

# **FIELD GUIDE TO THE PERCENTAGE TAX DESIGNATION SYSTEM: PAST, PRESENT AND FUTURE**

**Research project to assess the impact of the percentage tax systems with  
recommendations for future policies**

Country Report

## **INTRODUCTION OF 1% SYSTEM IN HUNGARY DEVELOPMENT OF “ACTIVATING”**

### **❖ *Hungary***

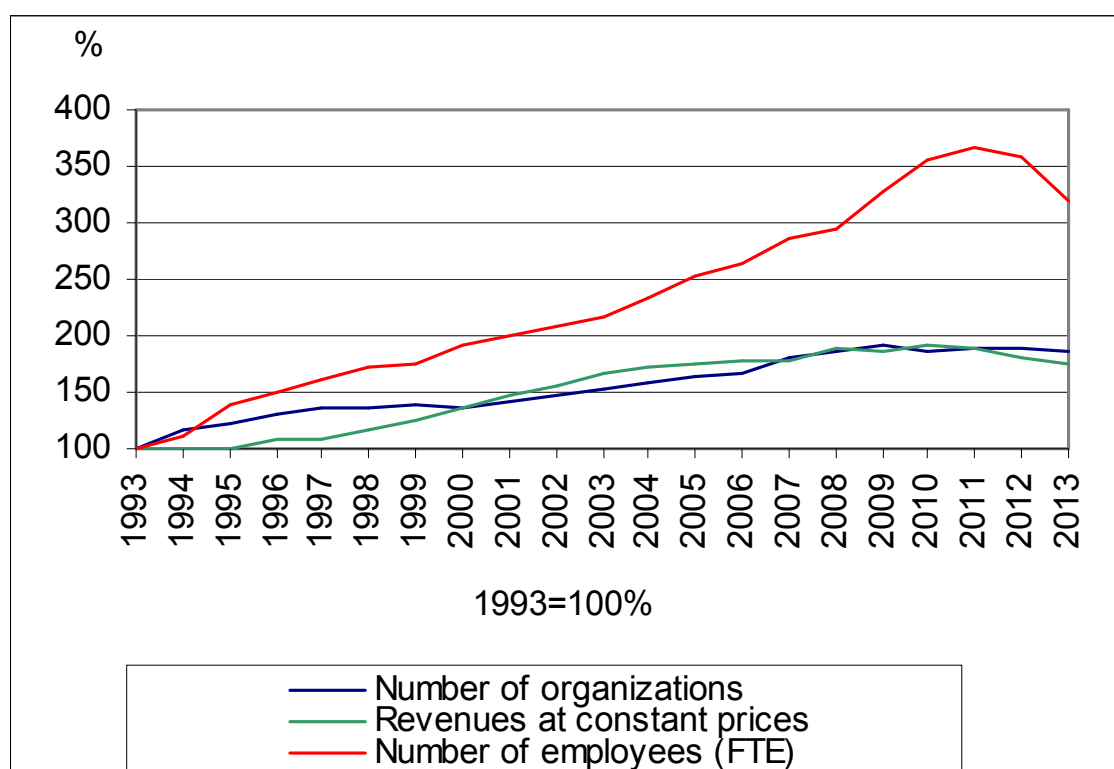
The population number of Hungary was 9 million 849 thousand on 1 January 2015, 28 thousand fewer than one year before. In 2014, major demographic processes developed favourably: the number of births and marriages increased compared to the previous year, while the number of deaths and divorces fell, that of induced abortions decreased considerably and infant mortality rate sank to a record low. At the same time, the positive international net migration continued to decline compared to previous years. (*HCSO 2015:1*)

### **❖ *Size and structure of Hungarian nonprofit sector***

The changes in the size as well as in the economic and social weight of the non-profit sector can be illustrated by three main indicators: the number of organizations, the real value of revenue and the number of employees. Since the 1993 start of the regular statistical monitoring, these values have increased steadily at different rates, and with the exception of a few years. Since 2008, this trend, with the exception of employment, has become very moderate. However, 2012 was the first time that each of these three curves shifted down compared to the previous year, and this decline continued in 2013. Though the decrease in the organization number was not significant, but the real value of revenues fell by 3% and the number of employees decreased by 11%. Nevertheless, this reduction observed at the sector level is only detectable among the service provider non-profit enterprises (a 13% drop in revenues, a 17% decline in employment) without a change in their number.

Figure 1

*The development of the Hungarian nonprofit sector 1993–2013*



Source: HCSO<sup>1</sup>

*Number of organizations*

In 2013, about 64.5 thousand civil and other non-profit organizations operated in Hungary – it was seven hundred less than a year before – approximately one-third (22.5 thousand) of them operated as foundations and 42 thousand as social non-profit organizations. 62% of foundations continue to be tied to three areas of activity: education (32%), social services (16%) and culture (14%). Among social non-profit organizations, leisure (25%) and sports associations (16%), as well as cultural organizations (13%) still had the highest proportions. The proportion of organizations with public benefit status amounted to 55%.

