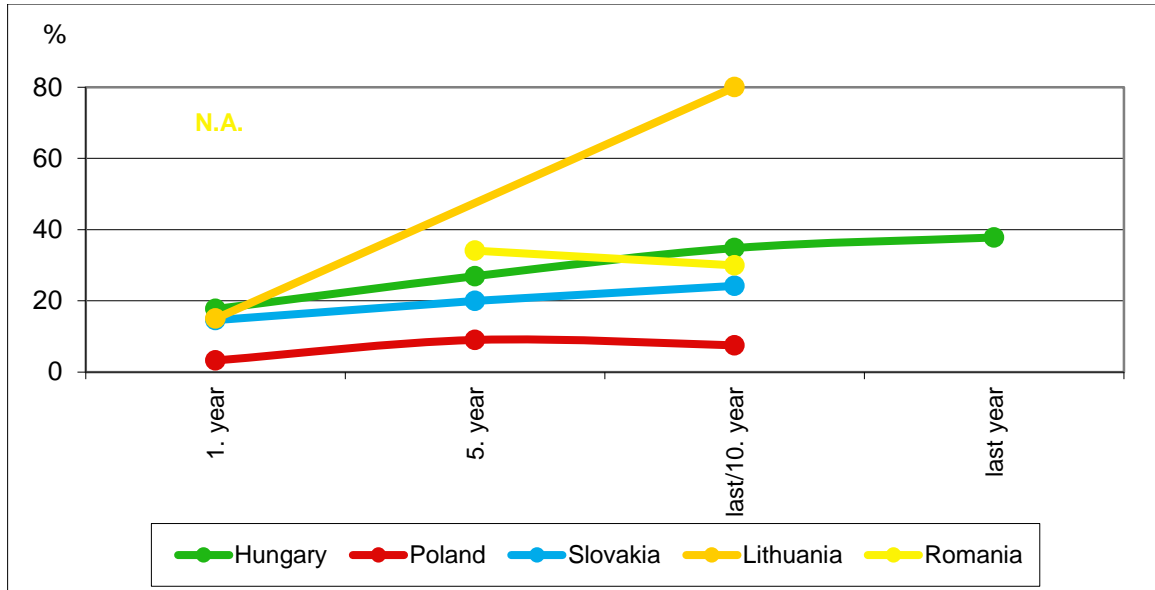


Figure 2 Ratio of designated organizations among all NGOs over the years in five CEE countries (based on “Per Phil database” using national data sources)

To sum up this section, one can say that the percentage laws that are often viewed as support mechanisms for NGOs, go in practice beyond being a mechanism for not-for-profit organizations⁶ in most countries. As of 2016, only in one country (Poland) is the group of beneficiaries limited to PBOs. At the same time, assuming that all members of the non-profit sector benefit from the mechanism is inaccurate, as in none of the above countries do all NGOs benefit from it.

3.4. Designated Percentages

The source of the tax percentage designation resources is the personal income tax that, based on the taxpayer’s decision either remains at the disposal of the state or it is channeled towards public benefit. (For this reason it is administered as state resource in national accounts.)

The level of the possible designation is determined by the laws of different countries. In Italy it is 0,5%, in Hungary and Poland a 1% mechanism was introduced and maintained to date (not considering the additional 1% for churches in Hungary). In Slovakia, since 2002, individual tax payers can designate 1%, and as of 2003, the percentage had been raised to 2% (moreover, the tax designation model had expanded to include corporate bodies). Today, it can even be 3% in case the individual taxpayer provides the regulatory body with a

⁶ This area of the law, that regulates the group of beneficiaries, has broad variations in the different countries and was amended several times in the different countries.

certificate of 40 hours of volunteer work. In Romania and Lithuania, the original law introduced the 2% mechanism and it has been maintained at that level (with the option of designating an additional 1% to political parties in Lithuania). Most recently, Moldova has introduced a 2% system. In Italy, there has been a policy to announce the total amount of money that can be allocated through this mechanism annually (of € 500 million in 2015) (Art. 1, paragraph 154, Law 190/2014 - the Italian Budgetary Stability Act 2015).

Today, in CEE countries that use the percentage systems, there is an option for tax paying individuals to make their own decision about dedicating certain percentage of the personal income taxes. It is max 3 % in Slovakia, 2%+1% in Lithuania, 2% in Romania, 1%+1% in Hungary and 1% in Poland (and 0,8+0,5+0,2% in Italy). In all of these countries, one of the percentage options is primarily aimed to benefit not-for-profit organizations (Slovakia offering the most, 3%, Italy is second and Hungary and Poland the least to this purpose: 1% of the CEE countries).

