

Non-Government Organisations in the Market of Social Services: Financial, Institutional, and Legal Aspects

Round-Table Presentation Materials

Kyiv, February 23, 2007



**Сприяння реформі соціальних послуг в Україні
Facilitating Reform of Social Services in Ukraine**

Factors inhibiting NPOs' access to the social services market

- Framework nature of the Law on Social Services, its disagreement with the laws on non-profit organisations.
- Lack of competitive operating conditions in the market of social services - preferential terms for organisations and enterprises of disabled people, UTOG (Ukrainian Association of the Deaf /UTOS (Ukrainian Association of the Blind) etc
- Non-transparent funding of tenders for social services provision
- Non-unified regulatory legislation on NPOs – public organisations, charity funds, religious organisations
- Weak financial and staff capacity of NPOs
- Imperfect incentives for charity support to NPOs

Distinction between charity funds and public organisations management

| | •Law on Associations of Citizens | •Law on Charity and Charitable Organisations |
|---|---|--|
| Addressees | organisation members | Society or certain categories of people |
| Overseas “analogues” | Mutual Benefit Organisation | Public Benefit Organisation |
| Founders | Individuals | Individuals and legal entities |
| Registration period | 3 to 30 days | 2 months |
| Register | <ul style="list-style-type: none"> •Unified State Register of Enterprises and Organisations (USREO); •in fact, there is no register of public organisations | Register of Charitable organisations |
| Limits of operating costs | - | 20% |
| Right to establish an enterprise | + | - |
| Sanctions | <ul style="list-style-type: none"> •Notification, penalty, discontinuance of operation, dissolution | Not defined by the law |

Regulation of NPOs' activity: Ukraine and the countries of Eastern Europe

- According to their **purpose**, NGOs are defined as **mutual benefit** and **public benefit organisations**.
- Tax benefits are generally provided for public public benefit NGOs.
- NGO-Private Joint Ventures (PJV) can be created both by individuals and legal entities
- Registration requires to specify the types of socially useful activities.
- The Law provides a comprehensive list of socially useful activities.
- Public benefit NGOs allocate funds only for socially useful activities.
- Efficient mechanisms of transparency, control, accountability and liability.
- If NGO-PJV authorities abuse their position, misuse funds etc, the leader of an organisation is prohibited from providing social services (for a definite period)
- Under the Law o on Associations of Citizens, all public organisations belong to mutual benefit organisations.
- Charitable organisations, that is public benefit organisations, have no additional tax benefits.
- Public organisations cannot be established by legal entities.
- Registration does not require to specify the types of activities.
- The Law does not define the types of socially useful activities.
- NGOs are allowed to channel funds not only for social services, but also for other activities laid down by the statute.
- Total lack of control.
- The only sanction imposed by NGOs is to terminate or suspend the activity, or withdraw a non-profit code.

Tax systems for NPOs in Ukraine and the countries of Eastern Europe

| | Ukraine | Eastern Europe (Bulgaria, Poland, Romania, Slovakia, Hungary, the Czech Republic) |
|--|--|---|
| Income tax (revenue) | Non-profit status | Non-profit status |
| VAT | <ul style="list-style-type: none"> • Charity received by all types of NPOs is exempt from VAT. • Some operations are exempt from VAT, whether fulfilled by NGOs or commercial organisations (provision of special goods for people with disabilities, provision of services in homes for older and disabled people, meals and night shelter for homeless people) | <ul style="list-style-type: none"> • VAT-exemption for all outputs. At the same time inputs are not exempt from VAT. • Zero tax rate for both inputs and outputs. • Reduced rate for a certain list of operations. |
| Tax incentives for patronage • <i>for legal entities</i> • <i>for individuals</i> | <ul style="list-style-type: none"> •5% (reduction of income tax) •5% (tax credit) | <ul style="list-style-type: none"> •2-20% (reduction of income tax) •0-30% (both tax credit and reduction of income tax) |
| Wage-fund taxes and charges | No benefits | No benefits |

