

CORPORATE TAX AS A DIRECT TOOL FOR SUPPORTING THE PUBLIC SECTOR IN THE SLOVAK REPUBLIC

Jana Kušnírová

*University of Economics in Bratislava,
Faculty of National Economics,
Department of Finance,
Dolnozemská cesta 1, 852 35 Bratislava, Slovakia
jkusnirova1@gmail.com*

Abstract

The economic power and the influence of the third sector on the society are indisputable. While the independent Slovak Republic has been developing, the various forms of non-profit sector have been developing, too. During the first years of their existence non-profit organisations in Slovakia were supported mainly from foreign financial resources. Since 2002 the main financial resource of most non-profit organisations in Slovakia has been the tax assignment from both individuals and legal persons. The paper is focused on the development and direction of tax assignment in Slovakia. The main methods of research include the analysis and application of the economic model.

Key words: *non-profit sector, legal entity, tax assignment*

INTRODUCTION

The third sector represents the sector which operates in the space between the state and market. The main aim of the third sector is not to generate profit and distribute it among its owners. If any profit is generated it is returned to other public benefit programmes. In most of cases it is obvious that the subjects of the third sectors are not able to secure sufficient financial resources for their operation and activities related to their work. Therefore, the search for new sources of financing is a very important task. Tax assignment as the source of financing of non-profit organisations was implemented to the Slovak Law Order by the change of the tax law. Income tax assignment represents the main financial resource for most non-profit organisations in Slovakia.

From the point of view of economic theory, the tax assignment denies the basic tax principle - non-equivalence. The amount that a taxpayer pays to the state budget in the form of income tax, does not entitle him to make decisions about its use. The principle of justice is violated. In case of two entities having the same taxable income, when one entity uses the assignment mechanism and the other one does not, it follows that the entity which has used the assignment contributed to the payment of public goods less than the other entity which has paid the share of tax to the state budget. Another risk might be represented by the ineffective allocation of financial resources caused by the imperfect awareness of tax payers. The main positives of tax assignment include the fact that such income of non-profit organisations differs from state subsidies and lead to a higher number of the recipients of financial support and a more even redistribution among regions. The assignment supports the principle of partnership and expands funding possibilities for the non-profit sector [Kolibova 2016].

1. LITERATURE REVIEW

Since the time of Adam Smith economic theory has emphasized the importance of private markets in the effective offer of goods. However, altogether with the existence of private markets there are some limitations in the provision of selected basic social needs. The attempts to eliminate the negatives lead to the gradual increase of the role of state in the economy [Stiglitz 1986].

Many economists agreed on the fact that there are the areas of social life, where the state is not able or willing to meet the needs of citizens partially or at all. Many people in the East and West start to realize that free market and free elections are not enough for building and maintaining healthy and democratic societies. Market economy can be effective in terms of providing consumer goods and service, but it is not sufficient in the role of a mechanism for meeting various social needs by its very nature. However, citizens cannot depend on the government either, if they want the basic important collective interests, such as clean natural environment, civil rights and social care to be applied and protected [Siegel, Yancey 1992].

Boukal matches the third sector to the concepts of public and non-profit sector. He defines it as the broad space between the state and state institutions, the market representing profit-oriented companies and a citizen, who, based on his internal conviction, wants to offer a service that cannot be realized based on the profit. He defines public sector as the subset of non-profit third sector [Boukal 2009].

The sources of financing of non-profit sector are closely-linked to the overall economic, social and political situation in the country. According to Davis and Etchart the financial resources of non-profit organisations consist of the set of external and internal resources. The external ones are divided into domestic and foreign resources [Davis, Etchart 1999]. They are American economists mainly who emphasize the importance of the third sector, not only from the point of view of its formation and activities within providing public service activities, but also because of its position on the job market. The non-profit sector employs more than 7 % employees in the West European countries. The share of employment is significantly lower in the countries of the Middle and East Europe and it is above 1 %

[Anheier, Carlson, Kendall 2001]. There is an open question, not only the theoretical one, about the adequate size of the non-profit sector.

The basic financial resources of the non-profit sector in Slovakia can be divided into the direct and indirect ones. The direct form of financing mainly includes providing subsidies and grants, redistribution of revenue from public collections and funds from EU funds. The exemption from tax, deduction of the donation from the tax base and tax assignment belong to the indirect forms of the financial support of non-profit sector. After the establishment of the Slovak Republic Slovak non-profit organisations received sources especially from America (United States Information Service, United States Agency for International Development - Your Earth Program), the Netherlands (ecological programme), the Great Britain (Know How Fund) as well as EU pre-accession funds. It was also true that many foreign investors also supported the activities of non-profit organisations after arriving to the Slovak market [Marcek 2004]. Financing of the non-profit organisations in the form of donations and tax allowance had a temporary character in the Slovak Republic. Tax assignment has been the part of tax system in the Slovak Republic since 2002. It is an important source of non-profit organisations financing.