3.5. *The Process*

The key steps in the process of allocating the percentage mechanism itself are the same in each of the five CEE countries.

Step 1.:

At the end of the tax year, the taxpayer pays the full taxes to the tax authority⁷. If the taxpayer wishes so, he/she can decide to designate a certain percentage of the full tax to a public purpose. The decision regarding the allocation of the given percentage is fully the decision of the taxpayer and the taxpayer names a concrete entity as beneficiary. If a person pays 100 Euros in personal income tax at the end of the year, that person will pay the total amount but may decide to assign a certain percentage of that tax, say 1%, i.e. 1 Euro to an entity serving the public good of his/her choice (within the limits of the regulations). In some countries, an open, "active" system is used where the organizations are listed in advance and taxpayers can choose only from that list (Italy, Poland and Slovakia and from 2015 Hungary) while in other countries there is no list provided to the taxpayers.

Step 2.:

If the taxpayer decides to use this opportunity, he/she communicates the decision to the authority that will follow up by transferring the 1 Euro amount (in our example) to the given entity. If the taxpayers decide not to use this opportunity, the personal income taxes are fully

⁷ A certain variation of the percentage mechanism operates in Japan on a local government level (not in focus of this work).

paid and used as usual by the state. In some of the countries (in Lithuania, Slovakia, Poland, and Romania), there is an option of sharing the percentage designation among several beneficiaries.

Step 3.

The entity is to receive and use the resources generated from percentage allocations according to the law (usually defining the use to be of public benefit purposes, sometimes the amount that can be used for fundraising or regulates the use of the resources for overhead etc.). In the classic model of the mechanism, due to data protection reasons, the entity receiving percentage assignments receives the resources in one lump sum without knowing who has contributed the resources.

The way the process is set up affects the outcome to some extent. It is easy to see that the more user friendly the system is, the more likely it is for taxpayers to use it. In Poland, for example, it was originally the taxpayer who was transferring the percentage to an NGO of his/her choice and was later reimbursed by the tax authorities, a complication that was argued not to be a user-friendly experience. This was changed in 2006 and resulted in a procedure where the taxpayer only needs to write the official number of the organization he/she wishes to designate to and the rest is done by the tax authority - resulting in higher number of people using the mechanism. This change was an important driving force behind the immense growth of the popularity of the mechanism in Poland (2006: 1,1 million, 2007: 1,6 million, 2008: 5,1 million).

A procedural point that has received a lot of criticism in all of the countries is related to the connection of the “percentage donor” and the recipient entity. As the receiving end is not aware of who its supporters are (due to data protection reasons), there is a missing link between the two. It has been argued that without this link, there will not be a real connection between the individual and the receiving entity and thus it will be impossible to develop a relationship where the individual designators could be approached by their recipients, build a long-term relationship, and work or collaborate to further their work. (The identity of the taxpayer is hidden from the recipient). Responding to this criticism, the most recent changes in Hungary and in Slovakia include an option where taxpayers can opt in to reveal their identity to the recipient by marking it on their tax papers when making their designation. With this new option, if the taxpayer wishes to, his/her identity is revealed to the recipient that can make use of this information and get in touch with the “donor” to ask not only for regular donations but also to establish a relationship beyond the percentage assignments. It is to be seen (and empirically researched) how many people are willing to

share their identity and whether this technical change will contribute to a better relationship between designator and recipient.

Changes in the procedures have been frequent, often resulting in some differences in outcome, but the essence of the system has remained the same.

3.6. *Conclusion*

To conclude the question about the percentage designation system definition, based on the variety of practices and understandings examined, it is understood as a decentralised decision making mechanism where state resources, namely certain percentages of the income tax are channelled mostly to not-for-profit organizations as well as other entities with (mostly) public benefit purposes based on the decision of the taxpayers and therefore reflecting the societal needs as perceived by taxpayers. An individual makes a choice to benefit a concrete organization from the tax amount that he/she would pay anyway. Therefore it is incorrect to call the system private “philanthropy” as the resources used are not private resources, but resources that must be paid as income tax. It is also inaccurate to assume that the mechanism supports the non-profit sector at large, as not only, and not all not-for-profit organizations benefit from the percentage mechanism. Nevertheless it is true that the system aims to support the public good.