*Economic background*

91% of organizations had a full cash flow in the reference year, 2% of them had only revenues and 3% had only expenditures. 4% of the organizations did not conduct any financial activities. The amount of revenues was nearly HUF 1,242 billion (4.2 billion €)<sup>2</sup> this

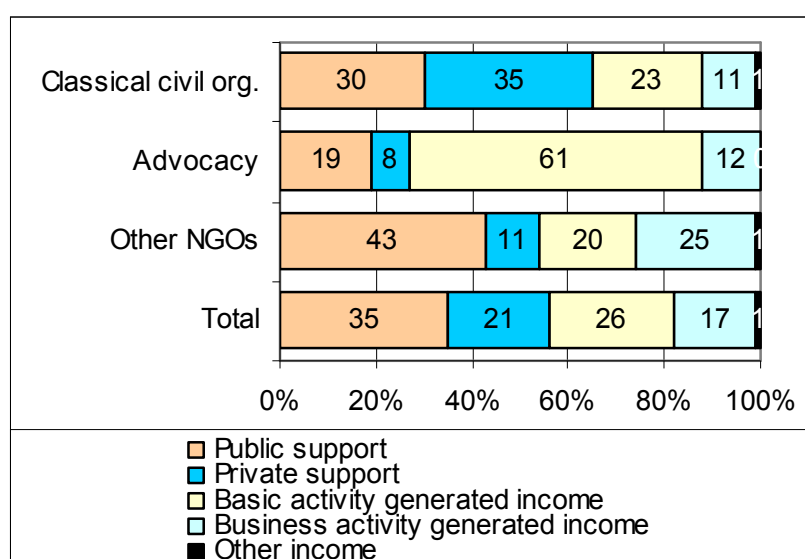
<sup>1</sup> HCSO: Hungarian Central Statistical Office.

<sup>2</sup> Exchange rate in 2013: 1€=297 HUF)

was a 1% decline at current prices and a 3% decrease in real terms compared to 2012. The proportion of organizations with a revenue of less than HUF 500 (1.7 thousand €) decreased from 45 to 42%.

The proportion of funding from state aid continued to decrease. In 2013, 35% of the revenues of the entire sector originated from state or local government budgets, which was a 5 percentage point decline compared to the previous year. Simultaneously, the proportion of own (basic activity and business) revenues increased from 40 to 44%, so the 60% support index<sup>3</sup> of the sector decreased to 56%. Compared to 2012, the state contribution in the sector decreased by HUF 74 billion (250 million €), this evolved as the balance of the HUF 87 billion (293 million €) withdrawal of funds related to non-profit enterprises and the HUF 14 billion (47 million €) surplus emerging in the different forms of associations as well as the HUF 1 billion (3.4 million €) “loss” in the foundation sector

*Figure 2*  
*The income structure of the nonprofit sector, 2013*



Source: HCSO

### *Human resources*

Between 2012 and 2013, the number of those employed in the non-profit sector decreased by 10%; in 2013 the total number exceeded 130 thousand. This value amounted to more than 3%

<sup>3</sup> The proportion of the total (public and private) support in all revenues.

of those employed<sup>4</sup> in the national economy. Within this, the number of full-time workers in main job was 83.5 thousand, beside them 46.9 thousand employees worked part-time or in non full employment. So the joint performance of the sector corresponded to the work of 104 thousand calculated full-time employees. Non-profit companies accounted for 64% of the calculated full-time employees, while associations or foundations accounted for the rest.

In 2013, the estimated number of volunteers active in the sector was 490 thousand. The 51 million hours performed by them<sup>5</sup> corresponded to the working time of more than 24.5 thousand full-time employees; the estimated value of their work was HUF 55 billion (185 million €). In the sector, three-quarters of the necessary human resources were ensured by employment and nearly one-fifth of them by the involvement of volunteers.

#### *The weight of the non-profit sector in the national economy*

Many data are available on the non-profit sector's role in the national economy, its direct and indirect participation in public services, its contribution to the gross domestic product and its employment potential. Between 1993 and 2011, the total revenue to GDP ratio of non-profit organizations increased modestly, by just one-third, but still did not reach 5%. A much more dynamic development evolved in employment: the labour market share of the sector increased nearly threefold. Since during this period the total number of employees was virtually unchanged in the country; this expansion was realized in absolute terms as well. This positive trend was broken in 2012, and there was a further decline in 2013.