2. METHODOLOGY

The main aim of the article is to outline the complex view of financing of the non-profit sector in the Slovak Republic from 1993 to 2015. Analysis, regression analysis and synthesis were the main scientific methods applied in the article. The analysis of the tax system was applied because of the identification of selected tax tools used for financing the non-profit sector in the Slovak Republic from the beginning to the present. The selected aspects of the assignable process in the Slovak Republic were also analysed. In particular, it is the analysis of the number of legal entities assigning the corporate tax, the number of recipients of financial resources from assignment, the amount of the assigned tax coming from legal entities in the Slovak Republic as well as the effectiveness of the use of assignable mechanism by legal entities in the Slovak Republic. In the other part of the article the regression analysis was used to study the relation between the income from the corporate tax and the amount of the assigned tax by legal entities in the Slovak Republic for the whole period of the assignable mechanism existence.

3. RESULTS

However, since 2002 the main financial resource of most non-profit organisations in Slovakia has been the tax assignment from both individuals and legal entities. The assignable mechanism distributes the public funds from the central level to the individual one. A legal entity can use the institute of tax assignment to decide whether it provides a part of paid tax to another subject or the state. The company redirects a share of paid income tax to a selected organisation that is not business-based. Therefore, tax assignment represents a method which can be used by a legal entity to participate in the decisions on public benefit.

The opportunity to deduct donations from the tax base of a legal entity belonged to the oldest forms of public sector financing in the Slovak Republic. Donations could

have been of a financial or material character. The only condition for their application to the company's costs was a donation for public purposes. Tax legislation precisely set the purpose of donation. However, the group of recipients was unclear. The above-mentioned form of financing did not represent an important source of income of non-profit organisation in the Slovak Republic. The biggest share of means was directed to schools, health care and social facilities. However, this form of the support of the non-profit sector was not sufficiently motivating for providers. Therefore, donation stopped to be perceived as an indirect form of state support. For the above-mentioned reasons, a new tax law cancelled that form of financing the non-profit sector in 2004.

Actual sources of financing non-profit organisations are significantly different. Organisations acting in the third sector are forced to diversify their financial sources. One of them is also the tax assignment of paid income tax. The assignment mechanism distributes the public funds from the central level to the individual one. A company can use the institute of tax assignment to decide whether it provides a part of paid tax to another subject or the state. Therefore, the company redirects a share of paid income tax to a selected organisation which is not based on business and so the legal entity can participate in the decision about the public benefit.

The ideas of assignment mechanism in the Slovak Republic are dated back to 1997. This process is mainly supported by the representatives of the third sector as it is the opportunity for long-term financing. The original proposal of the mechanism contained the opportunity of assignment only for individuals, who could assign 1 % of paid income tax. However, the assignment mechanism which could be used only by individual for the first two years of its existence was put in practice only in 2002. It has gone through several changes during a 15-year-period, but it has preserved its position within tax policy until now. As we have already mentioned, the mechanism could have been applied only by natural persons from 2002 to 2003. In 2004 the tax reform cancelled deductible items for legal entities in the form of donations. However, the pressure of non-profit organisations in Slovakia enabled the implementation of a new system, concretely the system of tax assignment by legal entities in the amount of 2 % of their tax liability. Therefore, the support of public sector was extended to legal entities in 2004. The Slovak Republic became the only European country with such a right given to legal entities. A legal entity can assign the tax to several non-profit organisations. However, the minimal amount of assigned income tax for one organisation is defined in legislation (legal entities can assign at least 8 EURO for one receiver). The total corporate tax revenue reached 1 billion EURO in 2004. The theoretical maximum value of 2 % of corporate tax represented 20.3 million EURO. The actual assigned tax reached 18.9 million EURO. It represented 92.7 % usage of the tax assignment mechanism by legal entities in the first year of the existence of the assignment mechanism.

