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TAX *ASSIGNATION* SYSTEM

—

A POTENTIAL FUNDRAISING MECHANISM
FOR ALBANIA



Policy paper, "Tax Assignment System".

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INTRODUCTION

This document was prepared in the framework of Partners Albania for Change and Development engagement in support of civil society sector for the development of alternative ways of financing with the aim to increase its sustainability.

Partners Albania has prepared a policy paper on the “Tax Assignment System” which serves as an informative material for all CSOs interested in diversifying financial resources.

This document introduces the new concept of “Tax Assignment Mechanism” as a sustainable model for strengthening the CSO sector by improving its image, increasing public confidence and financial sustainability.

This document analyses the best models and practices of Southeast European countries and not only, which have been pioneers in the application of this mechanism.

Following its endeavours to improve the climate of cooperation between public administration and non-profit sector, Partners Albania aims to contribute to the financial sustainability of civil society organizations by strengthening the capacities of the CSOs. In this way, it enables them to explore new financial resources as a way to increase their sustainability, mitigate the dependence from the usual sources of funding from donors and institutions, as well finding new methods of strengthening the impact in their local communities.

This document also aims to present a new financing model for the CSO sector which has been applied and proven to be successful in many European countries and to take the first steps for a igniting a public debate on the replication of this system in Albania.

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TAX ASSIGNATION SYSTEM

What is tax assignation system?

The concept of the tax assignation mechanism firstly appeared in Central and Eastern Europe in policy debates on the issue of financing cult and civil society institutions in the early 90s (1992-1995). New democratized governments at the time, first in Hungary and then in other countries, were looking for ways to establish new relations with these social actors.

Following discussions between stakeholders, the mechanism first appeared in Hungary and later in Slovakia, Romania, Lithuania and Poland, as a novelty of public finances that channelled public funds into civil society for public benefit purposes in a decentralized manner. Today, this mechanism manifests itself in different forms in each of the countries that apply it, but the basic principle remains the same: giving a taxpayer the right to distribute 1-3% of the income taxes paid by him, for a non-profit organization, or in other types of public benefit entities, such as cult institutions (in this case the church) or in political parties.

The main reasons for the introduction of this mechanism were the support and development of civil society, the development of a philanthropic culture and tradition, as well as the de-politicization of state funds for civil society.

Different countries have introduced different mechanisms. For example, in the Italian model where this mechanism originated, "otto per mille", the beneficiaries are the churches. Later, Italy, after assessing the sustainability of this mechanism, they used the same model to include other entities in the circle of beneficiaries, such as non-profit organizations and political parties.

The "otto per mille" system is a mechanism through which the Italian taxpayer is given the right to distribute a percentage of the annual personal income tax, to allocate it for social services in one of the religious organizations of the country (Allen, 2007) (Tremonti, 2015).

The idea of the tax assignation mechanism appeared both in policy debates beyond Italy. In some countries, the possibility of implementing the system is still debatable; while in countries such as the Czech Republic and Estonia, a similar mechanism was discussed and it was decided not to adopt. Meanwhile, a form of a mechanism was discussed and materialized not only in Italy but also in Hungary, Japan, Lithuania, Slovakia, Spain, Poland, Portugal, Romania, and most recently in Moldova. In Portugal, initially only for religious purposes, but now part of the income tax can go to non-profit organizations.

In Spain, taxpayers have the right to distribute 7% of their income tax to churches or distribute it for "other social purposes" (usually these are projects related to social issues such as poverty, social inclusion, the elderly, immigration, and also projects directly related

to quality of life). But, as in the case of Portugal and Spain, the taxpayer cannot directly choose the beneficiary (Montedore, 2011).

In Spain, the taxpayer may choose to use the "church" or "social issues" option in his statement but not to nominate the institution directly. Further, in the case of churches, the money raised is distributed through the state support fund, while the money raised from the choice of "social issues" option is used to fund social projects selected by line ministries. Similarly, in Portugal since 2001, 0.05% can be distributed, but taxpayers cannot nominate a beneficiary entity. The distribution of the tax rate is part of the support provided by the state, which is the most important financial resource for organizations in Portugal, followed by revenues generated from member contributions (Franco, 2006).

