

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

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**FACILITATING REFORM OF SOCIAL SERVICES  
IN UKRAINE (FRSSU)**

Contract Number: CNTR 03 5289

**THE INTERFACE BETWEEN LEGISLATION ON NON-GOVERNMENT  
ORGANISATIONS, TAXATION AND THE DELIVERY OF SOCIAL  
SERVICES**

**IMPROVING THE POLICY ENVIRONMENT FOR THE PARTICIPATION OF NON-  
GOVERNMENT ORGANISATIONS IN THE SOCIAL ECONOMY OF SOCIAL  
ECONOMY**

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Responsibility for the contents of this consolidated information resource rest with the Project Director of DFID's FRSSU project and the authors.

## **LIST OF ABBREVIATIONS**

CEEC	Central and Eastern European Countries
CoM	Cabinet of Ministers
DFID	Department for International Development
ESF	European Social Fund
FRSSU	Facilitating the Reform of Social Services in Ukraine
GAP	Government Action Programme
GNP	Gross National Product
IMF	International Monetary Fund
IT	Information Technology
ISIC	International Standard Classification of All Economic Activities
LSS	Law on Social Services
NACE	Statistical Classification of Economic Activities in the EC
NGO	Non-Government Organisations
MBO	Mutual Benefit Organisation
MoFYS	Ministry of Family Youth and Sport
MoJ	Ministry of Justice
MoLSP	Ministry of Labour and Social Policy
NPM	New Public Management
PEM	Public Expenditure Management
PBO	Public Benefit Organisation
SNA	System of National Accounts
SRMO	State Run Mass Organisation
TLWC	Temporary Loss of Working Capacity Fund
UKT ZED	Ukrainian Foreign Trade Goods Classifier
UMIF	Ukrainian Unemployment Insurance Fund
UN	United Nations
UTOG	Ukrainian Society of the Deaf
UTOS	Ukrainian Society of the Blind
USA	United States of America
USAID	United States Agency for International Development
VAT	Value Added Tax

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## EXECUTIVE SUMMARY

### Setting the Scene:

Non-Government Organisations [NGOs] make an important contribution to national life in Ukraine by providing vital services, strengthening communities, identifying new needs, representing important interests that otherwise would be marginalised from public view, contributing to public goods such as poverty reduction and promoting social cohesion, and innovating new ways for tackling social problems that affect communities. However there are barriers in the policy environment that hinder achievement of the full contribution and growth NGOs can make to national life. With the advent of the Law on Social Services (LSS) [2004]<sup>1</sup>, which makes legal provision for NGOs to enter into license-based contractual<sup>2</sup> obligations for the provision of community social services, the barriers have become particularly acute. Identifying the nature of these barriers is therefore of critical importance for ensuring that NGOs are able to develop their full potential, and for ensuring that deficits within the legal and regulatory framework are analysed and addressed.

The strategic analysis set forth in this report is an integral part of the DFID Project on Facilitating Reform of Social Services in Ukraine [FRSSU] that includes a focus on the development of:

*Policy objectives and priorities, and the development of strategies for social services reform, which support the Government of Ukraine's [GoU] overall aims of poverty reduction and decentralisation*

And, the identification of:

*Financial systems and processes that need to be in place to support the delivery of community-based social services...and new approaches to financial planning, management and auditing.*

The focus of this report is complementary to other policy related inputs instituted by the FRRSU project<sup>3</sup>, which have been developed in collaboration with a range of local stakeholders, and specifically focuses on the development of new approaches for the financing and management of community-based social services through the involvement of NGOs. The report, which adopts an evidence-based approach to particular areas of NGO policy, does not provide a holistic analysis of the NGOs in Ukraine. The focus is, therefore, on the identification of strategic barriers that can be tackled by changes to the legal and fiscal framework, and draws the attention of policy makers and NGO representatives to the following dimensions:

- A Social Economy approach towards the involvement of NGOs in the delivery of community-based social services in Ukraine

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<sup>1</sup> The Law on Social Services, Verkhovna Rada (BVR) 2003 N45, p.38 updated under Law No. N 1891-IV, of June 24, 2004. The origins, and rationale, for the Law on Social Services can be traced to Presidential Decree No 1166/97 of 18 October 1997 which focused on economic and social policy for the period 1997-2000 [see footnote 16], and reinforced by Presidential Decree 637 of 15 August 2001 [see footnote 17] which focused on the development of Poverty Reduction Strategy [PRS]. It should be noted, however, that the PRS never materialised into a coherent policy and governance framework for reform.

<sup>2</sup> See Clause 8 of the Law on Social Services – which states that “Non-governmental entities who want to provide social services on a professional basis at the expense of their own means, attracted means, or means of state or local budgets, shall provide [services] on grounds of license”

<sup>3</sup> These inputs have focused on Public Expenditure Management for the Reform of Social Services; Demographic Trends and Future Demands for Social Services; and the Development of Legislative Frameworks and Social Services Policy.

- The legal status of NGOs in Ukraine
- The current tax treatment of NGOs in Ukraine, and the relationship between NGO legislation and the taxation system with the regard to a creating an enabling environment for NGOs to engage in the provision of social services.
- An assessment of the models and approaches that have been used/adopted in Central and Eastern European Countries to facilitate and support NGO service provision, and the regulatory arrangements for establishing their position – as public benefit organisations - within the system of taxation.

In the context of these broad dimensions, the report specifically draws attention to:

- State policy towards social services;
- The development of the non-governmental sector in Ukraine;
- The identification of key institutional trends in the NGO sector, and a delineation of the structural opportunities and systemic threats to the emergence of NGOs as effective and sustainable service providers of community-based social services across Ukraine
- General observations, with supporting explanations, on policy options that should be considered in Ukraine – including specific amendments to the legislative framework and the current taxation regime - in the context of promoting the growth and sustainability of NGOs in the Social Economy
- An evaluation of the advantages and disadvantages of specific policy options
- The identification of critical issues that call for legislative attention over the short and medium term with regard to the pre-conditions that are necessary for enhancing the role of NGOs as providers of community-based social services within a public benefit ethos.

#### **Methods:**

The team that undertook the analysis was comprised of Ukrainian and international consultants, experts in NGO law, economics, administration and policy. The team gathered information using a range of methods. There were meetings with central government ministries, Oblast level authorities, representative NGO bodies, and various national and regional consultation events organised by the Agency for Legislative Initiatives [ALI]. Draft reports were subject to peer review. The terms of reference for the analytical tasks, papers setting out key questions, and options for reviewing the legislative and taxation regime were prepared ahead of the actual tasks being undertaken.

#### **Format of the Report:**

The report is divided into five chapters.

- Chapter 1 focuses on the development a framework for the delivery of social services by NGOs, and elaborates on central concepts that underpin the Social Economy and public

benefit, analyses government strategies towards social services and NGOs between 1994 and 2000, the creation of an enabling framework for a social economy in social services, and an overview of conceptual and organisational links between these features in the Ukrainian policy environment.

- Chapter 2 focuses on a review of existing analytical studies on the characteristics of NGOs in Ukraine with a particular focus on qualitative and quantitative features delineated in studies conducted by Counterpart Creative Centre, USAID and the World Bank
- Chapter 3 focuses on an analytical review of the legal frameworks that govern NGOs and their potential and actual roles in the provision of social services. Particular attention is devoted to the definition accorded to NGOs in the LSS, the interface between the Law on Association of Citizens and the LSS, the interface between the Law on Charity and Charitable Organisations and the LSS, the interface between the Law on Freedom of Conscience and Religious Organisations and the LSS, regulating and registering the activities of NGOs according to distinct legislative and institutional structures, new trends in the regulation of social services provision, and legislative regulation of NGOs in the Social Economy of countries in Central and Eastern Europe, and some general observations on the legislative framework for supporting the Social Economy with specific reference to social services delivery in Ukraine.
- Chapter 4 focuses on taxation policies and tax incentives for NGOs in the Social Economy. Particular attention is devoted to the framework of taxation in Central and Eastern Europe, the current system of NGO taxation in Ukraine, tax exemption and tax benefits for NGOs in Ukraine, the treatment of incentives for goods and services provided by NGOs for the benefit of others; a comparative analysis of NGO taxation in Ukraine and in Central and Eastern European countries, and some general observations on the taxation regime and its interface with the social economy for the delivery of social services in Ukraine.
- Chapter 5 focuses on a framework for policy dialogue between the government and NGOs with a particular focus on principles that need to underpin the common objective of elaborating the LSS, and measures for encouraging the participation of NGOs in the delivery of social services.

### **The Structure and Composition of Recommendations:**

In the context of the analysis set forth in this report and the report being used to facilitate policy, the report offers a number of general observations – which incorporate specific recommendations – that will need to be considered by government policy makers and NGO representatives. These observations are based on a technical assessment of the evidence assembled.

### **Chapter 1: A Framework for the Delivery of Social Services**

1. Capturing the distinctive purpose of organisations that are neither part of government nor part of business, and which have emerged in the wake of the collapse of the communist welfare state, is clearly important in the context of developing a framework that enables the identification of barriers that inhibit their potential to make important contributions to national life in Ukraine in general, and to the delivery of social services in particular. The definition of these Non-Governmental Organisations as a group of organisations that: (i) have both economic and social missions, (ii) provide public benefit, and (iii) whose final objective is not the redistribution of

profit helps identify their purpose, and distinguishes their purpose from that of business and government. The term Non-Government Organisations [NGOs] is the accepted noun that is used to identify the specific components or different facets of these organisations, and is retained in this report.

2. Linking NGOs to the Social Economy is a valid route to follow in the context of policy developments in Ukraine. This validity is supported by the following facts:

- The legislation covering the activities of NGOs is rapidly evolving in Ukraine. This is reflected in the fact that legislative frameworks governing the activities of NGOs have become increasingly differentiated to reflect and legitimise new organisational forms of associational life;
- The declared direction of reform as defined in government social policy, from conditions that prevailed under a communist welfare state to new conditions under a pluralist democracy and a market-based economy, has increasingly placed NGOs at the epicentre of this process. This is reflected in the declarative statements enshrined in the national strategies and policy priorities in the social policies of governments between 1994-2004;
- The national strategies and policy priorities of governments explicitly include declarative statements that support the emergence of a Social Economy. This is demonstrated by the delineation of tax entitlements and financial privileges ascribed to certain categories of NGOs that are engaged in the performance of tasks that have a declared ‘public benefit’ focus;
- The Law on Social Services enshrines the principle of engaging NGOs under a licensed-contracting and tendering regime for the provision of community-based social services. This demonstrates an intention with government to deepen the Social Economy in general, and expand the scope of organisations involved in the delivery of social services in particular.

3. Despite these favourable pre-conditions, it is discernable that the content and focus of strategic documents covering the interface between social services, the Social Economy and NGOs are have hitherto been declarative in nature, with little evidence of a co-ordinated approach that draws on a distinctive vision for the future role of NGOs in national life.

## **Chapter 2: Survey Data on NGOs in Ukraine**

1. Evidence from existing survey data on NGOs in Ukraine indicate that little attention has so far been devoted to assessing the national profile of NGOs in the Social Economy, or the contribution that the Social Economy makes the national economy of Ukraine. Within current survey data it is difficult to establish with any degree of certainty the organisational or financial trends that are taking place within the Social Economy. This partly due to wide variations in focus of these studies and the methodologies they deploy to collect and analyse data. This observation is important because NGOs carry out a wide range of activities – ranging from service delivery through to advocacy and lobbying and the pursuit of leisure. Thus for policy questions like the scope for, and involvement of, NGOs in the delivery of social services it is helpful to know what kinds of activities are being undertaken by NGOs in the economy, and the pattern of distribution across different types of activities. In the context of the growing size and importance of the Social Economy to Gross National Product [GNP] many countries, including those in Central and Eastern Europe, are devoting considerable attention to assessing and measuring the contribution the NGO



sector makes to the generation of wealth and the forms in which its contributions take to national life and the well-being of citizens.

2. The European Union and the United Nations have been championing the approach of Satellite Accounts for the Social Economy, which is based on *identifying* what NGOs have in common, and *classifying* organisations based on their differences. The two principles of identification and classification use as their starting point the International Standard Classification of All Economic Activities [ISIC] and the Statistical Classification of Economic Activities in the EC [NACE]. The system of satellite accounts for the social economy is intended to collect useful information about the NGO sector and present it in a consistent form of accounts. The UN *Handbook on Non-Profit Institutions in the System of National Accounts* adopts an approach based on:

- A fully elaborated satellite account structure;
- A system of extended accounts that include a range of social and economic indicators that may be useful to extend the data coverage of the satellite account system beyond monetary representations of activities;
- A short pro-forma that focuses on the most readily available variables and relationships that can be used until the system is elaborated

3. In the context of systemic weaknesses with Ukrainian data on NGO activities in particular, and the need to advance a Social Economy approach to the sector in general, it would – as the LSS is elaborated and the *modus operandi* of social services delivery by NGOs develops a higher level of operational definition – be advantageous for policy makers in Ukraine to consider adopting a satellite account system. This system - which has been advanced under the rubric of UN *The Handbook* – aims to capture the structure, organisational composition, and financial dimensions of NGO activities. The current system of ad hoc surveys is an inadequate for assessing characteristics of the sector, emergent trends, capturing the contributions the sector currently makes to the economy, or for defining the policy frameworks that are necessary for elaborating the governance systems necessary for a functioning Social Economy.

### **Chapter 3: NGO Legislation and the Interface with the Law on Social Services**

1. The LSS does not draw sufficient distinctions between different types of NGOs [civil association, charities, and religious organisations] or the operational implications that stem from the separate regulatory frameworks that govern their participation in the delivery of social services. Addressing this matter – initially through a review of the various NGO legislative frameworks, and then by developing relevant regulations that specify the types of NGOs eligible to engage in procedures for the deliver social services - is an essential pre-requisite for ensuring that all NGOs are able to participate in the Social Economy on an equal footing.

2. The privileged status accorded to State Mass Run Organisations [SMROs] is a residue from the communist welfare state, and creates imbalances in the way the state relates to NGOs in general. Inevitably changes to the prevailing arrangement of grants and subsidies awarded to SMROs will take time to implement [as they have done in many other CEECs]. The LSS provides an opportunity for the government to evaluate current arrangements that govern the administration of grants and subsidies, with a view towards exploring options that will help establish a regime that, over time, places less of a premium on this form of funding and begins to incorporate a number of features that have come to characterise funding and service delivery regimes in CEECs.

3. The body of NGO legislation in Ukraine is hazy on the operational concept of ‘public benefit’ and there is clear need, in the context of the LSS, for consideration to be given to the development of a conceptual and operational framework that draws on the draft law on Non-Entrepreneurial Organisations [2004]. This observation is premised on the assumption that the government is minded to support the organisational frameworks set forth in the draft law on Non-Entrepreneurial Organisations.

4. Implementation of the LSS, and the development of accompanying regulations, needs to take account of the operational realities [constraints and opportunities with regard to staffing levels, financing, partnerships with local tiers of government etc] that confront the majority of NGOs that might engage in the delivery of social services. While the declarative ambitions of the LSS clearly resonate with policies pursued in other Central and Eastern European Countries [CEECs], the accompanying regulations need to be grounded in the social, economic and political conditions under which the majority of NGOs operate. Failure to take account of these realities could jeopardise the emergence of a diversified Social Economy that encourages innovations in the delivery of social services.

5. Articles 8 and 16 of the LSS require NGOs intending to provide professional social services must obtain a relevant license. The procedures that are established for a licensing regime will need to take account of the type of financial regimes [e.g., grant, subsidy, tendering and contracting] that are to govern the financing of social services. The link between licensing and financing is critical for ensuring that the licensing regime does not disfavour NGOs that are currently excluded from resource allocations from the state budget and associated payroll privileges. Moreover, the LSS will need to ensure that clarity is developed on the balance that needs to be struck between the registration of NGOs [to provide social services] and the licensing of NGOs [to provide social services]. Combining registration and licensing into a single administrative procedure would undoubtedly reduce the transaction costs [for both the government and NGOs] associated with determining organisations that are deemed eligible to provide social services.

6. Under current legislative arrangements, the Charity Law and the LSS have the strongest levels of congruence on matters associated with the delivery of social services. This congruence provides a platform from which the government can, over the medium term, seek to foster conditions that will help the Social Economy to emerge; and draw the necessary distinctions between the prospective roles of mutual and public benefit organisations in the delivery of social services.

7. The LSS can only be effectively implemented in the context of a clear separation of commissioning and provider functions. Thus a regulatory framework that effectively separates these functions is required at the oblast and sub-oblast levels. This framework will need to be accompanied by robust inspection and quality assurance structures that ensure services delivered by NGOs meet accepted standards of public accountability, and meet professional standards that accord with the regulations enshrined in the LSS and the NGO legislation.

8. Particular attention needs to be given to the interface between the LSS and the Law on the Fundamentals of Social Protection of Disabled People in Ukraine and the Law on Youth and Children’s Public Organisations – given that associations and organisations covered by these bodies of legislation are not adequately represented or accounted for in the LSS.

9. The experience from CEECs is that the decentralisation of power and authority to local tiers of government has opened-up important spaces for NGOs to participate in localised Social

Economies. These spaces have emerged in the context of systems of governance that promote and foster policy dialogue and partnership between NGOs and local tiers of government. Under the LSS, regulations should be developed that offer – drawing on the experience of CEECs - guidance on the formation of such partnership arrangements for the delivery of social services.

#### **Chapter 4: The Taxation Regime for NGOs**

1. The Ukrainian taxation system for NGOs has some features that are comparable with CEECs. For example, NGOs are exempt from taxes on incomes received in the form of voluntary donations, irretrievable financial assistance, humanitarian or technical assistance, allocations or subsidies received from the nationwide or local budgets and state target funds. In addition, taxes are not levied on the business activities of NGOs if the business in question is closely related to the aims and objectives for which a relevant NGO was set up [i.e.; the “relatedness” test].
2. The Ukrainian VAT regime has many features that bear similarity to those that apply in CEECs. Indeed, the current Ukrainian VAT regime cannot be described as providing greater or lesser benefits to NGOs than the legislation applied in the majority of CEECs. However, the Ukrainian VAT regime does accord a greater range of benefits and privileges to SMRO-type NGOs that concentrate on disabled people organisations. In the context of the LSS, and the future growth and sustainability of the Social Economy, such discrepancies need to be rectified if a wider circle of NGOs are participate in the delivery of social services as defined in Article 1 of the LSS.
3. Terms of employment – as defined in legislation - between different types of NGOs demonstrate a degree of inequity that hampers and hinders the development of the Social Economy, and results in the majority of NGOs [i.e., those that are not part of the SMROs that were established under the Communist welfare state] incurring higher payroll tax costs. In the context of an expanding Social Economy such inequities cannot be justified and will – over time - lead to increasing levels of inefficiency given that non-SMRO-type NGOs will not be able to compete in a tender and contracting regime [as defined in the LSS] on a equal basis given that their overhead costs will always be higher.

#### **Chapter 5: A Framework for Policy Dialogue**

This concluding chapter draws together key issues and themes under the rubric of forging ahead with policy dialogue that has a focus on the broad aim of establishing a common platform for elaborating the Social Economy; and the design of a framework that supports the delivery of social services in accordance with the central tenants of government policy as delineated in *Towards the People* and the LSS. Specific attention is devoted to the elaboration of some key principles that should underpin the content of policy dialogue, namely:

- The Freedom of Association;
- Respect for the NGO Sector’s Independence;
- Promoting Public Confidence;
- Supporting the Delivery of Public Benefit;
- A Proportionate Approach to Risk Based Regulation;

- Simply and Harmonise Regulation where Possible;
- Clear, Consistent and Transparent Regulation.

It is anticipated that the observations set forth in this report will contribute to, and inform, the elaboration of on-going work on public expenditure management for the reform of social services, the development of social services legislation, the development strategic plans, and transition action plans that assist with implementation of the LSS.

## Chapter 1:

### DEVELOPING A FRAMEWORK FOR THE DELIVERY OF SOCIAL SERVICES BY NON-GOVERNMENT ORGANISATIONS

#### Defining Organisations in the Social Economy

Non-Government Organisations [NGOs] are often associated with phrases such as ‘Third Sector’ and ‘Civil Society’, Not-for-Profit, and the ‘Voluntary Sector’. These terms are inveighed to distinguish the purpose of the sector as something different from government and business. However, these terms do little to define the sector itself and are unlikely to be very well recognised by the general public. A term which captures the distinctive purpose of organisations that are neither fully part of government, nor part of business, would therefore be preferable. There are essentially two ways to do this. One is to identify what such organisations are **not about**: i.e., making profits for investors. It is in this vein that the term ‘not-for-profit’ has evolved into widespread usage in the USA<sup>3</sup> and has been transferred, often with little scrutiny, into other contexts. However, the term carries the inaccurate implication that organisations are aiming only to break even, whereas in many instances they are in fact aiming to make a surplus – in order to reinvest this surplus into a social purpose. The other approach is to say what such organisations **are about**: i.e., pursuing community or social purposes. It is in the context of emphasising what the sector is about that the term ‘Social Economy’ has come into widespread usage across all member states – including the recent members from Central and Eastern Europe - of the European Union<sup>4</sup>.

The rationale for the ‘Social Economy’ is linked to alternative modes of governance that can be deployed for the production of goods and services. Traditionally these modes of governance have been linked to “public” and “private” production. The term “public” production focuses on “public goods” which are carried out by governments and include defence, law and order, the enforcement of contracts, and public welfare policies aimed promoting social cohesion and reducing socio-economic inequalities. Such goods are financed through compulsory measures of taxation, and because they are indivisible [i.e., collective] are available to everyone if they available to anyone. In this sense public goods are a pre-requisite to economic activity<sup>5</sup>. The term “private” production, on the other hand, refers to companies and firms that produce goods and services that yield a profit in a competitive market i.e., firms must try and sell as much as they can until the cost of producing another unit exceeds the price of that unit<sup>6</sup> i.e., the price they receive is less than or equal to the cost of production. The Social Economy – which is comprised of private

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<sup>3</sup> See Salamon, L.M., and Anheier, H.K., 1996; and Salamon L.M., *et.al.* 1999

<sup>4</sup> The ‘social economy’ was adopted by the European Commission in 1997: *Promoting the Role of Voluntary Organisations and Foundations in Europe*. Brussels. CoM 1957 241 final 6 June 1997. The term ‘Social Economy’ is widely used to refer to the production of goods and services that seek to strike a balance between economic growth and social cohesion. Organisations within the social economy organise their activities around the following principles: precedence of the person, voluntary and open membership, democratic control by members, conjunction of interests between user members and the general interest, defence and implementation of solidarity and responsibility principles, management autonomy and independence vis-à-vis the state, and reinvestment of the benefits for development of their own activities or the interests of the community. Organisations belonging to the social economy include associations, co-operatives and mutual organisations, and foundations.