The changes in the mechanism of tax assignment were recorded immediately in the second year of its existence. A positive change was the reduction of administrative burden for legal entities in 2005. Since then legal entities could assign the share of paid income directly via a tax return without the necessity to use an independent document. Based on the comparison of theoretical maximum assigned amount and actual assigned tax in 2005 we can say that the percentage of assignment mechanism usage by legal entities reached 97 %. In 2006 the growth of the volume

of tax assigned by legal entities was more than 24 % in year-on-year comparison. However, on the other hand, it caused more significant reduction of budget income from corporate tax. That is the reason why there were the suspicions about tax evasion in the form of unauthorized tax assignment (the existence of these legal entities was suspicious, since they were non-profit organisations which got only incomes that were not the subject of taxation and were not obliged to register at the tax office). The percentage of assignment process usage by legal entities was above 90 % in 2006.

In 2007 the receivers who were focused on the protection of natural environment, human rights, the development of spiritual values and education were excluded from the assignment mechanism. On the other hand, the assignment process was extended by the areas of prevention support, the treatment and re-socialisation of drug addicts within health care and social services. In the following year 2008 the support expanded also to non-profit organisations aimed at research and development. The authorized recipients also included The Drug Fund and the Vocational Training and Development Fund. The percentage of the assignment process use by legal entities did not drop under the level of 90 % in both above mentioned years (it was 93.4 % in 2007 and 98 % in 2008). The effects of the economic crisis affected the development of many macro-economic indicators and they also influenced the development of the assignment process in the Slovak Republic. The percentage of the assignment process use reached the level of 88.4 % in 2009 and it fell to 67.2 % in 2010.

The biggest volume of financial means was indicated to non-profit organisations in 2009 in the total amount of more than 55 million EURO; 68 % of this sum was assigned by legal entities. The effect of the world financial crisis was registered in the Slovak Republic only at the end of 2009 and beginning of 2010. Therefore, the fall of economic activity of the Slovak economy and higher unemployment lead to the reduction of tax income. It resulted in the reduction of assigned tax volume which is paid right from the income. The drop of total assigned sum by legal entities recorded the annual fall by 23.8 %; it was more than 8.9 million EURO.

A new amendment of the tax law was put into practice in 2011, what causes the reduction of the percentage of assigned tax legal entities could assign to the non-profit sector. In that year the legal entities who decided to assign 2 % of their tax liability, had to contribute a donation to the non-profit sector in the minimum amount of 0.5 % of tax base. If a company had not given a donation during the taxation period, it had the right to assign only 1.5 %. The change caused the drop of the volume of assigned tax by 12.4 % in year-on-year comparison. In that year there was also the drop of legal entities assigning their financial means to the non-profit sector. Only 9.53 % (2,467) from 25,754 legal entities took advantage of the opportunity to give a donation in the taxation period for public purposes what would enable them to assign 2 % from the paid tax later. The remaining 90.47 % (23,489) of legal entities assigned only 1.5 % of paid tax. The total amount of tax assigned by legal entities when classified according to the percentage (1.5 % or 2 %) shows that the most profitable companies assigned 2 % and therefore they also gave the donation in the minimal amount of 0.5 %. The average assigned sum per one legal entity was 615 EURO in case of a legal entity assigning 1.5 %. The average sum of a legal entity assigning 2 % was 4,336 EURO. The percentage of assignment

mechanism use by legal entities recorded slight annual growth to 77 % in 2011. Its level fell to 74 % the following year.

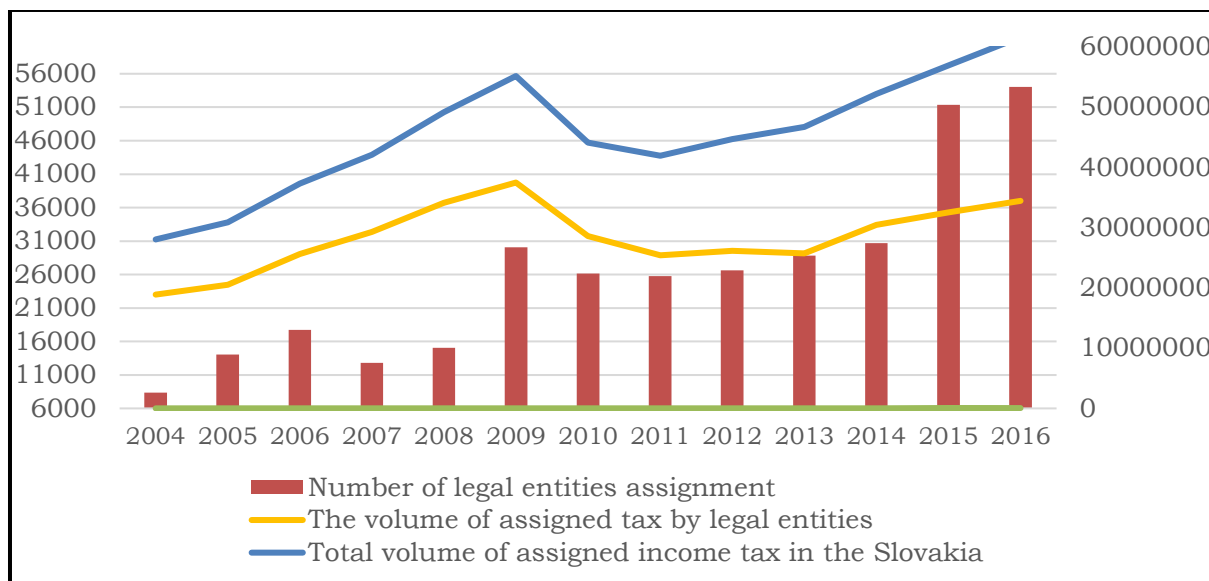
Table 1. The total amount of assigned tax in the Slovak Republic (in EURO)