The essential procedure of the mechanism is the same throughout the years and countries (individual taxpayer communicates its decision on the personal income tax percentage allocation to the tax authority and the beneficiary receives his/her designation together with other designations), small technicalities of the operation⁸ vary from one country to another (Török & Moss, 2004) and adjustments in the processes and procedures can influence the outcome.

4. **The financial value of the percentage designation mechanism**

It is assumed by many that the percentage tax designation mechanism system provides substantial financial contribution to the revenues of the non-profit sectors, some believing it to be one of the most important sources of funding. This section is to examine this assumption by focusing on the revenues this mechanism brings to the non-profit sector and its organizations. For this purpose available data and certain policy instruments of the five CEE countries will be examined.

⁸ <http://szazalekosadomany.honlaphat.hu/index.php?menu=1536&langcode=en>

4.1. Revenue Growth

The percentage mechanism is estimated to be a 242 million euro yearly revenue source in the five CEE countries (Table 3). Over the years, the mechanism has provided around 5 billion euro of support to a variety of beneficiaries in Europe, including Italy⁹ (based on the different time periods of functioning of the system).

Country	Amount of designated percentage (million €)
Hungary	22
Poland	120
Slovakia	22
Lithuania	46
Romania	32
"CEE Percentage Club"	242

Table 3: Amount of designated percentage allocations in the CEE countries of the percentage mechanisms in most recent years (based on "Per Phil database" using national data sources)

Revenues from this type of percentage designations in four countries tend to be below 50 million euro a year per country, while in Poland it is around 120 million euro and in Italy, for similar entities, it is 264 million euro¹⁰. The reason for these major differences lies partly in the disparity of salaries and taxes paid in different countries and partly in the number of taxpayers as it is related to the number of actual designators. In Poland alone, the number of the taxpayers making use of this opportunity in most recent years is around 10-11 million people a year (i.e. more than the whole population of Hungary). Meanwhile in Italy, 16,7 million people have made percentage tax designations in 2011 (40,4% of total of 41,3 millions of taxpayers).

While the total amounts may look substantial, the average amount per beneficiary is not high in any of the countries. When not counting the highest Polish average, the average in the remaining four CEE countries is 1 291 euro while with Poland included, it is 4 104 euro per organization (based on the tenth year of operation)¹¹.

⁹ Not counting the church and the political party percentage mechanisms and the ones where no direct decision can be made about the beneficiary entity.

¹⁰ 264 million euro benefiting not-for-profit entities

¹¹ The Italian average in the 9th year of the operation is a bit less than the Polish (in 2014 total amount was 485 million euro and the total admitted organizations beneficiaries were 53.457 out of which there were 37.904 NPOs (as reported by *Agenzia*

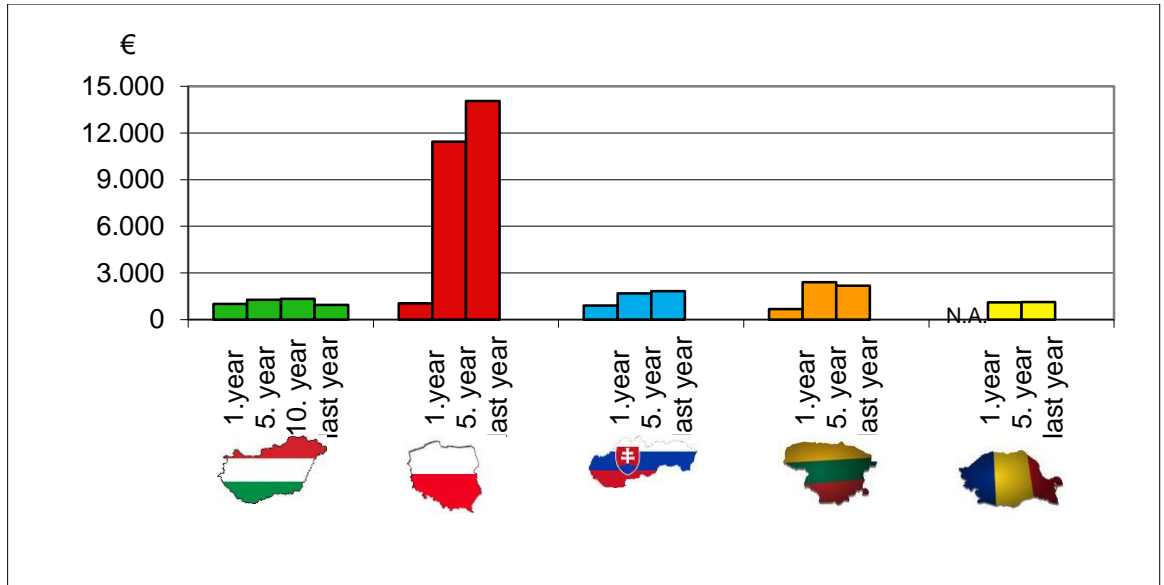


Figure 3 Average amount of percentage designation per beneficiary in the CEE countries of the percentage system (based on “Per Phil database” using national data sources)