Shortcomings in the Law on Social Services

- Framework nature of the Law with multiple references; its inefficiency for direct application
- Lack of the list of social services; vagueness of the very concept of social services
- The Law is not in line with the acts regulating the activity of NGOs (the Law on Associations of Citizen and the Law on Charity and Charitable organisations)
- Uncertain procedures for licensing professional activities in social services provision
- Unspecified requirements to social services providers
- The Law does not regulate issues on service quality, quality control of social services, and responsibility for law-breaking
- Unequal conditions for social services providers (licensing applies to the non-government sector, but not to public and municipal)

Unfair “game rules” in the social services market

- **Direct funding of certain organisations from the State Budget**

Examples: NGOs of the disabled – UAH 27110 thousand (in 2006), NGOs of veterans – UAH 2768 thousand (in 2006), NGOs of Chernobyl victims – UAH 1 mln (in 2006), NGO “Suzirya” – UAH 11500 thousand (in 2006), children’s NGOs – UAH 600,000, physical culture and sports NGOs – UAH 10450 thousand, the Confederation of Ukrainian NGOs of disabled people – UAH 6000 thousand.

- **Non-transparent Tenders for the Attraction of Budget Funds for Social Services Provision** (Resolution of the Cabinet of Ministers of Ukraine # 559 of 29.04.2004)

- **Additional tax benefits for some NPOs** (organisations of disabled people are exempt from VAT; dues to the Pension Fund – 4% (others – 32%); dues to the Industrial Accident and Occupational Diseases Insurance Fund are twice lower than others, wage fund – 0% (others – 1.6%), dues to the Social Insurance Fund for Temporary Disability – 0.7% (others – 2.9%)

- **Different requirements to charity funds, public and religious organisations**

- **Unreasonable criteria of the exemption of public organisations from income**

(only environmental, health-improving, amateur, sporting, cultural, educational, and scientific activities are exempt from taxes)

Non-transparency of tenders for attraction of budget funds for social services provision

- There are no clear criteria for evaluation of bidding proposals.
- The order of publishing the decisions on holding tenders and on their results is not fixed (clause 2 of the Rules of organisation and Hosting of Tenders – “the decision shall be published in the mass media”).
- The procedure of considering bidding proposals is not transparent.
- There is no list of grounds for nullifying tender results, and consequently, it is impossible to appeal against against them.
- Tenders are of a closed character, there is a lack of control over them (membership of NGOs’ representatives in tender committees is not obligatory, an applicant cannot submit additional explanations, documents etc).