<sup>5</sup> The concept of ‘public goods’ is traditionally defined as any good such that if any person in a group consumes it, the good cannot be withheld from others in that group. In other words, those who do not purchase or pay for any public or collective good cannot be excluded or kept from sharing in the consumption of that good, as they can where non-collective goods are concerned (Olson, 1971; Olson and Kahkonen, 2000)

<sup>6</sup> *op cit.* Olsen 1971.

groups and associations - is assumed to operate according to principles of governance – linked to public advocacy and improving service delivery - that serve community or social purposes, and that seek to balance economic growth with social cohesion. As such the rules that govern their purpose are different from those that govern relationships between firms in the marketplace or between taxpayers and the state<sup>7</sup>. The principles of governance in the Social Economy can be systematised<sup>8</sup> into functions that concentrate on:

- Encouraging civic and political engagement;
- Delivering services;
- Enacting private and religious values and convictions;
- Providing a channel for social entrepreneurship

In the context of analysing the service delivery function, which is perhaps the most directly observable and clearly visible role for NGOs<sup>9</sup>, economic theory on the production of goods and services provides a useful starting point for defining and understanding the role of NGOs that function as part of the Social Economy. Indeed, the rationale underpinning the Social Economy is linked to the twin problems of *government failure*<sup>10</sup> – which can arise when consumers demand a collective good but the government may not have the information that the good is demanded by taxpayers, or because government may not have the capacity to respond appropriately to meet the demand - and *market or contract failure*<sup>11</sup> – which can arise when the market fails to meet demand because of the benefits of the good or service are available only to consumers who have the ability to pay for it or because there are high externalities which cannot be reflected a market price that would generate profit.

Establishing an identity for organisations that serve community or social purposes outside of government and business is therefore important. For the purposes of this report, organisations that fall within the ambit of the Social Economy are therefore defined:

*As a group of organisations that exist between the state and market that fulfil both economic and social missions, which provide **public benefit**, and whose final objective is not the redistribution of profit.*

Organisations captured in this definition of the Social Economy pursue a broad range of purposes including welfare and health, sport and recreation, environmental concerns, and art and culture. Some provide services to the public and others provide mutual benefits to their members. For the purposes of this report, the sector is defined broadly defined to include organisations in Ukraine

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<sup>7</sup> Seligman, 1992; Carroll, 1992

<sup>8</sup> Frumkin, 2002

<sup>9</sup> However, because citizens – as users of goods and services not only want their needs meet - also want to be heard in terms of voicing their interests and needs the focus on the role of NGOs within the Social Economy incorporates: strengthening existing service systems through the aggregation and representation of interests; and the generation of pressure for better services by holding the state and the market to account through policy advocacy and monitoring.

<sup>10</sup> Weisbrod, 1988; Weisbrod, 1998a; Weisbrod 1998b; Weisbrod 2001.

<sup>11</sup> Hansmann, 1987

covered by the Law on Civic Associations<sup>12</sup>, The Law on Charity and Charitable Organisations<sup>13</sup>, The Law on Youth and Children's Public Organisations<sup>14</sup>, The Law on Freedom of Conscience and Religious Organisations<sup>15</sup>, NGOs covered in the Law on the Fundamentals for the Social Protection of Disabled People in Ukraine<sup>16</sup>, and the draft Law on Non-Entrepreneurial Organisations<sup>17</sup>. The Social Economy does not, therefore, include organisations such as political parties, business groups, trade unions, employers groups or, hobby groups that are part of the wider realm of civil society<sup>18</sup>.

It is clear that providing a benefit to the public is at the heart of NGOs operating in the Social Economy. Indeed, defining what constitutes 'public benefit' has critical implications for the development and regulation of organisations that operate in the Social Economy, and for defining the taxation regime that should govern their activities. A number of countries<sup>19</sup> have adopted different approaches to address the question of which organisations should acquire this status, or have the status revoked if the conditions of their registration are breached. There is no single best method for defining how public benefit status should be attributed and determined. Indeed, what makes sense in particular countries is dependent on local circumstances. Nevertheless two generic requirements<sup>20</sup> are considered essential to determining whether the activities of an NGO can be deemed eligible for the status of providing a 'public benefit':

- *Public* – the benefit provided by an organisation is available to the public or a sufficient section of the public

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<sup>12</sup> Verkhovna Rada No 2460-X11 June, 16 1992, and Revised Draft by Ministry of Justice 2006

<sup>13</sup> Verkhovna Rada No 531/97-BP April, 23 1991

<sup>14</sup> Verkhovna Rada No 281-XIV, December 1, 1998.

<sup>15</sup> Verkhovna Rada No 987-X11, April 23, 1991

<sup>16</sup> Verkhovna Rada No 875-X11, March 21, 1991

<sup>17</sup> Draft Law: Tkachuk, 29.06.04

<sup>18</sup> Definitions of civil society are bewildering diverse, but are essentially underpinned by two underlying sociological and political conceptions of the term. The political conceptions of civil society are rooted in the tradition of liberal democratic theory which identifies political activity as an essential component of the emergence of particular type of political society based on the principles of citizenship, rights, democratic representation and the rule of law. Sociological conceptions of civil society focus on the intermediate realm situated between the state on the one side and the basic building blocks of society on the other [i.e., individuals, households, families] which are inhabited by social organizations with some degree of autonomy and voluntary participation. Taking the political and sociological dimensions, civil society can broadly be defined as the broad arena where collective citizen action takes place on crucial aspects of social, economic and political life [Putnam, R. 1993; Burnbridge, J. 1997; Lewis, D. and Wallace, T. 2000; and Edwards, M. and Gaventa, J. 2001]. NGOs involved in the Social Economy are, within this broad conception, an integral part of civil society.

<sup>19</sup> For example, in **Poland** NGOs engaged in public tasks, as defined by the Public Benefit and Volunteer Work Act of 24 April 2004, can apply to the Ministry of Social Policy for public benefit status [see: [www.pozYTEK.gov.pl/Public\\_Benefit\\_and\\_Volunteer\\_Work\\_Act\\_567.html](http://www.pozYTEK.gov.pl/Public_Benefit_and_Volunteer_Work_Act_567.html)]. The law provides a framework for NGOs to cooperate with central and local tiers of government, to engage in economic activities, to acquire tax privileges, and regulates the engagement of volunteers, and to investment in government bonds. The definition of 'public benefit' excludes political parties, and business organisations. While in **Moldova** associations of citizens, regulated by the Law on Public Associations 1996, can apply for public benefit status through the Moldova Certification Commission of the Ministry of Justice [see: <http://www.e-democracy.md/en/ngo/resourcecenters/>]. In the United Kingdom [UK] the Charity Commission is currently working with the government on the legal principles and technical criteria, under the Charities Bill, that will establish a framework for defining 'public benefit' that will replace existing presumptions of charitable activity [see: [www.charity-commission.gov.uk](http://www.charity-commission.gov.uk)]

<sup>20</sup> Modified and adapted from the UK Charity Commission [see: [www.charity-commission.gov.uk](http://www.charity-commission.gov.uk)]

- *Benefit* – the pursuit of an organisation’s purposes must be capable of producing a benefit which can be demonstrated and which is recognised by law as beneficial.

These generic elements can be broken down further into five principles that are designed to demonstrate where an organisation provides benefit to the public. These are:

*The Public:*

- The benefit must be to the public at large, or to a sufficient section of the public;
- Private benefit must be incidental;
- Members of the public who are less well off must not be excluded from benefit.

*The Benefit:*

- There must be an identifiable benefit;
- The benefit provided must be assessed against prevailing socio-economic conditions that prevail in a society.

In the context of developing and implementing the principles enshrined in the LSS, the term ‘public benefit’ is critical to determining the extent to which associations of citizens, charities, religious organisations, youth and children’s organisations, disabled peoples organisations, and new forms of organisation - such as non-entrepreneurial organisations - are able to participate in social policy under conditions of increasing levels of decentralised decision making. Indeed, the strong interdependence between social policy reforms – particularly with regard to social services, health, employment, and community development - and an enhanced role for NGOs is one of the most important features of the Social Economy sector in both EU member states and transition economies, and has particular resonance in view of the following empirical observations:.

- The provision of social services by NGOs has hitherto the LSS not been a high priority in Ukraine, and identifying steps that will develop and encourage their potential as cost effective service providers over the medium term is an emerging priority;
- NGOs are concerned that the potential introduction of a contracting and tendering regime under the LSS will curtail their freedoms to campaign for their membership, and promote independent campaigns for the reform of public policy that aims promote the ethos of public benefit;
- The need to integrate the LSS with existing legislation on children, the elderly, the disabled, and other population groups, and to revise and update legislation to meet policy objectives that are geared towards the expansion of community-based social services;
- The absence of a strategic direction for social services, apart from the parameters set forth in the LSS, and the absence of normative directions for social services which would help determine the composition of policy towards supporting NGOs engage with service delivery;



- The cross-over between the ‘lead’ and ‘co-ordination’ functions of different central line Ministries that have responsibilities for social services, and the implications of this fragmented structure for effective implementation of tasks associated with decentralised decision-making arrangements for social services at the oblast, city and rayon levels;
- The need to establish an effective and co-ordinated approach towards social services in the context of a wider social policy framework for reducing poverty and social exclusion through the Social Economy.

## **Government Strategies and Creating the Enabling Framework for a Social Economy in Social Services**

The reform of social services, and the specific involvement of NGOs in the delivery of social services - as part of a nascent Social Economy - has evolved over a 15-year period in Ukraine. Indeed government aspirations for the reform of social services and the formation of a Social Economy, can be traced through a number of declaratory policy documents that have sought, in the context of the collapse of the communist welfare state - and the transition to political pluralism and a market-based economy - to open spaces for the participation of NGOs in social policy. The key documents are:

**The General Principles of Economic and Social Policy<sup>21</sup>: The National Strategy for Decentralising Social Service Delivery:** This was the first strategic document that raised the issue of reforming the social services system. It was commissioned under the Presidency of Leonid Kuchma and approved by the Verkhovna Rada under resolution No 216/94-VR on October 10, 1994. The report, which focused on the social protection of the population, was underpinned by a stance that reforms had to be instituted in ways that created incentives for each worker to improve his/her well being. Incomes lay at the root of this strategy for social protection, and emphasised that specialised social service programmes should be devised to provide cash, in-kind benefits, and social services to families on low incomes, pensioners and disabled people. The Strategy declared that targeted social aid and social services should be the main priority, and delegated the provision of such services to local self-government authorities<sup>22</sup>. Such services included providing medical, municipal services, homecare services and cash assistance. The strategy set out a commitment to create financial incentives that encouraged the activity of municipal social service foundations and the development of charitable organisations.

**The Principles of Social Policy for 1997-2000:** This was the next strategic document elaborated by the Cabinet of Ministers, which was promulgated by the Presidential Decree №1166/97 of

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<sup>21</sup> Government of Ukraine (1994) *Resolution on the General Principles of Economic and Social Policy*; Verkhovna Rada, No 216/94-VR, October 19, 1994, Verkhovna Rada of Ukraine, Kyiv.

<sup>22</sup> Paragraph 13 of Chapter 17 of the strategy, entitled the “*privatisation and decentralisation will be the key element of the President’s activity in the social policy area*” emphasised that a significant part of social expenditure had to be undertaken by local and regional authorities. Social institutions that previously been funded by state-owned enterprises and organizations had to be brought under the authority of municipalities. Preservation of the social orientation of mentioned institutions was guaranteed. Funding of those institutions had to be provided through the introduction of new local taxes. The Strategy also stipulated that new tax incentives had to be introduced in order to enhance private investments in the social sector, and that private initiatives in the area of social expenditure had to be placed on a sustainable footing. The Report was the first strategic document emphasizing the importance of introducing payable social services for persons with high incomes. The Strategy was the first to raise the prospect of an enhancing the role of local authorities and non-government organisations.

October 18, 1997<sup>23</sup>. The document declared that the promotion of non-governmental forms of social protection was one of the key elements for ensuring the reform of social policies inherited from the communist regime.

**The Priorities of Social Policy for 1997-2000:** This document emphasised the need to reform the social protection sector and the development of appropriate social infrastructure. In the area of demographic and family oriented policies, it stipulated the development of both public and non-governmental family oriented social services. It also emphasised the need to create public and non-governmental child-care centres that were to be engaged in rehabilitation of children living in disadvantaged conditions. In the course of reforming the social services system, the strategy placed significant emphasis on the need to establish alternatives to dominant use of residential institutions, and the development of community-based social services<sup>24</sup>. It is noteworthy that the document stressed the importance of previously State-Run Mass Organisations [SRMOs] that had been part of the communist welfare state<sup>25</sup>, and granted them particular legal and financial privileges.

**The Priorities of Social Policy for 2000-2004**<sup>26</sup> This document followed the trends set in the priorities articulated for the period 1997-2000, but placed much more emphasis on elaborating policies for families, children and youth; and support to charitable organisations involved in social policy. The document provided a critical assessment of the manner in which previous priorities had been established, and the ways in which the reform of social services had been advanced. The document stressed the need to expand and strengthen the legislative and financial framework for community-based [home care] services; and, in line with the previous strategy for 1997-2000, emphasised: (i) the goal of improving the quality of services provided by the territorial centres; (ii) the need to establish cooperation between state institutions and NGOs that provide social services to the poor; (iii) the importance of state financial support to organisations of disabled people through the introduction of tax exemptions, and to enterprises employing disabled people; and (iv) the creation of a new network of medical and social rehabilitation centres for disabled children.

**Towards the People (2005)**<sup>27</sup>: This is the Government Action Programme [GAP] promulgated by the government of President Yushenko. The document supports the broad thrust of previous policy directions, but emphasised that the principle improvement tasks for the social protection system of the population is *“to solve the problem of poverty (and) to increase the quality of social services in order to approach the European level and to enlarge the circle of those who render such services. Priority will be given to socially un-protected elderly people, not sufficiently*

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<sup>23</sup> Government of Ukraine (1997) *The Principles of Social Policy for 1997-2000*; Presidential Decree No 1166/97, October 18, 1997.

<sup>24</sup> The document lists that priorities should focus on elaborating the role of territorial centers that provide community-based social services to elderly and disabled people, that NGOs should be supported and encouraged to engage in the delivery of social services to all citizens at risk of poverty and social exclusion, and that system should be developed that defined services for which fees or co-payments were due [payable social services] for citizens who were assessed as being in position to pay for social services.

<sup>25</sup> The document outlined an entitlement framework for ensuring that a number of NGOs – particularly war veterans, disabled and youth organisations - that were previously part of the communist state would be eligible for funding from the state budget. Despite the emphasis on SMROs it is notable that the strategy set forth in the document made an important step in categorising the activities of NGOs by their cliental groups rather than restricting the categories to membership of the organizations. This step change was an important, if subtle change, in the development and ascription the ‘public benefit’ purpose to NGOs.

<sup>26</sup> Government of Ukraine (2000) *The Priorities of Social Policy for 2000-2004*. Presidential Decree No 717/2000, May 24, 2000, Government of Ukraine, Kyiv.

<sup>27</sup> Government of Ukraine (2005) *Towards the People: Government Action Programme*; Government of Ukraine, Kyiv.

*provided families, invalids, and families with children*". It is noteworthy that the objectives set forth in the GAP have not been elaborated into a strategic document to guide government action. In this respect, the document amounts to little more than a statement of intent, rather than a programme for implementation.

### **General Observations and Recommendations:**

Capturing the distinctive purpose of organisations that are neither part of government nor part of business, and which have emerged in the wake of the collapse of the communist welfare state, is clearly important in the context of developing a framework that enables the identification of barriers that inhibit their potential to make important contributions to national life in Ukraine in general, and to the delivery of social services in particular. The definition of these Non-Governmental Organisations as group of organisations that: (i) have both economic and social missions, (ii) provide public benefit, and (iii) whose final objective is not the redistribution of profit helps identify their purpose, and distinguishes their purpose from that of business and government. The term Non-Government Organisations [NGOs] is the accepted noun that is used to identify the specific components or different facets of these organisations, and will be retained in this report.

Linking NGOs to the Social Economy is a valid route to follow in the context of policy developments in Ukraine. This validity is supported by the following facts:

- The legislation covering the activities of NGOs has evolved significantly in Ukraine, and is reflected in the fact that legislative frameworks governing the activities of NGOs is becoming increasingly differentiated to reflect and legitimise new organisational forms of associational life;
- The declared reforms of government social policy, from conditions that prevailed under a communist welfare state to new conditions under a pluralist democracy and a market-based economy, has increasingly placed NGOs at the epicentre of this process. This is reflected in the declarative statements enshrined in the national strategies and policy priorities in the social policies of governments since 1994;
- The national strategies and policy priorities of governments explicitly include declarative statements that support the emergence of a Social Economy. This is demonstrated by the delineation of tax entitlements and social privileges ascribed to certain categories of NGOs that are engaged in the performance of tasks that have a 'public benefit' focus;
- The Law on Social Services enshrines the principle of engaging NGOs under a licensed-based contracting and tendering regime for the provision of community-based social services. This demonstrates the potential for deepening the Social Economy in general, and expanding the scope of social service delivery in particular.

However, and despite these favourable pre-conditions, it is discernable that the content and focus of strategic documents covering the interface between social services, the Social Economy and NGOs are predominantly declarative in nature. It is with this observation in mind, and the need to obtain a better appreciation of qualitative features in the policy environment that impinge on NGOs in Ukraine that the next chapter focuses on some of the features that currently dominate interests in the sector. The emphasis therefore focuses on assessing the extent to which the policy environment is favourable to NGOs, and the degree to which the policy environment enables

adequate responses to the challenge of engaging in the Social Economy through the delivery of social services.

## Chapter 2:

### A CRITICAL EVALUATION OF ANALYTICAL SURVEYS ON THE QUANTITATIVE AND QUALITATIVE ATTRIBUTES OF NGOS IN UKRIANE

#### Overview:

Non-Government Organisations [NGOs] can be registered, under Ukrainian Law as civic associations, charitable or religious organisations. NGOs categorised as belonging to the first category essentially operate as Mutual Benefit Organisations [MBOs] since their activities must be implemented in the interests of their members. Charitable Organisations [COs] are defined as public benefit by their nature and by legal status as they operate in the interests of the whole society or a section of the society. The third category - comprised of Religious Organisations [ROs] - cover both mutual and public benefit purposes since religious associations promote the religious views of their members, and can also implement public benefit activities<sup>1</sup>.

In assessing qualitative features in the regulatory environment that impact on NGOs in Ukraine, it is noteworthy that there is dearth of reliable and open information sources. Thus it is important to note that although there is a Single State Register of Civic Associations and Charity Organisations in Ukraine maintained by the Information Centre of the Ministry of Justice [MoJ], the register is not open for public access. On the other hand, the databases maintained by research-oriented NGOs [e.g., the database of the Counterpart Creative Centre] do not represent an adequate overview, since inclusion in such databases is, unlike those maintained by the Ministry of Justice, not mandatory. Another feature is that government data on NGOs is not classified by the type and range of activities performed by either civil or charity organisations. Thus it is impossible devise a framework that would classify NGOs into public and mutual benefit organisations<sup>2</sup> due to the lack of the explicit usage of these concepts in Ukrainian legislation – though the legislation implicitly makes these distinctions through the wording it uses to describe the purpose of organisations.

In addition to the features outlined above, it is noteworthy that most in-depth studies on NGOs in Ukraine have been performed by organisations that are themselves part of the sector. The studies exhibit the following characteristics: (i) they quite limited with regard to the specific areas or activities they focus on; and (ii) and do not look at the work of NGOs in the relation to the political, economic, social and legal conditions that prevail in Ukraine. Indeed, authors of such studies tend to focus on activities of which they are part; and are often confined to the activities of independent think tanks, or the sectional interests of categories of the population that are of concern to specific groups of NGOs. Moreover, the analysis is also typically restricted to certain regional frameworks and the internal operational aspects of specific organisations [i.e. relations with public authorities, management etc]. The studies also tend to be weak in terms of methodological rigour, and their recommendations and prescriptions tend to stretch beyond the available evidence assembled.

There are a small number of studies that extent beyond the parochial description of particular NGOs, and aim to provide an overview – based on quantitative surveys - of NGOs in Ukraine.

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<sup>1</sup> See Chapter 3.

<sup>2</sup> The difficulties associated with the classification of NGOs can, in part, be attributed to the fact that Ukrainian legislation on NGOs does not implicitly differentiate between organisations that are for mutual and public benefit. However, the legislation for civic associations and charities does explicitly recognise the difference between these different forms of associational life.

These periodic surveys, which use different methodologies, aim to collect data on the basic characteristics of NGOs, and provide snap-shots of nationwide trends on institutional capacities and activities. The most significant of these studies that have emerged over the last few years are:

- Civil Society Organisations in Ukraine: The State and Dynamics of the Non Government Sector Development in Ukraine – conducted by Counterpart Creative Centre<sup>3</sup>.
- The NGO Sustainability Index for Central and Eastern Europe and Eurasia – conducted by USAID which devotes a particular section to Ukraine<sup>4</sup>
- Civil Society in Ukraine – which was a one-off survey commissioned by the World Bank<sup>5</sup>

### **Civil Society Organisations in Ukraine –Counterpart Creative Centre:**

The Counterpart Centre survey is designed as panel-type study aimed at tracking the capacity of NGOs for sustainable development. The most recent survey was conducted in September and October of 2004. The surveys are based on data collected from questionnaires filled in by a sample of NGOs drawn from all regions of Ukraine, and from three cities [Kyiv, Kharkiv and Lviv] as individual units. The methodology relies on a sample of NGOs that can be contacted by telephone or by e-mail. This method introduces a bias into the study since many Ukrainian NGOs do not have access to either telephones or email. In addition, the questionnaire used in the survey has a tendency to include overlapping categories which do not provide sufficient distinctions between different types of NGOs, and the response data is conflated which inhibits a clear delineation of the activities undertaken by NGOs. The methodology undermines the ability of the survey to provide transparent insights into annual trends.

Despite these methodological shortcomings, the survey is one of the most useful in providing time-based snap-shots that reflect the evolution of NGOs. However, the utility of this panel-type survey can best be achieved when complemented by the analytical studies conducted by USAID and the World Bank.

### **The NGO Sustainability Index for Central and Eastern Europe and Eurasia**

This annual USAID survey – which is now in its eighth edition – is based on qualitative and quantitative analysis of NGO sector sustainability in different regions of Eastern Europe and Central Asia. The survey is specifically linked an assessment of the following criteria: the sustainability of NGOs, the legal environment, financial viability, competency in advocacy, the provision of services, the infrastructure available to NGOs [e.g., telephones, access to technical training etc], and managing their public image<sup>6</sup>. On the basis of the survey each country is scored on the basis of continuum that is used to ‘rank’ and measure [against a baseline score that ranges

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<sup>3</sup> Counterpart Creative Centre [2005], *Status and Dynamics of Non-Governmental Sector Development in Ukraine*, Brief Survey, Counterpart Creative Centre, Kyiv.

