Perspective on Regulatory Issues for Social Enterprise Development in CEE

Dragan Golubovic and Nilda Bullain
European Center for Not-for-Profit Law (ECNL)
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Factors influencing general environment for enterprise and NGO development:

- framework regulation – institutional forms available;
- level of taxation – profits tax, income tax, social security contributions;
- financing mechanisms – banking system, loans, investment schemes;
- governmental incentives and subsidies – supported employment, special loans, grants programs, etc;
- privatization and contracting of social services – procurement laws, licensing laws, regulation and practice of social contracting etc.

Where are NGOs privileged, where are they discriminated or in level competition with businesses?
Overview of Issues Involved

- Legal and fiscal environment for social enterprise:
  - Legal forms
  - Governance
  - Economic activities
  - Tax incentives
  - Fiscal regulations
  - Transparency and accountability
Legal forms

- Main NGO forms: associations, foundations, and institutions.
- Generally not allowed to conduct economic activities as primary activity.
- Special NGO forms evolved to address the „niche“: public benefit company (Hu, CzR, Sk), micro finance organizations (Bosnia).
Governance

- Difference between membership (associations) and non-membership organizations (foundations, institutions).

- A public benefit company is governed like private enterprise („owners, quotaholders“).

- Governance responsibilities and liability issues still unclear in CEE countries (standard of diligence of board members of an NGO that engages in economic activities: prudence of the common person v. prudence of the business person?).
Economic activities

Issues involved in regulating NGOs' economic activities:

- How are they defined?
- Should they be allowed with or without further conditions?
- To what extent they should be taxed?
- How to prevent an unfair competition with business?
Permissibility of economic activities:

- Almost all CEE countries allow NGOs to engage at least to some extent in economic activities (*exception: Macedonia*).
- Economic activities defined as *regular sales of goods and services on the market*.
- *Not included*: occasional sale of good and services and fundraising activities; receipt of gifts and donation, passive income, activities carried out using volunteers; and fees that are intrinsically connected to PB purposes of an NGO (tuition)
Permissibility of economic activities

Most CEE countries allow only related economic activities (*Slovenia, Croatia, Romania, Bulgaria, BiH*).

- **Difficulties**: not a clear-cut line between related and unrelated economic activities.

- Most CEE countries have a non-distribution constrain clause (*Albania, Hungary, Latvia, Poland, Slovenia, BiH, Czech Republic*).

- **Difficulties**: how is a non-distribution constrain clause construed?
Permissibility of economic activities

- Some CEE countries allow only PBOs to engage in economic activities (Poland).
- Some CEE countries prohibit certain types of NGOs to engage in economic activities (foundations and funds in the Czech Republic and foundations and non-investment funds in Slovakia).
### Taxation of NGO economic activities in CEE: *Survey of Tax Law* (www.icnl.org)

<table>
<thead>
<tr>
<th>Taxation Method</th>
<th>Countries</th>
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<tbody>
<tr>
<td>Prohibit direct ec.act.</td>
<td>Macedonia</td>
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<tr>
<td>Not taxed (related)</td>
<td>Federation of BiH</td>
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<tr>
<td>Fully taxed</td>
<td>Albania, Bulgaria, Slovenia</td>
</tr>
<tr>
<td>„Relatedness“ test</td>
<td>Estonia, Latvia</td>
</tr>
<tr>
<td>„Destination of income“ test</td>
<td>Poland, Kosovo</td>
</tr>
<tr>
<td>Hybrid test /tax thresholds</td>
<td>Czech Rep, Hungary, Romania, Slovakia, Serbia, Montenegro</td>
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Tax Incentive - Philanthropy

- General rule: donations to NGO by individual and corporate donors enjoy tax benefits:
  - tax deductions
  - tax credits (only in Hungary for individuals)
- Limits: percentage of income tax base, only donations to public benefit organizations (charities) are tax exempt.
- **Difficulties**: PB narrowly defined in some countries (Bosnia, Serbia, Croatia).
- Percentage laws (Hu, Sk, Pl, Lt, Ro)
Fiscal regulations

- Taxation – VAT, customs etc.
- Accounting laws
  - is there a separate regime for NGOs?
- Laws on financial and credit institutions
  - is it possible to lend to NGOs?

+ Tax authorities’ capacity and understanding of NGO issues!
Transparency and accountability

• Most common basic accountability mechanism: public benefit status (charitable) status (*Poland, Hungary, Latvia, Bosnia*).
  • Increased requirements of transparency and accountability in exchange for tax and other benefits.

How to balance public and private interest?
Conclusion

- Social enterprise regulation: complex challenges, no easy answers.

To find out more, visit

www.ecnl.org.hu/icnl.org

Or contact us at: dragan@ecnl.org.hu

Thank you!