These different examples can be considered as a broad interpretation of the tax assignation mechanism. It is also worth noting a more interesting variant presented in Slovakia, which allows corporations to distribute a certain percentage of their taxes, a mechanism that has had a significant positive impact on the financial sustainability of non-profit organizations in Slovakia.

The mechanism of the right to distribute a certain percentage of income taxes, as a widely understood concept, is a mechanism that channels public resources (collected from taxes) in a decentralized manner for the purposes of public benefit. The essence of the tax assignation mechanism gives a taxpayer the right to distribute a portion of his income tax for the purpose of public benefit.

Assignor “the donor”

In the tax assignment mechanism, we have two actors, the individual or the corporation exercising the legitimate right to distribute a certain percentage of their taxes, as well as the beneficiary entity.

The decision-making power of a taxpayer to distribute a portion of his/her taxes is a feature of this mechanism. Such a solution is unprecedented in the post-communist region and can be considered a unique form of participatory budgeting rather than philanthropy. In general, individual taxpayers can take advantage of this opportunity, while in Slovakia, for example, corporations also have the opportunity to service a certain percentage of their taxes.

In the tax assignment mechanism, individual taxpayers make their decisions autonomously (without any political or economic influence) that are respected and not opposed by any entity, for reasons other than formal in cases where irregularities are observed.

The individuals aim to support the public good, alleviate the pain of social problems and improve the quality of life for people, as they do in the case of philanthropy and charity. However, there is a big difference between the tax assignment mechanism and philanthropy. In the case of philanthropy, the private resources of individuals are used, while in the case of the tax assignment mechanism, the distributed resources are related to personal income, but they are taxes that the individual pays anyway.

This is why this mechanism should not be considered philanthropy and the resources distributed are not donations. This also means that the tax assignment option is only available to taxpayers, unlike philanthropy, which is open to anyone.

Beneficiaries of the tax assignment scheme

The tax assignment system is seen often as a financial support mechanism for the non-profit sector / civil society organizations.

First, in the widely understood tax assignment mechanism, the beneficiary groups may be churches, political parties, and civil society organizations in some countries. (Figure 1)

It is wrong to assume that the beneficiaries of the percentage mechanisms are only nonprofit organizations. There are at least three broad categories that benefit from the tax assignment mechanism in countries that have adopted this system. Therefore, it is wrong to think that only the civil society sector benefits from the tax assignment system through nonprofit organizations.