There is a close relationship between income and employment, so these are not two independent variables. If we take the average of the two indicators, and this is considered as the weight of the sector in the national economy, it can be stated that this weight ratio has steadily increased – almost doubled and exceeded 4% during 2010–2012 – however, it decreased in 2013. This is due to changes occurred in the provision of public services, which, within the sector, had a significant impact on the non-profit companies. (*HCSO 2014*)

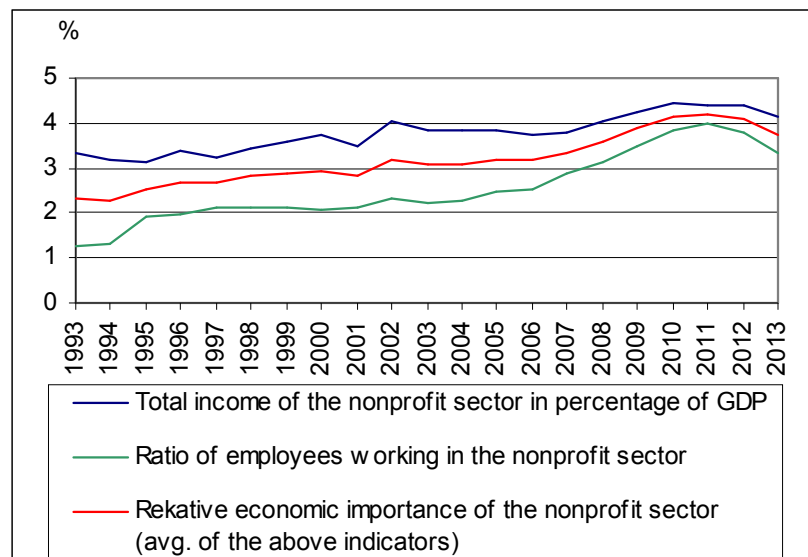
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<sup>4</sup> Compared to the number of employed persons aged 15–74. Source: Labour Force Survey.

<sup>5</sup> This calculated value expresses how many full-time employees in main job are replaced by volunteers in the organizations.

Figure 3

*Economic importance of the non-profit sector, 1993-2013*



Source: HCSO

❖ *1% percent mechanism in Hungary*

Beginning in 1997, Hungarian taxpayers may designate 1 % of their personal income tax paid to a chosen not-for-profit organization and, beginning in 1998, an additional 1 % to a church in accordance with Act CXXVI of 1996 on the Use of a Specified Portion of Personal Income Tax According to the Designation of the Taxpayer.

Though the 1 % is connected to the tax system, it is a peculiar type of indirect state support, rather than a tax benefit. Its “source” is the tax revenue of the public budget, but its distribution is based on the taxpayers’ decisions, and not on a central (governmental) decision.

The Act recognizes two categories of potential beneficiaries. Certain organizations of the civil non-profit sector belong to the first, while churches and advance (earmarked) budgetary purposes belong to the second. The Act determines the requirements of the beneficiary status differently for the two categories.

Beneficiaries in the “civil” category can be civil society organizations, with the exception of political parties and interest groups for employers and employees, which were established on the basis of the Act II of 1989 on Freedom of Association<sup>6</sup> and foundations

<sup>6</sup> From 2012 on the basis of the Civil Act.

fulfilling the following requirements constitute one “component” of this category. They must be registered by the court at least two (earlier three) years prior to the first day of the year in which the designation statement was made and they must effectively pursue a public benefit activity as defined by the Act on Public Benefit Organizations and set forth in their founding documents for at least one year before the first day of the year in which the designation statement was made. Public foundations pursuing public benefit activities, nonprofit enterprises (earlier public benefit companies), and, respectively, certain national public collections and other cultural institutions also belong to this category.

With regard only to the “secular” half of designations, the mechanism of the 1 % system is the following. Individual taxpayers may make their designation statements on a special form provided by the Office for Taxation and Financial Control, or a copy of this form. The only data taxpayers must indicate on the form in every case is the tax number of the beneficiary organization. Then taxpayers must put the completed forms into a standard size envelope, seal it and write their name, address and tax identification code on the envelope. They must place this envelope in their tax return package. In the event that the personal income tax is reported by the employer instead of in an individual tax return, the individual must give this envelope with the designation statement to the employer no later than March 25th. As the tax declaration can be done by electronic way in this case taxpayer need not use envelope, the designation of the two 1% is part of the virtual form.

Tax authorities instruct beneficiary organizations to certify that they do not have public debts due and they comply with other prescribed requirements of the 1 % Act<sup>7</sup>. If beneficiary organizations can meet the requirements until the given deadline, the office transfers the funds to the beneficiary civil organizations. Beneficiaries previously must have published a press release on the proper (targeted) use of the designated funds, but since 2008 they have to send the report directly the tax office and publish it on their homepage if they have. Tax authorities are entitled to control whether the designated funds transferred are used in accordance with public purpose activities.