<sup>4</sup> USAID [2005] *The 2004 NGO Sustainability Index for Central and Eastern Europe and Eurasia*, Office of Democracy, Governance and Social Transition, USAID Bureau for Europe and Eurasia, May 2005. Washington DC.

<sup>5</sup> World Bank [2003] *Civil Society in Ukraine: Analytical Report*. World Bank, Democratic Initiatives Foundation and SOCIS.

<sup>6</sup> The assessment is based on a review of: What has been accomplished? What remains a problem? Do local actors recognise the nature of outstanding challenges? Do local actors have a strategy and the capacity to address these challenges

between 1(high) and 7 (low)] incremental improvements in the NGO policy environment. The scores are used to categorise the policy environment of countries included in the survey into three groups:

- Early Transition: which are scored on a range of 5-7
- Mid Transition: which are scored on range of 3-5
- Consolidation: which are scored on range of 1-3

According to the USAID survey, the policy environment for NGO's in Ukraine is in the mid-transition phase [i.e.; the NGO environment is attributed scores that range between 3.1 and 4.6 on each of the sustainability criteria]. The survey data for 2004 [which is when the data was collected] the report states that there were about 40,000 NGOs registered in Ukraine – though only around only 10 per cent of these organisations are believed to be active<sup>7</sup> in a population of 47 million people<sup>8</sup>. The report notes that although there have been significant legislative advancements in the policy environment for NGOs, the effect of these legislative changes have been mitigated by vague or unclear wording “*which has allowed authorities to ignore some provisions and interpret others at their discretion*”<sup>9</sup>. The report also observes: “*NGOs are still generally unaware of the new opportunities provided under the Law on Social Services, and have yet to take advantage of their new rights to engage in economic activities*”<sup>10</sup>.

### **Civil Society in Ukraine - Analytical Report**

This World Bank study, which is based a survey of 603 respondents, drawn from a cross-section of NGOs, documents a number of important features of NGOs in Ukraine. Like the USAID study it reports that there are believed to be close to 40,000 NGOs registered in Ukraine and that only 10 per cent of these are active<sup>11</sup>. The report highlights the following features of NGOs in Ukraine:

- The most common activity of surveyed NGOs is the development and implementation of education and training programmes;
- A significant number of NGOs focus their activities at the Oblast and sub-Oblast levels with few organisations operating at the national level;
- The distinction between membership-based and public benefit organisations is weak, with the majority of NGOs surveyed reported to have a ‘relaxed and liberal’ attitude towards membership and membership structure<sup>12</sup>;

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<sup>7</sup> The report notes that the exact number of registered NGOs is unknown.

<sup>8</sup> In Poland, by comparison, there are an estimated 52,000 NGOs of which 60 per cent are reported to be active in a population of 39 million

<sup>9</sup> *op cit*: USAID p259

<sup>10</sup> *ibid*: USAID p259

<sup>11</sup> The reasons for the gap between ‘registered’ and ‘active’ NGOs are delineated in the literature, but one of the reasons is reported to be the fact that it is easier to officially register an organisation as an NGO than to officially de-register it from the relevant register once it has been registered – See Sydorenko, A. (2005)

<sup>12</sup> Part of the reason for this approach can be explained in the observations made by Alexander Vinnikov (undated) who observes - in *Why Advance the Legislation on Public Benefit Activities in Ukraine* - that the general criteria of Public Benefit Activities [PBA] “*is not clearly expressed in the laws*”...and that “*Even experienced lawyers are confused in distinguishing “charitable”, “public benefit” and “related” activities in accordance with current legislation*”.

- That around 50 per cent of NGOs have no staff;
- The primary sources of financial support to NGOs are reported to be membership contributions, donations by local businesses, and grants from international donors;
- The main problems confronting growth and sustainability were reported to be financial, followed by the absence of effective information on projects and programmes, and legal problems associated with NGO related legislation;
- The main problems concerning partnerships between NGOs and government were defined as being: the absence of adequate legal mechanisms, the absence of public information on key decisions made by public authorities, and a lack of will – on the part of government authorities – to collaborate with the NGOs.

### Key Features and Characteristics of NGOs in Ukraine

Drawing on data from these three studies, the following quantitative features of NGOs can be delineated:

#### *National and Regional Representation and Categorisation of NGO Activities:*

According to the World Bank, about 85 per cent of Ukraine’s NGOs operate at the level of cities, districts and regions, with 1 in 10 organisations describing themselves as have nationwide coverage, and 5 per cent defining themselves as being part of an international network<sup>13</sup>. Table 1 below provides an overview

<b>Table 1: Classification of Ukrainian NGOs by Operational Scope</b>		
International	Nationwide	Local /Regional
5%	10%	85%

Source: World Bank

According to the Counterpart Centre’s 2004 survey, the majority of NGOs in Ukraine are registered as civic organisations and only 10 per cent are registered as charity organisations<sup>14</sup>. In the context of the oblasts of Donetsk, Odessa and Sumy the total number of active NGOs that can provide social services [as stated in their charters] is reflected in the data in table 2 below<sup>15</sup>.

<sup>13</sup> By comparison, in Poland 51 per cent of NGOs operate at local government [gmina, powiat] or city levels, 23 per cent operate at regional level [województwo], 25 per cent operate nationwide, while 16 per cent are part of international networks.

<sup>14</sup> *op. cit.* Counterpart Creative Centre [2005] p7.

<sup>15</sup> It should be noted, as observed by Alexander Vinnikov (*op cit*), that despite legislative requirements which restrict activities to members only, many associations of citizens declare in their charters an intention to provide their activities to non-members [i.e., provide a ‘public benefit’]



**Table 2: Distribution of Active NGOs by Selected Regions**

Region	Total Number of Active NGOs	Civic Associations		Charity Organisations	Socially-oriented NGOs (as a share in the total number of active NGOs, %)
		Public Benefit	Mutual Benefit		
Donetsk	241	167	54	20	143 (60%)
Odesa	176	124	36	16	89 (50%)
Sumy	54	37	10	5	33 (61%)

Source: Counterpart Creative Centre

The data in table 2 suggests that the activities of the majority of NGOs in the selected regions are oriented towards social issues, and that by implication they are oriented towards the provision of either public benefit or mutual benefit. Indeed, around 30 per cent of the NGO's in the selected regions [see table 3 below] state that the provision of social services is one of the types of activity they concentrate on. Given, the proportion of NGOs in each region that are oriented towards social issues, it is possible to argue that there is a potential reserve [at least in these particular regions] that could – subject to the presence of appropriate financial incentives and supporting policy environment – be involved in the provision of social services<sup>16</sup>.

According to the Counterpart Creative Centre data, a significant proportion of active NGOs concentrate on the protection of public interests and lobbying [45 per cent], this followed by the provision and consultation Training [41 per cent] of respondents; while 39 per cent of organisations are involved in the dissemination of information and 37 per cent in education. According to most recent survey [2004] by Counterpart Creative Centre many more now deal with protecting interests and lobbying compared with 2002 [when this share constituted 16 per cent]. Table 3 below provides an overview of the distribution of activities recorded by NGOs in 2004

**Table 3: Types of NGO Activity**

Protection of Public Interests and Lobbying	45%
Trainings and Consulting	41%
Dissemination of Information	39%
Education	37%
Provision of Social Services	28%
Legal Aid	27%
Research and Analysis	23%
Charity	19%
Rehabilitation	10%
Development of Social and Political Recommendations	10%
Administration of Grant Programmes	8%
Other	5%

Source: Counterpart Creative Centre

<sup>16</sup> This observation is subject the caveat that the density and spread of NGOs is geographically uneven across Ukraine. Thus according the survey data compiled by the Counterpart Creative Centre the Lviv region there is one active NGO per 3,500 persons while in the Zhytomyr region there is one NGO per 29,000 persons.

The growth in the number of NGOs that record the protection of public interests has risen, albeit a slower rate over the same period, in line with the number that record social services as part of their activities. This trend suggests that many NGOs realise that they need not only to act in accordance with their charter objectives, but also to be energetically involved in the initiation and adoption of decisions in the interest of their target groups, and to lobby for the public interest in the context of government social policies [i.e., to extend their public benefit purpose]. However, according to Counterpart Creative Centre there is a gap between the desire to expand this shift in emphasis and the constraints imposed by the policy environment<sup>17</sup>. Among NGOs included in the panel-type survey conducted by Counterpart Creative Centre, the most common target groups of NGOs are recorded as “youth” [48 per cent], “organisation members” [32 per cent], and “children” and “students” [24 per cent each]<sup>18</sup>.

**Table 4: Key Target Groups**

Youth	48%
Organisation Members	32%
Children	24%
Students	24%
All Population	19%
NGOs	19%
Women	14%
Disabled Individuals	13%
Pensioners and Elderly	12%
Other Categories	9%
Trade Associations	9%
Businessmen	8%
Media	8%

Source: Counterpart Creative Centre

#### *Qualitative Features of NGOs in Ukraine:*

Analysing the qualitative features of NGOs – in the absence of in-depth case studies – is fraught with risk. Indeed, the studies conducted by Counterpart Creative Centre, the World Bank and USAID adopt a variety of methods for assessing institutional capacity, efficiency and managerial competencies. The methods used, nevertheless, can be narrowed down into the following parameters:

- Organisational [or internal] NGO capacity which focuses on management, strategic planning, membership, human resources, logistics and financial support [Vertical Features];
- Institutional Relationships which focus on NGO relationships with public authorities, businesses, and other NGOs [Horizontal Features];

<sup>17</sup>Counterpart Creative Centre 2005 p7

<sup>18</sup> The delineation of categories in the Counterpart Creative Centre survey is, as mentioned previously, problematic. The delineation in this instance fails to define what the term “organisation members” actually means

- Programme activities and the capacity of organisations to work and make a difference [Vertical and Horizontal Features].

In the context of this report, these vertical and horizontal dimensions have been deployed to assess the qualitative features of NGOs, and synthesised to draw some general observations to characterise NGOs that are part of the nascent Social Economy of social services provision. The general observations focus on:

- NGO Management and Strategic Planning;
- Membership and Human Resources;
- Financial Capacity and Logistics;
- Co-operation Among NGOs and Other Social Actors;
- Information Management.

*NGO Management and Strategic Planning:*

Studies of Ukrainian NGOs often argue that the level of strategic planning and managerial skills of NGOs do not meet the required level of professionalism. According to the USAID study, the total organisational capacity of Ukraine's NGO sector in 2004 was rising very slowly<sup>19</sup>. It goes on to note that while the leading NGOs are constantly working on the improvement of their organisational capacity, the majority of smaller organisations still remain at a low stage of development. The study revealed a considerable gap between a small group of well-developed organisations [often based in large urban centres] and other representatives of the third sector. This observation is supported by evidence suggesting that while a few organisations have improved their management and capacity to work in accordance with their strategic plans, other NGOs either do not follow their plans or, do not have strategic plans.

According to data compiled by Counterpart Creative Centre, 66 per cent of NGOs have a strategic plan, but only 80 per cent had updated the plan within the previous two years. The data also demonstrated that there was a tendency towards a decrease in the number of respondents that practiced strategic planning: for example in the 2003 and 2004 rounds of the survey the number of organisations that had a strategic plan for three and more years was less than in 2002 [14 per cent against 22 per cent in 2002]. Moreover only 86 per cent of NGOs reported that they assessed their performance against planned activities. In addition, the Counterpart Creative Centre data revealed that 87 per cent of NGOs had a written mission statement that was used to guide the activities of their organisation. These observations suggest that considerable investment is required to ensure that NGOs improve their strategic planning and organisational skills – particularly in the context of meeting the requirements necessary for participating in the Social Economy. This observation has particular resonance for NGOs that focus their activities at the Oblast and sub-Oblast levels since their access to funding is more restricted, and their visibility less well established among local stakeholders.

Associated with weak strategic planning systems is evidence that the level of transparency in the decision-making systems of NGOs is weak. Counterpart Creative Centre data, for example,

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<sup>19</sup> *op. cit.* USAID 2004 p260

suggests that in many NGOs, it is the executive director [83 per cent] and the collective management body [45 per cent] that is allocated sole responsibility for decision-making, while the organisation's members and staff are often less frequently involved in decision-making processes. In many organisations, the level of accountability in decision-making is quite low, and management is inclined towards authoritarian approaches. This style of management can threaten the promotion of the public benefit ethos and/or the interests of the membership; and, lead to private interests becoming a dominant feature of the management style of such organisations.

#### *Membership and Human Resources:*

According to data compiled by Counterpart Creative Centre 80 per cent of Ukraine's NGOs are membership organisations with 24 per cent recording between 11 and 30 members; while 26 per cent record that they have in excess of 100 members. According to the World Bank study [2003], only 28 per cent of the NGOs included in the survey had a requirement for formal registration of membership. Indeed, the majority of NGOs define membership without any specific obligations, or do not require any membership at all. Informal membership appears to be typical for different types of civil associations, and is reported to most popular among charitable organisations.

In terms of staffing, it is reported that 57 per cent of NGOs have an average five permanent staff members. Half of the surveyed organisations had less than three permanent staff members, while the other half had three or more permanent staff members. In terms of job descriptions 39 per cent of NGOs reported that they had written job descriptions for staff; 43 per cent of NGOs had written administrative procedures; 58 per cent had updated the procedures within the last 12 months prior to the survey; and 66 per cent of NGOs encouraged the professional development of their staff by providing them with financial resources to attend conferences, round table meetings, and attend training courses.

Data from the Counterpart Creative Centre revealed a tendency towards a gradual decrease in the number of volunteers involved in NGOs: in 2004, 73 per cent of NGOs involved volunteers compared with 78 per cent in 2002<sup>20</sup>. On average, 15 volunteers were reported to work for the majority of civil associations. According to the World Bank survey, about 10 per cent of organisations function exclusively through the services of volunteers<sup>21</sup>. It should be noted that volunteers mainly perform tasks that do not require high qualifications, and they do not bind their professional future with such organisations. This, partly, explains why there are a high number of students reported among groups defined as 'volunteers' in the studies. In 53 per cent of NGOs, volunteers are students who view their activities with NGOs as an avenue for improving their qualifications and for developing their work experiences<sup>22</sup>. At the same time, volunteers also reportedly include some highly qualified citizens who attribute part of their time to public benefit purposes.

In terms of the organisational capacities of NGOs the fact that many are located outside large administrative centres, coupled with weak financial structures, means that the majority are not able to maintain permanent stipendiary staff. Moreover, such organisations – particularly those that focus on social issues - have scarce means to send their active members on training and skill development courses. Indeed, in many rural areas, NGOs are often not registered in accordance

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<sup>20</sup> *op cit.* Counterpart Creative Centre, 2005 p12. The figures provided in this survey appear very high and could be result of NGOs either exaggerating the numbers, or counting members of an association under the term 'volunteer'.

<sup>21</sup> *op cit.* World Bank 2003, p19

<sup>22</sup> *op. cit.* Counterpart Creative Centre, p12

with the legislative requirements, and thus survive on the good will and private initiative of the membership<sup>22</sup>.

### *Financial Capacity and Logistics.*

The USAID study [2005] attributes the lowest financial capacity score to Ukrainian NGOs among other third sector capacity indices<sup>23</sup>. Even though the USAID study demonstrates an improvement in the financial status of Ukraine's NGOs in 2004, the World Bank study [2003] reported that the majority of organisations considered insufficient funding and low logistical support to be among their main constraints<sup>24</sup>.

According to data from Counterpart Creative Centre, 95 per cent of NGOs included in the survey have access free or rented office premises, with 13 per cent owning their offices; 75 per cent of NGOs had computers and 65 per cent had access to e-mail and/or Internet<sup>25</sup>. The World Bank study, on the other hand, states that 75 per cent of Ukrainian NGOs had office premises, but that only 50 per cent had access to modern office equipment<sup>26</sup>. However, many organisations outside of the big administrative centres, especially NGOs that had a social orientation, had neither offices nor office equipment. According to the USAID study, many small NGOs - especially those in the regions - do not have, or do not need, considerable funding. Many of them are reported to perform low-cost work – such as the distribution of humanitarian aid to vulnerable social groups or provision of other social services – and are content with small charity donations. The rationale for their contentment is apparently based on the fact that they wish to avoid complicated financial reports or the involvement of relevant professional staff. Indeed, in order to avoid taxes and financial reporting some NGOs do not engage in the process of registration - which can hinder their public work and their cooperation with the media. In broad terms, most Ukrainian NGOs lack the wherewithal for auditing and bookkeeping. Indeed, the USAID survey asserts that many Ukrainian NGOs do not make, or are incapable of making, medium or long-term plans for securing their financial stability<sup>27</sup>.

In analysing the findings of these surveys on NGOs, it is important to look into the ratio of funding sources. According to the Counterpart Creative Centre, financial support to NGOs by businesses constitutes - on average - 38 per cent of the total budget of NGOs, contributions from central and local government are reported to constitute 34 per cent; while the share of the international donor contributions is dominant and makes up on average 67 per cent<sup>28</sup>. Although the World Bank survey asserts that the stereotypical opinion that Ukrainian NGOs exist exclusively on revenues

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<sup>22</sup> According to the USAID survey, comparative data from Poland suggests that a significant number of NGO staff are also largely unqualified and results in high turnover of permanent staff appointments. Salaries in the sector remain quite low, and NGOs are not able to retain highly professional and qualified employees [e.g., lawyers, accountants, or advisers]. These characteristics account for why the most active members of the organisation have high workloads. Training is too expensive for NGO staff, particularly for organisations that work outside main economic centres. Poland, however, demonstrates a tendency towards an increase in the number of volunteers in NGOs, since volunteering is regarded as valuable experience and a good route for improving access to the formal labour market. The general in- and out- flow of volunteers is therefore high.

<sup>23</sup> Ibid – p. 198.

<sup>24</sup> World Bank – p. 22.

<sup>25</sup> Counterpart – p. 12.

<sup>26</sup> World Bank – p. 38.

<sup>27</sup> USAID – p. 198.

<sup>28</sup> Counterpart – p. 13.

from grants is unfounded, it worth noting that overall around 93 per cent of NGOs receive assistance from foreign donors [53 per cent of organisations whose scope is at the Oblast and sub-Oblast level, and 63 per cent whose scope is either nationwide or part of an international network]. Due to issues associated with accessibility, funding from foreign donors is predominantly accessed by the NGOs whose scope is nationwide, or by organisations located in large administrative centres - particular in the capital, Kyiv. On the other hand, it is noteworthy also that less than 45 per cent of NGOs whose scope is nationwide have contacts with businesses. Instead, it is regional and local NGOs, at the sub-Oblast level, that have most contact with access to funding from local business that are familiar with content and focus of local NGO activities<sup>29</sup>.

The diversification of funding sources for NGOs in Ukraine, and the need – over time – for a shift in emphasis to greater reliance on domestic sources of finance needs to take account of several objective and subjective factors that exist in the policy environment:

1. Firstly, a culture of private donations to meet the public benefit functions of NGOs in Ukraine is weak. In particular, extending support to NGOs is not associated with a sense of corporate social responsibility, or with a positive image for the Ukrainian business sector. Also, the incomes of many Ukrainian companies prevent them from providing funds for the benefit of supporting NGO activities. In addition, the legislative framework does not encourage or facilitate the emergence of a beneficial climate for the development of private sponsorship. Thus in many instances private funds – from citizens and businesses - to Ukrainian NGOs are channelled in opaque forms i.e., often from hand- to-hand, and often as direct result of active lobbying by NGO management and active members, rather than from an inclination of good will by businesses<sup>30</sup>.

The problem of businesses funding NGOs is also linked to questions of trust and transparency – particularly of the trust businesses can invest in NGOs doing what was expected. On the other hand, donations to NGOs can, in some circumstances, be conceived as a form of money laundering, or as mechanism for a tax evasion. The distrust and lack of information on NGO activities is also exemplified by the fact that businesses have no means [apart from their personal tastes] of ascertaining the *bona fides* of NGOs, or of their ability to use resources in an efficient manner. Likewise, many businesses have an implicit interest in initiatives that resonate with their profit motive rather than the public or mutual benefit agendas of NGOs. This can result in a conflict of interests between the grantee and the grant recipient, and result in a reluctance of NGOs to become the captive to the profit motives of commercial businesses.

2. Although the World Bank study observes that Ukrainian NGOs work in parallel with the central executive authorities, and cooperate with local authorities, this observation deserves some qualification given that some NGOs [particularly those that previously existed as State Run Mass Organisations (SRMOs) under the communist welfare state] are treated by legislation, and by the state budget, in a manner that differs significantly from NGOs that have emerged under conditions of transition to democratic pluralism and a market-based economy. This multi-tiered approach to the public funding of NGOs has resulted in the following structure:

- 1) Direct state funding of NGOs included in the state budget act [e.g., the Ukrainian Society of the Blind (UTOS) and Ukrainian Society of the Deaf (UTOG)];
- 2) Indirect subsidies and employment regulations set for the NGOs that provide services to certain socially vulnerable or significant groups [e.g. funding of nationwide

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<sup>29</sup> World Bank – p. 19.

<sup>30</sup> See Chapter 4 for an elaboration of this feature

organisations and companies established by disabled organisations which are channelled through the Fund for Social Security of Disabled Individuals via the Ministry of Labour and Social Policy (MoLSP), and children, youth, and women organisations through the Ministry of Family Youth and Sport (MoFYS)];

- 3) Funding of NGO through a competitive tendering and contracting regime in accordance with the effective Clause 8 of the LSS.

The first two forms of funding relate to the SRMO-type organisations that emerged under the Socialist Welfare State and have continued to exist - albeit within a revised legislative framework that - categorises them as “associations of citizens”<sup>31</sup>. Likewise organisations that fall under category 1 are entitled to certain financial privileges that are determined by law, and to be consulted by government on the development of policies and programmes<sup>32</sup>. The dichotomy between NGOs that have statutory guarantees to state funding and privileges, and those, in category 3 that do not, is stark. Within this dichotomy organisations in categories 1 and 2 can be classified as enjoying a privileged financial relationship with the state, while those in category 3 are devoid of a similar privileges.

Overall, the hierarchical relationship between different types of NGOs and the government are, to a considerable extent, clearly dominated by the inheritance from the communist regime that prevailed when Ukraine was an integral part of the Soviet Union and as a legacy from the earlier years of transition when much of the legislation of NGOs was promulgated. The structural [e.g., the ability to engage in policy discussions with government] and financial [e.g., entitlements to state budget support] foundations of this hierarchy have provoked protest from vocal members of category 3 NGOs, and have hindered the emergence of more effective forms of dialogue and co-operation with central government with these types of NGO organisation. The underlying tensions in the relationship are characterised by a lack of trust, a sense of unfairness, and among some 3<sup>rd</sup> category NGOs – who have hitherto been able to exist on the basis of grants from foreign donors - a desire to support the *status quo* in order to avoid becoming entangled with government or becoming reliant on funding from state sources.