Year	The number of assigning LE	The amount assigned by LE	The total amount of assigned tax in the Slovak Republic	The share of tax assigned by LE compared to the total volume of assigned tax (%)
2004	8,364	18,896,000	28,055,000	67
2005	14,063	20,525,000	30,896,000	66
2006	17,74	25,629,000	37,342,000	69
2007	12,819	29,306,000	42,125,000	70
2008	15,036	34,144,000	49,180,000	69
2009	30,078	37,496,000	55,180,000	68
2010	26,172	28,592,000	44,145,000	65
2011	25,754	25,444,000	41,970,000	61
2012	26,621	26,146,000	44,694,000	59
2013	28,827	25,762,000	46,706,000	55
2014	30,682	30,465,000	52,205,000	58
2015	51,377	32,537,000	56,941,000	57
2016	54,042	34,456,000	61,631,000	55

Source: Own processing according to the data of Financial Directorate of the Slovak Republic. Note: own table

The permanent growth of the number of the organisations involved in the process happened during the monitored years of 2004 to 2016 (Table 1). Exceptions were the years 2010 and 2011 when the significant changes of the assignment mechanism happened, as we have mentioned above. At the same time there was the drop of the volume of the tax assigned by legal entities. These two years were a breakthrough from the point of view of the share of the tax assigned by legal entities when compared to individuals. This indicator fell by 10 % in favour of individuals. The mechanism of the assignment process was used by legal entities in 63.5 % in 2013. The next year the indicator value rose to 78.2 %. In 2015 the effective use of the assignment mechanism significantly fell to the historically lowest level, when the value of effectiveness of its use by legal entities reached only 61.5 %.

Fig. 1. The development of the assignment mechanism in the Slovak Republic



Source: Own processing according to the data of Financial Directorate of the Slovak Republic. Note: own table

As we can see from the figure 1 the volume of the tax assigned by legal entities increases altogether with the growth of economic performance and the growth of the amount of corporation tax revenue, which was at the highest level in 2009. Therefore, we can say that the corporation tax revenue has an immediate impact on the development of the volume of assigned income tax in the Slovak Republic. However, it is obvious that apart from this factor there are several other factors which significantly influence the assignment mechanism. The purpose of the regression analysis we used was the identification of these factors as well as pointing out their quantitative justification; what is the extent up to which they influence the volume of assigned corporation tax (Input data necessary for the construction of regressions were acquired from several sources, especially from the statistical data of OECD, EUROSTAT, NBS, Slovstat and MF SR). A linear regression model was tested for the unambiguous interpretation. However, when constructing the graph, we also tested a polynomial, logarithmic, exponential and power trend (the trend which explained the highest part of the variability of a dependent variable (it reached the highest value of coefficient of determinacy) was then graphically depicted.)

The statistical significance of the regression model as a whole was tested at the degree of reliability of 90 %. F-statistics was used for the determination of the model significance. F-test calculated value was 4.539478; F-test critical (tabular) value was 1.37218. It follows from these values that the model is statistically important as a whole. The P-value (F) (0.058961) also confirms the statistical significance of the model. It is below the level slightly above 5 %. Therefore, the model as a whole is justifiable at the significance level of 10 % and it can be further analysed and interpreted. The testing of the statistical significance of

model parameters was also realized at the significance level 10 %. In the constructed regression model no. 1 there is only one parameter (corporation tax revenue in the Slovak Republic). We achieved the following values by the means of T-test. T-test calculated value was 2.1306; T-test critical (tabular) value was 1.37218 (table 2).