The 1 % Act was criticized in different ways. For example, some participants of the non-profit sector complained that the length of time between the preparation of designation statements and the destination of designations to the beneficiary organizations is too long – around six months in practice - and consequently should be reduced. Critics also suggest that

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<sup>7</sup> E.g. they modified their founding documents in order to prove that they are not engaged in prohibited political activity; they continuously pursue a public benefit activity.

the amount of invalid designations which do not reach the addressee for various reasons (e.g. incorrect tax numbers, or the beneficiary can not meet the requirements) should not be left in the state budget, but rather should be used for supporting the sector<sup>8</sup>. Moreover, some suggest that the state should renounce the 1%, even if the taxpayer did not designate it. Until now this problem has not been solved, so the undesignated 1% stay at the state. (*Csóka 2000*)

Another problem was the anonymity of designators. Some beneficiaries required to be aware of the list of their designators, in order to get in contact with them, as they can become possible donors as well. At the same time it could have caused embarrassing situations for those who did not designate 1% at all or not to certain “expected” or even more to “sensitive” organizations.<sup>9</sup> In 2013, this issue was positively closed down, designators must give a declaration whether they agree or disagree that their availability can be learnt by the given organization.

There are two other significant changes which can have an effect on the output of the system. Between 2011 and 2013 the dual-key personal income tax system gradually changed for flat tax system with the lower rate, as a consequence the possible amount of 1% which could be designated has been decreasing (besides the rate is going to be 15% instead of 16%). Above all, from 2015 an “active system” is applied instead of “passive system”, it means, that those organizations who want to collect 1% must be registered in a list of the tax office in advance, so the number of “spoiled”, wrong and unnecessary designations is expected to decrease.

### ❖ *Facts about 1% in Hungary*

In order to determine the economic and social impacts 1% system has had on the nonprofit sector, it is worth sketching the main tendencies and changes taken place in the last decade in Hungary.

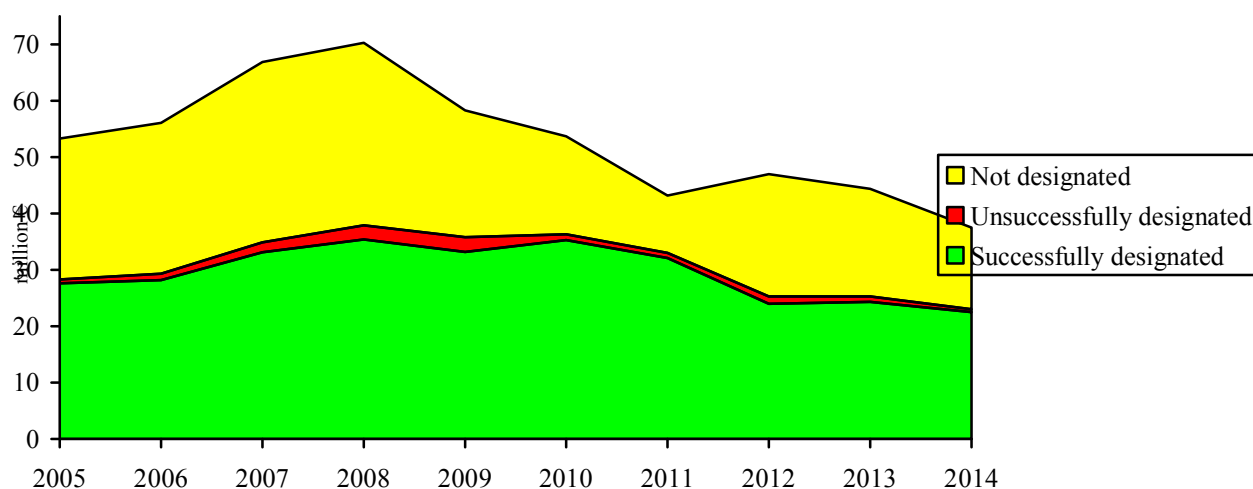
The possible sum to be designated increased until 2008, when it reached 70 million euro. Later a negative trend appeared, probably due to the economic crisis which brought financial restrictions cutting back wages and salaries. However in the last four years the government’s tax policy tended to transformed the dual-key system into flat tax, radically reducing the tax rate, so the sum of personal income tax has diminished.

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<sup>8</sup> The concept of National Civil Fund was born on the base of this idea in 2003.

<sup>9</sup> E. g. let us think of school foundations’ expectations toward parents, or of minority organizations.

