The Legal and Regulatory Framework for CSO Self-financing in Romania

Written and edited by Loïc Comolli, Nicole Etchart, and Eva Varga
Nonprofit Enterprise and Self-sustainability Team (NESsT)

This guide examines the legal and regulatory framework that governs the use of “self-financing” (i.e., income-generating, commercial) activities of civil society organizations (CSOs) in Romania and provides an assessment of the relevant law and its practical effects in order to identify areas where the law might be improved. In Chapter 1, the guide explains the importance of understanding the regulatory environment as it relates to self-financing, defines the concept of CSO self-financing, and explains the methodology used by NESsT in researching and assessing the legal framework in Romania. Chapter 2 outlines a generally-accepted typology initially developed by the International Center for Not-for-Profit Law (ICNL) for evaluating the legal framework that regulates CSO self-financing. Chapter 3 presents the current regulatory framework and its application in Romania. The chapter illustrates that CSO self-financing activities are permitted in Romania if they are mission-related; otherwise a separate legal structure is necessary to conduct commercial activities. Finally, in Chapter 4, five criteria are applied to critique the Romanian legal framework, assess its current strengths and weaknesses, and make recommendations for improvement.
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Nicole Etchart and Lee Davis
Co-Founders & CEOs
NESsT

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The term “civil society organization” (CSO) encompasses the wide diversity of not-for-profit, non-state organizations as well as community-based associations and groups that fall outside the realm of the government and business sectors. Given the limited philanthropic and government assistance available, many CSOs undertake self-financing to generate revenues in support of their mission and programs.

NESsT has documented hundreds of CSOs in Latin America and Central Europe that engage in these types of activities and has analyzed the impact of these strategies on the organizations’ performance and sustainability. An important factor that emerged from these investigations is the need for a clear and supportive legal and regulatory framework to foster the adoption of self-financing strategies among CSOs. This framework defines whether CSOs can or cannot engage in self-financing activities and influences the circumstances under which and the degree to which they will do so. In addition, the tax structure, the level of bureaucracy, and the clarity of the applicable legal rules have a direct bearing on the use of self-financing activities. CSOs are often unaware of...
these rules. Many believe that they cannot prac-
tice self-financing; others feel that if they do, it
will damage their public image or their relations
with donors. Even when CSOs are aware of the
relevant legislation, they often do not understand
what taxes they need to pay, what forms to file, or
what procedures to follow. In Romania, self-
financing activities by CSOs remain a rare prac-
tice, partly because of the lack of capacity and
tenpreneurial spirit on the part of the CSOs,
but in part also because of the lack of a clear
interpretation of the legal framework which, in
principle, allows CSOs to engage in commercial
activities.

Romanian legislation encompasses a variety of
types of CSOs engaging in activities aiming to
achieve general or common interest. They
include associations, foundations, and federations
(with the former two having the option to be
granted public benefit status). This guide will
attempt to clarify the legal framework faced by
Romanian organizations, focusing on associations
and foundations, which constitute the bulk of
Romanian civil society. The guide will, then,
assess the degree to which this framework pro-
vides an enabling environment for these organiza-
tions to pursue self-financing strategies.

1.1. What Is Self-financing and Why Is It
Important?

Self-financing strategies are used by CSOs to
generate revenues in support of their missions. The
use of self-financing is a response to the current
funding paradigm in which CSOs compete for a
limited pie of existing government and philan-
thropic resources from both national and interna-
tional sources. This reality makes many CSOs
heavily dependent on short-term, project-based
funding and prevents them from focusing atten-
tion on the long-term, strategic development of
their organizations. Through self-financing, CSOs
may be able to increase their long-term viability
and independence by generating some of their
own resources to supplement support from public
and private donors.

Self-financing need not lead to the commercial-
ization of CSOs. Rather, self-financing can provide
CSOs with a greater level of independence and
sustainability without compromising their mission
objectives or values. Self-financing income can be
one alternative for CSOs to support work that is
often difficult to finance through traditional
sources of funding (e.g., core operating expenses,
new programs, advocacy efforts). NESST does not
argue that CSOs should entirely replace their tra-
ditional sources of funding with self-financing,
but instead posits that self-financing can provide a
powerful complement to government and philan-
thropic support. Through self-financing, many
CSOs are not only financially strengthened, but
also institutionally empowered by their ability to
generate new revenues and to determine the
course of their work with fewer constraints from
funders.

Furthermore, when pursued in a socially and envi-
ronmentally responsible manner, the enterprise
activities of CSOs can help create an “alternative
economy” more responsive to the needs of local
communities, small producers and low-income
people. By purchasing products and services sold
by CSOs, consumers are simultaneously promot-
ing the mission of CSOs and contributing to a
more equitable and sustainable world.

The types of self-financing activities include the
following:

- Membership fees: raising income through
dues from members or constituents of the
organization which is considered a fee for
some kind of product, service, or other bene-
fit provided by the CSO to its membership.
- Fees for services: capitalizing on some exist-
ing skill or expertise of the organization by
contracting work to paying clients in the public or private sector (e.g., a CSO provides consultation services to businesses or local government).

- Product sales: selling, rather than giving away, the products of CSO projects (e.g., books or other publications); reselling products (e.g., in-kind donated items) with a mark-up; or producing and selling new products (e.g., T-shirts, mugs).

- Use of “hard” assets: renting out CSO real estate, space/facilities, equipment, etc. when not in use for mission-related activities.

- Use of “soft” assets: for example, generating income from license of CSO-held patents or other intellectual property, or by endorsing products with the CSO name/reputation.

- Investment dividends: passive investments such as savings accounts and mutual funds, or other more sophisticated financial transactions (e.g., active trading on the stock market).

CSOs engage in self-financing activities primarily to strengthen their financial resources, to advance their social mission, or both. On the one hand, a CSO may be purely interested in generating profits that it can use to fund its core mission programs. In these instances, the organization is not concerned with advancing its social mission directly through the self-financing activity, but rather indirectly by applying the revenues from the activity to further its social mission. An example of this is a health education organization that starts a printing press and uses the revenues to fund the organization’s research projects. This activity would be considered non-mission-related.

On the other hand, a CSO may be primarily interested in using a self-financing strategy to advance its social mission. For example, a CSO whose social mission is to offer carpentry training and job placements to recovering substance abusers may begin selling the furniture that the trainees produce in order to pay for the costs of materials and the salaries of the trainees. This activity would be considered mission-related.

Yet these examples are not mutually exclusive—and neither are the financial and social goals that motivate CSOs engaging in self-financing activities. Many times, CSOs aim to achieve financial and social goals simultaneously through a self-financing activity. The health organization may be better positioned to disseminate the findings from its research by publishing its own materials, and the job training organization may be able to apply surpluses from its furniture sales to fund other programs of the organization or its core operating expenses. In each of these scenarios, the objectives of CSO self-financing activities and the relation of these activities to the organization’s primary mission strongly influence the success of the activities and may play a role in determining the legal treatment of these activities, as this guide will illustrate.

1.2. Purpose and Contents of This Guide

In an attempt to diversify their funding base, a number of Romanian CSOs have initiated self-financing strategies. For the most part, however, they have done so with little know-how, capital or other forms of support. NESsT research on the use of self-financing among CSOs in Romania demonstrates that many of them have limited internal capacity (i.e., staff skills and time, adequate financial resources, business plans) or the external support (i.e., financing, consulting support, favorable legal/regulatory environment) to engage in self-financing activities. When such organizations nevertheless attempt to pursue self-financing strategies, they have to deal with a range of legal, financial, management and organizational issues for which support is not readily available. If CSOs decide to pursue self-financing
activities, it is important that they do so with the appropriate types and levels of technical and financial assistance and within an enabling external environment.