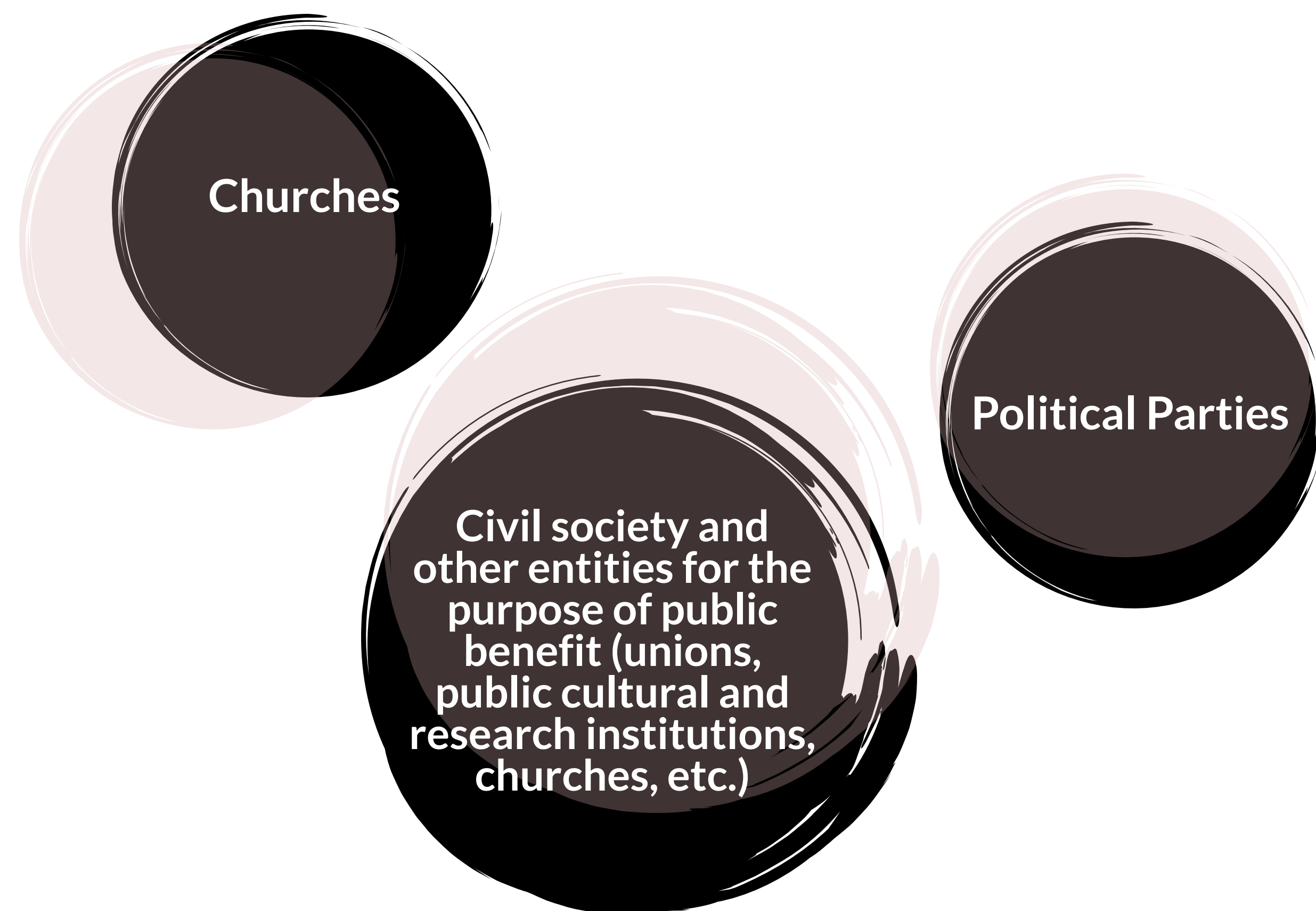


Figure 1: Tax assignment scheme beneficiary groups

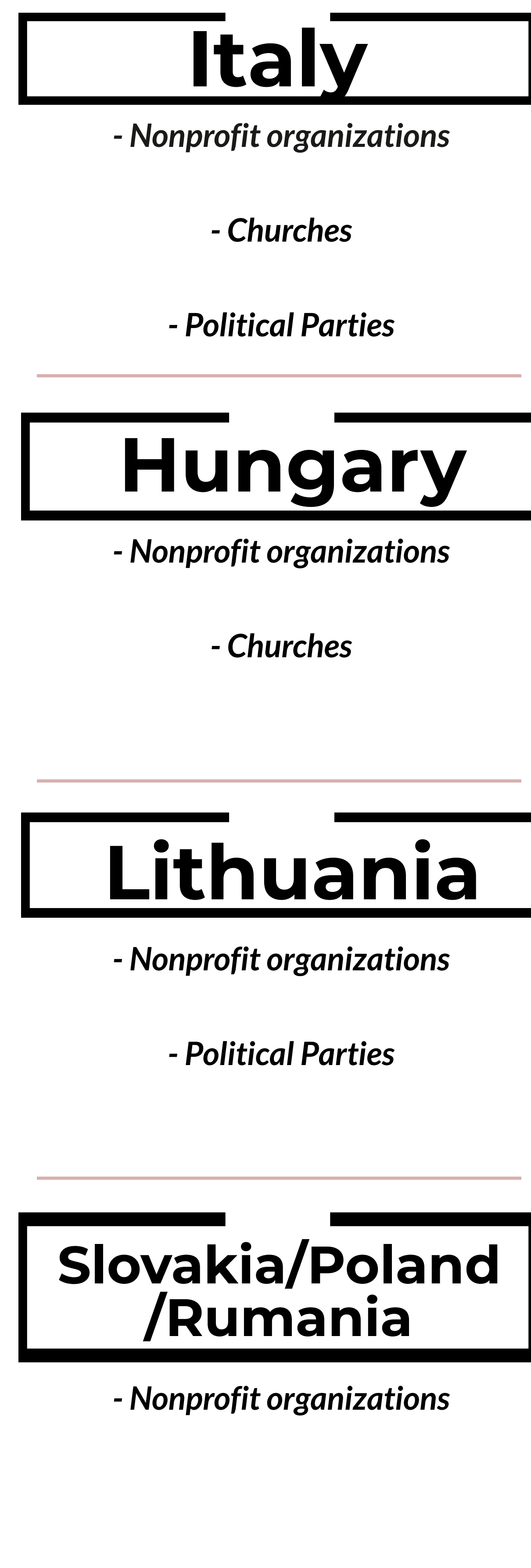
In Italy, for example, there are three tax assignment mechanisms aiming at different beneficiaries: a) a supporting mechanism for churches, b) one for political parties, and c) another for nonprofit entities. In the five countries of Southeast Europe, there is a maximum of two separate mechanisms, mainly one mechanism for nonprofit organizations and another for churches (the case of Hungary), or one mechanism for nonprofit organizations and another for political parties (the case of Lithuania). In Poland, Slovakia and Romania, there is only one mechanism for non-profit entities and other public benefit entities.