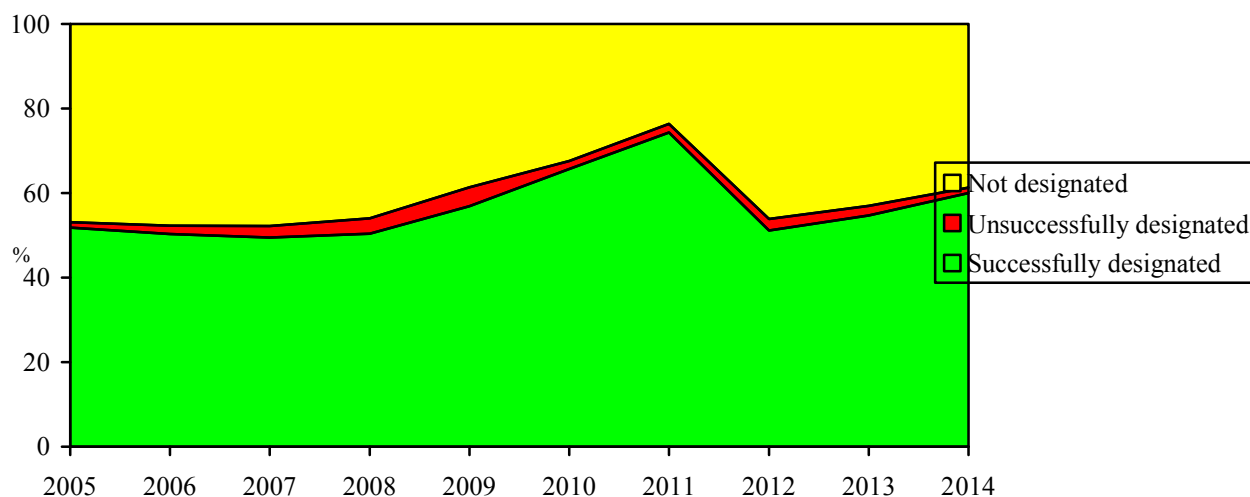
*Figure 4  
Composition of possible sum of civil 1%, 2005–2014*



Sources: NTCA<sup>10</sup>

The willingness of designation – except 2011 – seems to be more or less stable; 50-60 percent of the total 1% has happened to be transferred to nonprofit organizations. On average, the unsuccessfully designated amount represents 2-3 percent, increasing the “mass of stuck 1%”.

*Figure 5  
Distribution of possible sum of civil 1%, 2005–2014*



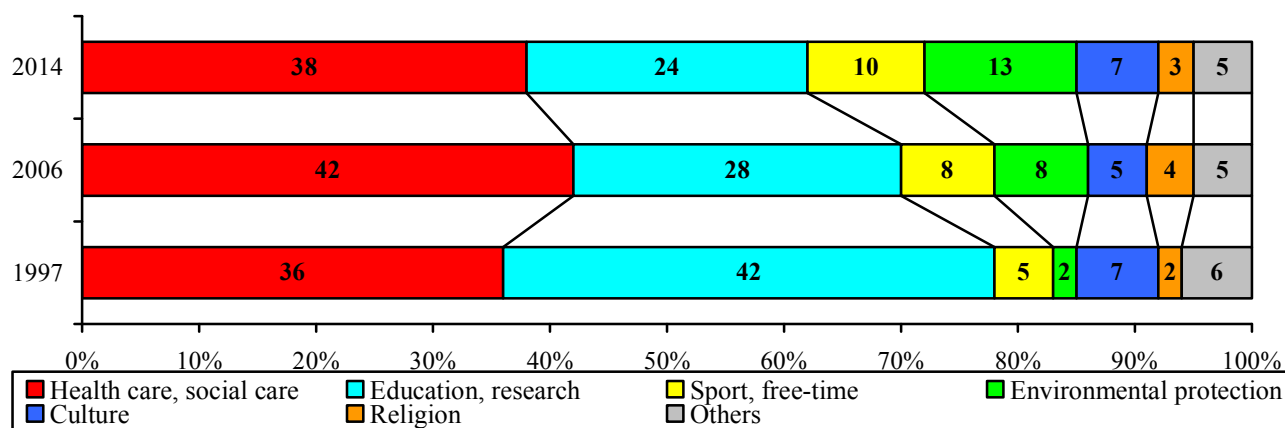
Sources: NTCA

<sup>10</sup> NTCA: National Tax and Customs Administration of Hungary



Although organizations performing health care and social services, or operating in the field of education receive continuously the majority of the 1% support, the share of environmental protection and sport, recreation is growing, the former radically, the latter a bit moderately.

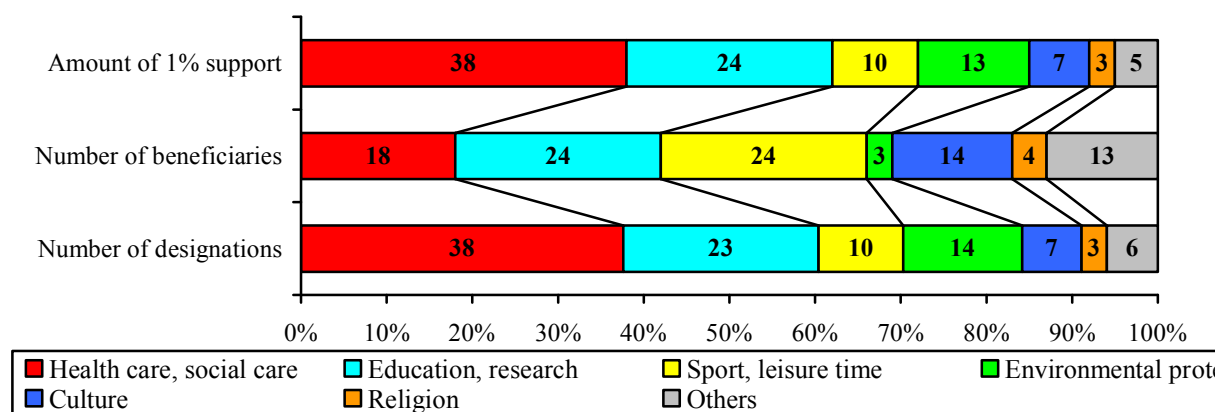
*Figure 6  
Changes in the distribution of the 1% support by field of activity of recipients*