Table 2. Regression model 1

Dependent variable: The share of the tax assigned by legal entities					
	Coefficient	Std. Error	t-ratio	p-value	
const	15,7472	5,83558	2,6985	0,0224	**
corporate tax revenue	0,0065777	0,00308723	2,1306	0,059	*
Mean dependent var	27,84167	S.D. dependent var	5,388786		
Sum squared resid	219,6978	S.E. of regression	4,687193		
R-squared	0,312217	Adjusted R-squared	0,243439		
F (1, 10)	4,539478	P-value(F)	0,058961		
Log-likelihood	-34,47134	Akaike criterion	72,94268		
Schwarz criterion	73,91249	Hannan-Quinn	72,58362		

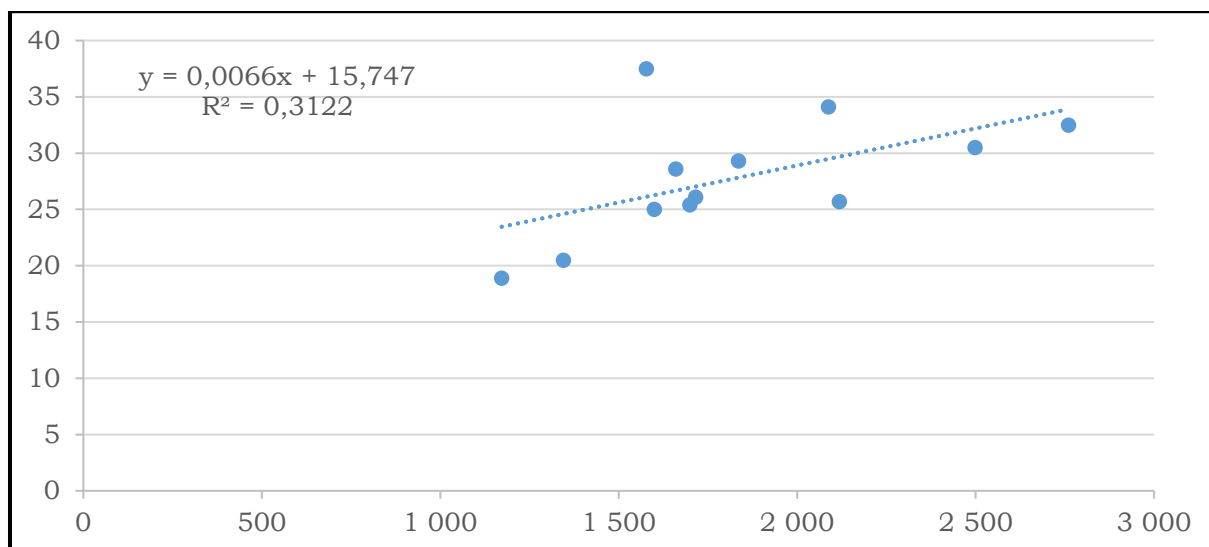
Source: Own processing using the programme GRETL. Note: own figure

Based on the comparison of obtained and tabular quantities it applies that the parameter (corporation tax revenue) is statistically important in the constructed model. The coefficient of determinacy (R^2) gains the value of 0.312217. It follows that 31.22 % of the changes in the volume of the tax assigned by legal entities is influenced right by the changes of corporation tax revenue. The equation has the form of

$$\text{corporation tax revenue} = 0.0066 \times \text{volume of assigned tax} + 15.747$$

The equation results in direct dependence. If the revenue of corporation tax, respectively tax liability of a corporation increases, we can observe the growth of the volume of assigned corporation tax. However, the results of the model proved that higher corporation tax revenue does not automatically represent higher volume of tax assignment by companies. The model proved that the revenue of assigned tax is closely related to other factors, too. The impact of the external factors which influence the corporation tax revenue the most is noticeable. They were mainly the effects of the economic crisis in the Slovak Republic. There is the graphic representation of the regression model in the figure 2.