3. Co-operation between NGOs and local government, on the other hand, is less problematic – although in most instances co-operation is often related to the performance of small-scale tasks that are of local relevance to the elected local government, and to provision of material resources by the local government [often premises] to NGOs. The extent to which reciprocal relationships have emerged at the local level is more often than not based on the level of awareness that exists among local government officials, a better appreciation of the roles NGOs can perform in the context of pressing community problems, and the density of local NGO networks.

4. The practice of private philanthropy is still relatively underdeveloped in Ukraine. The low levels of private giving for public benefit purposes is partially related to the low levels of private disposable income, and by a prevailing mistrust among the public of the *bona fides* of people who are involved with NGOs. The levels of mistrust can, in part, be attributed to frequent adverse reports in the press, and by word of mouth, of various financial scams that have sought to solicit

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<sup>31</sup> For example, Article 6 of The Law on Youth and Children’s Public Organisations (1999) states that “the status of youth and children’s public organizations and unions thereof shall be defined hereunder and according to the Law on of Ukraine “On Associations of Citizens”.

<sup>32</sup> For example, Section 3 (Articles 12-16) of the Law on the Fundamentals of Social Protection for Disabled People in Ukraine (1991) defines public disabled organizations, their entitlements to material and technical resources from the state, and the duties of the state to consult and inform them of policy proposals that affect the particular population groups that they serve.

funds for illegal ends. According to the World Bank survey, one third of Ukrainian NGOs rely on membership fees and on in-kind contributions as the predominant form of funding for their activities. However, the evidence from the surveys conducted by USAID and Counterpart Creative Centre suggest that the payment of membership fees is often little more than symbolic, and such can rarely be used as sustainable form of funding<sup>33</sup>.

#### *Co-operation Between NGO's and Other Social Actors [External Relations]:*

In the context of assessing the organisational capacity of NGOs, it is imperative that attention is devoted to at the type of problems NGOs have with their public benefit profile given that external relations can have a decisive impact on the way in which NGOs function and secure their long term sustainability. The main social actors that have a decisive influence on the life of society and with which NGOs have most contact in the process of their work include government authorities, businesses, and other third sector organisations. According to the Counterpart Creative Centre survey data 99 per cent of NGOs claim to cooperate with public authorities in Ukraine – though the extent of such ‘co-operation’ varies significantly. For example, 19 per cent of NGOs state that they cooperate with public authorities on a daily basis, 35 per cent of NGOs state that they contact public authorities at least once a week, and 23 per cent state they have contact with the public authorities once a month. On the other hand, a small number of NGOs have contacts with the public authorities on quarterly/ annually basis, and some even less frequently. Where co-operation between NGOs and public authorities is take place 64 per cent of the NGOs in the Counterpart Creative Centre survey claim that such initiatives are based on the willing initiative of both parties. However, there is a general perception that NGOs are more often not the instigators of such cooperation, rather than the public authorities actively soliciting such cooperation. In the 2004 survey, 43 per cent of the NGOs reported that they implemented between 1 and 2 projects jointly with public authorities, while 31 per cent claimed they had no projects that involved co-operation with public authorities. According to NGO representatives, the main obstacles to co-operation with government are: the lack of understanding of the benefits of such cooperation by public authorities” and “their low awareness of NGO activities<sup>34</sup>.

In general terms, the patterns of cooperation between NGOs and public authorities are at the central level are characterised by the following features:

- 1) Initiatives that facilitate cooperation between the state and NGOs, that are not part of old SRMRO network, are highly irregular in Ukraine;
- 2) Cooperation between the executive authorities in central government with NGOs largely takes place in the shadows of official policy [examples of such cooperation are exceptions that only confirm this general rule];
- 3) Funding of NGOs from the state budget – aside from SMROs – lacks transparency. This feature, when combined with systemic and attitudinal constraints on the part of business weakness reinforces the need for NGOs to rely on funding from foreign donors;

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<sup>33</sup> Establishing secure forms of funding has traditionally been a major obstacle to the creation of the Social Economy in transition countries. It is in this context that countries like Poland, Hungary, and Croatia have developed innovative measures – such ring-fencing gambling taxes [in Croatia] and the development of the 1 per cent voluntary personal income tax [e.g. Hungary, Poland, Latvia] that can be earmarked for organization that provide a public benefit [See Chapter 4].

<sup>34</sup> *op. cit.* Counterpart – p. 14.



- 4) Public authorities and NGOs, for the most part, operate in parallel universes. Where co-operation does take place it is often restricted to activities associated with public events that often have little practical influence on the adoption of decisions by public authorities, or a substance.

Trends similar to those that apply at the central level can be observed, with some variations, to the patterns of co-operation between NGOs and local tiers of government. For example almost one third of Ukrainian NGOs do not cooperate with the business sector, while 25 per cent of NGOs cooperate with one or two businesses, 22 per cent co-operate with between 3 and 5 companies, and 18 per cent of NGOs cooperate with more than 5 or more companies. Half of NGO's in the Counterpart Creative survey stated the main reason for establishing co-operation with companies was to explore the possibility of obtaining material, rather than cash, support. Indeed, the survey data reveals that 42 per cent of NGOs solicited co-operation with companies with the motive of securing non-monetary support; while only 34 per cent of Ukrainian NGOs were interested in establishing financial partnerships with commercial companies, and 16 per cent in using their contacts with commercial enterprises to acquire new experience<sup>35</sup>.

The World Bank study states that NGOs are mostly interested in cooperation with other organisations that have similar levels of organisational capacity. Indeed, the geographical spread and content of cooperation between NGOs have a number of common features: local, regional and nationwide organisations are more inclined to cooperate where they are in close geographical proximity, and exhibit a tendency to work on similar subject areas; organisations that have higher levels of organisational capacity have higher a higher propensity to establish international connections; and there is clear trend of closer cooperation between NGOs that have similar funding sources<sup>36</sup>.

According to Counterpart Creative Centre survey data, 92 per cent of Ukrainian NGOs cooperate with other third sector organisations. However, only 24 per cent of the NGOs surveyed consider that they are sufficiently aware of the activities of other organisations that work on the same, or similar, subjects at the national level. The level of awareness of NGOs of the activities of similar organisations does, however, increase at the Oblast and sub-Oblast levels. Indeed, 80 per cent of NGOs surveyed claim they are aware of the activities of similar local organisations. The most widespread types of co-operation between NGOs are the exchange of information (88 per cent), and convening joint meetings (78 per cent). Other common practices include consultations, provision of services, and working as partners on projects. The NGOs believe that lack of professionalism among their representatives, and the personal ambitions of their leadership contribute to the generation of inter-agency conflict and hinder the development of horizontal co-operation<sup>37</sup>.

#### *Information and Dissemination:*

According to the Counterpart Creative Centre survey, 85 per cent of NGOs in Ukraine disseminate information about their activities through the press [either their own media outlets or the media owned by others], or through booklets and leaflets (50 per cent). It is, however, becoming increasingly common for NGOs to use their own web sites to reach a broader audience<sup>38</sup>. The

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<sup>35</sup> Ibid. p. 16.

<sup>36</sup> *op. cit.* World Bank, p 31-32.

<sup>37</sup> *op. cit.* Counterpart p. 15.

<sup>38</sup> Ibid. p. 17-18.

percentage of NGOs that in reality are able to engage and maintain media links [press, web etc] is probably a lot less than claimed by the survey data, since only well-established NGOs - in large administrative centres - are able to maintain their own media, publish booklets or keep a web-site at a satisfactory level. Many smaller NGOs whose scope of activity is pitched at the regional or local do not necessarily fit the patterns reflected in the survey data.

In general terms, Ukrainian NGOs experience severe constraints on maintaining active public relations with regard to the dissemination of information about their organisations or their activities. This constraint leads to weak levels of awareness among the general public about NGOs, as well as a lack of understanding of their public role by businesses, which results in a low levels of effective cooperation with NGOs. Also, a lack of strong and efficient information and communication measures on behalf of NGOs enables public authorities to marginalize or ignore the opinions in the majority of cases in the process of decision-making – the exception being the SMROs protected by specific legislative provisions [See Chapter 4].

### **General Observations and Recommendations:**

From the above review of the available data the following tentative conclusions can be drawn: The majority NGOs in Ukraine have a declared social orientation and proclaim public benefit roles. However, the prospects for a full-scale re-orientation of NGOs [aside from those that fall under Categories 1 and 2] to engage in the provision of social services – as envisaged in the LSS- is likely to be a long-term goal. Indeed, the number of Ukrainian NGOs [that are classified under Category 3] that have the wherewithal to provide community-based social services to children, the elderly, and the disabled is likely to be small in the short-term. The prospects, over the medium term, are compounded by the unequal geographical distribution of NGOs, and by systemic weaknesses in the quality of management and leadership. Nevertheless, there are a number of steps that the government can take in the short to medium term that can be taken to improve the policy environment that will support the emergence of a Social Economy, and ensure that technical and organisational capacities are supported by more consistent legislative frameworks.

Furthermore, the review of existing survey data suggests that aside from wide variations in methodology [which generate a host of problems] little attention has so far been devoted to assessing the national profile of NGOs in the Social Economy, or the contribution that the Social Economy makes the national economy of Ukraine. Within current survey data it is difficult to establish with any degree of certainty the organisational or financial trends that are taking place within the Social Economy. This observation is important because NGOs carry out a wide range of activities – ranging from service delivery through to advocacy and lobbying and the pursuit of leisure. Thus for policy questions like the scope for, and involvement of, NGOs in the delivery of social services it is useful to know what kinds of activities are being undertaken by NGOs in the economy, and pattern of distribution across different types of activities. In the context of the growing size and importance of the Social Economy to Gross National Product [GNP] many countries, including those in Central and Eastern Europe, are devoting considerable attention to assessing and measuring the contribution that this sector makes to the generation of wealth and the forms in which its contributions take to national life and the well-being of citizens.

The European Union<sup>39</sup> and the United Nations<sup>40</sup> have been championing the approach of Satellite Accounts for the Social Economy, which is based on *identifying* what NGOs have in common, and *classifying* organisations based on their differences<sup>41</sup>. The two principles of identification and classification use as their starting point the International Standard Classification of All Economic Activities [ISIC] and the Statistical Classification of Economic Activities in the EC [NACE]. The system of satellite accounts for the social economy is intended to collect useful information about the NGO sector and present it in a consistent form of accounts. The UN *Handbook on Non-Profit Institutions in the System of National Accounts* [hereafter referred to as *The Handbook*] adopts an approach based on:

- A fully elaborated satellite account structure;
- A system of extended accounts that include a range of social and economic indicators that may be useful to extend the data coverage of the satellite account system beyond monetary representations of activities;
- A short pro-forma that focuses on the most readily available variables and relationships that can be used until the system is elaborated

The system of satellite accounts is designed to take capture and take account of many variables and features that are not normally captured in the standard [UN] System of National Accounts [SNA]<sup>42</sup> that is used as the framework for reporting statistics on national economies. *The Handbook* recognises that it will be difficult – in view of data and systemic constraints - for all countries to achieve a full satellite account system in the short term. To cope with these constraints *The Handbook* proposes a strategy for data collection – based on the short pro-forma method using available data with a view to elaborating the system over time and at a pace that is aligned to expansion of the Social Economy.

In the context of systemic weaknesses with data on NGO activities in particular, and the need to advance a Social Economy approach to the sector in general, it would – as the LSS is elaborated and the *modus operandi* of social services delivery by NGOs becomes more well defined – be advantageous for policy makers in Ukraine to consider adopting a satellite account system – as advanced under the rubric of *The Handbook* – that begins to capture the structure, organisational composition, and financial dimensions of NGO structure. The current system of ad hoc surveys is currently inadequate for assessing operational capabilities, emergent trends, capturing the contributions the sector currently makes to the economy, or for defining the policy frameworks for elaborating the governance systems that are necessary for a functioning Social Economy.

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<sup>39</sup> European Commission Seminar on the Satellite Accounts for Social Economy held in Brussels on 23 April 2004 – See: <http://www.europa.eu.int/comm/enterprise/entrepreneurship/coop/conferences/coop-statistics-se...>

<sup>40</sup> United Nations (2003)

<sup>41</sup> Mertens, (1999)

<sup>42</sup> The SNA groups activities according to five major sectors: (a) non-financial corporate sector, (b) financial corporate sector, (c) general government sector, (d) household sector, and (e) nonprofit institutions serving households. Prior to the development of *The Handbook*, the activities of NGOs were captured in national accounts in manner that meant that different activities were grouped under all these five categories, and it was only when the activities of an NGO did not fit with the first four categories was this activity included in the 5<sup>th</sup> category. This approach did not reflect the public benefit and non-profit purpose of NGOs. In EU countries like Spain and Belgium the definition of the Social Economy – besides naming its distinct organizational forms – also cites the ethical principles that guide them in the context of the public benefit purpose [OECD, 2003]

## Chapter 3

### THE LEGAL FRAMEWORKS FOR NGOs AND THE PROVISION OF SOCIAL SERVICES IN A SOCIAL ECONOMY

#### Overview:

This Chapter focuses on an overview of the policy impact NGO legislation has on the overall level of NGO activity in the context of developing the Social Economy, and the interface between specific NGO legislation and the LSS. The peculiar features of the regulations governing NGOs are also taken into account and specific attention is devoted to the following features:

- The definition of NGOs in the LSS;
- The interface between the Law on the Association of Citizens and the LSS;
- The Interface between the Law on Charity and Charitable Organisations and the LSS;
- The interface between the Law on Freedom of Consciousness and Religious Organisations and the LSS;
- Regulating and Registering the Activities of NGOs According to Distinctive Legislative and Institutional Structures;
- New Trends in the Legal Regulation of Social Service Provision;
- The Legislative Regulations of NGOs in the Social Economy of Countries in Central and Eastern Europe;
- Some General Observations on the Legislative Framework for Supporting the Social Economy: Implications for Social Services Delivery in Ukraine.

#### The Definition of NGOs in the Law On Social Services:

A useful starting point for evaluating the prospects of NGOs to engage in the delivery of social services is Article 12 of the LSS - which is concerned with defining areas defined as community-based social services, and the legal entities/operational sectors that can deliver such services. Article 12 delineates two sectors that can engage in the delivery of community-based social services: the state [governmental] and non-state actors [i.e., NGOs]. However, in elaborating this dichotomy Article 12 sub-divides delivery agents into five types:

- Entities that are in state ownership that are managed by central executive bodies [central government];
- Institutions and establishments that are subordinated by central government to local communities [local government];
- Institutions and establishments that are accountable to both central and local government [shared responsibility];

- Non-State actors [i.e., NGOs] – including citizens organisations, charities and foundations, and religious organisations<sup>1</sup>;
- Physical persons – i.e., individual citizens acting as volunteers.

The activities of NGOs in the context of the LSS is based on the premise that their activities in the delivery of social services will be regulated by the statutes that govern their status as distinct types of NGO. However, it is noteworthy that Article 1 of the LSS, which establishes the terminology and definitional framework, is very general and does not provide sufficient elaboration that would make the distinctions intended clear. For example, in referring to the involvement of NGOs in the delivery of social services the LSS does not elucidate on the distinctive attributes of civil associations, charities, religious organisations; nor does Article 12 elucidate on the particular attributes of SRMOs that funded from the state budget and their particular roles. Moreover, Articles 12 and 1 do not elaborate on the regulations that will govern the role of volunteers [physical persons] in the provision of social services. Despite these ambiguities, it can be concluded, on the basis of Articles 1 and 12, that NGOs delivering social services must be: legal entities whose economic and social mission is linked to public benefit, and not to the accumulation of profit; and the activities they undertake within the framework of the LSS are primarily governed by distinctive legislative frameworks that legitimates the activities of NGOs i.e., the laws on: “The Associations of Citizens”, “Charitable Organizations”, and “Freedom of Consciousness and Religious Organizations”. Thus a baseline for assessing the adequacy of NGO Legislation in the context of providing social services has to take account this body of legislation in relation to specific legal provisions of the LSS. The base line, therefore, of necessity focuses on the following dimensions:

- The interface between the Law on the Association of Citizens and the LSS;
- The interface between the Law on Charity and Charitable Organisations and the LSS;
- The interface between the Law on Freedom of Consciousness and Religious Organisations and the LSS.

### **The Interface between the Law On the Associations of Citizens and the LSS:**

#### *Equality and Distinctions:*

The Law on the Association of Citizens (1992) draws a distinction between two types of association: the first concerns organisations that are defined as *political parties* (Article 2) that are concerned with the elaboration of national policies; and secondly with *public organisations* (Article 3) that are defined as organisations concerned with meeting the legal, social economic, creative, age, national and cultural, sport and other common interests<sup>1</sup>. The Law on the Association of Citizens has a number of features that serve to distinguish ‘associations’ from other

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<sup>1</sup> Article 1 states that Non-State actors are by definition non-profit making, and by implication have public benefit objectives.

<sup>1</sup> It should be noted that the Law on Civic Associations (1992) is in the process of being updated under the auspices of the Ministry of Justice by a new Law on Associations of Citizens (2006). The revised law, which is yet to be approved by the Verkhovna Rada, does away with the bifurcation of association and adopts a unified definition that focuses on Public Associations. A Public Association is defined – under Article 1(1) – as “*an association of people established to exercise and protect the rights, satisfy social, economic, creative, age-specific, ethnic-and-cultural, sporting and other joint/common interests. Public association is a non-commercial fellowship that does not aim at earning profit and distributing it between members*”. Article 1(2) states that: “*the law has no effect on professional associations, religious, co-operative, juvenile or children’s associations whose foundation and functioning procedures are set by separate laws.*” Thus the revised draft law clarifies the confusion between organisational types that can classified as an Association of Citizens”, and also retains and reinforces the distinctive nature of such associations.

types of NGO. Among the features include provisions under Article 9 draw distinctions between associations that are local [i.e., their scope is restricted to particular territorial or regional administrative units] and those that are defined as “All-Ukrainian” [i.e., for the most part organisations that fall within the meaning of this term are those that have been defined as SRMOs that existed under the communist welfare state - their scope covers the whole territory of Ukraine and they have an established presence in the majority of oblasts]. Under Article 8, the Verkhovna Rada has to affirm the list of associations deemed eligible for the status of All-Ukrainian; and it only by entry onto this list that associations become eligible for financial support from the state budget. Thus associations that are localised in scope are not entitled to state budget support, while those on the All-Ukrainian list, and approved by the Verkhovna Rada, are eligible for state budget support. In other words, the legislature is entitled to accord preferences to NGOs with All-Ukrainian status. However, the LSS does not pay heed to this distinction, or to the implications for the delivery of community-based social services. Indeed, the LSS accords all NGOs [irrespective of their status under various NGO laws, or within specific NGO laws] equal status and defines them as a single category. This approach suggests that the drafters of the LSS were either not aware of the distinctive features of NGO legislation, or assumed that these distinguishing features would be elaborated in separate regulations. The presence of these ambiguities suggests that supplementary regulations will need to be developed under the LSS that take account of inter- and intra-variations in NGO legislation and ensure that the legal framework provides a level playing field that fosters growth of the Social Economy.

#### *The Definition of Associations of Citizens and Opportunities to Engage in the Delivery of Social Services*

Article 3 of the Law On Associations of Citizens states that an association of citizens exists to satisfy their specific and legitimate social, economic and other joint interests. In accordance with this definition, an association is called upon to protect in its activity the interests only of its members. Hence it follows that associations of citizens can deliver services only to their members and by implication are more akin to Mutual Benefit Organisations [MBOs]. In practice, because the government strictly requires that Associations - during registration – publicly declare in their articles or registration the goal of their activities, including the scope of their activities with regard to protecting and promoting the interests and rights of its members. However, under the LSS, it is envisaged that NGOs will not only provide services to - or meet the needs of - their immediate membership, but also provide services to non-members. This raises a dilemma that requires regulatory clarification given that scope of operations open to Associations of Citizens are not adequately reflected in the LSS [this observation holds true even under the new draft law on citizens associations (2006)]. Under current legislation it would appear that Associations are unable to provide social services to people other than those within the confines of their membership – unless an association establishes a separate legal entity [institution on non-entrepreneurial organisation] to deliver social services.

#### *State Assistance, Financial and Material / Technical Support to NGO Activities*

Article 8 of the law on Associations of Citizens addresses conditions under which they may secure state funding [by meeting the All-Ukrainian criteria] to support the delivery of social services. Article 8 specifically states that NGOs, and enterprises founded by them, are entitled to a preferential taxation regime, and All-Ukrainian NGOs may receive material assistance from the state. The LSS (Article 7) also makes provision for the emergence of a tendering and contracting regime to facilitate cooperation between NGOs and central and local-self government bodies for the delivery of social service. Although there is no conflict of principle between Article 8 of the Law on Associations and Article 7 of the LSS, it is notable that the new draft law on Associations

of Citizens provides no clarity on whether Associations may participate in a tendering and contracting regime for the provision of social services. Moreover, the eligibility criteria for state funding to Associations may need to be relaxed given that many Associations that intend to deliver, or are capable of delivering, community-based social services will not meet the All-Ukrainian criteria

### *Non-Governmental Social Services and the Requirements for Registering the Activities of NGOs*

Articles 8 and 16 of the LSS stipulate that NGOs willing to engage in the delivery of social services on a professional basis – and through the means of state and local budgets - may do so after meeting the requirements of being issued with a license. The Requirements for a license to provide social services are underpinned by the Cabinet of Ministers [CoM] Resolution on Licensing of Certain Types of Economic Activity<sup>2</sup>. However, under Article 6 of the Law on Associations of Citizens, Associations are guaranteed the right to freely choose their spheres of activity. This means that associations can choose to deliver social services to their members based on the statutes submitted at the time of registration with the Ministry of Justice [MoJ]. Although not clearly stated, the LSS implies that Associations must include the delivery of social services in their statutory goals and tasks if they are to be considered eligible for a license. It would be beneficial if regulations on licensing took account of the requirements necessary for securing a license, and should specify the terms and conditions under which associations would be eligible to be licensed for the delivery of social services. The regulations for licensing will need to take account of provisions in the new draft law on Associations of Citizens (2006)<sup>3</sup> the draft law on Non-Entrepreneurial Organisations (2004) and the Civil Code of Ukraine. The latter defines NGOs as non-entrepreneurial organisations that do not have profit as their goal<sup>4</sup>.