The pressures and demands faced by CSOs engaging in self-financing activities highlight the need to understand the legal environment affecting them in Romania. In this context, the purpose of this guide is twofold:

A. To outline key laws, regulations and procedures governing the use of self-financing by CSOs in Romania. Chapter 3 explains what Romanian law says about the use of self-financing and discusses the administrative and tax regulations that apply to CSOs engaging in such activities. It also explains the procedures – forms that must be completed and fees that must be paid – required to initiate such activities. It offers a general overview of the relevant laws and regulations, so that Romanian CSOs have an idea of where they fit within the legal system and what they have to do if they wish to undertake self-financing.

B. To assess the relevant laws governing CSO self-financing in Romania, to evaluate their practical effects and to identify areas where the law might be improved. This guide identifies the strengths and weaknesses of Romanian laws – whether they help or hinder the use of self-financing, and whether they foster the development of the sector as a whole. The legislation is considered within a tax treatment typology that makes it easier to understand and assess.

The typology was first developed by the International Center for Not-for-Profit Law (ICNL) to examine the legal treatment of CSO economic/commercial activities in Central and Eastern European countries; it has now become a widely accepted typology for understanding and assessing the tax treatments of such activities.

The ICNL typology is presented in Chapter 2; Romania’s legislation is analyzed in the context of this typology in Chapter 3; and the five criteria of the typology are used as a basis for the assessments and recommendations offered in Chapter 4.

1.3. Background and Methodology

This guide is a component of NESsT’s efforts to foster self-financing among CSOs in Romania. In 1997, NESsT began conducting applied research on CSO self-financing in Central Europe in order to identify the typical challenges and needs in the region. The objectives of the applied research were as follows:

- To assess the current use of self-financing activities among CSOs in Central Europe. NESsT completed case studies documenting successes and obstacles in CSO self-financing activity in four Central European countries: Hungary, Slovakia, Czech Republic and Slovenia.

- To examine the current legal environment for CSO self-financing in the region overall, including the regulatory and tax framework in place at local and national levels that affects the self-financing activities of CSOs.

- To disseminate lessons from the research – by publishing case studies and legal guides and by organizing local workshops – for stakeholders from all sectors in an effort to develop strategies for assisting CSOs in the use of self-financing.

In 2005, NESsT updated the research in these four countries and also conducted a similar assessment in Croatia as part of its strategy to expand its work to that country.

In 2007, such research was conducted in Romania. It was conducted using a methodology developed by NESsT to evaluate the legal environ-
ment for CSO self-financing activity in a particular country. The following four areas were considered:

A. What the law states. What is the current legal treatment of CSO self-financing activities (including current legislation, legal provisions, history of the law, revisions of the law, regulatory approach, tax rates, reporting requirements, other laws and regulations, legal cases, and organizations or lawyers providing service or assistance)?

B. How is the law understood. Are the regulations of CSO self-financing activities understood by CSOs?

C. Effects of the law. What is the effect of current regulations on CSO self-financing activities?

D. Recommendations for the law. What are the most important recommendations for addressing current regulatory problems?

The research encompassed extensive interviews with Romanian attorneys with a deep understanding of nonprofit law and Romanian CSOs engaging in commercial activities to assess their views on the topic as well as an analysis of relevant laws, and a review of related literature. The guide was then reviewed by lawyers with extensive expertise of the Romanian regulatory framework for CSOs.
Chapter 2

The Legal and Regulatory Framework for Self-Financing in Romania

Presenting a Typology for Assessing the Legal and Regulatory Framework

This chapter presents a typology for analyzing the legal rules that govern CSO self-financing activities. The typology was developed by the International Center for Not-for-Profit Law (ICNL). NESsT has expanded and modified it to make it more applicable. The following section presents four key areas that are vital for understanding the legal structure for CSO self-financing before assessing the specifics of Romania: 1) the legal characteristics of CSOs, 2) the legal definition of self-financing, 3) the criteria for permitting self-financing, and 4) the taxation of self-financing activities.

It is important to note that in its texts, ICNL uses the term “nonprofit organizations” or “NPOs,” which refers to a subgroup of the broader classification of “CSOs,” the term used by NESST. While the term “CSO” encompasses registered NPOs, it also includes community-based associations and groups. This guide uses the term “CSO,” except in parts that specifically draw upon the ICNL typology, where it maintains the original ICNL terminology. Romanian laws make reference to the term “association” (asociatie) and “foundations” (fundatia), which are consistent with the broad scope of organizations encompassed by the term “CSO.”
2.1 Legal Characteristics of Nonprofit Organizations

These characteristics highlight the key differences between nonprofit and for-profit organizations and therefore provide a context for understanding how NPOs engage in self-financing or commercial activities. The discussion that follows in this chapter and the rest of the guide addresses a subgroup of all NPOs – those whose not-for-profit purposes are intended to promote the public benefit. While NPOs pursuing the public benefit represent a large subgroup of all Romanian NPOs, it is important to recognize that some NPOs, such as mutual associations of stamp collectors or chess players, may not pursue these goals. These organizations are still considered NGOs and generally the same regulations apply, but this guide will address only those NGOs that pursue the public benefit. However, there is no fixed way of determining what constitutes the public benefit, and while Romanian laws make mention of public benefit organizations (PBOs) the concept remains vague and very few Romanian NGOs fall under this status. ICNL also makes this distinction, and its typology accordingly identifies two basic legal assumptions that distinguish public benefit NPOs from for-profit entities:

1. Non-distribution constraint. Although NPOs are not prohibited from generating profits, these profits may not be distributed to private parties who might be in a position to control them for personal gain, such as founders, members, officers, directors, agents, employees, or any related party.

2. Public-benefit purpose. By definition, this class of NPOs is organized and operated primarily to provide a public benefit.

These characteristics are not primarily dependent on the particular legal form of the NPO. Accordingly, this discussion addresses NPOs registered as associations and foundations as long as they provide a public benefit and uphold the principle of non-distribution.

2.2 Legal Definition of Self-financing

There are many terms and definitions, both legal and non-legal, currently in use to describe activities that generate revenues for CSOs (e.g. commercial activity, economic activity, nonprofit enterprise, social enterprise, social-purpose business, earned income, income-generating activity). ICNL uses the term “economic activity” to refer to self-financing activity. ICNL defines economic activities as “regularly pursued trade or business activities,” with the exception of those that have traditionally been excluded (i.e., ticket sales for cultural events, tuition fees at educational institutions, and patient fees at nonprofit hospitals). NESsT, on the other hand, uses the term “self-financing” to refer to activities that generate revenues for the CSO, including the six types of activities described in the previous chapter. In Romania, the terms “self-financing,” “economic activities,” and “commercial activities” are used interchangeably to indicate both mission-related and non-mission-related activities undertaken by CSOs for revenue-generating purposes.

2.3 Criteria for Permitting Self-financing

According to ICNL, “a threshold issue is the extent to which NPOs should be permitted to engage in economic or commercial activities without losing their not-for-profit status.” At this stage of the analysis, the question is not whether such activities should be tax-exempt, but under what circumstances they should be permitted at all.

In countries where NGOs are permitted to engage in commercial activities – NESsT argues that the prohibition of NGO commercial activities is against good regulatory practice since it limits the sustainability of the sector – there are two typical tests used by governments around the world for determining whether eco-
Economic activities are “nonprofit” or “for-profit”:

1. Principal-purpose test. The principal purpose test provides one legal model for regulating NPO self-financing. It does not prohibit the use of self-financing activities, but rather emphasizes that the NPO is established and operated primarily for not-for-profit purposes and not for private gain. The test implies that self-financing would be for mission-related, not-for-profit purposes and/or would not be the principal activity of the organization. Examples of principal-purpose test conditions typically found in government regulations include that: economic activities do not make up the primary (i.e., main activity) purpose of the NGO; economic activities are accessory (or additional) activities; economic activities are related to statutory objectives.

