Community Foundations in Slovakia

2% Tax Designation Instrument

Martin Šimčík

Introduction

There was never enough food for cultural institution in the table. That is the fact number one that music, theatre, museum and all other arts managers would agree on without hesitation. I wrote this paper as an indirect but certainly essential contribution to the discussion on music management studies. I believe that fundraising is an important tool for revitalization of cultural sector and as such should be given much more attention. The reason why I choose community foundations as an object of my interest is that my dissertation thesis (on Local Cultural Planning) is focused on local culture and community foundations are definitely an essential part of local cultural infrastructure.

About community foundations

Community foundations (CFs) are instruments of civil society designed to pool donations into a coordinated investment and grant making facility dedicated primarily to the social improvement of a given place. Community foundations are a global phenomenon with 1400 existing around the world of which over 700 are in the United States. Some of the generally accepted characteristics of the CFs are:

1. Grant-making, e.g. give grants to support local development projects
2. Serve geographically defined communities – typically a city or administrative area (county, region…)
3. Seek philanthropic contributions primarily from inside the community
4. Are governed by local boards

5. Campaign for capital endowment, The assets of community foundations are pooled and invested, with donors usually having a decision-making right about investments (that is why *donor-advised funds* is how they are referred to in US).

The funds established at community foundations can be expendable funds (i.e., grants can be made in any amount at any time) or they can be endowments, which limit distributions to the interest earned on the assets. The second option is the most important element of their sustainability.

According to research conducted in 2004 by Donors Forum (Správa o stave slovenských nadácií, 2005) there are (or were) **294 registered foundations** in Slovakia in three categories:

A. Corporate foundations [60]

B. Community foundations [12]

C. Other [222]

In numbers, revenues of all foundations in Slovakia in 2004 totaled:

1 079 052 565 SKK[1].

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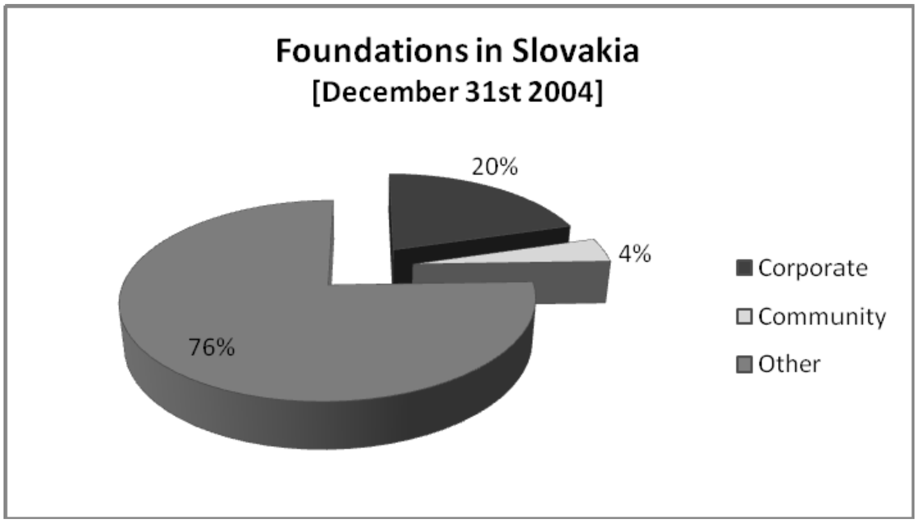
[1] as on December 31st 2004 – 1 Slovak Crown = 28,5 USD (i.e. 37 861 493 USD)