### *Membership of Associations and the Issue of Human Resources for Social Services*

Article 17 of the LSS sets forth requirements on securing human resources for social services, and stipulates that community-based social services can be delivered by social workers or by other persons educated in fields relevant to the deliver social services. However, it is central bodies with executive powers that define the qualification requirements and procedures for the examination of social workers and other persons who can deliver social services. On the other hand, the qualifications of volunteers are deemed to be subject to separate regulations that are approved by the Cabinet of Ministers [CoM]. These qualification requirements embrace all legal subjects involved in the delivery of social services, including NGOs. However, the Law on the Association of Citizens does not specify educational qualification requirements for staff or for members. This implies, given the composition of skills in many associations, that a significant number of associations will not be in position to qualify as agents that can tender, or be contracted, to provide social services in accordance with the LSS. With this observation to the fore regulations, under the LSS, will need to be developed that specify the conditions under which associations can establish institutions and enterprises that employ social workers that will enable them to participate in the Social Economy.

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<sup>2</sup> Resolution of the CoM No 756 4<sup>th</sup> July 2001.

<sup>3</sup> It should be noted that the 1992 Law on the Association of Citizens stipulates that associations can engage in economic activities by creating enterprises and organisations that have the status of legal entities. The draft 2006 draft Law on Associations of Citizens does not change this stipulation. The regulations will therefore have to take heed of this fact once the new law comes into force.

<sup>4</sup> According to Article 85 of the Civil Code of Ukraine, non-entrepreneurial associations are defined as organisations that do not aim at earning profit so as to distribute such profit among the members.

In addition to the need for specific regulations in this area, policy makers will need to take account of data from the studies in Chapter 2 which indicate that at the Oblast and sub-Oblast levels many associations lack the wherewithal to establish institutions and non-entrepreneurial organisations that could employ social workers as specified in Article 17 of the LSS. It is also doubtful that the education system can – over the medium term - supply the required numbers of qualified social workers that would effectively enable associations to establish institutions and non-entrepreneurial organisations that would enable them deliver social services. This constraint effectively means that the absence of professional social workers in any given community would deprive it of opportunities for developing a Social Economy for the delivery of social services. Indeed for the social work profession working in an NGO might not be appealing given that they would not be able to enjoy the same levels of financial remuneration or labour and social guarantees that exist in the governmental sector or in SRMOs<sup>5</sup>. The regulations on the criteria for the employment of qualified social workers by NGOs, may need to be less rigidly specified and linked to the types of social services that are being delivered. For example, it would be difficult to justify the employment of a university-trained social worker to deliver basic [e.g., washing, or cleaning] domiciliary care to older people. On the other hand, a qualified social worker might be required if the NGO was engaged in the delivery of services to children with special needs, or to people with learning disabilities.

### **The Interface Between the Law on Charity and Charitable Organisations and the LSS:**

#### *Definition of a Charitable Organisation*

According to Article 1 of the Law on Charity and Charitable Organisations [hereafter referred to as the Charity Law], a charity is defined as an NGO whose main is to conduct charitable activities in the interests of society or separate groups of people. This definition accords strongly with the status ascribed to Public Benefit Organisations [PBOs], and differs substantially from the definition of an Association of Citizens whose purpose is more directly to promoting the mutual benefit of its members. Although organisations covered by the Charity Law can – under Article 4 - engage in a broad variety of activities, and are - under Article 2 – not deprived of the right to receive support from the state, particular provisions of the LSS rest uneasily with the Charity Law. For example, because the LSS lumps all NGOs into a single category, it omits reference to the specific roles that Charity and Charitable Organisations can perform. This observation has particular ramifications for the list of services that are defined as ‘social services’ under Article 1 of the LSS, and the list of activities and services that can be delivered Article 16 of the Charity Law. The two lists have a number of overlapping categories - such as service to people with disabilities, children and families, the elderly and sick, social rehabilitation. Regulations will need to be developed under the LSS that specify the types of social services that Charities can provide, and cross reference this list with those specified under Article 4 of the Charity Law in the context of common provisions – across the two sets of legislation – on licensing<sup>6</sup> [see below].

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<sup>5</sup> For example, Article 11 of the LSS states that persons providing social services have rights which are restricted to the provision of medical examinations, public defense, skills training, the provision of clothing and foot ware, bicycles and transport tickets. This specification is at variance with employment and payroll tax criteria specified in various NGO legislation – see Chapter 4 for an elaboration of these matters.

<sup>6</sup> Under Charity Law, Article 16 states that “charitable activity by charitable organizations in the form of providing specific services [work] which are the subject of compulsory certification or licensing, shall be permitted after obtaining a relevant certificate or license in an order envisaged by Ukrainian legislation”



### *State Assistance, Financial and Material /Technical Basis of Charitable Activity*

In comparison with the Law on Associations of Citizens, the Charity Law is reticent about defining instruments of the state support. Indeed, as noted above, Article 2 of the Charity Law states that they are not deprived of the right to state support, but is silent on what form such support might take. This reticence generates a dilemma in that while activities of Charities correspond closely with the activities defined as ‘social services’ in the LSS, the funding opportunities open to charities to deliver social services under the LSS are constrained and the Charity Law does not specify whether Charities are eligible for financial support from state or local budgets. The position of Charities with regard to access to funding from state and local budgets stands in sharp contrast to the position of Associations of Citizens [given that the latter – if they meet the All Ukrainian criteria - are eligible for subventions from state and local budgets. This legal position is likely to hinder the effective engagement of Charities in the delivery of social services. Furthermore, although Charities will - under the LSS - be able to tender and enter into contracts for the delivery of social services, a similar provision does not exist under the Charity Law. An amendment to the Charity Law that explicitly permits Charities to tender and enter into contracts for the delivery of social services with central and local executive bodies would therefore be advisable. This amendment would ensure that Charities are not in breach of their obligations to the executive body that is responsible for supervising and implementing Charity Law.

### *Requirements for the Registration and Regulation of Charitable organisations*

In contrast to associations of citizens, there is an obligatory requirement that charitable organisations should be registered with the state authorities. The Charity Law requires that a charitable organisation should indicate, from a list of eight specified under Article 16, which types of activities it intends to engage with. However, the list is comprised of fairly generalised categories that do not explicitly mention social services. It would, in the interests of establishing clarity, be helpful if the Charity Law could be amended with an insertion that specifies social services as being among the specific, and legitimate, forms of charitable activity.

As noted earlier, Article 16 of the Charity Law – which incorporates the licensing of charitable activities [where appropriate] – has strong associations with the licensing provisions of the LSS and with the Law on taxation Corporate Profits of Tax<sup>7</sup>; in addition, Article 20 of the Charity Law specifies the types of economic activities that charitable organisations can engage in. Unlike the law governing the activities of associations, charitable organisations are not required to set up or establish parallel non-entrepreneurial organisations or institutions to conduct activities that are deemed economic [e.g., delivery of social services]. These positive attributes are however tempered by the fact that Article 20 of the Charity Law states that charitable organisations that rely on charitable donations and membership fees are freed from the responsibility of contributing to revenue and payroll taxes. It is presently unclear whether the exemptions charitable organisations enjoy [under existing legislation], and which confer a number of advantages, would be foregone if they were to engage in tendering and contracting for the delivery of social services that are funded from state or local budgets. Aside from this particular ambiguity on the likelihood of foregone tax advantages, provisions of the Charity Law have strong complementarities with the agenda set forth in the LSS.

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<sup>7</sup> The law on Corporate Profit Tax defines and determines the non-profit status of charitable organisations – See Chapter 4.

## *Membership of Charitable Organisations and the Issue of Human Resources for the Delivery of Social Services*

As in the law on the Association of Citizens, there are no special requirements about membership and professional activity of employees of charitable organizations. Indeed, the terms and conditions of employment – as stipulated in Article 17<sup>8</sup> – are similar to those that apply to employees in the public and private sectors. Thus aside from differences that may apply in levels of remuneration and those associated with contributions to payroll taxes [See Chapter 4] there are no organisational impediments to the employment of social workers and allied professionals by charitable organisations [aside from a 20 per cent cap that a charitable organisation may devote to personnel and administrative costs].

## **The Interface Between the Law On Freedom of Conscience and Religious organisations and the LSS:**

### *The Definition of Religious Organisations and Delivery of Social Services*

The Law on Freedom of Conscience and Religious Organisations [hereafter referred to as “Religious Organisations”] stipulates [Article 7] that religious organisations can be set up with the purpose of meeting and satisfying the religious needs of citizens that accord with the practice and dissemination of their faith. The law states [Articles 8, 9, 10, and 11] that such organisations [which can include religious communities, offices and centres, cloisters, congregations and missions, and ecclesiastical educational establishments] are expected to act in accordance with their own hierarchical and institutional structures. Religious organisations, under Article 28, also have the right to establish non-entrepreneurial organisations and institutions akin to the arrangements that pertain to Associations of Citizens. This definition, and the delineation of structures that constitute a religious organisation, does not specify the type and range of activities that may be undertaken by extraneous bodies established by religious organisations. Indeed, the Law on Religious Organisations leaves the type of activities [aside from those prohibited under Articles 3 and 5] to the discretion of the organisation. However, under Article 23, religious organisations can in partnership with congregations, and associations of citizens carry out charitable activities. Thus on account of Articles 7, 8, 9, 10, 11 and 28 the law allows for a wider range of relationships than that permitted under the Law on Charity or the Law on the Association of Citizens. Within this broader framework the Law on Religious Organisations permits the dissemination of faith and charitable activity that combine elements associated with mutual benefit [akin to Associations of Citizens] and public benefit [akin to Charitable Organisations]. The Law on Religious Organisations thus has no fundamental contradictions with the LSS and the delivery of social services as part of a wider Social Economy.

### *State Support, Financial, Material / Technical Basis for Activity*

Relations between the state and religious organisations are mainly governed through the central body of executive on religious affairs. Under this system of governance the Law on Religious Organisations makes provision for numerous instruments of state support for the activities pursued by religious organisations - which might be used to deliver social services [although the law makes no specific reference to social services as defined under the LSS]. Under the system of state support, religious organisations have the right to receive buildings and property in state ownership. Furthermore, in accordance with cadastral legislation, religious organisations have the right to

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<sup>8</sup> Article 17 states that “the legislation of Ukraine on Labour, Social Security and Social Insurance shall be applied to employees of charitable organisations”

permanent use of land plots without incurring associated taxes that apply to other forms of land ownership.

In the sphere of financial and material/technical support religious organisations are permitted, within the Law, to solicit and receive voluntary financial and property contributions. Additional revenues can be generated from economic activities that are established through institutions and non-entrepreneurial organisations providing the proceeds are non-profit and are channelled into charitable activities. The Law on Religious Organisations is silent on state funding of religious organisations, and on the opportunities open to religious organisations to engage in tendering and contracting arrangements with central and local executive bodies. However, given that religious organisations can [under Article 28] establish institutions and non-entrepreneurial organisations - and offer employment conditions [aside from remuneration levels, which are likely to differ] akin to those that prevail in the public, private and charitable sectors – there appear to be few legal impediments to their ability to engage in a tendering and contracting regime for the delivery of social services.

#### *Requirements for the Registration and Regulation of the Activities of Religious Organisations*

The registration of religious organisations as legal entities is subject to the purpose documented in their specific statute at the time of registration. In terms of social service delivery the Law on Religious Organisations contains no prohibitions, and under the framework of the Law on Corporate Profit Tax [See Chapter 4], religious organisations are classified as not-for profit in a manner similar to that which is accorded to charitable organisations. Moreover, within the framework of the Law on Religious Organisations religious organisations can create charitable organisations and register these as legal entities. Thus religious organisations should, within the body of existing legislation, be in a position to create permanent institutions for the delivery of social services.

#### *Membership of Religious Organisations and the Issue of Human Resources for the Delivery of Social Services*

The definition of the labour rights of workers employed by religious organisations, or in the non-entrepreneurial and charitable organisations they establish, is an important feature of the Law on Religious Organisations. Employees of religious organisations, and their charitable organisations, must be employed on the basis of a labour agreement, and their term of employment must be compliant with labour legislation and social security legislation. In view of this feature in the legislation, the LSS will need to develop regulations that reflect the different employment conditions that apply to different types NGOs [associations of citizens, charitable organisations, and religious organisations] in the context of delivering social services [See Chapter 4 for an elaboration of this issue].

#### **Regulating and Registering the Activities of Non-Governmental Organisations According to Distinct Legislative and Institutional Structures:**

It is clear from the above analysis of NGO legislation that the approach of the LSS towards NGOs is inadequate – given that separate bodies of law apply to different types of NGOs. Moreover, the LSS makes no distinction between associations, charitable bodies or religious organisations; nor does the LSS take account of existing bodies of law that apply to organisations specified in the Law on the Fundamentals of Social Protection for Disabled People in Ukraine (1991). Unlike NGOs that fall into category 3, the status of organisations for disabled people, and those for children and youth organisations, differs in that they are accorded the right to influence and shape

state policy, enjoy privileged payroll contribution levels, and can enjoy the benefits of state and local budget support. In terms of their organisational structures disabled and children and youth organisations are akin to associations of citizens - that provide mutual benefit - in that they are expected to act as unifying bodies of citizens that protect and promote the interests of their membership. However, disabled organisations also embody characteristics of charitable organisations – that provide public benefit - in that they can establish non-entrepreneurial organisations to deliver social services.

It is also clear – based on the Public Expenditure Management [PEM] assessment conducted by the DFID FRSSU Project – that significant levels of budget support are extended to disabled SRMO type organisations – such as the Ukrainian Society for the Blind, the Ukrainian Society for the Deaf and Union of Organisations of the Disabled<sup>9</sup> – that have been classified in this report as belonging to Categories 1 and 2 [see Chapter 2]. The distinctive approaches towards the funding of different NGOs – with some being given preferences over and above those that fall into Category 3 creates imbalances that affect the efficiency and effectiveness of the Social Economy. These inefficiencies exist because the funding streams targeted at SRMOs have emerged from the legacy of the communist welfare state rather than through a strategic assessment of the goals and objectives of the Social Economy; and are embedded in legislation that emerged in the immediate aftermath of Ukraine’s emergence as an independent state<sup>10</sup>.

### **New Trends in the Legal Regulation of Social Service Provision**

In the context of plans under the LSS to establish a contracting and tendering regime for the delivery of social services, coupled with a system of licensing and registration of social services providers, the system of awarding SRMOs automatic access to state budget funding and privileged payroll contribution rates is likely to entrench existing inequalities between NGOs in Categories 1 and 2 on the one hand, and those that fall under Category 3. It is unclear, under present plans whether all types of NGOs [including SMROs] will be expected to subject themselves to the process of licensing and registration, or whether these procedures will be restricted to particular categories of NGO. Under the framework of the draft regulation on the registration of NGOs - i.e., that aim to become providers of services - will have their applications vetted by an Inter-Ministerial Commission. The decisions of the Commission will be based on system of majority voting.

The approach based on voting does not seem to be the most transparent and optimal manner in which an organisation is deemed eligible for registration as a provider of social services. The selection and registration process of organisations to deliver social services can never be scientific, but it needs to be based on objective criteria that involve some form of objective evaluation that can be ranked and scored. It would therefore be helpful for regulations or guidance under the framework of the LSS to be developed which specify the objective criteria, the threshold against which an organisation will be deemed eligible or ineligible for registration, and the types of NGOs that can apply for registration. In a similar vein, the draft resolution on licensing providers of social services - under the rubric of the LSS - does not offer much further insight into how these matters will be addressed.

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<sup>9</sup> In 2005 a total of 14,743,800 UAH was accorded as grants from the state budget via the Ministry of Labour and Social Policy [MOLSP] to these SMROs; an additional 2,469,000 UAH was accorded in as grants from the state budget by the MOLSP to war veteran NGOs.

<sup>10</sup> It is noteworthy that existing arrangements for the award of grants to SMROs has emerged under conditions of custom and tradition. Thus such grants are not subject to financial or outcome auditing procedures that would help determine whether resources generating public value.

One of the more promising legislative developments to have emerged in recent times, that could advance the development of the Social Economy, and help reconcile the existing NGO legislation with the LSS, is the draft Law on Non-Entrepreneurial Organisations [2004]. The draft law implicitly aims to create a unified body of law that governs many of the organisational forms that are currently fragmented across the Law on the Association of Citizens, the Law on Charity Organisations, the Law on Religious Organisations, and the laws that govern the activities of SMROs. Under the framework of the draft law, which embraces both the advocacy and service delivery functions of NGOs, Article 6 defines the activities non-entrepreneurial organisations as being: *“aimed at health and environmental protection; the observance of human rights; improvements of legislation; rendering social services and aid to vulnerable groups of the population, youth and children, assistance in food supply; carrying out research, support of science, non-commercial mass media and communication, amateur sport, art and culture, religion and education,; prevention and liquidation of aftermath of natural calamities and other catastrophes, as well as other activities stipulated by the legislation as being socially useful (charitable)”*.

The draft law also recognises the necessity of vertical and horizontal institutional structures that are essential for NGOs to function as both advocates for, and providers of, public services. The draft does this by making provision [Article 8 and 11] for three types of public benefit organisations: non-entrepreneurial partnerships, non-entrepreneurial institutions, and foundations. This delineation supports a framework that grants recognition to the fact that NGOs pursue public benefit purposes; acknowledges the special and distinctive features of NGOs in the context of a Social Economy; promotes a transparent legal environment - that is non-contradictory or shadowed in uncertainty; and minimises opportunities for conflicts of interest in the context of defining public benefit.

Clearly there is no single “right” way to design the laws that should govern NGOs. Indeed, history, legal traditions, as well as traditions of NGO activity differ wildly across countries. However, the distinctive attributes of the draft law on Non-Entrepreneurial Organisations has much that chimes with directions that have been pursued in Central and Eastern Europe countries – countries that share some important characteristics of history, legal tradition, and traditions of NGO activity with that experienced in Ukraine. It is with these common features in mind that next section focuses on some of the trends and experiences that feature on the emergence of a Social Economy in other Central and Eastern European Countries [CEECs]<sup>11</sup>.

### **The Legislative Regulation of NGOs in the Social Economy of Countries in Central and Eastern Europe**

Legislation in most CEECs allows for different organisational forms of NGO, and enables them to pursue a raft of legitimate activities. In broad terms the legal frameworks allow for public benefit and mutual benefit orientations. The emergence of these two primary types of NGO have followed in the wake of governments and citizens actively seeking to develop transparent policies that extend budget support, tax privileges and earmarked taxes that enable NGOs to contribute to and enhance the quality of national life. The evolution of current legislative frameworks have emerged in the context of political will that has been sustained over the period of transition – with all its attendant difficulties - to a democratic system of government that has sought to open up spaces that grant recognition to the role and function of public benefit organisations. This section

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<sup>11</sup> Given the number of countries that are part of the geo-polity of Central and Eastern Europe, the focus of the overview is primarily restricted to legislative features and characteristics in Hungary and Poland through references and illustrations are drawn from other countries such as Czech Republic, Slovak Republic, Romania, Croatia, Macedonia, Lithuania, and Romania.

therefore provides a general overview of the features and characteristics that have emerged in CEECs with regard to:

- NGO Registration and Licensing
- Material and financial support,
- Taxation regimes of public benefit organisations

*NGO Aims and Objectives as a Prerequisite for Acquiring the Status of a Public Benefit Organisation: Public Benefit Organisations' Criteria and Registration Procedures*

The experience of CEECs suggests that the status of a public benefit organisation is granted to an NGO either by special regulation within general legislative frameworks on public benefit activities, or by specific sector legislation. However, as general rule most CEECs have moved in the direction of embracing comprehensive legislative regulations on public benefit activities. In the majority of CEECs the list of activities attributed to public benefit incorporate some or all of the following:

- 1) Amateur sport;
- 2) Culture and art;
- 3) Assistance to, and protection of people with special needs;
- 4) Assistance to refugees;
- 5) Charity;
- 6) Protection of personal and civil rights;
- 7) Protection of consumer rights;
- 8) Assistance to democracy;
- 9) Environmental protection;
- 10) Education and training;
- 11) Fight against any form of discrimination;
- 12) Fight against poverty;
- 13) Health care and medical care;
- 14) Protection of historic monuments;
- 15) Children and youth affairs;
- 16) Animal protection;
- 17) Assistance to the state in the fulfilment of its individual functions;
- 18) Research and development;
- 19) Social cohesion;
- 20) Social and economic development;
- 21) Social well-being; and
- 22) Other activities of social importance.

The exact composition of activities vary by country, and a number of caveats are worthy of note: the list incorporates terms such as social cohesion which reflects the influence of European Union legislation and policy on domestic policies; not all countries incorporate all these activities, and the composition of the list of activities is highly influenced by local custom and tradition and the nature of social and economic change brought in the wake of transition<sup>12</sup>; in the Ukrainian context the draft law [Article 6] on Non-Entrepreneurial Organisations comes closest to listing activities that demonstrate public benefit akin to emergent trends in CEECs.

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<sup>12</sup> In Poland 24 activities are enumerated, while in Hungary 22 activities are enumerated.

Aside from listing the activities that constitute public benefit, some countries also list the range of organisational forms that can register as public benefit organisations. The objective behind this approach is to provide a rationale and transparent framework that enables closer working relationships to emerge between the public sector [government] and NGOs. In Poland, for example, this has been achieved under the Public Benefit and Volunteer Work Act (2003) which builds on pre-existing legislation on associations and foundations, and defines a framework that enables NGOs to participate in a tendering and contract based regime for the delivery of public benefit activities.

In order to establish their credentials as public benefit organisations NGOs in CEECs have to register, with the competent authorities, as civil associations and as public benefit organisations<sup>13</sup>. In Hungary and Kosovo for example, the procedure is simplified by allowing organisations to register simultaneously as civil associations and public benefit organisations; while in Bulgaria registration is undertaken in a two staged process that involves initial registration through the courts, and subsequent to this procedure are accorded the status of public benefit organisations – subject to certain criteria – by the Ministry of Justice. The procedures are designed to ensure that registration is efficient, transparent and supported by documentary evidence. As a rule documentary evidence has to demonstrate

- The public benefit of the organisation's activity;
- Compliance of the organisation's functioning principles with the legislative requirements, including an absence of the conflicts of interest;
- Compliance with the legislative requirements to the organisation's activities [i.e., the public benefit component] and restriction on for-profit and political activities.

Legislation in Poland and Hungary make special provisions for ensuring that registration is specifically linked to public benefit activities. These measures are designed to ensure the predominance of public benefit activities over and above other organisational priorities [including limiting activities that could hinder the fulfilment of their public benefit functions]. Polish legislation, for example, sets the following requirements to public benefit organisations:

- The activities defined in the organisation's charter shall be aiming at the interest of the entire community or a certain category of people that find themselves in difficult life circumstances;
- Public benefit activity shall be the only activity of the organisation;
- The NGO shall be either non-profit, or its profit-making activities shall be limited to the achievement of the organisation's charter objectives;
- All financial proceeds of the organisation shall be used for public benefit;

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<sup>13</sup> Bodies responsible for the provision of the public benefit status and registration of public benefit organisations differ from one country to another. In Bulgaria, Latvia, Romania and Slovakia registration is conducted through specialised offices of line Ministries. In Poland and Hungary registration as public benefit organisations is conducted through the courts. In a number of Western European countries registration is channelled through the tax authorities, while in Moldova [and the UK] registration is via specialised bodies that have statutory responsibilities for the governance of NGOs.