While not all countries issue official lists of top beneficiaries, it is clear that not-for-profits with a strong emotional appeal are the most likely to win taxpayers’ hearts to receive their percentage donations¹². By the type of activity, organizations that fall into the health and healthcare related issues category are the most popular, followed by education and science; religion; environment; sports and tourism; culture and arts in the five countries (based on reports of local researchers).

It has been assumed that the percentage designations are not reaching pro-democracy, advocacy, civil rights related organizations as their mission is not appealing enough to the general public. One needs to note a new trend in Hungary that goes against this argument. In most recent years, not-for-profit organizations with an advocacy role and independent voice have been benefiting more and more from percentage designations but is still not making it to the top beneficiaries list. The top beneficiaries of the percentage donations in Hungary remain to be children’s health related entities.

Another important aspect that points to the vulnerability of the mechanism when it is connected with advocacy activities is based on Slovak experience. In the 2006 parliamentary debate in Slovakia, human rights and education were proposed to be excluded from the list

delle Entrate

<http://www.agenziaentrate.gov.it/wps/content/Nsilib/Nsi/Documentazione/Archivio/ArchivioSchedeAdempimento/Schede+adempimento+2014/Richiedere+2014/Iscrizione+elenchi+5+per+mille+2014/Elenchi+5xmille2014/>.

¹² In Slovakia the survey among the Association of Corporate Foundations which is representative of over 1/3 of corporate tax designations show a different prioritization of issues than the individual designation giving a highest allocations to 1) Culture, 2) Education and 3) Sports.

of eligible public benefit purposes for the tax designation mechanism by a political party with strong illiberal and undemocratic background. In words of the party's deputy: "...it is mostly about limiting those non-profit non-governmental organizations that in 1998 secretly meddled with politics via their education, science and other [projects] and largely influenced election results". (Strečanský, Bútora, & Repčíková, Non-Governmental Organizations and Volunteerism, 2007). This motion was approved and human rights, education and environment were removed from the list of eligible organizations for one year. Despite the fact that this motion has been overridden in 2007, it showed the vulnerability of this mechanism to the distortions of the political discourse in a particular context.

4.2. *The financial significance of the percentage designations*

To assess whether the percentage designation is a key financial support mechanism for the non-profit sectors, an important point of perspective to take is the proportionate value of the percentage designations in the overall revenue of the non-profit sectors. **The revenue from percentage designation in proportion to the overall revenue of the non-profit sectors in the five CEE countries is around 2%** (Figure 4 based on data available around the tenth year of operation of the percentage mechanism). **Therefore assuming that the percentage mechanism is one of the most important sources of funding for the non-profit sectors is wrong.**

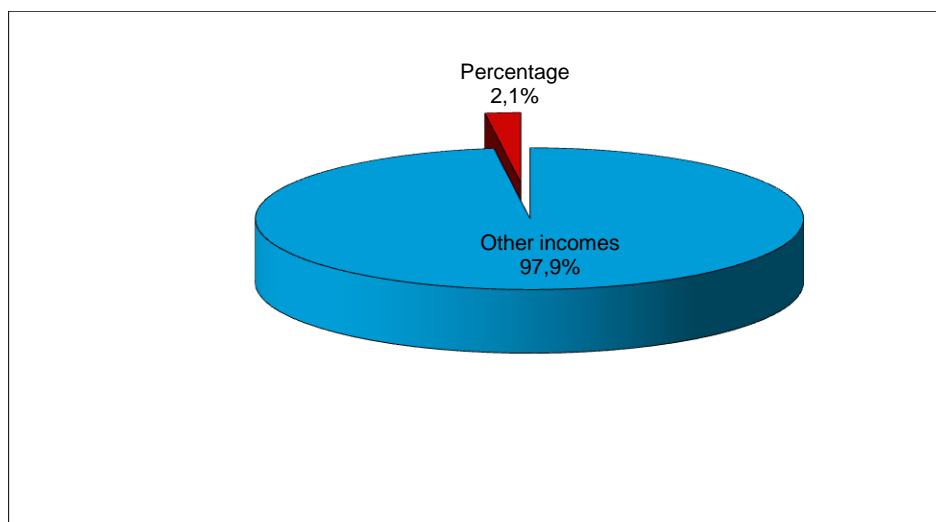


Figure 4 Share of percentage designations within the total revenues of five CEE countries (based on "Per Phil database" using national data sources)