2. Destination-of-income test. Contrary to the principal-purpose test, the destination-of-income test, in its pure form, ignores the economic or commercial nature of the activity in question and focuses exclusively on the purposes for which profits from the activity are used. Under this test, an organization must devote all of its income to its not-for-profit purposes in order to qualify as an NPO. Accordingly, an organization that spends 99% of its time pursuing commercial endeavors, spends 1% of its time undertaking public-benefit activities, and devotes all of its profits to these public-benefit activities could still qualify as an NPO. An example of destination-of-income test condition is that income from economic activities is used to support the mission goals of the organization and is not distributed as profit.

Under either test, an NPO is permitted to engage in economic activities that further the not-for-profit purposes for which it is organized. It should be noted that governments can – and sometimes do – use a combination of conditions under the principal-purpose and destination-of-income tests to determine whether NGO commercial activities are permitted. For example, a government may only permit mission-related NGO commercial activity (relating to the principal-purpose test) and require that income from the commercial activity be used for mission activities (destination-of-income test). But what justification is there for governments to permit NPOs to conduct self-financing activities? There are two main public policy rationales for permitting NPOs to engage in such activities:

A. Self-financing applies non-public resources to the public good. Income from economic activities is a primary source of funds for NPOs (particularly in countries in transition, where there is an absence of private capital and philanthropic tradition) and enables them to do their public-benefit work with less dependence on governmental support and charitable donations.

B. Self-financing accomplishes public-good objectives. Certain economic and commercial activities directly accomplish public-benefit purposes. For example, although the selling of a book on teaching techniques by an educational organization is an economic activity, the distribution of the book directly serves the public-benefit purpose of promoting education. Preventing NPOs from using such commercial and economic means to attain their goals could directly impair their ability to serve public-benefit purposes.

2.4 Taxation on Self-financing Activities

While the legal treatment of CSO self-financing varies on a practical level from country to country, most have ruled out polar extremes (i.e., a complete prohibition against economic activities or allowing economic activities to be the principal activity in the organization). Beyond this decision, the issue becomes the tax treatment of such activi-
Governments have typically employed four public policy approaches, singly or in combination, to determine the tax treatment for CSO self-financing activities:

1. Blanket tax. A blanket tax policy taxes income from all economic activities, regardless of the source or destination of the income. Under this approach, the organization is not limited by level or type of activity, but is taxed for all revenues generated through these activities regardless of how these revenues are used.

2. Destination-of-income tax. A destination-of-income tax policy exempts income from economic activities that is used for public-benefit purposes. Under this approach, the organization is not limited by level or type of economic activity, but is taxed on all income that is not used to further its public-benefit purposes. The destination-of-income tax should not be confused with the destination-of-income test. The test is used to establish that CSOs may conduct economic activities without compromising their nonprofit legal status as long as any revenues are destined to the organization’s mission. The destination-of-income tax, on the other hand, focuses solely on the tax treatment of nonprofit organizations.

3. Source-of-income tax (or relatedness test). A source-of-income tax policy focuses on the source of income, granting a tax exemption only when the income results from activities that are related to the public-benefit purposes of the organization. Under this approach, the organization is taxed for all income generated from non-mission-related activity even if the income is used to support mission-related activities.

4. Mechanical tax. A mechanical tax policy makes a rigid distinction based on fixed criteria in order to determine the difference between economic activities that are taxed and those that are not. An example of a mechanical test is an exemption ceiling (i.e., an income level below which economic activities are tax-exempt and above which they are taxable).

Some governments have created hybrid tax policies that are based on two or more of these approaches. For example, it is possible to allow net income from economic activity to be tax-exempt below a specified threshold and to apply a mission-relatedness mechanical test to determine whether net income above that threshold should be taxed.

CSOs in Romania are explicitly permitted to engage in commercial activities, in line with the non-distribution constraint. They are only allowed to engage directly in mission-related activities, and can engage in non-mission-related commercial activities only by setting up a separate, for-profit entity. As the following chapter will discuss, CSOs are exempt from taxes on profit generated from their economic activities up to a certain income level. Above this level, CSO income is taxed at the regular corporate profit tax rate. In this respect, CSOs are taxed on profit from their economic activities using a mechanical tax. For separate, legal entities established by CSOs to conduct commercial activities, profit is taxed regardless of the activity and on all income levels, and therefore these entities are taxed using a blanket tax.
There is no consensus regarding which of these tax approaches is best, since each entails certain benefits and costs and defines a different public policy objective. ICNL applies four criteria (adapted by NESsT) to shed light on the practical implications of each approach.

A. Complexity of administration and practical implementation issues. Blanket taxation of all economic activity is the simplest approach to administer and implement – once economic activities are defined. NPOs are treated the same way as for-profit organizations. The destination-of-income rule is slightly more complex to administer and implement. The main difficulty is establishing and enforcing criteria for what constitutes an expenditure in furtherance of public benefit purposes and to supervise the actual use of profits.

Nonetheless, it is still necessary to monitor NPOs and their use of funds, and this “policing” function may prove to be administratively difficult. Moreover, this approach creates a greater potential for abuse by unscrupulous individuals seeking to use NPOs as vehicles for tax evasion. A relatedness test is the most complicated to apply because it is difficult to specify the necessary connection between the economic activity and the public-benefit purposes. This approach tends to work best when developed over time through administrative practice. On the other hand, this relatedness approach is the most likely to keep NPOs focused on economic activities that also benefit the public good.

B. Effects on revenue collection. Assuming the tax rates under the various treatments are equal, the largest potential tax revenue is generated using the blanket taxation approach, since it subjects the greatest number of NPO self-financing activities to taxation. However, empirically, it is unclear how much tax would in fact be collected, because, other things being equal, the level of commercial activity by NPOs will presumably be lower under this rule than under the others (because taxation provides a disincentive for NPOs to initiate commercial activities).

In its purest form, the destination-of-income rule has the lowest potential to produce tax revenue because all income from whatever sources is free from tax if it is applied to performance of public-benefit purposes. In practice, many countries impose limits upon the amount of income that is exempt under the destination-of-income rule, thus limiting potential losses to the state’s revenue base. The mission-relatedness test also potentially reduces the size of the tax base, but probably less so than the destination-of-income test, because the former has the effect of channeling NGO economic activity into specific areas that produce public benefit.

C. Effects on the commercial sector. The blanket taxation approach to NPO income from economic activities is most favorable for the commercial sector, since there is no possibility of “unfair” or prejudicial competition (i.e., NPOs do not receive preferential tax treatment compared with their for-profit peers). The destination-of-income rule, in its purest form, does nothing to prevent claims of unfair competition, since the nature of the use of income may give NPOs a tax advantage that their for-profit competitors do not share. Naturally, a limit on this benefit reduces the comparative advantage for NPOs. The mission-relatedness test minimizes unfair competition by encouraging NPOs to focus on activities that produce a public benefit and by applying the standard tax treatment used for for-profit enterprises when NPO activities are conducted purely for profit. The difficulty in implementing this mission-relatedness rule lies in establishing which economic activities advance the public benefit and which do not (or which do not advance it enough).
D. Effects on the development of the NPO sector. The blanket taxation approach reduces resources for the nonprofit sector, essentially transferring money away from NPOs and into the governmental sector. It is generally accepted that NPOs devoted to public-benefit purposes, if not eligible for state subsidies, should at the very least not be required to transfer resources to the state (in the same fashion as for-profit enterprises). Blanket taxation of all NPO income from economic activities eliminates the incentive to engage in income-generating, public-benefit activities and is most unfavorable to the nonprofit sector. At the very least, NPO proponents claim, such taxes should be at a lower, preferential rate than taxes for for-profit enterprises.