- The NGO should have a collective monitoring and oversight body that operates independently of the organisation's management; and
- The organisation's founding documents shall prohibit any contracts with the organisation itself or engage in activities that could generate a conflict of interests.

Hungarian legislation, on the other hand, requires that the founding documents of public benefit organisations should include:

- The list of the types of public benefit activities;
- The provisions setting out that the organisation shall conduct its business exclusively in the interest of, and without prejudice to, its public benefit activities;
- The provisions according to which the organisation shall not distribute its proceeds among its founders, but use them for the achievement of its charter objectives;
- The provisions that the organisation shall not be involved in politics or provide financial assistance to political parties; and
- The provisions of the organisation's internal structure, the absence of the conflict of interests and reporting requirements.

Hungarian legislation also envisages the formation of so-called *authorised public benefit organisations with a special status* [referred to as “prominent/outstanding public benefit organisations”]. To achieve this special status an NGO needs to acquire delegated powers for the fulfilment of functions that have traditionally been performed by public authorities in certain areas [e.g., health, education, social services etc] as defined by law. Organisations that acquire this status are required, as a means of ensuring transparency and public accountability, to publish information about their activities and their charter objectives in manner that is open to public scrutiny.

Polish and the Hungarian legislation sets a time limit within which the governing authorities have to decide on whether and organisation should be accorded public benefit status: 30 days in Hungary [or 45 days if additional information is required], and 90 months in Poland [or up to maximum of six months if further information is required]. In Hungary an NGO's application for public benefit status is considered automatically approved if the competent authority does not issue a decision within the established time limit. The rationale for specific deadlines on decisions that have to be met by the governing authorities is designated to meet the principle of legal clarity and to protect NGOs from an abuse of power that may be committed by public authorities. Moreover, NGOs have the right of appeal to the higher courts in the event that a decision to refuse registration is made.

#### *Licensing Procedures for NGOs that Provide Social Services*

It is universally acknowledged that a poorly designed licensing procedure can slow down the emergence of NGOs in the Social Economy. It is also true that a licensing procedure for social services is a necessary condition for ensuring that the state is empowered to protect the public from unscrupulous activities that may pose risks or cause actual harm. Thus a licensing regime has to be premised on striking a balance between enabling for the formation of NGOs and protecting the public from harm. Hungarian legislation has sought to achieve this balance by



dividing all social services into two categories: (i) basic social services – which includes services that focus on the provision of food, domestic services, and family assistance etc; and (ii) day care and residential services.

To obtain a *basic social services* license, the organisation shall provide the licensing authority<sup>14</sup> with the following documents:

- A professional plan for the provision of social services developed in compliance with the law;
- A copy of the organisation’s tax code;
- A written statement from the candidate NGO that it has sufficient qualified and appropriately educated social workers;
- A copy of the organisation’s founding document if the services to be provided by an NGO are to be provided with the support of public funds;
- Confirmation from a religious institution or an individual that can prove the existence of the social service provider if such a provider [i.e. the NGO] receives support from the institution or individual;
- A current certificate issued by tax authorities for the month prior to applying for registration to prove that the social service provider has no tax arrears if such service provider is not funded by the state;
- Registration certificate of a social entrepreneur providing social services (for individuals);
- An extract certificate proving that the service provider has been included into the register of business operators [for legal entities] or companies that are not legal entities;
- A certificate issued within the month prior to applying for registration by the regional or municipal court to prove that the service provider is included into the register of civil associations or foundations [if an NGO - as a provider of social services - is a civil association, a foundation, or a public fund).

A municipal notary is mandated to issue a permit for the provision of social services by an organisation within 30 days after the relevant application is filed.

For the provision of day care and residential services the licensing procedure is channelled through a two-staged process: The first stage entails the organisation applying for a preliminary license. Four months after the initial application the preliminary license comes into force, which entitles

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<sup>14</sup> The licensing authority is the municipal notary or any other public authority [official] properly authorised by law. If a licensing authority is a public authority [official], it shall notify the notary on the issuance, amendment or revoke of the license by providing it with a copy of the relevant decision. It should be noted that that the license for basic social services can be issued retrospectively if once an individual or organisation that has been providing [unlicensed social services] comes to the attention of the authorities. For a basic social services license to be issued under these conditions the individual/organisation is subjected to an inquiry and providing the services are delivered in compliance with the legislative and professional standards, and is requested to file an application for a license within 15 days of the investigation being completed. If the applicant does not meet the deadlines or does not meet the criteria they are issued with a prohibition order that compels them stop providing social services.

the NGO is to submit an application for an actual license [if within the four month period an application for an actual license is not submitted, the preliminary license is automatically revoked].

The preliminary license, if approved, is issued within 60 days of the license being filed. However, this license does not entitle the applicant to deliver day care or residential social services, rather it entitles the applicant to proceed to the second stage of assessment for an actual license. The content of the preliminary license application is similar to the information required for a license application to provide basic social services, and requires that the premises to be used by the applicant is inspected and assessed against fire, health and building regulations. These inspections are evaluated and determined within a period of 30 days. The licensing authority can also ask the municipality or relevant organisations [including religious bodies] to provide their written opinions on the social services plan submitted by the applicant. However, comments solicited from this process are not key determining factors for granting a license, the opinions are one part of the wider assessment that takes account of professional qualifications of the management and staff, and a financial plan. The actual license is only issued once all the conditions have been met.

Organisations that provide social services that do not fall into the categories of basic social services or day care and residential services are subject the same licensing requirements but have to meet additional requirements [Hungarian Ministry of Public Health, Social Policy and Family, Order No 1/2000]. Social services in this category include those that focus on meeting specific needs and have a higher level of social work inputs [i.e., these are defined as personal assistance services that are concerned with the essential functioning, and with personal and professional issues]. Organisations that aim to provide these specialised services – often in the community – are expected to meet the following requirements:

- The organisation shall be located in the area easily accessible by public transport;
- Any person shall be able to have a free and unimpeded access to the organisation's location;
- The organisation shall have the equipment and technical means to ensure the access and sojourn convenience for the social services beneficiaries.

In line with the licensing regime, organisations that provide specialised social work service in the community are expected to meet the following function requirements:

- A permit or a license for its activities;
- Organisation principles and functional rules;
- An internal order regulation;
- A professional action plan;
- Detailed job descriptions; and
- Other documents [depending on the content of an organisations activities].

Organisations licensed to provide social services are expected to meet the following minimum staffing requirements:

- Basic social service organisation shall have no less than 50% of the professionally educated staff working directly with customers;
- Day Care and Residential institutions shall have 80% of staff with professional training;
- Organisations that have fulfil the criteria set out in Order 1/2000 the number of professional social workers is established against set criteria based on the type of services being offered. In addition, individuals holding managerial positions in these organisations have to pass a special qualifying exam.

NGOs licensed to provide social service are mandated to develop individual social service /social care plans for every client. Such plans are divided into three categories: individual care plans, individual recovery plans, and individual development plans. Specific requirements, for monitoring outcomes, are also set against each of the above plan types.

#### *Reporting and Public Accountability of NGOs providing Social Services under a Licensed Based Regime*

NGOs that provide social services on a contractual basis are expected to meet all the commitments specified in the contract. However, although Hungarian legislation sets no special reporting demands on NGOs registered to provide social services, they are subject to a professional inspection and quality assurance regime in addition to an auditing regime that inspects mandatory tax, labour and social reports. As public benefit organisations they are required to keep records and make open public reports on their public benefit activities. These public report are mandated to include: a financial report; a description of the use of public funds, assets and targeted grants; financial support received from public authorities; the total amount of remuneration paid to staff; and an outline of the public benefit activities performed. Such reports have to be published annually on the organisation's web page or in other ways that make the reports accessible to the public<sup>15</sup>.

NGOs that acquire the status of “outstanding public benefit organisations” are also expected to publish annual reports on their activities with a detailed account of their activities and the use they have made of public funds. Publication of these reports is a precondition for securing future funding from public funds.

#### *Public Funding and Oversight of NGOs that Provide Social Services*

In CEEC countries public funding of NGOs is mainly channelled through the following measures:

- Subsidies;
- Grant Funding;

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<sup>15</sup> In Poland The Law on Public Benefit Activity and Volunteerism [2003] makes similar provisions for reporting and accountability. All reports have to be submitted to Minister Responsible for Social Security Issues [i.e., the Minister for Social Policy].

- Tendering and Contracting for services;
- Normative Cost-Recovery.

*Subsidies:* This form of funding often entails the provision of financial resources that are not directly linked to specific projects. The subsidies may be used as a measure that ensures NGOs are able to meet general organisational expenses, or to fund general measures that contribute to wider government objectives in particular areas of state policy. Such funding arrangements can be seen as testimony to the fact that the state recognises the contribution that NGOs, and broader civil society, can make to the achievement of national objectives. However, in manner similar to that pertaining in Ukraine, NGOs that benefited from subsidies in CEECs were predominantly the SMROs variety that had existed as part of the communist welfare state. Although the practice of subsidies from the state budget to NGOs has begun to decline, it is noteworthy that in countries like Hungary there are still over 20 organisations that are eligible for direct budget support issued in the form of subsidies. In recent years, the practice of funding NGOs through subsidies has begun to decline. Subsidies from the state budget have been slow to disappear in context of declining levels of foreign donor support, and the slow pace at which institutional structures have emerged to take full advantage of new blends of funding – e.g., the blending of state budget funds and structural funds [e.g., European Social Fund (ESF)] from the European Union that require formal partnerships to be formed between government agencies, NGOs and the private sector. Some countries, such as Croatia, have experimented on a large scale with replacing subsidies from the state budget with earmarked extra-budgetary resources such as the lottery proceeds. The Czech Republic, on the other hand, experimented with channelling some of the proceeds from the sale of state property to provide a broad spectrum of support to NGOs.

*Grants:* Unlike subsidies, grants are often provided in CEECs through open competitive procedures and do not depend on administrative decisions or parliamentary resolutions. Grants are used in many CEECs to fund social services that are part of, or complementary to, the core range of services provided by the central or local tiers of government. Grants are funded from a variety of sources and often overlap with subsidies and tendering. The distinction between subsidies and grants is that the latter is often tied to the achievement of particular objectives, and usually disseminated by governments or special governmental organisations. The distinction between grants and tenders is that the latter often gives larger weight to price alongside specific social or economic objectives [see *contracting* below]. In Croatia, a specialised organisation was established to administer grants based on proposals submitted by NGOs against pre-defined criteria that are determined by the government; while in Poland local self-government authorities are the main administrators of grants, and are responsible for the organisation of tender procedures and the conclusion of contracts for the provision of social services.

Procedures for the provision of grants usually involve elements of competition and selection. In CEECs typical selection and evaluation criteria include: previous activities of the organisation; partnership background; non-involvement in political and other kinds of activities which would contradict the public benefit objectives; technical quality of proposals; quality of staff and levels of demonstrable professionalism and qualifications; experience and history of performing tasks on projects in similar areas; ability to deliver outcomes; administrative and financial capacity; the ability to generate additional funding from other sources; establishing long-term partnerships with other actors etc. The selection process in CEECs usually includes a number of important elements that aim to ensure openness and transparency. These objectives are achieved through the public announcement of the grants, and the technical and organisational criteria that needs be met. An open and fair selection process also envisages publication of the information on the tender outcomes, as well as the rights of appeal against decisions made by the selectors. The procedures

are usually completed with successful bidders via a contract between the grantee institution and the NGO.

*Tendering and Contracting* is linked to practices developed with the framework of New Public Management [NPM] and is principally based on: i) the separation of tasks associated with the commissioning of services from the provision of good and services, ii) competition based on either cost and quality or a combination of both cost and quality; and iii) the production of services and/or the delivery of goods in forms specified in the contract. The tendering and contracting mechanism is premised on an equal and level playing field that encourages the potential participation of all available suppliers [i.e., for-profit and NGOs] – though in some countries tender notices can restrict the range and type of suppliers invited to tender<sup>16</sup>. In Croatia, local self-government authorities are authorised to subject public benefit tasks to tendering and contracting procedures. In Poland, following ratification of the Law on Public Benefit Activity and Volunteerism, NGOs secured the right to compete for tenders issued by public authorities.

The development of effective tendering and contracting regimes for social services involving the full participation of NGOs has, in general terms, been slow to emerge in CEECs. The reasons for the slow emergence of a tendering and contracting regime can be traced to one or more of the following: institutional gaps and weaknesses in the legislative framework; the technical and organisational capacities of NGOs; the geographical density of NGOs; and the eligibility criteria specified in contracts. A further hindrance has been attitudinal - which is associated with institutional mind-sets in both government and NGOs that have been slow to associate public benefit functions with tendering and contracting regimes.

*Normative cost-recovery* essentially takes the form of calculating the costs of producing and delivering goods and services delivered by service providers [including NGOs], and remunerating them according to a capitation system that sets the threshold of payment for the production of particular units of service. Cost thresholds under a capitation system are applied in a uniform manner to who whoever provides the service [public, private or public benefit]. The distinction between different providers is not based on their form of ownership, or whether they are for-profit of public benefit, but on the range, diversity, quality and choice of services they are competent to provide. Under such arrangements individual citizens are then open to choose the most appropriate service provider based on their needs, tastes or convenience. However, such arrangements are premised on the existence of unit costs for specific types of services – including for different types of social services – and the existence of a tendering and contracting regime that separates commissioning functions from those of service provision. This form of arrangement is gathering momentum in some CEECs<sup>17</sup>. In order to elucidate on the institutional arrangements that govern this form of financial arrangement the case of Hungary is delineated below for illustrative purposes.

### *The Hungarian Experience*

NGOs providing social service under normative cost-recovery arrangements are funded through two primary sources: (i) the state budget and various service security funds [the pension fund, the public health care and employment funds] and (ii) from local budgets. The basic parameters of remuneration [that takes account of unit costs] is linked to:

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<sup>16</sup> For example, in Hungary contracts for social services can be restricted NGOs that have acquired the status of “outstanding public benefit organisations”.

<sup>17</sup> For example, Hungary, Poland and Croatia.

- The social and economic characteristics of the population;
- Cost recovery of over-heads;
- Costs of providing different units of service grant support; and
- Special decisions of the parliament or public executive authorities on the rules governing support of NGOs<sup>18</sup>.

Within the framework of a tendering, contracting, and cost-recovery regime the vast majority of NGOs participating in the Social Economy are local in scope. This means that NGOs have to establish strong and effective relationships - based on local partnership arrangements – with local government authorities. Under these arrangements, the cost-recovery arrangements are based on the same capitation thresholds as those that apply to service providers in the public [government] sector. Although private for-profit organisations are eligible to participate in tendering and contracting regimes for social service provision, the levels of reimbursement for cost-recovery are set at 30 per cent of the normative for government and public benefit organisations that provide social services. This distinction clearly acts as a disincentive to the private sector, and indicates a desire, on the part of public policy, to foster and support the emergence of a vibrant Social Economy.

The policy environment has been a critical factor in emergence of new relationships between the state and NGOs in Hungary. Three particular features are worthy of note:

- *The 1% Law*: the introduction of the so-called “1 per cent Law” – which was introduced in 1996 – was a step change in public policy towards the way NGOs are funded. According to the provisions of this law, individual taxpayers are entitled to transfer 1% of their income tax to a specific NGO, and another 1% to a religious institution [See Chapter 4].
- *The National Fund for the Support of Civil Society*: the main objective of this national fund – which was established in 2003 – is designed to provide a policy structure that can co-ordinate and negotiate the collective organisational and financial interests of NGOs. The Fund’s top management body, the Council, consists of 17 members - 12 of whom are NGOs. The Hungarian government supports the Fund with the counterpart funding from the state budget to a level that is equal to the amount transferred – under the 1% Law - by taxpayers. Over 70 per cent of the Fund’s resources are directed at covering the core administrative and overhead cost of NGOs<sup>19</sup>.
- *The Expansion of Open Tendering and Contracting*: According to the Hungarian legislation NGOs are eligible to access state funding from various public funds and budget allocations that are designated for basic programmes implemented by competent

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<sup>18</sup> This includes the allocation and approval of targeted support and subsidies from special state budget lines to a designated list of NGOs. However, in the context of the expanding use of the tendering and contracting regime the use of targeted support and subsidies to NGO has diminished in scope with each successive government. This pattern suggests that there is an emerging cross-party consensus on the direction of policy towards the role of NGOs in the context of an expanding Social Economy.

<sup>19</sup> NGOs that receive core support from the state budget – in the form of subsidies and grants – are excluded from receipt of finances administered by the National Fund.

government ministries. Each ministry, that has direct engagement with NGOs, has a dedicated NGO unit [comprised of a director and a board that includes NGO representatives] that oversees the structural and programmatic relationships on matters of common interest, and helps promote policy dialogue between civil servants and NGO managers. The Directors of NGO Units have considerable oversight powers on the administration and allocation of line Ministry funds designated to promote partnerships with NGOs at the national level<sup>20</sup>. Similar arrangements have been instituted at the local level to facilitate relationships between local self-government and NGOs. For social services, such partnerships are grounded in the Social Services Act, which designates NGOs as among the key suppliers of goods and services that eligible to engage in locally defined tendering and contracting regimes. However, such contracting regimes are applied in accordance with centrally defined public procurement procedures.

#### *Custom and Practice in other CEECs:*

Other CEECs are developing practices – with some degree of variation - that accord with the broad policy directions being pursued in Hungary. This trend has emerged in the context of a pluralist democracy that has sought to define more clearly the spaces within which NGOs can thrive within a pluralist democracy and a market-based economy. It is clear from the analytical overview above that governments have recognised that for a Social Economy to emerge, NGOs cannot rely solely on the erratic financial tastes [i.e., donations] of individual citizens, and that governance regimes – i.e., regimes that are structurally supported by transparent rules and regulations – in which the state acts as arbiter is essential. In the course of the evolution of these regimes it is clear that distinctions between for-profit and not-for profit activities have become blurred. The blurring has emerged in a context that sought to grapple with measures for ensuring ways in which NGOs can become sustainable entities that contribute to national life, maintain their public benefit status; not place undue demands on public finances; and encourage volunteerism. In seeking to address and strike a balance between these factors a significant number of countries are adopting approaches that resonate with policy direction that has evolved in Hungary. These approaches have a common foundation – namely the reform of the communist welfare state, and the adoption of measures that ensure welfare provision under conditions of a market-based economy.

In grappling with this transformation a particular group of countries have legally enabled specified categories of NGO to engage in entrepreneurial activities [i.e.; commercially oriented] that must accord with their public benefit orientations. In Croatia, for example, NGOs may engage in entrepreneurial activities that generate profits [that have to be reinvested in the organisations and not distributed for the private benefit of the membership, staff or management of the organisation] if their charter documents define such activities as necessary for the achievement of the objectives of the organisation. In Romania civil associations and foundations can engage in non-entrepreneurial activities if such activities are performed as an accessory activity and are closely related to the main aims of the organisation. Similar arrangements in Bulgaria, Bosnia and Herzegovina, the Czech Republic, Estonia, Kosovo, Serbia and Montenegro, Slovakia and Slovenia.

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<sup>20</sup> Given the relative novelty of the tendering and contracting regime, and the creation of centralised NGO Units in line Ministries, there have been numerous teething problems which have led to criticisms by NGOs. Most of the criticisms have been directed at large variations in the way the normative procedures are applied by different ministries, and the high transaction costs that NGOs have to endure in the context of their relationships with line Ministries.

## **General Observations and Recommendations:**

1. It is clear that the LSS does not draw sufficient distinctions between different types of NGOs [civil association, charities, and religious organisations] or the operational implications that stem from the separate regulatory frameworks for their participation in the delivery of social services. Addressing this matter – initially through a review of the various NGO legislative frameworks, and then by developing relevant regulations that specify the types of NGOs are eligible to engage in procedures for the deliver social services - is an essential pre-requisite for ensuring that all NGOs are able to participate in the Social Economy on an equal footing.
2. The privileged status accorded to SMROs is a residue from the communist welfare state, and creates imbalances in the way the state relates to NGOs. Inevitably changes to the prevailing arrangement of grants and subsidies awarded to SMROs will take time to implement [as they have done in many other CEECs]. The LSS provides an opportunity for the government to evaluate current arrangements that govern the administration of grants and subsidies, with a view towards exploring options that help establish a regime that, over time, places less of a premium on this form of funding and begins to incorporate a number of features that have come to characterise funding and service delivery regimes in CEECs.
3. The body of NGO legislation in Ukraine is hazy on the operational concept of ‘public benefit’ and there is clear need, in the context of the LSS, for consideration to be given to a conceptual and operational framework that draws on the draft law on Non-Entrepreneurial Organisations. This observation is premised on the assumption that the government is minded to support to the organisational framework set forth in the draft law on Non-Entrepreneurial Organisations.
4. Implementation of the LSS, and the development of accompanying regulations, needs to take account of the operational realities [constraints and opportunities with regard to staffing levels, financing, partnerships with local tiers of government etc] that confront the majority of NGOs that might wish to engage in the delivery of social services. While the declarative ambitions of the LSS clearly resonate with policies pursued in other CEECs, the accompanying regulations need to be grounded in the social, economic and political conditions under which the majority of NGOs operate. Failure to take account of these realities could jeopardise the emergence of a diversified Social Economy for the delivery of social services.
5. Articles 8 and 16 of the LSS require NGOs that wish to provide professional social services must obtain a relevant license. The procedures that are established for a licensing regime will need to take account of the type of financial regimes [e.g., grant, subsidy, tendering and contracting]. The link between licensing and financing is critical for ensuring that the licensing regime does not disfavour NGOs that are currently excluded from resource allocations from the state budget and associated payroll privileges. Moreover, the LSS will need to ensure that clarity is developed on the balance that needs to be struck between the registration of NGOs [to provide social services] and the licensing of NGOs [to provide social services]. Combining registration and licensing into a single administrative procedure would undoubtedly reduce the transaction costs [for both the government and NGOs] associated with becoming eligible to provide social services.
6. Under current legislative arrangements, the Charity Law and the LSS have the strongest levels of congruence on matters associated with the delivery of social services. This congruence provides a platform from which the government can, over the medium term, seek to foster conditions that will help the Social Economy to emerge, and draw the necessary distinctions



between the prospective roles of mutual and public benefit organisations in the delivery of social services.

7. The LSS can only be effectively implemented in the context of a clear separation of commissioning and provider functions. Thus a regulatory framework that effectively separates these functions is required at the oblast and sub-oblast levels. This framework will need to be accompanied by an inspection and quality assurance structure to ensure that services delivered by NGOs meet accepted standards of public accountability, and with professional standards that accord with both the prescriptions of the LSS and the NGO legislation.

8. Particular attention needs to be given to the interface between the LSS and the Law on the Fundamentals of Social Protection of Disabled People in Ukraine and the Law on Youth and Children's Public Organisations – given that associations and organisations covered by these bodies of legislation are not adequately represented or accounted for in the LSS.