While the percentage designation is a small portion of the overall revenues of the non-profit sectors in the 5 CEE countries, some believe it is the most important source for three reasons: a) it is the most important source for many entities b) it is highly used by potential beneficiaries in many countries, and c) it has a strong communications component reaching the public.

There are a number of organizations for whom the percentage revenue is the only revenue source, and for many it is the only source from state and local government which may give the impression of being the most important source of funding for the sector. The example of Hungary illustrates the high value of this state support for many NGOs (Figure 5).

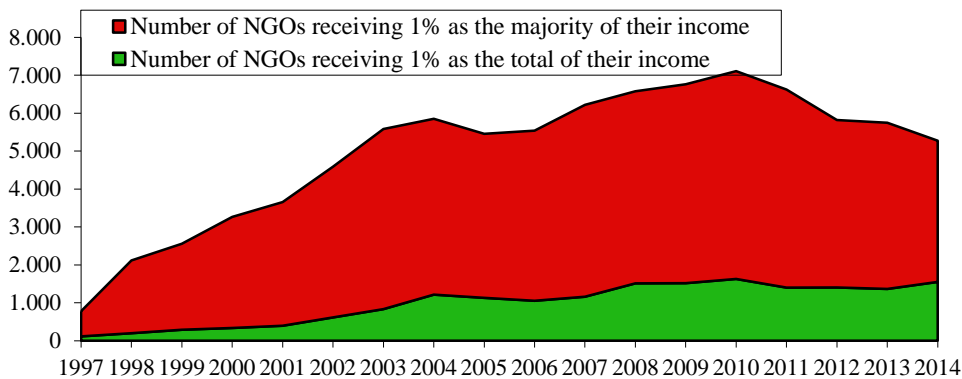


Figure 5 Number of NGOs receiving 1% in Hungary as the majority and as a total of their revenues
Source: HCSO

In Hungary, the country where such data is available, the percentage designation has been the most important revenue stream for thousands of organizations. As much as 8% of the non-profit sector has received the majority of its revenues from percentage designations and for 2,4%, percentage revenues were their only source of income in 2010. This shows how important the percentage system is for many not-for-profit organizations in Hungary, even when it is only a minor revenue source in the overall not-for-profit financial eco-system.

The perception that the percentage designation mechanism is a support system for the whole of the non-profit sector may also have resulted from the fact that in some countries, almost all NGOs that are eligible for it end up benefiting from it (giving the inaccurate perception that it is the whole of the sector). It is a wrong perception. In Hungary, for example, where there has not been a list to choose an entity from, the proportion of real beneficiaries has been ranging between 26-43% over the years, in Slovakia, where there is a list to chose from, it has been 13-22%.

While it is not the whole of the sector that benefits financially, the voice of this segment is strong. The active promotional campaigns targeting potential beneficiaries have been unprecedented in the CEE region. Thanks to the percentage mechanism, organizations started to put more emphasis on communication with their own members and clients as well as reaching out to the broader public. It goes without saying that it has had an effect on the intensity and quality of communications of the whole of the sector as well.

4.3. *The question of crowding out of resources*

Claims of the significance of the percentage system are reported to be frequent in all CEE countries. Politicians, private individuals and companies often use the existence of the percentage system as an excuse for not providing support and giving enough/additional resources to certain areas and organizations, arguing that the percentage system should finance them. These observations suggest to some, that there might be a crowding out of resources taking place.

As a starting point in this discussion, it needs to be noted that based on the limited data provided by national sources of four countries, a trend of growth in the overall financial revenues of the non-profit sectors can be observed over the years (Figure 6) since the start of the percentage system.