Incentives for financial support to NPOs in the countries of Eastern Europe

- 1 per cent Law

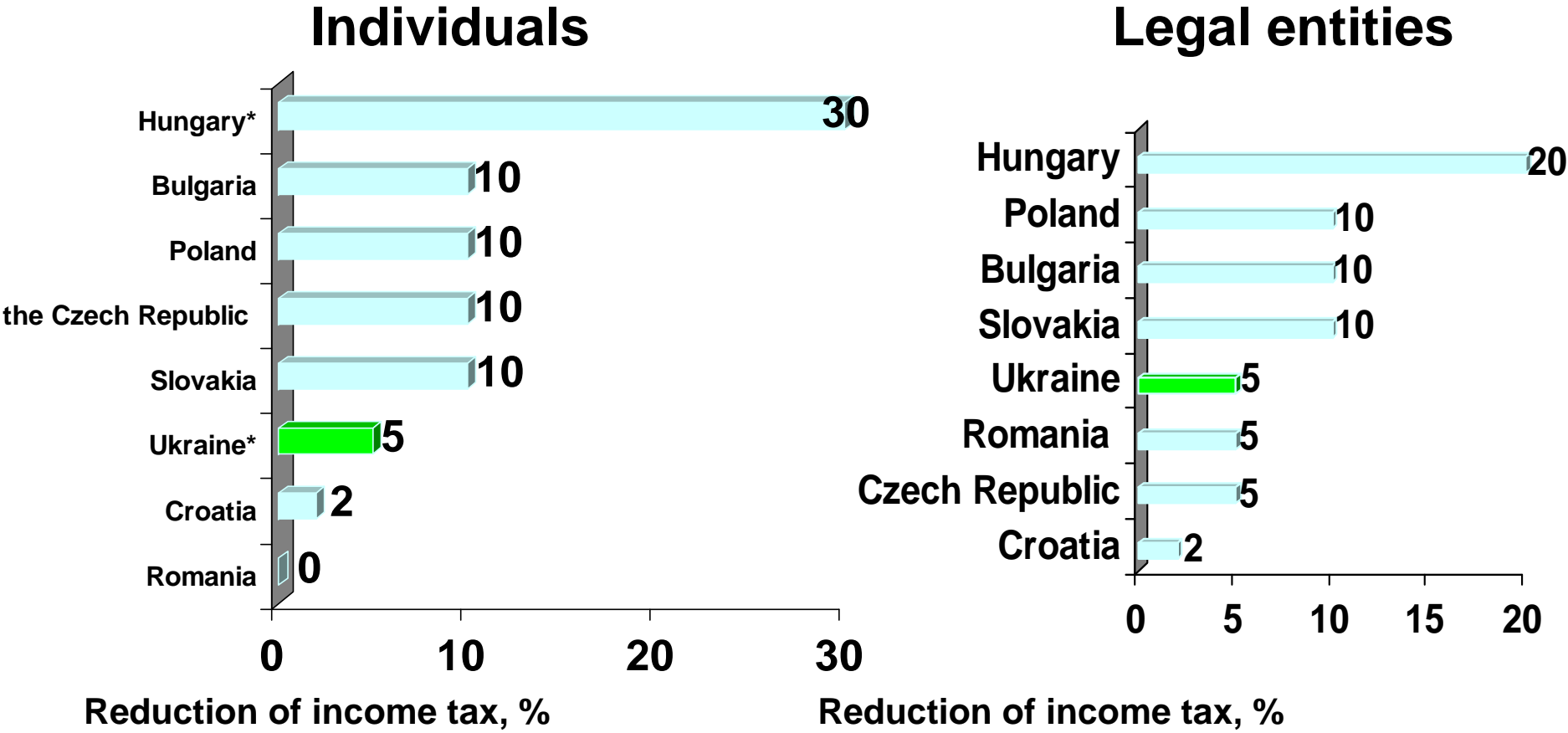
- Allows to channel 1% of income tax to NGOs' needs (initiated in Hungary in 1996).
- Later this approach was adopted by Slovakia in 2001, Lithuania in 2002, Poland and Romania in 2003.
- In all these countries (except Slovakia) the Law also applies to individuals.

| | Without patronage | Income tax cut | 1% Law |
|------------------------|-------------------|--------------------------------------|----------------------------------|
| Income | 100,00 | 100,00 | 100,00 |
| Net income | 75,00 | $100 - (5 + 23,75) = \mathbf{71,25}$ | 75,00 |
| In the budget | 25,00 | $(100 - 5) * 0,25 = \mathbf{23,75}$ | $5 - 25 * 0,01 = \mathbf{24,75}$ |
| Support of NGOs | 0,00 | 5,00 | $25 * 0,01 = \mathbf{0,25}$ |

- Encouraging long-term patronage

Individuals and legal entities that conclude a contract with an NGO for financial support for a period over four years are granted additional tax benefits (Hungary)

Facilitating financial support to NPOs in Ukraine and the countries of Eastern Europe (tax benefits for individuals and legal entities)



* - tax credit

Disputable issues

- The expediency of introducing a unified classification of NPOs as public benefit and mutual benefit organisations;
- the expediency and stages of reducing privileges for some NPOs (UTOG/UTOS, organisations/enterprises for the disabled etc) and the recession from direct budgetary financing of NPOs;
- the ways of improving the transparency of tenders for attracting budgetary funds to finance social services;
- the ways of enhancing NPOs' fiscal capacity ;
- the expediency of the creation of a single register of social services providers;
- the mechanisms of enhancing NGOs' staff capacity;
- the ways of introducing the standards of social services;
- the expediency of narrowing the range of activity types that are subject to licensing in social services provision;
- the ways of improving the effectiveness of control by government/local self-governance bodies in social services provision.