9. It is clear from the experience of CEECs that the decentralisation of power and authority to local tiers of government opened-up important spaces for NGOs to participate in localised Social Economies. These spaces have emerged in the context of systems of governance that promote and foster policy dialogue and partnership between NGOs and local tiers of government. Under the LSS, regulations could be developed that offer – drawing on the experience of CEECs - guidance on the formation of such partnership arrangements for the delivery of social services.

## CHAPTER 4

### TAXATION POLICIES AND TAX INCENTIVES FOR NGOs IN THE SOCIAL ECONOMY

#### Overview:

Developing a Social Economy that encourages the involvement of NGOs in the delivery of social services – as envisaged under the LSS is clearly dependent on the normative legislative environment, and on the ways in which the distinctive attributes of particular types of NGO – i.e., mutual benefit and public benefit – are accorded recognition in public policy. An equally important factor is the fiscal framework, particularly the ways in which the privileges, exemptions, and entitlements afforded to NGOs are governed by taxation policies. Indeed, it is clear from the preceding chapter that financial incentives are an important feature in the Social Economy, and the principle of NGOs being worthy recipients of support from government has long been recognised in CEEC countries that have adopted a democratic system of government. However, not all forms of NGO are perceived to be deserving of such support from government, since government will naturally tend to favour NGOs that serve those interests of society that accord with its own policy priorities.

The economic case for granting tax-based privileges, entitlements, and exemptions to public benefit NGOs can broadly be summarised as follows:

- They provide public benefits through two means: special goods to ordinary people [e.g., health, education and social services], and ordinary goods to people in need [e.g., food, shelter];
- They promote pluralism and diversity, which are deemed to be desirable and closely linked to supporting democratic values;
- There is a close correlation between the public benefit purpose of NGOs and public services which governments aspire to provide to the general public;
- Tax privileges encourage the development of NGOs in areas characterised by market and state failure, and the optimal supply of public goods and services<sup>1</sup>
- Voluntary donations to NGOs that provide public benefits is evidence of demand for their services and the undersupply of these services by the market and/or government;
- They have a unique ability to leverage public sector financial support in the form of additional grants and donations from the private sector, the general public and from other sources – such as other NGOs.
- Income tax can only logically be levied by the state on activities undertaken for private profit;
- NGOs that preclude private benefit and the distribution of profit are fundamentally different in nature from other legal entities that are surrogates for the individuals that

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<sup>1</sup> See Chapter 1 for characteristics of market and state failure.

own them [directly or indirectly] or can otherwise participate in benefiting from their profits.

These arguments are generally accepted in most CEECs, and by international organisations<sup>2</sup>. Indeed, the principle that NGOs that provide public benefit are appropriate recipients of tax privileges is generally accepted – including under Ukrainian legislation – regardless of the legal system that prevails. Thus while common law [e.g., UK, Canada and the USA] and civil law [e.g., most continental European Countries] jurisdictions may exhibit different approaches to defining public benefit, in practice there is great deal of common ground in the purposes of organisations that are considered eligible for tax privileges. It is notable that governments have generally accepted the case for granting relief to NGOs that provide public benefit from a particular tax at the time that the tax was introduced. For example, when income tax was first introduced in most countries in the early years of the twentieth century, the original legislation provided for a degree of exemption to NGOs. The scope of exemption varied from one country to another, and was subject to change of time, sometimes broadening to facilitate NGO activity, and at other times narrowing to prevent particular abuses. However, it is exceptional for NGOs that have public benefit purposes to be taxed on the same basis as commercial – for profit - enterprises<sup>3</sup>. It is thus with these general observations to the fore that this chapter, in the context of elaborating the role of NGOs under the LSS, that particular attention is devoted to:

- The Fiscal Framework and General Treatment of NGOs;
- The Current System of NGO Taxation in Ukraine;
- Tax Exemption or Tax Benefits on Income Generated by NGOs for the Benefit of Others;
- Comparative Analysis of NGO Taxation in Ukraine and other CEECs ;

### **The Fiscal Framework:**

The main sources of income for NGOs in Transition Countries generally comprise

- Grants and other forms of support from domestic and foreign governments, and international organisations;
- Private donations and gifts, and other forms of support, from the general public;
- Self-generated income [i.e., income from investments and income from the provision of goods and services];

The first two categories of income are not generally considered appropriate for taxation. Indeed, most income tax systems do not include public sector grants and subsidies in taxable income unless the grant is geared to funding forms of commercial activity. Donations are also usually not regarded as taxable income unless the recipient of the grant is providing the donor with a valuable benefit associated with the gift.

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<sup>2</sup> For example, the IMF Model Tax Code. See – <http://www.imf.org>

<sup>3</sup> It is worth noting that tax privileges to NGOs represent a form of subsidy, which governments should allocate on the basis of the types of policy considerations that inform the allocation of governmental subsidy in general. Widening or narrowing the scope of activities deemed eligible for such privileges therefore has first and foremost to be linked to the notion that the activities contribute sufficiently to the public good to justify the subsidy.

The tax treatment of self-generated income is particularly important in countries where there is no established tradition of private giving, or if there is a non-transparent pattern of government funding to NGOs [as is currently the case in Ukraine]. Total or partial exemption of investment income and gains, while not universal, is the prevailing practice across most CEECs. This is generally justified on grounds that, in the case of NGOs that have surplus funds, these funds should be invested for relatively short periods of time prior to their deployment for public benefit purposes, and in the case of foundations – that award grants – the income is their only or main source of return on their endowments that can be used to make grants to further advance their public benefit purposes<sup>4</sup>.

The most controversial area of fiscal policy towards NGOs is the granting of tax privileges to activities that have an economic orientation. Where NGOs engage in economic activities they compete with the private for-profit sector. This in itself is not undesirable; rather the concern is to limit the scope of unfair competition. The question hinges on whether granting tax privileges to an NGO that operates in the same activities as a private enterprise constitutes an unfair subsidy. This question cannot be addressed or resolved without account being taken of the fact that NGOs operate under several legislative restrictions that are not faced by the private sector, namely: (i) their primary purpose must be non-profit which differs sharply from the commercial sector; (ii) their inability to distribute profits means they cannot offer private benefits or rewards, and therefore cannot raise equity capital; and (iii) the fact that they cannot offer staff profit-linked remuneration and therefore have difficulty competing for skills in the labour market.

There are two conventional approaches to the taxation of such activities by NGOs:

- To exempt profits from all economic activities to the extent that the income is applied to public benefit purposes [“the destination test”]<sup>5</sup>;
- To exempt only profits from economic activities that can be related to the organisations public benefit purposes [“the relatedness test”]<sup>6</sup>

In most CEECs [including the Ukraine<sup>7</sup>] where NGOs with a public benefit purpose use separate legal entities [usually a wholly-owned subsidiary limited liability company] to undertake related business activities, there is generally no justification for granting the subsidiary entity the tax privileges that are granted to the “parent” NGO, since the subsidiary entity is not usually subject to the non-profit and public benefit purpose restrictions imposed on the NGO. The conventional approach is therefore to tax the subsidiary entity on the same basis as other forms of commercial enterprises. These general observations resonate with directions for the delivery of social services set forth in LSS, and for the involvement of public benefit NGOs – associations, charities, and religious organisations - as defined under existing NGO legislative frameworks.

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<sup>4</sup> This is based on the fact that in many instances foundations have restrictions on their ability to spend endowment capital.

<sup>5</sup> The *destination test* suffers from the disadvantage that it can create confusion in the public mind as to the difference in practice between an organization whose purpose is not-for-profit and a commercial enterprise that makes donations for the purpose of charity.

<sup>6</sup> The *relatedness test* is more commonly found in practice, although it can sometimes prove difficult in practice to draw the line between related and unrelated activities, and has to be based on the facts and circumstances of each case.

<sup>7</sup> See Chapter 3

## **The Current System of NGO Taxation in Ukraine:**

In Ukraine there are at least two aspects that are of import to the elaboration of the tax position of NGOs, and for stimulating their participation in the delivery of social services:

- 1) Tax exemption and Tax Benefits for NGOs; and
- 2) Tax Exemption or Tax Benefits on Goods and Services Provided by NGOs for the Benefit of Others

## **Tax Exemptions and Tax Benefits for NGOs**

In Ukraine, the taxation of NGOs - as opposed to other legal entities - has a number of distinctive features, namely:

Income Tax Exemption: The Corporate Profit Tax Act sets out an exhaustive list of institutions and companies that fall under the definition of an NGO which, in accordance with Article 7 [Sub-clause 11.1] include:

- a] Ukrainian public authorities, local self-governance bodies and institutions/organisations that are funded by relevant public funds;
- b] Charitable funds and organisations, including non-governmental organisations established to perform environmental, sanitary, amateur sport, culture, education, and scientific activities, as well as creative unions and political parties, non-governmental organisations of disabled individuals and their local offices set up in accordance with the Civil Associations Act of Ukraine, research institutions and III-IV accreditation level academic institutions of higher learning included in the State Academic Institution Register and supported by the state, as well as preserves and preservation museums;
- c] Pension funds and credit unions;
- d] Other non-profit legal entities [that are different from those listed in (b) above] the activities of which are not intended to generate profit;
- e] Unions and associations of legal entities set up to represent the interests of their founders and supported only by their founders' contributions, provided such unions and associations are not making business, apart from receiving passive incomes;
- f] Religious organisations;
- g] Residential and construction cooperatives; unions of co-owners of apartment houses; and
- h] Trade unions and their associations and organisations.

As can be seen from this list, NGOs that delivery social services may be classified as falling under categories listed in [b] and also, perhaps, under category [d]. However, under prevailing legislation such organisations are not directly mentioned in the law on Corporate Profit Tax. In view of the LSS, and the omission, in the Corporate Profit Tax Law, it would be expedient to supplement organisations listed under category [b] - which refers to charity organisations – with the phrase “and non-governmental organisations providing social services ”. The NGOs

mentioned under category [b] do not pay taxes on income received in the form of money or property acquired free of charge, or as irretrievable financial assistance, voluntary donations or passive incomes [e.g. dividends, interest, rent], as well as funds or property acquired by such non-profit organisations through performance of their main activities, allocations or subsidies received from the state or local budgets, state target funds or charity, including humanitarian or technical assistance provided to such non-profit organisations in accordance with international treaties ratified by the Ukrainian parliament, excluding price-regulating allocations provided to such non-profit organisations or through them to their beneficiaries in accordance with the law to decrease prices for paid services<sup>8</sup>.

The non-profit organisations defined under the Act [excluding those mentioned in categories (a) and (c)] must meet the “non-distribution” requirement. This means that the incomes and property of non-profit organisations shall not be subject to distribution between their founders or participants, and cannot be used for the benefit of any of their individual founders or participants and their management [this excludes labour remuneration and social fund contributions - Clause 7.11.8]. If a non-profit organisation is liquidated, its assets shall be passed to another non-profit organisation of a relevant kind or included into the budget revenue [Sub-clause 7.11.11].

The procedures for filing accounts by NGOs are set by the central tax authorities. The tax authority has the right to exclude organisations from the non-profit organisation register if they violate the provision of the above Act and other laws on non-profit organisations [Sub-clause 7.11.12.]. In practice, according interviews with the tax administration, it does not register 50% of organisations that apply. Registered religious and charity organisations – including those that provide social services - are also exempt from land tax. The legislation does not envisage any other tax benefits for NGOs. Moreover, no specific preferences are given to NGOs that engage in the provision of social services.

However, Ukrainian legislation provides considerable tax benefits to a special category of NGOs, namely civil unions and organisations of disabled individuals [that are an integral part of the body of SRMOs that were inherited from the communist welfare state]. Enterprises created by such organisations are eligible to enjoy these tax benefits if 50 per cent or more of the staff employed are registered as disabled. In addition, such enterprises have to direct at least 25 per cent of the total wage bill to disabled individuals. Such enterprises and organisations are allowed to use tax benefits if they have a special permit issued by the Interdepartmental Commission for the Activities of Enterprises and Organisations Established by Organisations of Disabled Individuals.

The Commission is a specially authorised state entity which was set up to decide on, among other things, the expediency of providing governmental assistance [i.e. in the form of tax benefits] to civil organisations of disabled individuals, their enterprises and organisations, financial assistance, lending, provision of preferences for the purpose of making state orders.

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<sup>8</sup> The definition of “main activities” means the activities of non-profit organisations on provision of charity assistance, education, culture, education, and other similar services for the social use, on establishment of social self-security systems [non-state pension funds, credit unions, and other similar organisations]. The main activities may also include the sale by a non-profit organisation of goods/services that promote the principles and ideas for the protection of which such non-profit organisations were set up, and which are closely connected to its main activities, if the price for such goods/services is lower than the usual one or if such prices are regulated by the state. The main activities do not include the transactions on provision of goods/services by non-profit organisations mentioned in points “в”-“д” of Sub-clause 7.11.1 of Clause 7 to the persons, different from founders/members/participants of such organisations. The Cabinet of Ministers of Ukraine may introduce temporary restrictions on the extension of the norms of the above Clause to the sale by non-profit organisations of certain goods/services if such sale threatens or contradicts the competition rules in the market of the defined goods, if there is sufficient evidence of such a violation provided by the persons taxed by this tax and providing the same goods/services. Charter documents of non-profit organisations shall contain an exhaustive list of the kinds of their activities”.

The system of privileges for this particular group of organisations are worthy of greater elaboration given that they are involved in providing social services, and the preferences they enjoy are not extended to other types of NGOs that may provide a similar or related set of services to the same population. The list of privileges accorded to this particular group of organisations is given below:

- Profit Tax Privileges. Under Sub-clause 7.12.1 of the Corporate Profit Tax Act enterprises and institutions established by non-governmental organisations of disabled individuals that own the property are exempt from the taxation of the profit received from the sale of goods [i.e., works and services], excluding goods subject to customs and excise duties, and gambling industry profits;
- Land Tax Exemption. Privileges accorded to disabled peoples organisations on exemptions from land tax are not exclusive, and are extended to NGOs, as defined in the Corporate Profit Tax Law, established by category [b] institutions – i.e., public authorities, local self-governance bodies and organisations that are funded by relevant public funds, as well as religious and charity organisations;
- VAT Privileges: Goods [i.e., excisable goods, and goods falling under Groups 1-24 of the Ukrainian Foreign Trade Goods Classifier (UKT ZED)] and services [excluding gambling and lottery businesses] are exempt from Value Added Tax [VAT] if they are provided directly by companies and organisations established by organisations of disabled individuals that own the property thereof. The list exempt goods / services is approved on annual basis by the Cabinet of Ministers based on recommendations of the Interdepartmental Commission for the Activities of Enterprises and Organisations Established by Organisations of Disabled Individuals. In addition, the added value of the goods that are produced and exported by the organisations of the disabled [excluding goods with a value added of less than 8% of their sale price] is zero rated for VAT purposes. This provision equalises these disabled peoples organisations with commercial organisations for export purposes, and allows them to obtain refunds on “input” VAT, i.e., the tax amount that they pay for purchasing goods or services.
- Temporary Loss of Working Capacity Contribution Privileges: Disabled organisations pay 0.7 per cent of the payroll tax of due to the Temporary Loss of Working Capacity Fund [TLWC] for all disabled people they employ; and 2.9% [which is the same for other types NGOs] of the payroll of their able-bodied employees. The enterprises and organisations set up by UTOG and UTOS [i.e., the Ukrainian Deaf People’s Society and the Ukrainian Blind People’s Society respectively] pay only 0.5per cent of the payroll taxes of able-bodied employees. Moreover, disabled employees of enterprises and institutions established by UTOG and UTOS pay 0.25 per cent in payroll taxes to the TLWC, while able-bodied employees working for other NGOs pay 1 per cent. In addition, if an insurance case occurs [i.e., an employee losses working capacity] for an individual insured by an NGO, the TLWC starts paying insurance benefits on the sixth day [in the period prior to the sixth day, the NGO has to cover the loss of income from its own resources]; while the disabled employees of UTOG and UTOS enterprises and institutions are eligible to claim for insurance from the first day at which they become eligible to make a claim.
- Unemployment Insurance Privileges: Enterprises and organisations established by organisations for the disabled are exempt from contributions to the Unemployment Mandatory Insurance Fund [UMIF] for their employed disabled individuals, while the UTOG and UTOS enterprises and organisations are exempt from the contributions for all

employees [i.e., able-bodied and disabled]. All other NGOs pay 1.6 per cent in payroll taxes to the to the UMIF.

- Accident at Work and Professional Disease Insurance Privileges: Enterprises and organisations set up by organisations of disabled individuals pay 50 per cent of the ordinary rates of insurance.
- Mandatory State Pension Insurance Privileges. Enterprises of organisations of disabled people whose scope is nationwide, and where disabled individuals make up not less than 50 per cent of the staff role, pay 4 per cent of the payroll taxes due to the Pension Fund – while all other types of NGOs pay 32 per cent of the amount due top the pension insurance fund<sup>9</sup>.

The range of tax benefits and exemptions extended to SMROs – particularly disabled peoples organisations – are considerable and are marked by sharp distinctions to the more limited range of benefits, entitlements and exemptions that are extended to other types of NGO. In the context of the LSS – these distinctions have important ramifications for the development of a Social Economy that enables NGOs to thrive and contribute to national life. Indeed for NGOs that are not covered by these tax benefits and exemptions, and which currently - or intend to - provide social services to disabled people, the inequalities mean that SMROs like UTOS and UTOG pay:

- Between 4 and 6 times less to the TLWC Fund, and their disabled staff pay 4 times less for able-bodied employees;
- Nothing to the UMI Fund, while other types of NGOs have contribute 1.6 per cent;
- 50 per cent of the normal rate of mandatory insurance against accidents at work;
- 8 times less to the pension fund;
- 0.5 per cent of the able-bodied employees' payroll to the TLWC, and are exempt from the UMIF payments for all employee;

In addition to these particular disparities between different NGOs UTOS and UTOG contribute only 0.5 per to the payroll taxes of their able-bodied employees, and are exempt from contributions – for both able bodied and disabled – to the UMIF. Other types of NGOs that provide social services to disabled people, on the other hand, are expected to contribute 0.7 per cent in payroll taxes to the TLWC, and 1 per cent to the UMIF. It goes without saying that encouraging and providing incentives for the employment of disabled people is a positive aspect of social policy. However, it is unlikely that objective measures to support the employment of disabled people should be explicitly linked to type of NGO that employs them. Likewise, steps for encouraging the employment of able-bodied individuals in the broader Social Economy should not be based on the type of NGO in which they are employed<sup>10</sup>. The presence of these phenomena in tax system

<sup>9</sup> It should be noted that a policy directive to ban this type of privilege the enabling law to enforce a ban not been introduced. According to the Accounting Chamber the absence of the enabling law and the accompanying loss of revenue to the state pension fund amounted to 444.4 million UAH in 2004, and 138.4 million in the first quarter of 2005.

<sup>10</sup> From an economic point of view the provision of discounted rates of contribution to social insurance is hard to justify between different categories of employee. This is because public social insurance schemes operate on the principle of pooling risks, and paying out benefits in accordance with standardised criteria. Thus public social insurance differs from private insurance schemes where the level of insurance contribution is set against specific risks associated with particular occupations. Under current arrangements the discounting of contribution rates to particular groups of individuals – able



does raise key questions: if the privileges are accorded to one group of NGOs why are they not extended to all? And, what are benefits and costs – in both fiscal and social policy terms – of maintaining the current system in the context of meeting the objective of increased participation by a wider circle of NGOs in the delivery of social services?

### **The Treatment of Tax Incentives for Goods and Services Provided by NGOs for Public Benefit Purpose:**

In the context of developing a Social Economy it is necessary to distinguish between different types of NGO. The Law of Civil Associations provides for the establishment of associations that in effect serve the common benefit of their members as opposed to a wider public benefit interest. As already established [see Chapter 3], such common benefit associations take the form of membership organisations that are conventionally defined as ‘mutual benefit’. In the typical mutual benefit type NGO, members acquire a legal interest in the NGO that entitles the member to vote at member meetings and to participate in the general distribution of assets to members. In most CEECs the conventional approach has been to accept that profits derived by the membership-type NGO from the provision of goods and services [including membership fees] by the NGO to its members essentially constitute a surplus that represents contributions received from members that have not yet been spent by this type of NGO. To this extent “mutual” income is usually granted exemption from income tax because no “real” profit has been earned on transactions with third parties. Based on the analysis in Chapter 3 this is prevailing regime for these types of NGOs in Ukraine. However, it is unclear - in the context of the LSS – where an NGO of this type provides social services to non-members what the tax status of these types of NGO would be [unless they set up separate organisations and institutions to deliver social services in which case any profits from these sources would be liable to income tax in full].

In the case of Charity organisations – as defined in the Charity Law – whose purpose is more akin to the public benefit purpose, the mutuality principle does not apply given that the members have no legal right to participate in the distribution of the Charities assets. Here the justification for exempting membership fees from income tax lies in the argument that either the purchase of membership does not confer on the member any valuable rights other than the right to vote at member meetings and receive a copy of the annual report or that the services provided to members are services that are being provided to further a public benefit purpose to the wider population or a significant body of the population. To all intents and purposes there are no fundamental conflicts between the Charity Law, the LSS, and the Corporate Profit Tax Law with regard to charities delivering social services.

As regards donations and grants received by NGOs, a key question is whether these are true gifts without strings attached, or whether the NGO has given some consideration of benefit to the donor or grantee in return for a gift, in which case the transaction is more in the nature of a good or service of payment by the NGO to the donor. Gifts without strings are generally not subject to income tax, either because they are not classified as income under general principles of law or because they are specifically exempt from the tax base. Gifts with strings attached may still be exempt from income tax if the good or service provided by the donor can be considered to be in the public interest, but would otherwise be taxed as unrelated to business income. The fact that donor receives a benefit generally precludes the donor from claiming income tax relief for the

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bodied and disabled – based on the type of NGO they work in does not meet the minimum criteria of effective risk pooling for public insurance schemes, nor does it meet the criteria of assessing specific risks that these particular groups of employee may encounter under private insurance schemes. The distinctions mean that although the privileges accorded to SMROs are insurance focused, they act as a tax on employees in other types of NGOs that are not eligible for these privileges. This burden of tax weakens the prospects of a robust Social Economy.

payment to the NGO, or reduces the value of the gift eligible for tax relief to the donor. However, this does not of itself determine the tax treatment of receipt by the NGO.

In Ukraine income to NGOs from foreign and domestic grants [either from the public or the government] appear to follow these broad principles alongside the tax-exempt status of grants. In this sense the tax regime towards membership fees and grants appear – with some minor variations<sup>11</sup> - to be in line with emerging best practice in CEECs.