The destination-of-income rule provides the greatest potential revenue to NPOs, since virtually any income can be made tax-exempt if channeled into public-benefit activities. The mission-relatedness test is less favorable to NPOs because activities that are undertaken purely to obtain revenue enjoy no tax exemption. However, the mission-relatedness test still provides significant tax benefits for NPOs, particularly when they focus on activities associated with public-benefit purposes. Moreover, the relatedness test channels NPO economic activities into more socially beneficial directions than the destination-of-income test, which encourages NPOs to engage in economic activities that can earn the greatest potential financial return.
Overview of Framework

The Romanian legal framework explicitly permits CSO commercial activities as long as they are mission related. CSOs wishing to engage in non-mission related commercial activities have to set up a separate, for-profit entity. The legal framework does not particularly promote CSO commercial activities since both mission-related and non-mission-related activities are regulated in the same way that for-profit commercial activities are regulated. Moreover, Romanian legislation recognizes the concept of public benefit organizations but the definition remains vague and the benefits not well-defined. A more precise legislation would greatly aid in establishing an enabling environment for the civil sector.

3.1 General Regulations for CSOs

CSOs in Romania are regulated by the Government Ordinance on Associations and Foundations, GO 26/2000, adopted in January 2000, and modified and put into law in 2005 by the Law on Associations and Foundations (No. 246/2005). GO 26/2000 was further modified in 2003 by Government Ordinance 37/2003, but GO 37/2003 was later abrogated in part because of a proposed, new registration process that would
have required that the appropriate ministry sign off on an organization’s application before it could be approved.¹

GO 26/2000 replaced the previous law on associations and foundations from 1924 (Law No. 21 for Legal Persons (Associations and Foundations) of the 6th of February 1924). Some changes between the 1924 law and 2000 ordinance included the elimination of the required authorization (“aviz”) from the competent ministry during the pre-judicial phase, the provision of clear deadlines during the entire registration procedure, a reduction in the number of members required to form an association (further reduced under 246/2005), and minimum asset levels to register the CSO. Moreover, GO 2000 mentioned for the first time the concept of public benefit organizations.² The 2000 ordinance also provided associations and foundations more independence from government oversight.³

According to Romanian law there are three types of CSOs: associations, foundations, and federations. These three types of organizations are commonly referred to as “non-profit organizations” in Romanian legislation,⁴ though some laws also use “nongovernmental organizations” or “civil society organizations.”⁵

An association is defined as “a subject of law constituted of three or more persons who, on the basis of an agreement, share, without being entitled to restitution, their material contribution, their knowledge and their lucrative activity, in order to accomplish activities of general interest, of community interest or, if such be the case, of their personal, non-patrimonial [non-financial or not-for-profit] interest.”⁶

The members, or associates, must draw a constitutive act (charter) and statute (bylaws) for the association. The charter specifies, among others, the founding members, association name, initial assets (equal to at least the amount of one minimum gross salary), and the governing bodies (including the board of directors). The bylaws specify, among others, the purpose and goal of the association and its asset and liability categories.⁷

The Law specifies that an association should be composed of three bodies: the general assembly, which has ultimate responsibility and authority for all matters relevant to the association, unless its bylaws give ultimate authority to the board of directors over certain matters; the board of directors, which “ensures the execution of the decisions made by the general assembly”; and the censor who ensures the internal financial control of the association. When membership exceeds 100 members, a censors committee is required, formed by an odd number of members.⁸

A foundation is defined as “a subject of law created by one or more persons who, on the basis of an act of will inter vivos or for cause of death, establish a patrimony designed permanently and irrevocably for achieving an objective of general interest or, if such be the case, of community interest.”⁹

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¹ The 2005 NGO Sustainability Index for Central and Eastern Europe, United States Agency for International Development.  
² Law No. 21 for Legal Persons (Associations and Foundations) of the 6th of February 1924; Ordinance on associations and foundations (Ordinance # 26 of 30 January 2000).  
³ For example, the 1924 law states that for the modification of a foundation, “[t]he Court of Appeal, with the approval of the superior commission of legal persons, shall be able to decide, on the request of the management and administration bodies, upon modifying the organization established by the founder, if this is found indispensable for preserving the goods and achieving the aim of the foundation.” The 2000 ordinance gives ultimate authority to modify the foundation to its board of directors.  
⁴ See Fiscal Code, Article 7, 18.  
⁸ Government Ordinance 26/2000, Articles 20, 21, 24, 27.  
⁹ Government Ordinance 26/2000, Article 15.
The founder, or founders, must draw a constitutive act (charter) and statute (bylaws) containing similar requirements to those needed to register an association. The initial assets (in-kind or cash) for a foundation must be equal to at least 100 times the minimum gross salary, unless the goal of the foundation is to fundraise for other associations or foundations, in which case the initial assets should be at least 20 times the minimum gross salary.\(^{10}\)

The Law specifies that a foundation should be composed of two bodies: the board of directors and the censor. The board of directors is the leadership and administrative body, whose responsibility is to achieve the purpose and goals of the foundation. The censor’s authority is similar to that for an association.\(^{11}\)

A federation is established by two or more associations or foundations. Federations operate under the same provisions as associations.\(^{12}\)

The concept of public benefit was first mentioned in GO 26/2000. Any association, foundation or federation can be recognized by the Government as of public benefit upon meeting certain eligibility conditions, including that the organization’s activity be carried out for the general interest or for that of a collectivity.\(^{13}\) As described below, the benefits accrued to public benefit associations and foundations are relatively small, and today only about 60 associations and foundations have registered under this status.

### 3.2 CSOs and Commercial Activities

Article 46 of GO 26/2000 defines revenues of associations and federations as: a) membership fees/dues; b) interests and dividends resulting from financial investments; c) dividends from commercial companies; d) revenues from direct economic activities; e) donations, sponsorships or legacies; and f) other revenues. For foundations, revenues are the same as those defined for associations and federations, except for membership fees/dues.

Article 48 further specifies that associations and foundations may carry out direct economic activities “if they have accessory character” and as long as they are related to their mission (“purpose”). The law does not specify what constitutes an accessory character, and this clause can be interpreted as a principal-purpose test for regulating CSO self-financing. As mentioned in Chapter 2, the principal-purpose test emphasizes that the CSO is established and operated primarily for not-for-profit purposes and that self-financing would not be the principal activity of the organization.

The law is also vague about what constitutes mission-related and non-mission-related economic activities, and in theory fiscal authorities could compare bills and contracts generated from the economic activities with the CSO’s mission contained in the statute. However, it’s unclear how – and if – the law is applied in practice.

