Key Aspects of the Percentage Designation Mechanism

Observations on the process of introducing the percentage designation mechanism in Ukraine

The present document provides some background information about the percentage designation mechanism in different European countries. Currently in Ukraine there is a discussion about the need to introduce such a mechanism. With this material the European Center for Not-for-Profit Law (ECNL) aims to provide important information about the percentage designation mechanism, present the key questions that Ukrainian stakeholders should answer and support an informed debate about the best approach to be taken in Ukraine.

ECNL is a leading European resource and research center which promotes supportive policy and legal environment for civil society and the adoption of legislation ensuring greater CSO financial sustainability. The organization has carried out extensive research and has been providing support for the introduction and implementation of the percentage designation mechanism in a number of countries and we have based our suggestions below on the practical experiences collected.

The percentage designation mechanism is an alternative source of funding for civil society organizations. A number of countries have already introduced it (Hungary, Poland, Slovakia, Romania, Lithuania), the latest one being Moldova. Researchers have noted a number of positive aspects of the percentage designation mechanism. In addition to supporting civil society organizations financially, it also:

- Gives taxpayers the possibility to directly decide on how a portion of their taxes is spent, making them more engaged.
- Helps raise awareness about CSOs and the important work they do among the overall population;
- Helps CSOs improve their communication skills and outreach;
- Creates a depoliticized way to distribute state funding to CSOs;

1 The material is prepared by Luben Panov, Consultant of European Center for Not-for-Profit Law Stichting (ECNL), with the assistance of Eszter Hartay, Senior Legal Advisor of ECNL. All rights reserved.
2 You can find more information about the activities of ECNL at www.ecnl.org
- Helps the development of a “philanthropic culture” in countries where there are no long-standing traditions for giving.

There have been arguments also against the percentage designation mechanism. There are countries where CSOs benefit tremendously from this tool (e.g. Slovakia) but there are other countries which have decided not to introduce this mechanism. For example, the only 2 countries with enhanced financial sustainability according to the 2018 USAID Sustainability Index are countries that do not have the percentage designation mechanism – Estonia and the Czechia. The amounts that they have declared from individual donations are quite impressive – 36 mln. EUR in Estonia (1,3 million population) and 478 mln. USD in Czechia (10,6 mln. population). On the one hand, the effect of the mechanism for developing philanthropic culture is not clear. In addition, as a side effect, the percentage designation mechanism has affected negatively the tax incentives for individual donors. The percentage designation mechanism is also not a magical solution that will bring effect immediately after its adoption – it takes several years to develop and promote the model until a substantial number of taxpayers (e.g. 30–50 % start using it).

Before introducing the mechanism, it is important to understand how it may affect Ukrainian CSOs and their sources of funding. As noted above, in many countries with percentage designation mechanism there are no tax benefits for individual donors (e.g. Slovakia, Hungary, Moldova). As the percentage designation mechanism is a form of state funding for CSOs, this may lead to the state reconsidering its plans for state grants to CSOs as well. Before any decision to introduce the mechanism, there should be an assessment of what is the expected impact of this mechanism on the following:

- How will the mechanism affect philanthropy (e.g. instead of providing donations, donors start assigning their percentage only) and the tax benefits for donors;
- How can the mechanism affect state funding to CSOs;
- What is the economic potential of the mechanism – how many people pay taxes, what is the maximum amount that could be received through the mechanism (and the realistic expectation if around 30–50 % of taxpayers use it);
- What are the types of organizations that will benefit the most (e.g. healthcare, war veterans, animal lovers, etc.) and how this may affect other CSOs (e.g. can we expect transfer of donors from less popular causes to the more promoted ones);
- How will the mechanism affect smaller CSOs that do not have big budgets for promotion and therefore this could lead to channeling the funding to a small circle of big, influential CSOs.

If after the assessment, the results show that the percentage designation mechanism is needed and would be beneficial to CSOs in Ukraine, it may be a good idea to prepare a policy plan and try to alleviate some of the expected negative effects of the percentage designation mechanism (e.g. the possible elimination of tax benefits for individual donors or decrease of state funding). One possible solution would be to consider the funding for CSOs holistically and prepare an overall plan for state funding and taxation of CSOs and their donors. In it may be included both the need for tax benefits for donors and the need for introduction of the percentage designation mechanism. In this way, one mechanism would not need to be adopted at the expense of the other one.
After a decision to introduce the percentage mechanism is made, we recommend you **consider several important questions in order to prepare a clear policy proposal to the government**. These questions relate to how the mechanism will work:

- Who are the beneficiaries and what are the specific requirements for them (e.g. to have existed for some years; to register in advance; to engage in public benefit activities; etc.)?
- How will taxpayers be able to designate their percentage (e.g. by submitting a tax declaration)?
- How will the system work from a practical perspective and how to ensure it will not impose too much burden to the administration, taxpayers and CSOs?
- Would there be a limitation on the use of received funds e.g. purposes to spend the money on, deadline for spending the money, etc.?
- How will the system be monitored and how will CSOs report?

There are also a number of other technical issues (e.g. can one taxpayer designate to more than one CSO; is there a minimum amount to be designated; etc.).

There are **two key conditions for the successful implementation of the mechanism**: 

1. **The development of the mechanism should be a collaborative process in which both the government and CSOs work together.** This will ensure that they have joint ownership and will help guarantee that the government will plan relevant resources needed for the implementation of the mechanism.

2. **There is a need to ensure that there will be a broad promotional campaign organized before the start of the system (and throughout its implementation) so that both CSOs and taxpayers are aware of this mechanism.** In many other countries, one organization (or a group of CSOs) has taken the lead in promoting the mechanism to ensure that it starts working. In addition, authorities have also been instrumental in raising awareness about the mechanism.

Below you can find links to several materials which may be useful in providing background information on the percentage designation mechanism and how it works in other countries:

- Experiences on the implementation of the percentage mechanism (Hungary, Ukraine and Slovakia): [https://ecnl.org/publications/experiences-implementation-percentage-designation-mechanism](https://ecnl.org/publications/experiences-implementation-percentage-designation-mechanism)
- Assessment of the first year of the implementation of the percentage mechanism in Moldova: [https://ecnl.org/publications/assessment-results-2-mechanism-moldova-1-year-later](https://ecnl.org/publications/assessment-results-2-mechanism-moldova-1-year-later)

ECNL remains ready to provide further assistance and support to the process of discussing the model of the percentage designation mechanism in Ukraine. You can contact us at luben@ecnl.org.