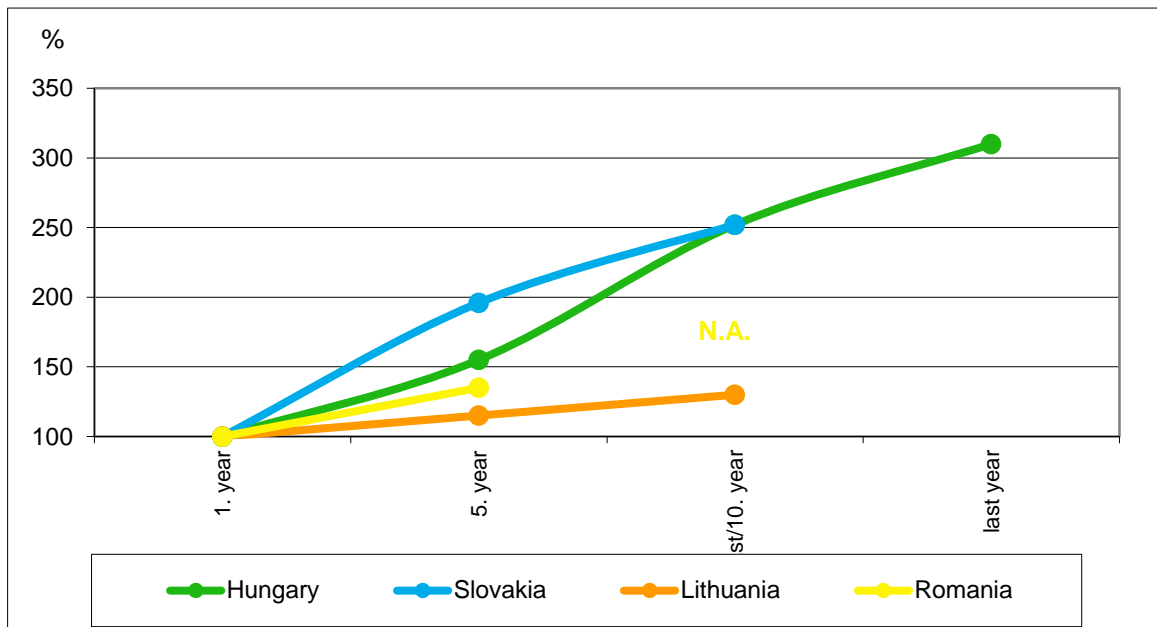


Figure 6 Increase of total revenue of the non-profit sector in four countries over the years (based on “Per Phil database” using national data sources)

Unfortunately, the availability of comprehensive, reliable and precise data is limited on the support of state and private entities to the non-profit sector in all the five countries that are of the prime concern of this paper. Our experts, however, have expressed that **in the five CEE countries observed, no crowding out of direct state resources has been noted as a result of the percentage designation mechanism¹³**.

At the same time, **decrease of indirect support can be noted in most countries in the form of fewer tax advantages for private giving**. Except for Italy¹⁴ and Romania, there have been legal changes that make private giving (of individuals and/or companies) to not-for-profit entities less attractive since the start of the percentage mechanism¹⁵. For example, in Hungary, the option of tax deductions and other allowances has been radically cut off. As of 2015, only corporate support can be deducted (to a limited extent). Whereas Slovakia's tax reform of 2003 completely abolished the tax deductions for both individual and corporate donations.

Whether these changes can be linked to the introduction of the percentage mechanism is not certain, except in the case of Lithuania, and partially in Slovakia. In Lithuania, the introduction of the percentage system was conditioned on the abolition of tax deduction for private individuals, such as the 15% income tax deductions for private donors (due to concerns that a proposed "2% scheme" would represent huge costs to the national budget). While it could have only been a temporary act, that if proven to be unnecessary, could be reconsidered, the original tax incentive has not been restored ever since in Lithuania. In Slovakia, the abolition of tax incentives for giving was part of a broader tax reform that coincided with the expansion of the tax designation mechanism to include corporate entities. Among the CEE countries, Romania is the only one, where the fiscal incentives for individual donors have not changed since the enactment of the percentage system (and giving by corporations is characterized by attractive fiscal incentives).

4.4 *Percentage mechanism and private philanthropy*

¹³ Whether the original source of direct support was European Union related resources or national and local government budgets was not traced.

¹⁴ Since 2005 (the 5x1000 was introduced in 2006), Italy also has had a special deduction for donations to not-for-profit organization, called "The More You Give, The Less You Pay" (Più dai, Meno versi). It works for physical persons and companies up to 10% of total taxable income for a maximum of 70.000 euro per year. In 2011, according to data of the Ministry of Finance, 681 672 of Italians used this option.