Associations and foundations can engage in non-mission related activities by setting up separate, commercial companies. Dividends obtained from the activities of these commercial companies, unless reinvested in the same commercial companies, shall only be used for advancing the mission of the association or foundation.\(^{14}\)

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\(^{10}\) Government Ordinance 26/2000, Article 15 and 16.  
\(^{12}\) Government Ordinance 26/2000, Article 35.  
\(^{14}\) Government Ordinance 26/2000, Article 47.
There is no limit on the amount of income a CSO can generate from commercial activities, either directly or through a commercial company.\(^\text{15}\)

**Debate on Public Benefit Organizations**

Various debates are under way about the treatment of commercial activities as they relate to public benefit organizations. With a few exceptions concerning tax exemptions on revenues from advertisements, certain imported products, and fees for vehicles, public benefit organizations do not enjoy fiscal exemptions. The current debate relates to whether public benefit status should grant additional fiscal exemptions, including for commercial activities. Among the proposals regarding commercial activities of public benefit organizations are an increase in the threshold for profit tax exemptions or elimination of the threshold altogether (see below).\(^\text{16}\)

### 3.3 Tax Treatment of CSO Commercial Activities

#### 3.3.1 Profit Tax

CSO commercial activities conducted directly by the CSO – and hence mission-related – are exempt from profit tax up to a certain income threshold. Above this level, the CSO must pay a profit tax of 16%, the same rate paid by commercial companies. The income threshold is 15,000 euros earned from economic activities in one fiscal year, but not more than 10% of the organization’s total tax-exempted income. The fiscal code defines a total of 11 categories of tax-exempt non-profit income, including member dues, registration fees, and contributions; income from sports activities donations received through sponsorship; dividends and interests from investment of exempt incomes; public and private grants; income realized from occasional fundraising events; occasional income from selling assets owned by the CSO, other than those used for a commercial activity; income for which the tax on shows is payable (see section 3.3.4 on other taxes); and income obtained from advertising and publicity (only applicable to public benefit organizations operating in certain fields).\(^\text{17}\)

With regard to income realized from occasional fundraising events and used for social or professional purpose in accordance to the organization’s bylaws, it appears that some organizations, not being aware such events are tax exempt, pay taxes on this income. While the law explicitly exempts income on such events, it does not

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\(^{15}\) Interview with Octavian Rusu, Civil Society Development Foundation, May 2007.

\(^{16}\) Fiscal Code, Article 15.

\(^{17}\) Interview with Octavian Rusu, Civil Society Development Foundation, May 2007.
define some key terms such as occasional, social or professional purpose, so CSOs should be aware of the potential tax implications.

To illustrate the payment of the profit tax, let’s assume a CSO is generating 10,000 euros in income from its mission-related economic activity. This commercial activity’s profit is tax exempt because income falls below the 15,000 euros threshold at which the profit tax is applied. Furthermore, if the 10,000 euros do not represent more than 10% of the CSO’s total tax-exempt income, the profit earned on this income is also tax exempt. However, if the CSO’s total tax exempt income is 50,000 euros, the income from the economic activity represents 20% of the CSO’s total tax exempt income, exceeding the tax-exempt income level of 10%. In this case the CSO would have to pay the profit tax.

For CSO commercial activities conducted through a separate, for-profit entity – necessary if the commercial activity is not mission related – the CSO must pay the profit tax of 16% on all profits earned by the commercial activity (regardless of income levels).

Foundations established as a result of a legacy are exempt from paying the profit tax.\(^\text{18}\)

The basis of the profit tax assessment is the profit determined as the difference between income and expenses, with additions or deductions in accordance with the provisions of Article 19 of the Fiscal Code. CSOs are required to pay the profit tax on an annual basis on or before February 15 of the year that follows the year for which the tax is computed.

As mentioned above, a current debate in the CSO sector is whether public benefit organizations should be granted special tax exemptions for their economic activities. One proposal is to increase or eliminate the income limit of 15,000 euros and to make all revenues from commercial activities, regardless of the amount, exempt from profit tax.

3.3.2 Value Added Tax (VAT)

New legal provisions on VAT are applicable since January 1, 2007 when Romania became a full member of the European Union. Former regulations on VAT zero quota or VAT reimbursement are no longer applicable, which has produced confusion among CSOs and fiscal authorities, particularly in the case of projects developed with foreign funds.

For CSO nonprofit (i.e., non-commercial) activities, CSOs are considered final users/beneficiaries and they are not reimbursed for the VAT paid on goods, supplies or services. For CSOs conducting projects funded by international donors, especially the European Union, new regulations related to EU accession came into effect in January 2007 that dramatically changed the VAT regime. Until 2007, the VAT paid on goods, supplies, and services purchased using international funds was reimbursable by the Romania government, and this greatly assisted CSOs who could not, under many grant agreements with international donors, use grants to pay for the VAT portion of the price of a service or product. However, with EU accession, changes to the Fiscal Code ended government VAT reimbursements, essentially leaving CSOs with no choice but to pay the full cost of VAT. An Emergency Government Ordinance issued in February 2007 apparently clarified this situation by establishing that the Romanian government would reimburse VAT on EU pre-accession funds (EGO 11/2007). At least two issues still remain: it is unclear how fiscal authorities should apply this provision (some interpretations of EGO 11/2007...
state that CSOs are not covered by the emergency ordinance), and the Emergency Ordinance treats only projects funded from EU pre-accession funds, leaving aside all other projects funded by international donors that do not accept VAT payments as eligible expenses. Negotiations are now pending between the Ministry of Finance and CSOs to resolve this issue.

With regard to CSO commercial activities, they are subject to the same VAT as that applying to commercial companies. The basic VAT rate paid on all goods and services sold is 19%, and a reduced rate of 9% applies to certain products and services: delivery of books, newspapers and magazines, and school manuals; deliveries of orthopedic products; and accommodations within the hotel sector. Current regulations allow VAT exemptions on some “operations of public interest,” on which VAT is paid on the purchase of goods and services but not charged on the delivery of these operations of public interest. The exempt operations are listed in the Fiscal Code and include provisions of goods and/or services closely related to assistance and/or social protection made by entities recognized as having social character; services related to children and youth protection; authorized providers of vocational training; services only provided for members (i.e., membership fees are exempt); sports services; services related to fundraising; productions and distribution of motion pictures, TV and radio programs; publishing activities; sales of religious materials and objects; and certain imports.

CSO commercial activities (and commercial companies) whose annual revenues are below 35,000 euros are exempted from VAT. When revenues are below this amount the CSO may request to be registered as a VAT payer if the organization wants the right to deduct VAT paid for purchased goods and services. The CSO would then have the obligation to charge VAT for all goods and services it delivers to its clients. Since the implementation of the new Fiscal Code in 2007, VAT deductions are limited to a few services that may not warrant VAT registration.

If a CSO earning less than 35,000 euros from commercial activities decides not to register as VAT payer, the Fiscal Code and associated legislation do not specify a legal framework applying to these organizations’ value added tax. The only tax regulation applying to these CSOs relates to the preparation of a special declaration of value-added tax if the CSO is the beneficiary of certain supplies of services performed by persons and organizations established abroad.

If revenues from CSO commercial activities surpass 35,000 euros in a given fiscal year, the CSO must request registration as a VAT payer within 10 days after the date of exceeding the threshold. Once the exemption threshold is exceeded, the CSO may not request the application of VAT exemption, even if subsequently it realizes annual revenues that are less than the exemption threshold provided by law.

CSOs registered as VAT payers have the obligation to maintain certain records associated with their operations. These include maintaining accounting records according to law and providing fiscal authorities the necessary documents to determine the operations performed by the CSO.

### 3.3.3 Dividends

In the case of non-mission related commercial activities, a Romanian CSO must set up a separate legal entity under Company Law. As a general rule, profit may be distributed to a shareholder only after payment of the profit tax and dividends tax. The dividends tax stands at 10% of the gross
dividend paid to the shareholder, except when the shareholder is a Romanian legal entity that has owned more than 15% (this will be reduced to 10% starting in 2009) of the shares of another Romanian legal entity for a period of two years prior to the payment of the dividend (Art. 36 para 2, 3, 4). By exception, the dividends obtained through the investment of profit-tax exempted revenues of a CSO are also tax free (art. 15 para.(2) lit.(f).

3.3.4 Other Taxes

The legal framework includes a number of local taxes and fees that require payments to local fiscal authorities.