Firstly, this means that nonprofit entities such as churches and political parties can also benefit from the tax assignment mechanism, without necessarily being civil society organizations, as is the case in most countries.

Secondly, it should be noted that in this mechanism, the main beneficiary group are nonprofit organizations and then come the other types of legal entities (from the public or private sector) which are often included in the same group as entities eligible for the assignment of the tax percentage.

While the mechanism is often perceived to bring benefits only to nonprofit grass-root organizations, in some countries, churches, public entities, unions, and even individuals in need may be beneficiaries of this system.

Figure 2: Tax assignment mechanism by country



Nonprofit organization as primary beneficiaries

The aim to support nonprofit organizations as entities with public benefit goals is evident in all European countries that have adopted this mechanism. In Poland, the beneficiaries of the mechanism include only those NPOs that have received the status of public benefit, while in Lithuania the beneficiaries were initially subjects who had the right to receive charitable donations. In Romania the original beneficiaries of this law were nonprofit entities. While in Slovakia, the law clearly defines a list of potential beneficiaries who combine "grassroot" NPOs with other types of NPOs with different special characteristics, such as religious-based organizations.

TAX ASSIGNATION PROCESS

The main steps of the process of the tax assignation mechanism are the same in each of the CEE countries.

In a simple analysis, it is noticed that the essential procedure of the mechanism is the same over the years in all countries applying the mechanism. In this mechanism the individual taxpayer communicates his decision on the distribution of the percentage of personal income tax to the tax authorities, and the beneficiary entity is awarded the amount set by individuals. Further, the small technicalities of the mechanism and the adjustments in processes and procedures vary from one place to another (Török & Moss, 2004)

Step 1

At the end of the tax year, the taxpayer pays the full liabilities to the tax authority. If the individual wishes to exercise his right, he may decide to assign a certain percentage of his taxes for a public purpose. The decision regarding the distribution of taxes is entirely the decision of the taxpayer who appoints a specific entity as the beneficiary. For example, if a person pays 100 Lek in personal income tax at the end of the year, that person may decide to distribute a certain percentage of those taxes, say 2%, ie 2 Lek, an entity that serves the public good of his choice (within the limits of the regulations). In some countries, is used an open active system where organizations are ranked in advance and taxpayers can only choose from that list (Italy, Poland and Slovakia and starting in 2015 Hungary) while in other countries there is no preliminary list.

Step 2

If the taxpayer decides to exercise his right, he communicates his decision to the tax authority, which will follow by transferring the amount of 2 Lek (in our example) to the entity. If taxpayers decide not to take exercise his right, personal income taxes are paid in full and used as usual by the state. In some countries (Lithuania, Slovakia, Poland and Romania), there is a possibility of dividing the percentage assignation between some beneficiaries and not just one beneficiary.

Step 3

The beneficiary entity must obtain and use the resources created by the tax assignation mechanism. In the classical model of the mechanism, due to the reasons of data protection, the entity benefits the resources without knowing who has contributed to these resources. Recently (2015), Slovakia and Hungary adopted a system that allows beneficiaries to discover the identity of their “donor” but not the amount allocated, if the taxpayer authorizes the tax authority to disclose their identity. In some countries, the cycle ends with beneficiaries reporting on the use of defined amounts.