Individual citizens can contribute – through donations - to the provision of goods and services provided by NGOs without being subject to income tax on these donations. The exemptions on personal income tax apply to money or gifts in kind made to all NGOs with the exception of credit unions and other non-bank financial institutions, and charitable foundations. Individuals can contribute to the following causes:

- Environmental, man made and natural disasters;
- Health care institutions to compensate for the costs paid for services for the medical treatment of a citizen;
- Orphanage institutions for the distribution of goods/services among individuals younger than 18 years old that reside in such institutions;
- Penitentiary institutions for the improvement of general conditions, food, and medical care of people kept in pre-trial facilities or prisons, or directly to such individuals;
- Elderly peoples homes or homes for disabled people for the improvement of general conditions, food, medical care, and social rehabilitation;
- Amateur sports organisations for the compensation of expenses for the purchase or lease of sports equipment etc.

Cash and in-kind contributions can also be provided for research and development purposes to compensate for the costs of equipment and materials provided the results of such research and development will be publicly disclosed and shall not be subject to patenting. However, if upon the completion of research, the researcher retains certain property [e.g. IT equipment], the researcher is obliged either buy such property at its usual price or return it to the charitable organisation, or recognise the profit assessed in accordance with its usual price and pay a relevant tax on it<sup>12</sup>. Overall Ukrainian legislation provides an enabling framework for private donations to NGOs. However, it is notable that the list of activities to which contribution can be in the field of social services are overtly linked to services provided in residential institutions. This means that many of the social services defined in Article 1 of the LSS are not explicitly listed in the types of activities that the public can make donations to. Although there is nothing in the legislation that

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<sup>11</sup> Companies that make cash or in-kind contributions to NGOs over a single fiscal year can include these expenditures as part of gross expenditure and regarded as part of the tax base. However, if such expenditures are channeled to NGOs that are nationwide in scope [for the main part SRMOs fall under this category] or to individuals that have suffered from the Chernobyl disaster, or to the protection of cultural heritage, science, education, museums etc the relevant limit of such contributions is restricted to a maximum limit of 10 per cent of the profit level that was taxed in the previous year. For individuals is permitted within a 2-5 per cent range of gross income earned.

<sup>12</sup> The provisions made for research provide a framework that will in the context of the LSS enable donations be made for research on matters associated with the delivery of social services.

prohibits donations to community-based social services, the lack of explicit guidance creates a grey area of policy, and policy-makers should consider the extent to which the list of activities should be brought in line with those listed under Article 1 of the LSS.

## **Comparative Analysis of NGO Taxation in Ukraine and in CEE Countries**

### *NGO Taxation*

Income/Profit Tax: As a rule CEECs exempt NGOs from income/profit tax. In particular, this is the case in the Czech Republic, Poland, Slovenia, Slovakia, and Hungary. Naturally approaches differ from one country to another country, but the majority of CEECs exempt the profits of almost all NGO categories. Other countries provide benefits only to NGOs that are involved in certain kinds of activities related to public benefit - thus Bulgaria, Poland, Slovenia, and Estonia explicitly list the range of activities in legislation. Macedonia has more limited tax benefits and exempts from profit tax only organisations sheltering disabled individuals. Normally, no tax is imposed on income from grants, irretrievable financial assistance, and membership fees and, under certain conditions - from business activities [e.g. sale of goods and services] and passive income. In the majority of the countries, income from business activities [providing NGOs are allowed to engage in business activities] are taxed; a country may exempt from income tax the income share that is essential for the main non-profit activities of the NGO, or set a certain amount of income that is not subject to taxation<sup>13</sup>.

Direct comparisons between Ukrainian tax legislation and that of other CEECs cannot be drawn given differences in the orientation and pace of transition, it is nevertheless appropriate to elucidate on a number of normative tests that Ukrainian policy-makers will need to consider, in the context of elaborating the system of user fees that can be charged by NGOs that provide social services within the framework of Article 7 of the LSS. Although Ukrainian tax legislation adopts a progressive stance towards the treatment of passive income accrued by NGOs - which helps stimulate investment in the Social Economy and provides for the sustainable fiscal development of individual NGOs – current legislation is silent on the way income from user fees are to be assessed for tax purposes. The omission in current legislation is important because NGOs – particularly those at the Oblast and sub-Oblast levels - have limited and restricted sources of income that inhibits their growth and technical capacities to delivery social services. This particular constraint is compounded by the fact that domestic sources of grants [from government] and donations [from enterprises and individuals] are likely to remain in short supply over the medium term. Addressing this constraint has been major hurdle in all CEECs given that the creation a permissive environment for NGO business activities can create risks. However, there are examples from the experience of CEECs incorporate a number of tests that can simplify the assessment and monitoring of this problem:

- The “relatedness” test – where taxes are levied only on the profit generated from the activities not related to the prime aims of the organisation;
- The “destination of income” test – where no taxes are levied on the profit from business activities of NGOs provided such profit is used to support the primary activities of such NGOs; and

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<sup>13</sup> There are, for example, countries like Slovenia and Bulgaria that tax the business activities of NGOs in a manner similar to all other legal entities. Indeed, some countries, like Bulgaria, The Czech Republic, Slovakia, Slovenia and Latvia that tax all forms of passive income; while others – such as Hungary and Serbia – tax passive incomes at a lower rate, and some – e.g., Poland, Romania and Lithuania – do not tax passive incomes.

- The “threshold” or mechanical test. Taxes are applied to all profit that exceeds the established margin.
- A Hybrid test - which combines elements of the above.

In Ukrainian legislation, the position on whether NGOs can charge user fees, and how such fees will be treated for tax purposes, is not sufficiently clear – particularly for organisations that fall under the Law on Civil Associations which prohibits them from engaging in business activities, except in circumstances where they create subsidiaries. The law on Corporate Profit Tax states that no taxes can be levied on an NGO’s primary activities within the definition the Act. Accordingly, NGOs are allowed to do business if:

- It is related to the promotion of principles and ideas for which the organisation has been established;
- It is closely related to the primary activities of the NGO; and
- The prices are lower than market prices or, are prices that are regulated by the state.

However, it is not clear whether these provisions would extend to subsidiaries created Civil Association that levied a charge for the delivery of social services. The Charity Law, on the other hand, allows charitable organisations to engage in business activities providing the activities are in full accordance with their charter aims and objectives.

Using the provision of the Corporate Profit Tax law as a yardstick is possible to argue that the tax position of businesses established by NGOs in do have features that correspond to the “relatedness” test. For example, an NGO may also be involved in other business activities while preserving its non-profit status – and thereby remain on the relevant NGO register – if it abides by specific Articles of the Corporate Profit Tax Law:

- Sub-clause 7.11.9: which states that “if any non-profit organisation gets profit from sources different from those mentioned in Sub-clauses 7.11.2-7.11.7 hereof, such non-profit organisation shall pay the profit tax defined as the amount of income received from such other sources less the amount of expenses related to the receipt of such incomes, but not higher than the amount of such incomes.”
- Sub-clause 16.10: which emphasises that “non-profit organisations mentioned in Clause 7.11 of the Act shall pay taxes on profit from other than its primary activities in accordance with the general rule.”

Thus, although the approaches to the taxation of profits by NGOs in Ukrainian tax legislation bear many of the hallmarks that accord with other CEECs, in specific terms it would be helpful for Ukrainian legislation to define in specific terms the types of NGO activity that are exempt from profit tax, and specify whether income accrued from charging user fees for social services would constitute a breach of their primary activities and whether income generated from such fees would be liable to be taxed in full. A threshold test might, therefore, be a helpful option to consider in the context of assessing the tax liability on user fees.

Property Estate Tax: The majority of CEECs, including the Czech Republic, Lithuania, Latvia, Poland, Romania, Slovakia, and Hungary, offer property tax benefits to public benefit NGOs. One

of the conditions for such benefits in Hungary is that an organisation has not paid profit tax in the previous year. Ukraine has a land tax [which is a proxy tax for a property tax]. However, only organisations of disabled people and charity organisations that are not engaged in conducting business activities are exempt from this tax. Taking into account CCECs experience, and observations on the prudence of allowing NGOs to be involved in some business activities - and even providing income generated by these activities with certain tax benefits - it would be worth policy makers considering the options for the exemption of charitable organisations involved in certain kinds of business activities from the land tax. Since the rates of land tax in Ukraine are not very high, and since, in the majority of cases NGOs do not presently own or lease land, these organisations do not complain about the land tax rate. However, if reforms were introduced - such reforms should aim to equalise the privileges granted to all NGOs. In the event that systemic reforms were introduced that accorded with the introduction of a property tax [as opposed to a proxy tax through land] the current discrepancies between different types of NGOs could magnify and impede the development of the Social Economy.

Value Added Tax: All CEEC countries levy VAT on the sale and transfer of goods and services. There are certain financial thresholds below which an entity does not need to be registered for VAT, irrespective of the organisational form of such a legal entity. However, the majority of the CEECs have different VAT levels for NGOs.

There are a number of approaches for addressing VAT on NGO transactions:

- Exemption of NGOs from VAT: In this case, NGOs do not have to calculate and pay VAT for their goods and services. However, they also are not able to get a refund for the VAT that they pay for the goods and services that they buy. The countries [see table 4.1 below] that exempt certain organisations from the VAT limits are those that: (a) serve as public benefit NGOs, or (b) are involved in non-business activities;
- Zero Rated VAT: NGOs [like other companies and organisations] do not pay VAT for those goods and services that are taxed at zero rate. The difference between this and the exemption approach is that in this case the VAT payers are able to rebate the VAT they paid while buying goods and services. This approach is more common in comparison with VAT exemption. VAT law in the countries that have adopted this approach [see the table below] list goods and services that are subject to the zero rate.

**Table 4.1. Application of VAT to NGOs in CEECs**

	<b>Organisation Exemption</b>	<b>Transaction Exemption</b>	<b>Zero Rate</b>	<b>Reduced Rate</b>
Albania		Yes		
Bulgaria	Yes	Yes		
Estonia		Yes	Yes	Yes
Kosovo		Yes		
Latvia		Yes	Yes	
Lithuania		Yes	Yes	
Macedonia	Yes	Yes		Yes
Poland		Yes		Yes
Romania	Yes		Yes	
Serbia		Yes		

Slovakia		Yes		
Slovenia		Yes		Yes
Hungary		Yes	Yes	Yes
Croatia	Yes		Yes	
Czech Republic	Yes			Yes
Montenegro	Yes			
<b>Ukraine</b>	Yes	Yes	Yes	

The effect of VAT on NGOs requires more detailed explanation. In contrast to the way in which other taxes work, the fact that an NGO is not subject to VAT or that the goods and services that it supplies to its clients are exempt from VAT does not mean that NGOs bear no VAT costs. VAT is conceived as a tax on the final consumer of goods and services. In most cases this will be an individual member of the public buying from a retail outlet for his/her personal private use. Commercial businesses can usually pass on the VAT that they pay on their purchases of similar goods and services to their own customers so that the only costs they incur as taxpayers are the costs of recording, administering and collecting the tax from their customers for the benefit of the government.

Most forms of NGO are in a different position from that of commercial enterprises. The design of VAT requires that it be imposed on all forms of economic activity, whether or not it is for profit. But the non-profit character of an NGOs purpose limits its ability to pass on to its clients, and their ability to pay, the VAT that is charged to the NGO on its own purchases of goods and services. Thus any VAT that an NGO does not pass on to its clients, whether by reason of law [i.e., because the NGO does not perform an economic activity or because the economic activity concerned is exempt from VAT] or by choice [e.g., because its clients cannot afford to pay the extra cost] becomes a permanent cost to the NGO. Thus an NGO that is not subject to, or is “exempt” from VAT will generally pay more VAT than one that is “taxable”. It is with these considerations in mind that practices have emerged in a majority of CEECs that ensures NGOs are VAT exempt on their output transactions. However, this approach is not necessarily advantageous to NGOs given that for the main part they are not VAT exempt on their input transactions. It is with this fact in mind that some countries have adopted the zero rate approach towards input and output transactions, or a reduced rate on pre-defined list of transactions

In Ukraine VAT is regulated by the VAT Act and the State Budget Act. An individual is obliged to be registered for VAT if he/she has a turnover in excess of 300,000 UAH. The law exempts charitable assistance received by all types of NGOs from VAT - with the exception of excisable goods, securities, non-tangible assets, and certain goods for business use. However, the law does make a number of distinctions on VAT “exemptions”:

- Transactions on delivery of special goods for disabled individuals [set by the Cabinet of Ministers of Ukraine];
- Transactions on the delivery of services for the maintenance of individuals at elderly homes and homes for disabled individuals, food and provision of night shelter to homeless individuals at specially-equipped places and in accordance with the procedure and norms set by the Cabinet of Ministers of Ukraine;
- Transactions on delivery of goods [apart from excisable goods and those that fall under the definition of UKT ZED Groups 1-24] and services [excluding gambling and lottery businesses] that are produced by companies and organisations of non-governmental

organisations of the disabled. The list of the goods/services deemed VAT “exempt” is established on an annual basis by the Cabinet of Ministers, and based on recommendations of the Interdepartmental Commission for the Activities of Enterprises and Organizations of Civic Organisations of Disabled Individuals.

Based on the evidence assembled on the VAT regime and its application to NGOs, it is clear that privileges and exemptions are geared towards disabled NGO. In the context of the policy directions set forth in the LSS the current legislative provisions are of questionable value, and policy makers need to consider amendments that level up the regime so that all NGOs are placed on an equal footing. This will ensure that the provision of community-based social services does not become the sole preserve of SMRO-type NGOs and open up spaces for the inclusion of a variety of NGO types that are able to respond to need achieve their public benefit purpose.

### *Taxation of Philanthropic Activity*

Practically all CEECs seek to encourage public support of charitable activities through tax deductions for private donations. The deduction permitted range from 0.5 per cent of gross income in Bosnia and Herzegovina to 40 per cent in Lithuania<sup>14</sup>. In the majority of CEECs individual citizens are free to choose the destination of their private donations, with the major difference being the maximum limit that can be off-set against personal income tax. Although legislation in many CEECs makes these tax provisions, it is left to individual discretion as to whether they wish to make private donations, and there are seldom active campaigns by government that seek to encourage citizens to engage in philanthropic activities. Thus government measures can, at best, be described as ‘passive’ rather than ‘active’. The distinction between ‘passive’ and ‘active’ measures that aim to encourage public participation in philanthropy became the subject of heated debate in many CEECs – particularly in the wake of significantly reduced levels of foreign donors involvement; in the context of the need to widening the scope of civic participation and encourage social cohesion, the need to build stronger networks - in the context of increasing levels of decentralised decision-making - between citizens and local communities; and to overcome attitudinal constraints – linked to trust and information asymmetries – between citizens and NGOs.

It was against the background of the debate between “active” and “passive” measures Hungary, in 1996, launched an “active” measures entitled the “1% law” [See Chapter 3]. The central idea behind this measure is based on a “percentage mechanism” whereby taxpayers can designate a certain percentage the tax they pay to a specific non-profit NGO – including religious organisations. This approach was later adopted by Slovakia in 2001, by Lithuania in 2002, and by Poland and Romania in 2003. In all these countries, with the exception of Slovakia, the percentage mechanism was also extended to individuals. Despite certain initial reservations about stimulating advocacy and service delivery NGOs [and wider civil society] through this mechanism the outcome – in financial terms - exceeded expectations. In addition to improving public awareness of roles and functions of NGOs, and strengthening relationships between the state and the citizen by reducing informational asymmetries, revenues available to NGOs increased substantially. The down side of the percentage mechanism was that it fostered policies that sought to constrain other forms of support – though the taxation system – for philanthropic activities. This has been the case in Lithuania and Slovakia, and is now being considered in Poland

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<sup>14</sup> Within this range, Czech Republic and Romania allow for a maximum of 5 per cent; Bulgaria Slovakia and Poland 10 per cent, and Hungary 20 per cent. It should be noted that Lithuania does utilise tax deductions to encourage public support of NGOs and uses tax credits instead. Tax credits involve the direct reduction of tax in contrast to a tax deduction that reduces the amount of income that can be subjected to taxation.

as well. In recognition of temptations of policy makers to down-size other forms of support for philanthropic activities, some countries [e.g., Hungary] has sought to elaborate the types of links that can be built and established between citizens and NGOs. This has been introduced through measures such as “long term charity assistance” – which grants special [i.e., higher] tax benefits to citizens and corporations that engage in the formation of a contract whereby the donor undertakes to provide financial assistance [based on a proportion of their gross income] to an NGO for period of more than four years. This measure has been particularly popular among NGOs that engage in the provision of social services.

In comparison with many CEECs Ukrainian legislation on the taxation of donations has a number of features that are common. However, in the context of the LSS and the declared intent to widen the scope of NGO participation in the delivery of social services, it would be worthwhile for policy makers to begin exploring options that place NGOs on a more secure financial footing, and does not discriminate in favour of SMROs – such as disabled peoples organisations that currently have privileged status within both normative legislation and the taxation regime. Such a review should also evaluate cost-benefit based options that would accrue from raising the thresholds of permissible donations that are eligible for tax deductions by individual citizens and commercial enterprises. The review will need to take account of growth trends in the macro economy, and changes in the trend of foreign donations that currently perform a significant role in the development of NGOs. However, it will be more important that review takes a medium-term view of the steps and measures that need to be put in place that secure the objectives of the LSS with regard to the delivery of social services by NGOs

### **General Observations and Recommendations:**

1. The Ukrainian taxation system for NGOs has some features that are comparable with CEECs. For example, NGOs are exempt from taxes on incomes received in the form of voluntary donations, irretrievable financial assistance, humanitarian or technical assistance, allocations or subsidies received from the nationwide or local budgets and state target funds. In addition, taxes are not levied on the business activities of NGOs if the business in question is closely related to the aims and objectives for which a relevant NGO was set up [i.e.; the “relatedness” test].

2. The Ukrainian VAT regime has many features that bear similarity to those that apply in CEECs. Indeed, the current Ukrainian VAT regime cannot be described as providing greater or lesser benefits to NGOs than the legislation applied in the majority of CEECs. However, it is clear that Ukrainian VAT regime does accord a greater range of benefits and privileges to SMRO-type NGOs that concentrate on disabled people organisations. In the context of the LSS, and the future growth and sustainability of the Social Economy, such discrepancies need to be rectified if a wider circle of NGOs are participate in the delivery of social services as defined in Article 1 of the LSS.

3. Terms of employment – as defined in legislation - between different types of NGOs demonstrate a degree of inequity which hampers and hinders the development of the Social Economy, and results in the majority of NGOs [i.e., those that are not part of the SMROs established under the Communist welfare state] incurring higher payroll tax costs. In the context of an expanding Social Economy such inequities cannot be justified and will – over time - lead to increasing levels of inefficiency given that non-SMRO-type NGOs will not be able to compete in a tender and contracting regime [as delineated in the LSS] on an equal basis given that their overhead costs will always be higher.



## Chapter 5:

### A CONCLUDING FRAMEWORK FOR POLICY DIALOGUE

The current system of delivery of social services in Ukraine is going through a transitional period that is shaped, to a considerable extent, by the LSS and by the declared objectives of the Government as stated in *Towards the People* which aims increase the quality of social services, ensure that these services approach European norms and standards, and to enlarge the circle of those who render such services. These declared objectives have, with minor changes in emphasis, remained consistent since initial strategy for the decentralisation of social services was declared in 1994. However, the implementation of these declared priorities remains patchy, and accelerating the process depends upon improvements to the legislative framework as well as implementing existing legislative and normative acts in practice.

This analysis makes a small but, nevertheless, important contribution to evaluating the scope and scale of the challenges and has sought to offer insights into the ways in which these challenges can be addressed in the Ukraine. The lessons of experience from CEECs are valuable in their own right, but also offer examples that Ukraine may wish to consider in the context of elaborating the LSS, legislation associated with different types of NGO, and the interface with the taxation regime. Taken together, the LSS, NGO legislative frameworks and taxation regimes are important ingredients for the creation of successful Social Economy. It anticipated that the themes covered in this analytical report help underpin the objectives set forth in *Towards the People*, and facilitate constructive dialogue between the government and NGOs in a context where the common objectives are underpinned by the following principles:

#### *The Freedom of Association:*

Individuals should be as free as possible to join together in pursuit of lawful purposes with the minimum interference of the state. In practical terms, this means that care will need to be taken in avoiding the introduction of measures that increase bureaucracy and discourage people from forming NGOs. Many small civil associations will have no wish to get bigger, and an even greater number will have no intention of engaging in the delivery of social services. Thus the features highlighted in this report will need to be considered with these features in mind.

#### *Respect for the NGO Sector's Independence:*

Civil associations, charities and foundations, and religious organisations are independently governed. This enables them to respond directly to the needs of local communities or interest groups. They can therefore choose whether to work with Government on the delivery of social services or not, or whether to advocate for policy changes. Some NGOs in Ukraine will seek to do both. Any changes in the legislative framework or the taxation regime should respect and safeguard the independence of all types of NGO.

#### *Promoting Public Confidence:*

NGO legislation should give the public in general, and private and corporate donors in particular, confidence that their money will be used for purposes for which it was given. Appropriate state regulation is therefore paramount in a context where the Social Economy is likely to grow in both scale and scope – particularly in fields that are of particular concern to the delivery of social

services. Promoting public confidence is an important principle because the NGO sector's success ultimately depends on public support.

*Supporting the Delivery of Public Benefit:*

Government support should be targeted at those NGOs which deliver benefit, as defined in this report, to the public. However, deciding which organisations deliver public benefit should be managed by an organisation that is independent of Government to ensure that public benefit does not get caught in a trap that leads to it being defined according to political interests. The current approach that differentiates between SMROs and other NGOs therefore needs to be modified.

*A Proportionate Approach to Risk Based Regulation:*

The regulation of NGOs should have clear objectives. Regulations governing NGOs involved in the delivery of social services should be carefully targeted and proportionate to the risks that need to be mitigated – both to the risk of regulations being abused, and to the risk of damaging public confidence. For the LSS this means that regulation of small organisations - that are not involved in the delivery of social services - should be lighter than the regulation of larger organisations that provide social services and may also have a disproportionate impact on public confidence.

*Simplify and Harmonise Regulation where Possible:*

Under current arrangements civil associations, charities and religious organisations are regulated according to their status, form and activities. Some of the complexity that this system throws up cannot be avoided, but where possible requirements in the context of elaborating the LSS for the delivery of social services should be simplified and harmonised.

*Clear, Consistent and Transparent Regulation:*

A lack of clarity and consistency in regulation makes it difficult for NGOs to understand their obligations – and therefore to comply with them. A lack of clarity can also make NGOs excessively weary of engaging in innovation and thereby reduce the level of public benefit they are able to deliver. Regulations under the LSS therefore need to be based on encouraging innovations in the delivery of social services and ensuring that these regulations reduce transaction costs.

It is within the framework of these principles that the analysis and evidence base has been assembled, and has sought to define and structure general observations and specific recommendations therein.

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