A. Tax on buildings

Any CSO that owns a building must pay an annual tax on this building. The Fiscal Code allows each Local Council to establish exemptions for associations and foundations owning buildings used for humanitarian activities. At the same time, the Fiscal Code also stipulates exemptions for certain organizations and facilities for the taxation on buildings. These exceptions apply to:

- foundations established by testament to maintain, develop or assist national cultural institutions, as well as to support activities with a humanitarian, social or cultural character;
- organizations whose exclusive activity is the provision of social services for free within specialized units ensuring hosting; social and medical care; assistance, support, rehabilitation, and social reinsertion for children, families, disabled persons, and the elderly;
- buildings that are used exclusively for the provision of tourist services for a period of not more than 5 months during a calendar year, and on which the tax on buildings is to be reduced by 50%.

The tax rate is established by a decision of the local council and may be set between 0.25% and 1.50% of the building’s accounting value.

B. Tax on land

Any CSO owning land must pay an annual tax on this land. The exemptions for certain organizations and facilities are the same as those for the tax on buildings. The land tax is established at a fixed amount per square meter, depending on the rank of the locality where the land is located, and the zone and/or category of use of the land.

C. Tax on shows

Any CSO organizing an artistic performance, sporting competition or other entertainment activity is required to pay a tax on shows. The tax on shows is to be computed by applying the appropriate tax rate to the amount collected from the sale of entrance tickets and subscriptions. The rate of tax varies depending on the show or performance, or the floor space depending on the type of location used for the show. If a show is organized for charitable purposes, which the law does not further define, the taxable portion of the receipts from the sale of entrance tickets or subscriptions is to exclude the amounts paid for charitable purposes. The tax on shows does not apply to shows organized for humanitarian purposes.25

D. Custom duties

For the most part CSOs and commercial companies pay the same custom duties on imported goods. However, a number of goods are exempt for CSOs that obtain authorization from the Ministry of Finance. These goods include: donations with social, humanitarian, religious, cultural, educational, or sport aim; and equipment and office supplies received as donations and used for

25 Fiscal Code, Chapter VII.
nonprofit activities. Thus, custom duties are paid for any product/good meant to be used for commercial activities.

### E. Fees

The fiscal code also defines a number of fees payable to the local fiscal authorities. These fees include:

- Fees on means of transportation, such as cars, buses, trucks, etc. Vehicles adapted for people with physical disabilities are exempt from this fee.\(^{26}\) Furthermore, public benefit organizations are exempted from fees on means of transportation for vehicles donated or directly financed from grants. However, the fee is applied for the first registration of all commercial vehicles.\(^{27}\)

- Fees for the issuing of certificates, approvals and authorizations by local authorities. These fees must be paid prior to the issuing of these certificates, approvals, and authorizations.

- Fees for advertising and publicity services, paid by the beneficiaries of these services at rates between 1% and 3% from the value of the services. Fees are waived for advertisements in the written and audio-visual media.

- Fee for hotel accommodation. The value of the hotel accommodation fee is determined by the local council, and may vary between 0.5% and 5% of the accommodation fee. Payment of the fee does not apply to people with “severe or serious” handicaps, pensioners, students, and other specified groups.\(^{28}\)

### 3.4 Tax Filings

CSOs must comply with the same tax filing requirements for their commercial activities as any for-profit entity. In this context, the tax laws, labor laws, and other special laws apply to each case according to the specific activity in which the CSO engages. All tax filings are submitted to the local fiscal authorities. For CSOs, these filings include:

- **Profit tax:** Nonprofit organizations are required to pay the profit tax on an annual basis on or before February 15 of the year that follows the year for which the tax is computed.\(^{29}\) Form 101 (the most commonly used form to file the profit tax) is to be submitted to the appropriate Fiscal Authority (“Administriatia Financiara”) office.

- **VAT:** VAT is usually paid on a monthly basis, on or before the 25th day of the month. CSOs registered as VAT payers and with revenues not exceeding 100,000 euros during a fiscal year may choose to pay VAT on a quarterly basis. Form 300 (the most commonly used form to file the VAT) is to be submitted to the appropriate FRS office.

- **Building and land taxes and fees on means of transportation:** these must be paid on an annual basis, in four equal installments, on or before March 15, June 15, September 15 and November 15.\(^{30}\)

- **Fee for advertising and publicity services:** these must be paid on a monthly basis, on or before the 10th of the month.

In addition to the above tax filings, CSOs must pay social contribution taxes on the gross income paid to their employees. These generally include contributions to social security (19.5% of the employee’s gross salary), health insurance (6%), unemployment insurance (2%), salary guarantee (0.25%), risk and accident (0.4%), and to the Chamber of Labor (0.75% when the labor contracts are kept by the Chamber of Labor, and 0.25% when the labor contracts are kept by the employee). In addition to employer contributions, the following taxes and contributions are paid by the employee, applied as well to the gross income: social security (9.5%), health insurance (6.5%), and unemployment insurance (1%).

\(^{26}\) Fiscal Code, Article 262.
\(^{27}\) Fiscal Code, Article 280.
\(^{28}\) Fiscal Code, Article 262.
\(^{29}\) Fiscal Code, Article 34, para 3.
\(^{30}\) Fiscal Code, Articles 249, 253, 255, and 285.
CSOs have the possibility to opt between paying all these contributions and taxes on a monthly or annual basis (Art. 109, para.(2) from Fiscal Procedural Code).

3.5 Reporting Obligations

Reporting obligations required by tax legislation are subject to the guidelines described above. CSOs are also required to register any modifications to their constitutive act (charter) and statute (bylaws) with the Registry of Associations and Foundations at the clerk’s office of their jurisdiction. Other reporting obligations only affect CSOs registered as public benefit organizations.

Public benefit organizations have the obligation to communicate to the responsible administrative authority annual activity reports and balance sheets. Excerpts of the activity reports and the balance sheet must also be published in the Official Gazette of Romania, as well as in the national registry of nonprofit organizations.

List of Laws Concerning CSO Operations and Commercial Activities:

- CSO laws: Government Ordinance on Associations and Foundations No. 26/2000, as approved by Law No. 246/2005
- Laws relating to donations: Law on Sponsorship No. 32/1994 as modified
- Laws relating to volunteerism: Law on Volunteerism No. 195/2001
- Public-law legislation: Law on the Conditions of Non-refundable Financing from Public Funds Assigned for General Interest Non-profit Activities No. 350/2005
- Labor, social security, and social laws: Law on Social Insurance State Budget no. 487/2006, Emergency Government ordinance 150/2002 regarding the organization and functioning of the health social insurance system,

3.6 Expertise Needed to Manage Commercial Activities and Sources of Assistance

The civil society sector in Romania has grown significantly since the 1989 revolution in terms of active CSOs, the fields in which they operate, and the quality of the services they provide. Despite close to 20 years of rapid development, the CSO sector is still largely funded by grants and donations. A 2003 Ministry of Finance report on financial statements of more than 17,000 CSOs showed that about 15% of CSOs’ funding comes from economic activities. It should be noted that this figure includes all types of legal entities registered as associations and foundations, and therefore does not only apply to CSOs conducting public benefit activities (as defined in ICNL’s typology, not in the legal framework). CSOs continue to need support services such as training, capacity building, and technical assistance in business planning, financial management, and legal issues to develop and sustain commercial activities.

While such support remains limited, the organizations below offer services to assist in the development of CSO commercial activities.

CENTRAS

Established in 1995 with the mission to contribute to the development of democracy in Romania by strengthening the nonprofit sector. CENTRAS provides training, technical assistance, and informational support to communities, NGOs, businesses, and governments interested in civil society.

31 Government Ordinance 26/2000, Articles 33 and 34.
and democracy development. CENTRAS has a branch in Constanta and supports a network of regional resource centers.

011454 Bucharest, Bd.Maresal Averescu nr.17, Pavilion 7, et.3, sector 1
Tel: +4 021 223 00 10, +4 021 223 00 11
Fax: +4 021 223 00 12
E-mail: office@centras.ro
Web: www.centras.ro

Civil Society Development Foundation
CSDF supports the development of civil society organizations by promoting the active involvement of individuals in their communities and by encouraging the efforts of non profit organizations to improve the quality of life and to strengthen democracy in Romania.