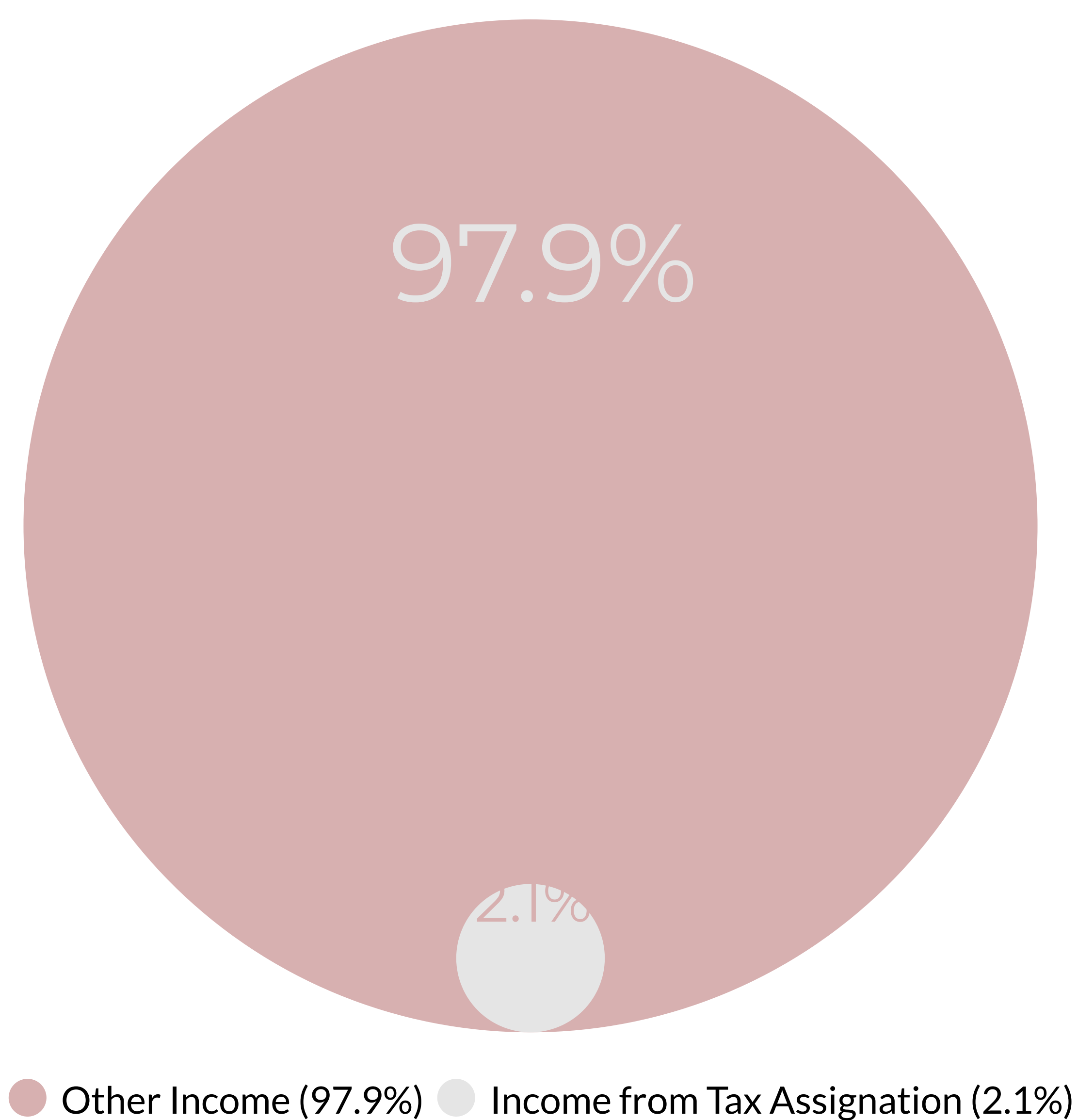
If we were to give a definition for the tax assignation mechanism, it would be: “a decentralized decision-making mechanism, where state resources, specifically distributed percentages of income taxes are channelled mainly to nonprofit organizations and others entities of public benefit purposes”.