Source: NTCA and HCSO

As we can see the distribution of the designations and the designated sum is very similar in terms of field of activity. It means that as far as the supported aims or missions are concerned, the priority scale of taxpayers being at the different income level does not deviate significantly.

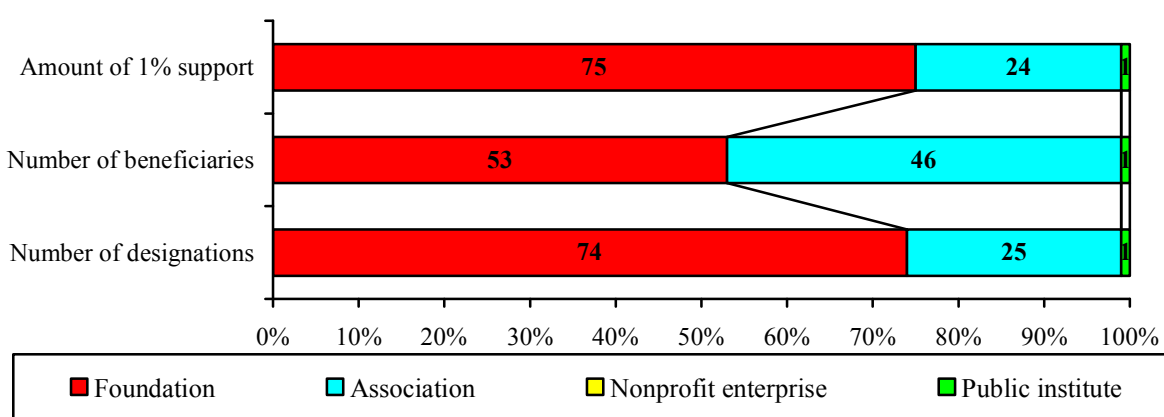
*Figure 7  
Composition of designations, beneficiaries and the amount of 1% support received by field of activity, 2014*



Source: NTCA

However the breakdown of number of beneficiaries shows a concentration for the benefit of health and social care. It suggests that in these highlighted areas rather some greater nationwide, mainly foundations can attract the big part of designations, while for instance, in the field of sport and culture a wide range of organizations happen to be supported naturally at a lower level on average. Not surprisingly the most popular and “competitive” issues in Hungary are the ill children and animals.<sup>11</sup>

*Figure 8  
Composition of designations, beneficiaries and the amount of 1% support received by type of organizations, 2014*



Source: NTCA

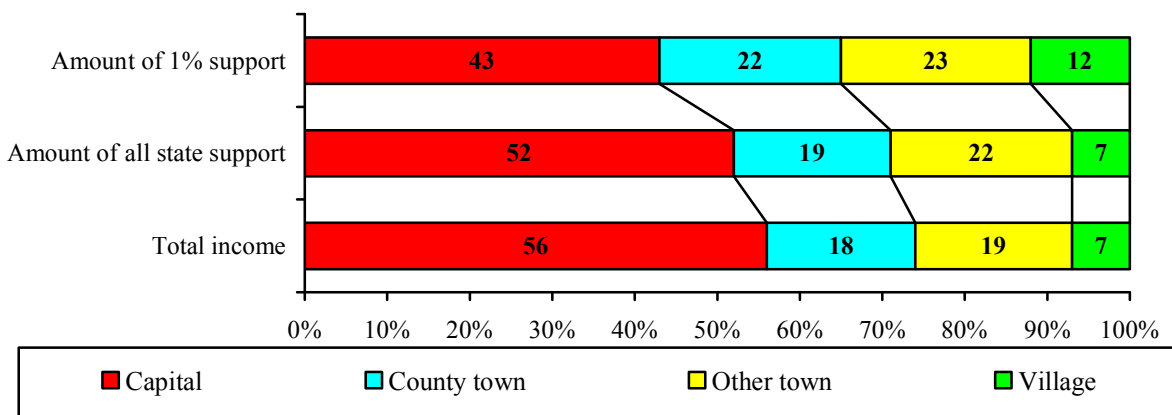
Three quarters of designations specify foundations as beneficiaries, due to the traditional foundational function such as charity, which needs public donation, of that 1% designation actually is a special form according to the public opinion. As we mentioned above civil organizations must compete with nonprofit enterprises and public institutes as well, but the latter both do not represent considerable share.