Splaiul Independentei nr. 2k, et. 4 sector 3, Bucharest
Tel: +4-021-310-0177
Fax: +4-021-310-0180
Email: fdsc@fdsc.ro
Web: www.fdsc.ro/index.htm

Foundation PACT
Foundation PACT’s mission is to contribute to sustainable community development by promoting local and regional initiatives, partnership and social responsibility. The organization’s team has expertise in training and consultancy projects in the field of community development, participatory planning, project planning and management, organizational development, public relations, fundraising, financial education and entrepreneurship.

Street Doctor Lister nr 55, Et.2, Ap 5, Sector 5, Bucharest, Romania
Tel: +40 031 690 09 61 / + 40 021 4101058
Fax: + 40 031 690 09 61
Email: office@fundatiapact.ro
Web: www.fundatiapact.ro

Romania Fund for Social Development
RFSD assists the development process of poor communities in Romania through grants awarded to sub-project proposals based on communities’ demands, and contracted with community-based organizations and intermediary organizations that directly receive the funds to implement subprojects. RFSD provides grants and training for community-based and CSO commercial activities.

Elisabet Blv 3, floor 3, Bucharest
Tel/Fax: +40 1 315 34 95, 315 34 40
Web: www.frds.ro

National Organization of People with Handicaps of Romania
ONPHR (by its Romanian acronym) provides assistance for the development of self-financing activities to its 78 member organizations working in the field of disability.

Centrul Comunitar “Daniel Vasilescu”
B-dul Maresal Averescu nr. 17, Pavilion 7, et. 3, Bucharest, sector 1, 011454, Romania
Tel: + 40-21-224.14.89
Fax: + 4031.81.05678
E-mail: onphr@easynet.ro; office@integration.ro
Web: www.integration.ro

Nonprofit Enterprise and Self-sustainability Team
NESST works to solve critical social problems in emerging market countries by developing and supporting social enterprises that strengthen civil society organizations’ financial sustainability and maximize their social impact. NESST operates the NESST Venture Fund, a philanthropic investment fund providing capacity building and financial support to social enterprises.

Str. Popa Tatu, Nr 3, Ap. 8 Sector 1
Bucharest
Tel: +40 311 0946
Web: www.nesst.org
Interpreting and Critiquing The Romanian Legal and Regulatory Framework

As discussed in the previous chapter, the basic legal framework applying to CSO commercial activities contains differences with the framework applying to for-profit commercial activities, yet these differences remain small. By treating CSO and for-profit commercial activities in a similar fashion, the framework has the benefit of providing a simple way to regulate all commercial activities (both for-profit and not-for-profit), but NESsT argues that this perspective fails to acknowledge and promote the social benefits that CSOs contribute to Romanian society.

This chapter evaluates the practical effects of Romanian laws on CSO commercial activities, discusses the strengths and weaknesses of the legal framework, and offers recommendations for the reform of the system which would enhance the development of CSO commercial activities, and, in turn, increase and sustain the contributions of the sector to Romanian society as a whole.
4.1. Evaluating the Romanian Legal Framework for CSO Commercial Activities

A legal framework that is grounded in fair principles and applied accurately and consistently is essential to the social, political and economic stability of any country. In this respect, while making progress in the past few years, the Romanian legal system remains weak in terms of the rule of law, independence, and accountability. Indeed, Romania’s judiciary was a major obstacle to the country’s process of accession to the European Union.\(^\text{32}\) In the more specific area of legal treatment of CSO commercial activities, the framework is clear, but it does not promote the development of these activities. The law specifically allows CSO commercial activities, yet applicable laws and regulations mirror those of for-profit companies, leaving CSOs with few preferential tax treatments. This lack of fiscal incentives does not encourage CSOs to develop economic activities – and sometimes even discourages them from doing so – and does not contribute to the strengthening of civil society. Romanian CSOs would benefit from a legal and regulatory system that would treat a for-profit company differently from, for example, a CSO selling products made by marginalized people who would not otherwise find appropriate jobs in the marketplace.

This section evaluates the Romanian legal framework with respect to the five analytical criteria established by the ICNL typology and presented in Chapter 2.

**Complexity of Administration and Practical Implementation Issues**

Since CSO commercial activities are uniformly regulated not only within the sector but also in line with the for-profit sector – aside from a few differences – the system is relatively simple to administer. The same rules apply to all entities (not-for-profit and for-profit) engaging in commercial activities with respect to reporting and tax filing (with minor adaptations for CSOs in terms of filing dates and forms). Furthermore, the system exempts entities from paying taxes on revenues below certain levels (15,000 euros for the profit tax and 35,000 euros for VAT). Under the ICNL typology, this system would be classified as a mechanical tax system since the difference between economic activities that are taxed and those that are not is based on fixed criteria. Because the Romanian mechanical tax system treats CSO commercial activities similarly to for-profit commercial activities (in a similar fashion to a blanket tax treatment), the system is relatively easy to administer. The only potential difficulty in implementing current laws and regulations relates to what constitutes mission-related commercial activities. It appears that, in practice, authorities do not monitor CSO commercial activities beyond their tax implications, and up to now this issue has not been a source of implementation difficulties.

From the perspective of CSO proponents, the simplicity of the system underscores its problems, for the uniform treatment of commercial activities conducted by CSOs and for-profit businesses fails to recognize and specifically promote the public benefits achieved by CSOs. NESsT therefore believes that although administration of the system would be complex as a result of the reforms proposed later in this chapter, such complexities are a small price to pay in exchange for the benefits that would accrue from these reforms.

**Effects on Revenue Collection**

Considering the mechanical tax treatment discussed above, the current Romanian system does not generate as much tax revenue as it would under a pure blanket tax treatment, yet it still potentially generates more than other tax treatments (destination of income or relatedness test). Aspects of the system, particularly the absence of

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tax discounts for CSOs engaging in commercial activities, make it difficult to assess the impact on the level of revenue-collection. First, many CSOs are discouraged from initiating commercial activities because they perceive that the incumbent tax burden would make it difficult to yield a profit. Thus, CSOs under the current system often conduct commercial activities at lower levels than they might within a more supportive regulatory environment. At the same time, those conducting such activities above certain revenue levels are also paying the full profit tax. It is unclear whether this revenue base would increase or decrease with a higher level of CSO commercial activity but a lower rate of taxation. Granting CSOs full tax exemptions would obviously decrease revenue-collection.

Effects on the Commercial Sector
Because CSO commercial activities receive a similar legal and regulatory treatment as that of for-profit commercial activities, the nonprofit sector does not have an unfair advantage over for-profit companies. While some CSOs receive tax exemptions (e.g., no profit tax paid on revenues under 15,000 euros, VAT exemption on protection of children and youth), these represent tax exemptions on low levels of economic activity or on income closely tied to specific nonprofit activities (such as social services, employment models, and training of public authorities and CSOs) that face little competition from for-profit companies.

Because of its tax treatment of the two sectors, the Romanian legal system could actually be considered more favorable to for-profit companies than to CSOs. Taxing CSOs at the same level as their for-profit counterparts is considered strongly favorable to the commercial sector since for-profit companies do not conduct resource-intensive mission activities – they do not carry the social costs often present in CSO commercial activities such as higher levels of capacity-building and lower productivity levels from the employment of beneficiares – and they have access to financial instruments facilitating economic activities (i.e., debt and equity) as well as tax breaks and write-offs that are not available to CSOs.