¹⁵ In Romania, the fiscal incentives for individual donors have not changed since the enactment of the percentage system. Giving of corporations is characterized by attractive fiscal incentives. (donations are deductible from the profit tax up to a certain amount (0.5% of revenue but not more than 20% of the owed profit tax).

The question of the percentage mechanism's effect on private giving has existed ever since the idea was born: will it be a training ground for private philanthropy ("School of Philanthropy") and encourage private giving, or will it discourage individuals from donating their own resources? The jury is still out to decide this question. Unfortunately, true comparisons have been impossible due to the lack of comparable data in the five countries. Nevertheless, this research has been able to collect some evidence that supports the argument that even with less legal incentives to encourage private giving, giving by individuals shows a clear, growing trend in the four CEE countries where data was obtained (Sičáková & Zemanovičová, 2010). As for corporate giving, based on even less data, the trend is not so evident. The drop in corporate giving in Slovakia, the only country where a corporate percentage designation is available, is a sign of concern.

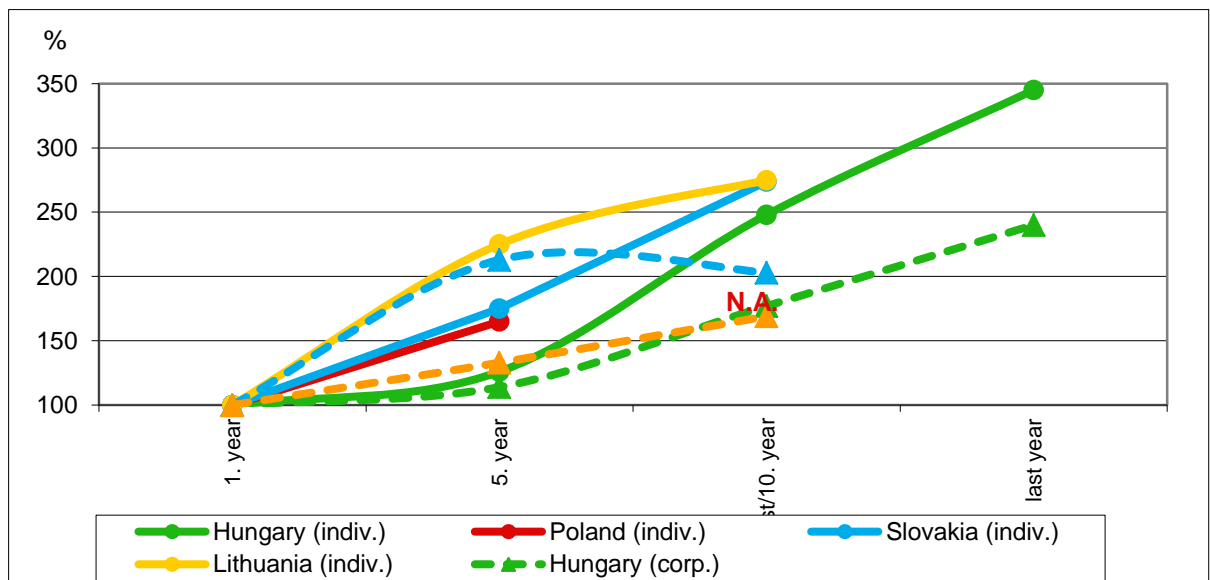


Figure 7 The value of private donations of individuals and corporations over the years (based on "Per Phil database" using national data sources)

In the additional sections of the research that is not part of this paper, two authors provide case studies from Hungary and Poland. **The case of Hungary**, based on information from István Sebestény and data collected by the Central Statistics Office of Hungary for the period 1997-2013, **provides some evidence to the argument that the percentage system does contribute to the development of private philanthropy.** In the section on Poland, Kuba Wygnanski argues that **in the case of Poland, greater public awareness of NGOs can be credited to the percentage mechanism system, but there is no conclusive evidence that it has contributed to the development of private philanthropy "...which may perhaps still require more time".**

As a last point in this discussion, one needs to mention the results of an experimental research (Csongrádi, 2008) that support the opinion that the introduction of the percentage

system does not significantly lower the level of individual contributions from income. Moreover, a little increase could be observed in the first round of the experiment's second part¹⁶. The experiment's results demonstrate that the possibility of a crowding out effect is not significant when the whole society is observed. (Csongrádi, 2008, old.: 33).