The 1 % system not only increased the number of beneficiary organizations, but also changed the composition of organizations receiving central budgetary resources. Statistical data also show that small local nonprofit organizations are more successful in persuading citizens to support them than in raising other state support. Similarly, the regional distribution of the 1% income is somewhat more even than other public support. Budapest, the capital,

<sup>11</sup> The TOP 10 organizations receiving the highest amount of resources from percentage allocation in 2014 are as follows: Foundation for Development of Pál Heim Children’s Hospital; National Ambulance Service Foundation; Bátor Tábor (Brave Camp) Foundation; Szent Márton Pediatric Emergency Medical Service Foundation; Together for Children with Leukemia Foundation; Children’s Cancer Foundation; Noah’s Ark Animal Shelter Foundation; Together for Children with Cancer Foundation; Rex Dog Shelter Foundation; Saint Francis of Deva Foundation.

receives 52% of all budgetary support, and “only” 43 % of the 1 % income. Nearly half of the 1% income is received by nonprofit organizations operating in towns. Although the “share” of villages “in the 1% cake” is very low, still they gain almost twice more funding from the 1 % designations than from central budgetary supports.

*Figure 9  
Composition of amount of 1% received, all state support and total income  
by type of community, 2013*



Source: HCSO

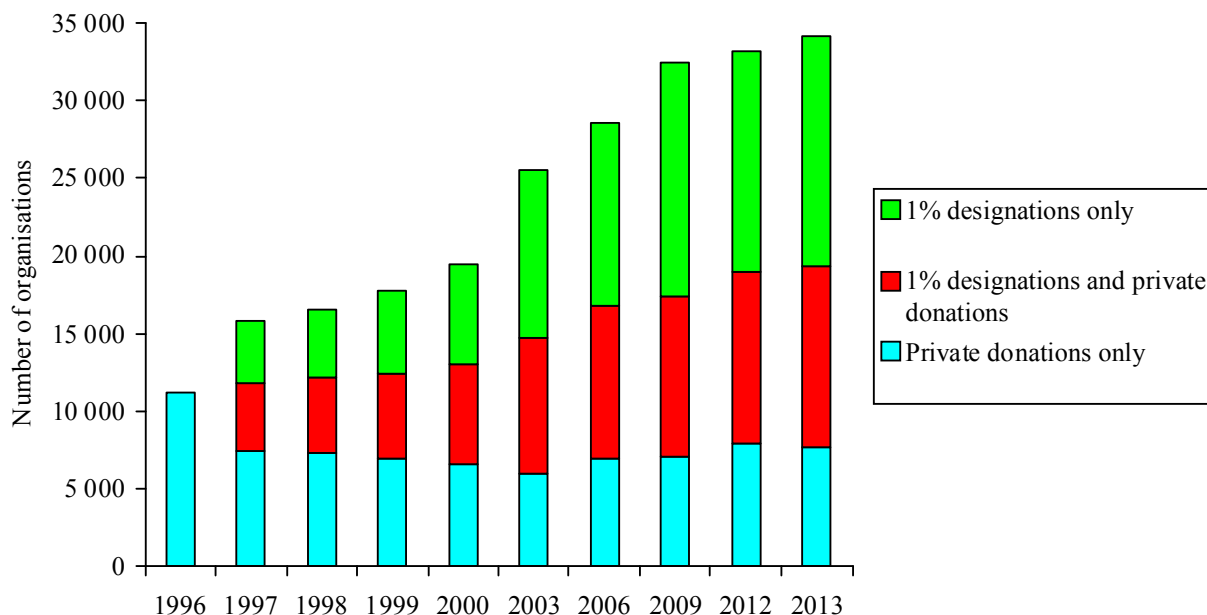
❖ *The relationship between 1% designations and private donations*

In the debates surrounding the “birth” of the 1% system (*Bossányi 1997; Mészáros–Sebestény 1997 and Kuti–Vajda 1997 in Vajda–Kuti 2000*), a central issue – certainly unresolvable at the time – was the effect its introduction would have on the levels of private giving among the general public. Those in the pessimistic camp feared that taxpayers would feel that their philanthropic act in the form of their 1% designations was sufficient, and therefore NGOs would become less able to attract private donations. The optimistic camp predicted exactly the opposite would happen, i.e. that taxpayers already persuaded to exercise the new form of costless ‘percentage philanthropy’ would also gradually be persuaded to give money from their own pockets to support NGOs. (*Kuti 2007*)

Data collected by HCSO for the period 1997-2013 seems to prove the optimists right. Since the introduction of the 1% system the number of NGOs that have received private donations has continually increased, albeit not very rapidly.