Effects on the Development of the Nonprofit Sector
As mentioned above, the current legal system does little to encourage CSO commercial activities and thus to promote the development of the civil society sector. The mechanical tax treatment is unfavorable for CSOs since it transfers resources from CSOs to the government. Setting a threshold for tax exemption on mission-related commercial activities discourages CSOs from developing socially oriented enterprises that provide more sustainable solutions to the issues they are addressing. It continues to put emphasis on CSOs’ seeking grants and donations, which are relatively limited in Romania and which further inhibits the development of the sector. A more enabling legal environment would encourage CSO commercial activities and contribute to the sector’s sustainability.

4.2 Working Within the System
Although the Romanian system explicitly allows CSOs to conduct direct commercial activities (if they are mission related), some organizations have faced difficulties dealing with the fiscal authorities regarding the amount of tax payments. Specifically, some organizations have reported difficulties obtaining VAT reimbursements because interpretation of the CSO’s nonprofit and commercial activities were left to the tax authorities, who often questioned the level of eligible reimbursements given the CSO commercial activities. Moreover, in some instances where CSO nonprofit and for-profit activities share the same resources (office space, vehicle, etc.), it may be difficult to demonstrate to fiscal authorities the expense amount related to each activity. In such cases fiscal authorities may limit the amount of deductible expenses under the CSO economic
activity. CSOs should therefore have strong financial systems in place to establish operational rules that do not allow much room for interpretation.

In response to the current tax treatment, which does not provide specific benefits to CSO commercial activities, some CSOs have devised ways to lower their tax liabilities. One common example is for a CSO to set up a separate, for-profit company to generate revenues for the nonprofit mission and to account for as many costs as possible in order to reduce taxable income. This strategy is more likely to be implemented when a CSO commercial activity is forecasted to surpass the revenue thresholds at which a profit tax liability is incurred (15,000 euros from commercial activities or more than 10% of the organization’s total tax-exempted revenues). Furthermore, and related to the point above, in the past some CSOs have preferred registering separate, for-profit legal entities to avoid interpretation by the fiscal authorities on the amount of expenses allocated to for-profit and nonprofit activities.

4.3 Perception of CSOs

Less than one in three Romanians trust NGOs, but in the past few years the public perception of CSOs has improved. This positive development is due in part to greater freedom of the press, which has sought information and opinions from CSO leaders on a variety of topics, in particular related to government transparency. The government, both at the local and national levels, has made a concerted effort to reach out to CSOs on important issues such as EU accession. In addition, the 1% and 2% campaigns led to increased outreach efforts from CSOs that motivated the public to become informed about the sector and particular issues. After two years of implementation, 8.6% of taxpayers have contributed to the CSO sector through the 1%-2% law.

4.4 Reforming the System

So far this guide has provided an overview of the legal framework regulating CSO commercial activities in Romania and a review of its practical implications. This section presents a critique of the existing system and offers recommendations for improvement of the current situation. It is hoped that these ideas will inform the debate on how CSO commercial activities are regulated with the ultimate objective of promoting such activities, strengthening the organizations that conduct them and enhancing their abilities to contribute to Romanian society. Emphasis is placed on two aspects of the system that could be improved to create a more favorable environment for CSOs and their commercial activities.

A. The legal framework does not promote CSO commercial activities. As described in Chapter 3, while the legal framework explicitly allows CSOs to engage in commercial activities, it does not promote such activities. The following criticisms are offered about the current legal framework:

i. CSOs can only engage directly in mission-related commercial activities. The requirement that CSOs set up separate subsidiaries to carry out non-mission-related commercial activities puts unnecessary legislative burden on CSOs, forcing them to develop management systems based on external legislation rather than organizational needs.

ii. Only a few differences hold in the way tax regulations treat CSO and for-profit commercial activities. The quasi-uniform application of these regulations to CSOs and for-profit entities fails to acknowledge the public benefits produced both directly and indirectly by CSO commercial activities. Specifically, the

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34 Report on the situation of direct governmental financing for NGOs in Romania. Civil Society Development Foundation.
profit tax penalizes CSOs for generating minor amounts of self-financing income (15,000 euros or 10% of the total non-exempt revenues), placing a significant burden on CSOs attempting to diversify their funding base and to become financially sustainable.

iii. VAT exemptions for CSO commercial activities are limited. Under the current regulation (see Section 3.3.2 above), VAT exemptions are only provided to services closely related to social assistance/protection and protection of children and youth, leaving many CSO commercial activities subject to VAT. However, in many cases, customers benefiting from CSO commercial activities are from low-income or marginalized groups. For many CSOs, including the VAT in the price of goods significantly diminishes their customer base and reflects an additional challenge to the already difficult task of making a profit in a low-income or marginalized community.

B. The legal concept of public benefit status remains vague. First introduced in 2000, and later improved in 2005, the concept of public benefit does not clearly define the general or collective interest these organizations should serve. Moreover, the public benefit status as it currently stands lacks clear incentives for CSOs to seek this status. This is a serious shortcoming as different types of associations and foundations pursuing various goals are placed on the same standing, effectively disadvantaging CSOs operated to provide a public benefit.

In response to the two criticisms presented above, the following recommendations are offered:

1. Allow CSOs to directly engage in non-mission related commercial activities. Since the current legislation allows both mission and non-mission related CSO commercial activities, regulations should be simplified to allow CSOs to engage directly in either type of activity. Tracking the accounting of commercial activities separately from program activities should suffice in maintaining clear and transparent financial systems.

2. Clarify the “accessory character” clause in the legislation to eliminate interpretations. Or, consider removing this clause for mission-related activities since, by definition, they advance the mission of the organization both directly and by generating revenues destined to support the mission.

3. Reform the taxation regime for CSO commercial activities. Providing tax incentives is a necessary condition for the development of CSO commercial activities. The Romanian legal system should eliminate the revenue threshold at which CSOs start paying the profit tax, or at the very least increase it to allow more tax-free income. Allowing CSOs to keep a greater share of their commercial activities’ income would motivate more organizations to engage in such activities and would help to increase their sustainability.

4. Expand VAT exemptions on CSO commercial activities. The Romanian regulatory system should provide additional VAT exemptions on CSO commercial activities beyond those already accorded for social assistance/protection and protection of children and youth services, such as those providing services to low-income communities in economic development, education, environmental protection, health, and human rights. These communities benefit from the products and services that CSOs sell, since very
often for-profit companies do not operate in these markets.

5. **Clarify public benefit status and its benefits.**
   The legal framework should clearly identify public benefit organizations as those providing a benefit to the public at large and not to their members only. Furthermore, public benefit status should be promoted through tax incentives in the areas of the profit tax and VAT (see above) and potentially local taxes.

6. **Rely on increased CSO awareness to modify the legal framework.** An increasingly positive perception of CSOs among the general public provides an opportunity to reform the legal framework, as the public is better able to understand the impact CSOs have in the community. This should translate into a public that is more supportive of providing tax benefits to CSOs to increase their financial sustainability and long-term impact. The progress made by Romanian CSOs in the past few years in improving their public image and reaching out to their constituents should be an opportunity to reform the legal framework and strengthen the sector.

**Conclusion**

As described in Chapters 3 and 4, a single legal framework is applied to both CSO and for-profit commercial activities in Romania. This uniform treatment fails to promote the beneficial effects that CSO commercial activities can produce for Romanian society.

In practice, many CSOs within Romania conduct commercial activities, but the payments they make to the tax authority tend to be small, both because they usually conduct commercial activities at low levels and because standard accounting practices significantly reduce or eliminate their taxable income. Creating favorable legislation for CSO mission-related commercial activities, particularly in the area of taxation, would not significantly reduce overall tax revenues, but it would create meaningful incentives for CSOs to initiate commercial activities and hence enable them to pursue their missions more effectively and in a more sustainable manner. Such reforms would go far in promoting CSOs and in strengthening their ability to contribute to Romanian society.