Figure 1

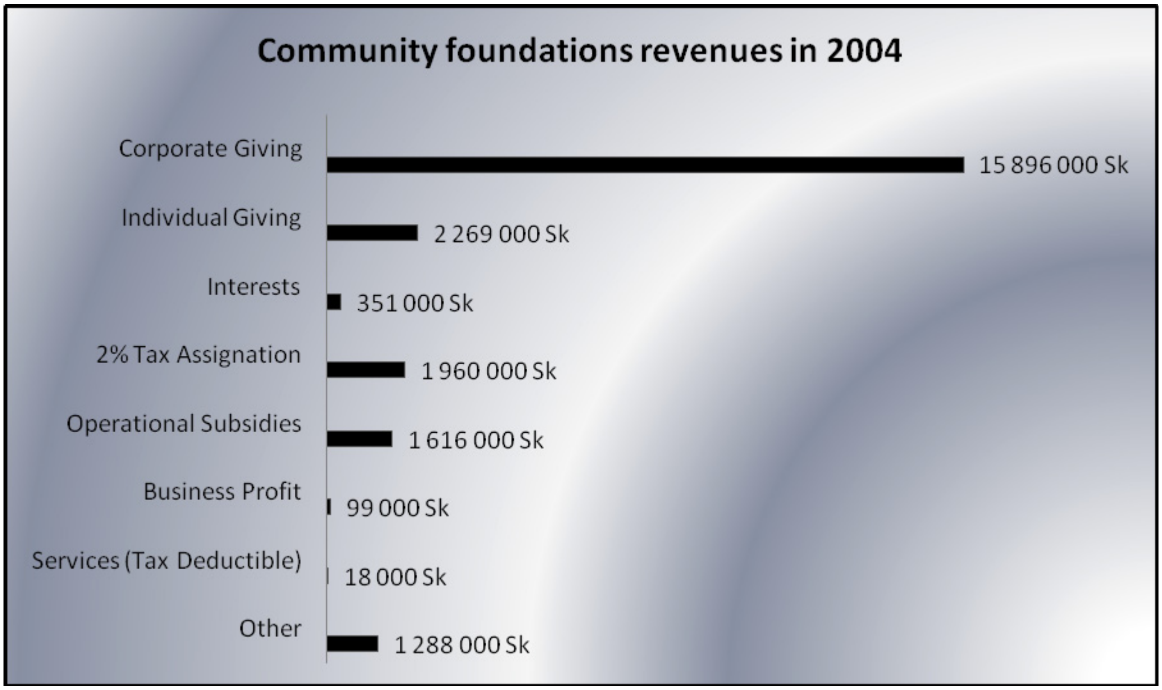


Source: PANET.sk

By the way, the first CF established on the European continent was Healthy City Community Foundation in Banská Bystrica, Slovakia. Healthy City CF awarded over years several grants to “Theater from the Passage” that integrates mentally handicapped young people into community through their theatrical performance (Mesik, 2007, p. 3).

There have been numerous creative projects prepared and managed by community foundations in Slovakia. An interesting example is a **Civic Choice of the Pivovar Šariš** Project, which allows local people decide which projects in the fields of sports, culture, education, cultural heritage preservation and community development would be supported by the local brewery **Pivovar Šariš.** The roles and functions of community foundations have not been given appropriate attention so far and I am sure it would make a nice topic for graduate project or even dissertation.

Figure 2



Source: PANET.sk

How do they work – Tax Percentage Designation Example

It would take more to describe completely how community foundations in Slovakia function. For purposes of this paper, I decided to introduce one of the most interesting and very important fundraising instruments – **Tax Percentage Designation**.

The NGO (non-governmental organizations) sector in Slovakia is still underdeveloped in many respects and it would certainly benefit from major improvements in many areas. Fundraising represents one of these areas. The lack of well-established culture of giving is critical. What is very effective about the percentage designation fundraising campaigns in this context is that they mutually strengthen each other, in spite of the serious competition. Percentage campaigns direct the attention to the "third sector" more effectively than the individual campaigns to raise awareness and collect donations. All community foundations highly benefit from that attention.