Figure 10

Number of NGOs that received 1% designations and/or private donations, 1996-2013

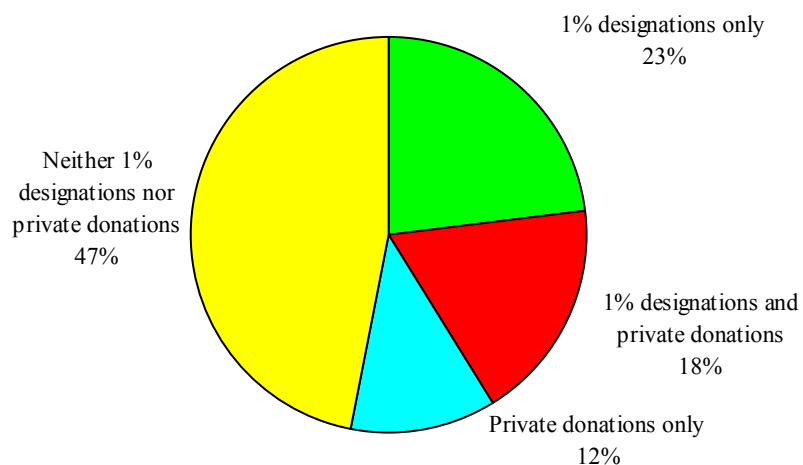


Source: HCSO

The figure above also shows that a large (and ever-increasing) number of NGOs were able to attract both private donations from members of the public and 1% designations. At the same time, there was a considerable rise in the number of organisations that received 1% designations, but not private donations.

Figure 11

Breakdown of NGOs by receipt of 1% designations and/or private donations in 2013

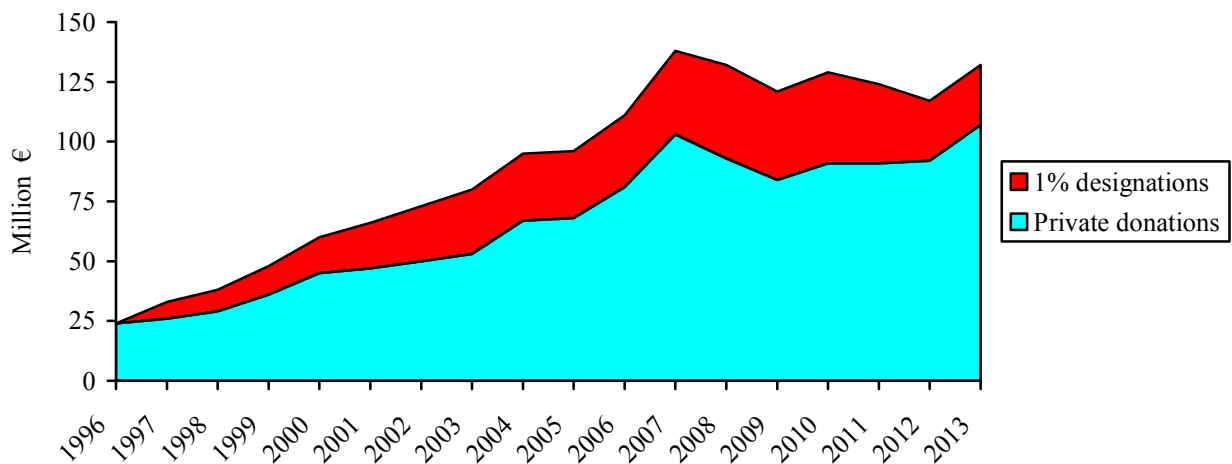


Source: HCSO

According to the most recent data available from HCSO, only 23% of NGOs received 1% designations and only 18% got both 1% designations and private donations. Almost half of all NGOs received neither 1% designations nor private donations.

In terms of the number of beneficiaries, the 1% system has clearly not overshadowed private donations, nor reduced their importance. The same is true in terms of the amounts received from the two forms of funding<sup>12</sup>.

*Figure 12  
Growth of 1% designations, individual donations in Hungary, 1996–2013*



Sources: HCSO

Notwithstanding the rapid growth in 1% designations, private donations continue to be of greater importance in the financing of the NGO sector. At this point, therefore, it is worth noting that there is now a new kind of NGO that seems to be focusing entirely on obtaining 1% designations rather than the labour-intensive process of attracting donations.

It seems particularly inexplicable that such an organisational attitude seems to be spreading when it is known that research carried out on private donations shows a very clear, positive and close link between taxpayers' exercise of the 1% designation option and their willingness to make individual donations. (*Kuti 2007*)

<sup>12</sup> The explanation of the break of positive tendency in 2008 is the economic crisis and the change in tax system as we described earlier.

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Kimutatás a 2001-2011. évi lehetséges nyilatkozók és az érvényesen rendelkező magánszemélyek számáról a nyilatkozatok származási helye és az 1 % alapja szerint

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