Financial impact of tax assignment

It is assumed by many people and it is undeniable that the tax distribution mechanism system provides a significant financial contribution to the non-profit sector, and some even believe that it is one of the most important sources of funding in countries where this system has been applied.

To assess whether the assigned amount of taxes is a key financial support mechanism for the non-profit sector, it is necessary to understand the proportional value of the revenues from the tax distribution system occupy in relation to the total revenues of the nonprofit sector. In a study conducted in CEE countries that have adopted this tax assignment mechanism, the income of organizations from the assignment system in proportion to the total income of nonprofit sector in the five CEE countries is about 2%. Therefore, the assumption that the tax assignment mechanism is one of the most important sources of funding for the nonprofit sector is wrong.

Figure 3: Ratio of tax assignment income to the total revenues



While the tax assignment mechanism occupies a small part of the total revenue of nonprofit sectors in CEE countries, some believe it is the most important resource for three reasons:

a) It's the most important source for many entities;

There are a number of organizations which declare that income deriving from the tax assignment mechanism is the only source of income for their organization. It is worth mentioning this fact as these benefiting organizations come in a large number.

b) Its widely used by potential beneficiaries in many countries;

In all CEE countries where the tax assignment mechanism has been applied, it has been found that the main beneficiaries are small organizations that work directly with the community.

c) Has a strong communication component that reaches the public.

Since for most countries applying this mechanism, the income provided by tax assignment is the only source for non-profit organizations from the state, this mechanism ensures high efficiency in communicating organizations with the public sector.

Added Value

It is believed that in addition to providing financial support for public benefit purposes, the system has had numerous, mostly positive, side effects, some of which are directly related to the sustainability of organizations for public benefit purposes, especially for the NGO sector.

The added value dimensions of the tax assignment mechanism can be grouped into two main groups: a) in relation to civil society and b) in relation to taxpayers.

In relation to civil society:

a. Strengthening community-based organizations and citizen participation in NGOs

The idea behind this goal was to use the tax assignment mechanism as a tool to intensify the relation between the public administration and civil society organizations.

Immediately after the 90s, which is considered the "golden age" of civil society in post-communist Europe, it became clear that civil society would not play as important a role as expected. Disappointment with post-communist transformation and political and institutional reforms combined with a legacy of mistrust of organizations and strong social capital are considered key elements that contributed to the documented weakness of civil society in post-communist Europe (Howard, 2011). This weakness has been acknowledged by many academics although some suggest that this view requires more change and that the post-communist civil society space is quite diverse (Ekiert, 2011). Weakness usually appears in low levels of participation and volunteering, as well as in membership in civil society organizations (Howard, 2011).

b. Decentralized financing, flexible and less bureaucratic.

This aspect seems to be more of a post-hoc realization of the tax setting effect than a policy goal at the time of presentation.

- *Decentralized financing*

Data from countries that have implemented the tax assignment mechanism suggest that the intensity of the state's influence on the distribution of funds to civil society has changed over time. Sometimes it was stronger and sometimes weaker in the impact of these allocations. The tax assignment mechanism has decentralized a part of the provision of government funding to civil society, and instead of centralized bureaucracy, it is the taxpayers who make the decisions. This has effectively blocked the state's ability to influence that selection.

- *Flexible and less bureaucratic*

The data show that the system is quite flexible from the perspective of beneficiaries. There are not many conditions that are attached to the benefit mechanism, as is the case with other public subsidy mechanisms. In the context of growing administrative requirements, attached to various subsidy and grant schemes, the value of fund flexibility stands, especially for grassroots NGOs, for which access to bureaucratic and administrative funds is quite limited.

- *Stable income, timely predictable*

The system today provides accurate and timely funding for its beneficiaries. The time limit for transferring funds to beneficiaries varies from 2-3 months (Slovakia) to 6-10 months (Romania). There is also an added benefit of predictability. Funds are distributed in a predictable period each year and this is an important added value for financial planning and the sustainability efforts of beneficiaries. Also, the financial planning skills of organizations may have improved due to the timely predictability of resources coming from the tax assignment mechanism.

c. Increasing the visibility, transparency and public image of NGOs

In this area, the impact between the beneficiary organizations is unequal. Due to its simple and unyielding nature, the mechanism is used more by grassroot beneficiaries and not just large organizations. At the same time, the mechanism facilitates the intensive communication of NGOs in the public sphere in this way by increasing the credibility and improving the image of NGOs.

d. Fulfilled financial needs of NGOs / replacement of leaving donors.