A history of tax designation in Slovakia is short. The arrangements in Slovakia's tax legislation which allow taxpayers to designate a percentage of paid tax to eligible recipients were inspired by Hungary's "1% Law" (Marček, Slovakia's percentage mechanism, 2007, s. 3).

Originally there were three groups involved – individuals, NGOs and the government. Percentage designators act as donors. NGOs collecting percentage designations conduct this activity as a kind of fundraising. Percentage philanthropy provides the government with a fiscal solution with a fairly predictable cost.

Percentage designation differs from the other forms of philanthropy in that it ***does not require any financial or other sacrifice***, and furthermore as a part of taxation, it is arguably ***not entirely voluntary***.

There were several shortcomings in the way the 1% system[2] was initially defined. The recipient of a taxpayer's 1% designation could be a NGO but also an individual if the money was used for covering the costs connected with education, health care, sports, environmental protection, culture and the renovation of cultural monuments. The system as defined in the law was not acceptable for NGOs. After months of negotiations this unique form of philanthropy was finally implemented (tax year 2002), immediately accepted and since then the number of donors has shown a distinctive rise, so now almost half of all tax payers make use of this option.

The main principles of this mechanism include:

1. anonymity of the taxpayer
2. taxpayers decide on the use of public money in favor of NGOs
3. transparency in the use of the transferred designations

In April 2002 the fastest legislative action within Slovak NGO advocacy history happened. After unofficial political offer to expand 1% designation to business taxpayers, it took only two weeks to make it official (Kollár & Mesežnikov, 2003). It was based on the same principles as 1% tax designations

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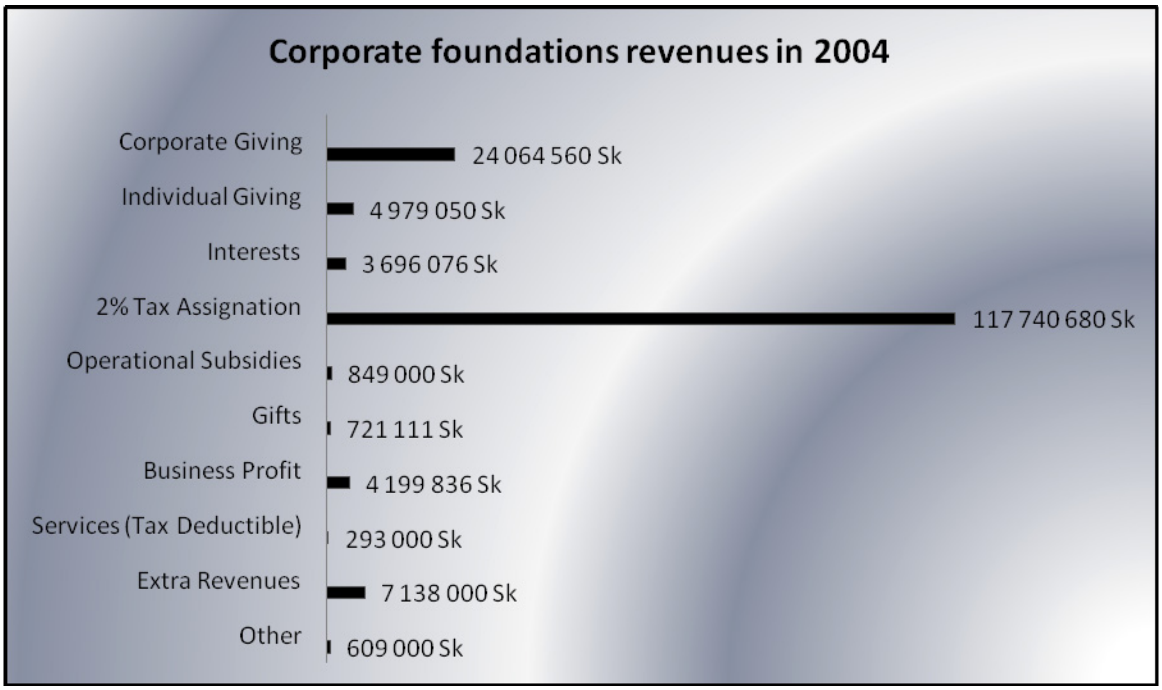
[2] see Annex for history of Percentage Legislation

from individual taxpayers. The main difference was in regard to the number of beneficiaries: whereas individual taxpayers could allocate 1% of tax to just one NGO, businesses were to be allowed to select one or more NGOs as recipients. There have been many disputes about this action, especially after increase in level of designation from 1% to 2% in 2003.