4.5. *Conclusion*

The percentage mechanism is an important source of revenue to many organizations that is estimated to have provided around € 5 billion of support to a variety of beneficiaries in Europe over the years. Still, this source is a small portion of the overall revenues of the non-profit sectors (around 2%) and therefore assuming that the percentage mechanism is a crucial source of funding for the non-profit sector is wrong. (The case of Hungary shows that it is an important, and often only source of revenue for many entities.) Since the start of the percentage system, growth can be observed in the overall as well the percentage revenues of the examined non-profit sectors. Crowding out of state and private resources can not be observed (the latter point is also supported by the cases of Poland and Hungary) and individual philanthropy contributions show a growing trend, even though incentives for individual private giving have gone down in most countries.

5. **Final remarks**

The percentage mechanism offers a unique way of redistribution of state resources that was met with enthusiasm in the transitional phase of post-communist Central and Eastern Europe. It has offered a redistribution of state resources to public benefit activities in an environment that was resource dry with bureaucratic and un-transparent, politically biased public funding mechanisms. It was hypothesized that there is a lack of systematic policy evaluation regarding the percentage designation mechanism, which was proven to be true in four of the five CEE countries (but not in Italy). Still, the system does not stagnate: changes and adjustments are frequent; the proportion of taxpayers using the system, the amounts designated, and the number of beneficiaries has been growing (with a slower speed and sometimes slight decline in some countries in recent years). The system that once was an innovative policy solution has become part of the in-country status quo that the societal

¹⁶ In this public good experiment students were asked to invest some money in a group project. The experimenter collected the contributions, multiplied them according to a previously given rule and then divided the money among the group. In some cases, no one knew the individual contributions, only the total. This game was modified over time and the goal of all modifications was to answer different aspects of individual behavior. In this research, the supply of public goods was observed with and without the possibility of the percentage system. Throughout the inquiry, groups have been examined under two different situations to determine the Nash equilibrium with and without the presence of the percentage system.

actors live with and enjoy the benefits of. There was no country in the subject five where abolishing the percentage mechanism would have been a concern¹⁷. On the contrary, the model is found to be used in new ways in three of the five countries and after twelve years a new country has enacted percentage legislation in 2015.

The review of the perceived effects and intended policies suggests, that today, 10 years after the implementation of the mechanism in any of the percentage club countries, there is a modest but distinctive contribution of the mechanism towards the sustainability of the public benefit organizations, especially the NGOs.

In terms of its effects, especially in the area of financial viability and public image, the mechanism produced visible benefits and added value to civil society organizations in all percentage club countries. At the same time, in parallel to the percentage mechanism, in all of the studied countries, positive changes occurred in the associative dimension of civil society or in philanthropic activities that have not been attributed as effects of the percentage mechanism. One of the most important elements of the mechanism has been its flexibility and predictability, which contribute towards the stability of the third sector and channel the public funds to those recipients that would otherwise have limited access to other funding. More intensive communication and increased visibility of NGOs are other positive effects of the mechanism.

There have been some unintended effects that raise concern. As far as the understanding of the concept goes, there has been an ongoing misunderstanding of the tax designation and confusing it with philanthropy. On the level of the actual effects, the system has morphed slightly in Poland where the channeling of funds through intermediary recipients to individuals opens up questions on the original purpose of the mechanism. Similarly, the emergence of scholarships in Romania as an eligible public benefit purpose is questionable as it draws the funding out from the NGO space.

One of the rather negative side effects or (unrelated occurrences) of the percentage designation from the perspective of the NGO sustainability, has been the abolishment of fiscal incentives for giving in several countries.

Looking at the reach of the idea beyond Italy and the CEE “Percentage Club”, some Post-communist countries have been identified in this research (as described earlier) that are considering this mechanism for adoption but most of them have not shown significant development by 2015. This research could identify one country, Moldova, where the percentage legislation was recently enacted.

¹⁷ Except Slovakia, where between 2006 - 2012 the extension of the tax designation to corporations has been repeatedly attempted to be abolished by the government, however, without success.

This has happened 12 years after the last two “Percentage Club” countries have introduced their percentage systems. In Japan, Portugal and Spain, a very different variation of the model works (that would require a separate work of comparison). The authors believe that awareness of this mechanism beyond CEE is limited. It is partly due to the limited amount of information available in English and other major languages regarding the value of the mechanism, partly due to the particular niche this mechanism can meet.

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