In most countries in the region, the tax assignment mechanism was introduced in the early 2000s, which was a period of democratic consolidation and the emergence of economic stability that led many public and private foreign donors to withdraw from supporting the establishment of civil society and move to other areas which needed. So the goal at the time was partly to meet the financial requirements of NGOs in the context of declining funding and partly in the context of still underdeveloped local philanthropy.

e. Promoting solidarity and philanthropy

In this rationalization of politics, the expectation for the tax assignment mechanism was to allow taxpayers to show solidarity (at no cost to them) and to act as a school of philanthropy, to contribute to building a philanthropic culture that was underdeveloped. Based on the available data, this has been a marginal goal and perhaps a post-hoc rationalization, rather than a bold political goal.

The argument for this political reasoning is clear. Forty years of experience in totalitarian welfare states during communism, destroyed the social structure that had been built for centuries. The paternalistic state educated several generations with the idea that the initiative would be punished and that passive waiting would be rewarded. At the same time, individualism emerged as a virtue of capitalism, and concern for the common good was pushed back. In this context, it is a sound policy to revive and nurture social solidarity.

The data are not appropriate to make a connection between the level of delivery and the percentage assignment. However, there is evidence that private philanthropy in some parts of the region is growing significantly.

In relation to **taxpayers:**

a) Allowing taxpayers to distribute a portion of their taxes - i.e., participatory budgeting.

The option given to taxpayers to freely decide on the distribution of the tax has been debated in Hungarian politics and has since been constantly discussed in other countries. This type of mechanism decentralizes decision-making by the central government in the hands of taxpayers who autonomously decide to distribute their taxes. This as a process has marked a major step forward in the context of participatory budgeting where the role of the individual is increasingly strengthened.

b) Support for public benefit purposes

Support for public benefit purposes - religious, cultural, social and others - has been the main goal and impact of the mechanism. If these goals have been reached by NGOs, public sector institutions or church-based organizations, this has been secondary. For example, in Slovakia, the early version of the system focused only on the goals of public benefit (Woleková 2000). By this logic, it is more important to meet the purpose of public benefit than who operates in it - a private civil society organization or a public institution. Meanwhile, in the Hungarian government program in 1994, it was determined that areas that have the right to benefit from the tax distribution mechanism will not be of a political nature, business purpose or advocacy. This approach is different in Lithuania, where the tax assignment mechanism has also been used to finance political parties.

Conclusions

- The paper aims to provide a new support mechanism for civil society organizations in Albania. The tax assignment mechanism is an opportunity to solve the financial needs of the non-profit sector, as well as to help the development of these organizations.
 - This paper seeks to answer two main questions such as: what is the tax assignment mechanism and what is the role of this mechanism in financing the nonprofit sector?
 - Based on the presented models as well as their financial and social impact, it can be concluded that the introduction of the tax assignment mechanism in Albania would be useful for non-profit organizations as a way to create a source of further financing by the public administration. Although this situation is unlikely to happen in the near future as it would represent additional costs to the state budget and require a deeper assessment of all the impact it will bring, it is worth presenting as an effective model that can be applied in the future in Albania as well.
 - It is undeniable that on the one hand, the tax assignment mechanism brings a number of positive effects, such as the decentralization of citizens' decision-making on their taxes or the support of public benefit goals. Furthermore, in relation to organizations, a decentralized and highly flexible financing is provided; also the establishment of closer cooperation between non-profit organizations and taxpayers exercising the right to tax assignment can be seen as an advantage, which certainly positively affects the visibility of non-profit organizations.
 - On the other hand, the tax assignment mechanism also brings a number of negative consequences that need to be considered. Among them we can mention: the increase of administrative costs related to the administration of the tax assignment mechanism, as well as other complications of the tax system. If this mechanism were to be introduced, it is necessary to clearly define what its public utility is and also provide adequate control to prevent abuses that may occur with the tax assignment mechanism.
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