Figure 3



Source: PANET.sk

Giving this option to businesses made many people upset, both politicians and NGO representatives. They argued that not only is this a non-systemic action but also it may be harmful in a long-run. The main argument was that the actual aspect of personal engagement when will die. And today we can say they were absolutely right. The opportunity to assign 2% of your taxes is available in 4 other countries (Hungary, Lithuania, Poland and Romania). In all of these countries the tax assignation is related to **natural person** tax regulations ONLY! **Legal persons** are not allowed to make percent designation.

One of the most visible (and negative) implication was that big companies set up their own NGOs, usually in form of foundation, and directed their designations to these organizations (see Figure 3). In other words, the businesses use this public money to finance employee services that were originally provided within a company (out of net profit = not deductable).

Despite the fact that corporate foundations make up only 20% (see Figure 1) of all registered foundations, the sum of their registered funds makes 70% of total volume of foundation assets in Slovakia (Marček & Vakulová, Medzisektorová spolupráca na Slovensku, 2005).

The truth is that nominal revenues for NGO sector increased considerably. Despite the fact, the systemic effectiveness of this regulation is relatively very low. How to “control” businesses 2% tax designation remains a challenge.

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Annex 1: Percentage Legislation in Slovakia – Amendments to the Income Tax Act, 1999-2006

Year of amendment of Income Tax Act	Percentage measure	Effective as of /Notes
Income Tax Act No. 366/1999	▪ Introduction of 1% mechanism into Slovak legislation	January 1, 2002 (Note: operating arrangements amended in 2000 and 2001)
Income Tax Act No. 466/2000	▪ Elimination of natural persons (individuals) as recipients of 1% tax designations	January 1, 2002
Income Tax Act No. 561/2001	▪ Adoption of definitive version of 1% mechanism arrangements allowing natural persons (individuals) to make 1% tax designations	January 1, 2002 (Note: individual taxpayers able to make 1% designations for the first time in 2002 from previous year's paid tax, and again in 2003. The rate increases to 2% in 2004 – see changes adopted in 2003)
Income Tax Act No. 247/2002	▪ Expansion of 1% mechanism to allow legal persons (businesses) to make 1% tax designations ▪ Introduction of requirement for recipients of 1% tax designations to publish details of the use of designated money in the Commercial Bulletin (above SKK 100,000) and of obligatory audit (above SKK 1,000,000)	January 1, 2003 (Note: business taxpayers able to make designations for the first time in 2004 from previous year's paid tax, but at the increased level of 2% - see changes adopted in 2003)
New Income Tax Law No. 595/2003 (Tax reform started)	▪ Increase in level of designation from 1% to 2% for natural persons (individuals) and legal persons (businesses) ▪ Abolition of requirement for recipients of tax designations to register annually in the Register of Recipients	January 1, 2004
Income Tax Law No. 659/2004	▪ Reintroduction of annual registration requirement for recipients ▪ Change in deadline for transfer of designated money by tax authorities to recipients' bank accounts	January 1, 2005
Income Tax Law No. 688/2006	▪ Introduction of limits on the purposes 2% designations can be used for (education, environmental protection and human rights excluded) ▪ Increase in minimum amount individuals can designate to SKK 100 ▪ Extension of deadline for publishing details of the use of designated money in the	January 1, 2007

Source: PANET.sk