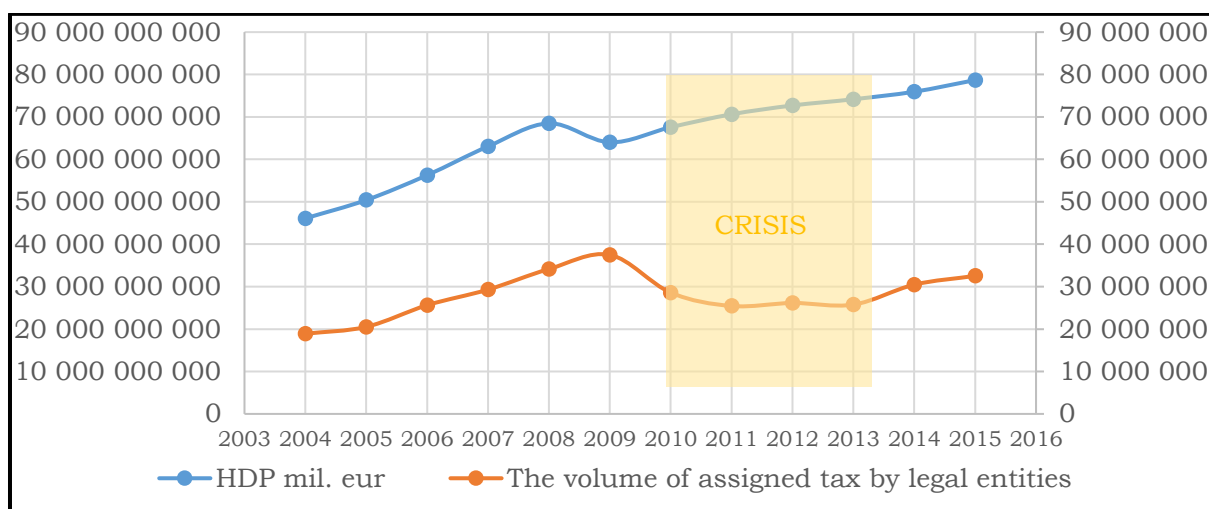
Fig. 2. The graphic representation of the regression model



Source: Own processing according to the data of Financial Directorate of Slovakia. Note: own figure

The regression analysis was also used for studying the dependence of the volume of assigned tax from the GDP size in the Slovak Republic. However, the conclusions of the model are relevant since the linear dependence of two quantities cannot be clearly confirmed for the whole monitored period. The period from 2004 to 2008 is characteristic by direct dependence, when the volume of the tax assigned by legal entities growth altogether with the growth of GDP. However, we observed a sharp drop of GDP in 2009 caused by the crisis effects, but the volume of assigned tax was still growing, since in 2008 we observed the volume of assigned tax for the period of previous year. There was a sharp drop of the volume of assigned tax in 2009, but it was accompanied by a slight growth of GDP. Therefore, the period from 2010 to 2013 is characteristic by the exactly opposite development than the period from 2004 to 2008. A slight growth of GDP is accompanied by a slight drop of the volume of assigned tax when the effects of the crisis slowed down the management of companies; there was the reduction of tax liability and also the reduction of the volume of assigned tax, as the figure 3 shows.

Fig. 3. The volume of assigned tax and GDP in the Slovak Republic (2003 to 2016)



Source: Own processing according to the data of Financial Directorate of Slovakia. Note: own figure

The share of the corporation tax in the Slovak Republic can be provided only to a defined group of receivers and for the intended purpose. Both conditions are regulated by the tax law. The list of assigned tax receivers is published by Notary Chamber of the Slovak Republic every year. The number of organisations involved in tax assignment from 2004 to 2016 was continuously growing. The reasons were mainly the awareness of assigning organisations as well as the successful media campaign of non-profit organisations.

CONCLUSION

A model for the assignment mechanism in the Slovak Republic was the system of tax assignment in Hungary. The assignment mechanism has been functioning in Slovakia for 15 years even though there have been many attempts to cancel it. During its existence in tax legislation this mechanism provided the important amount of financial resources to the non-profit sector. It motivated the establishment and registration of other non-profit entities which have shown a bigger effort in addressing the potential donors caused by the increasing revenue of the donated share of the income tax. A particularity of the assignable process in the Slovak Republic as the only European country is the right of legal entities to assign the tax.

The state gave legal entities the opportunity to decide about a receiver of the share of paid income tax. However, some limiting facts were put into practice together with the implementation of the assignment mechanism. In that case they are control mechanisms in some way, such as the definition of purpose range of assignment means usage, the obligation to register recipients in the list of recipients led by Notary Chamber of Slovak Republic, the determination of time for drawing means as well as the obligation of publication of information about the recipients of assignation tax. The recipients with the summary of shares of tax assignation in the corresponding calendar year over 33,000 EURO are obliged to create a particular bank account where the means of tax assignation will be separately recorded.

The fact is that the assignment mechanism motivated mainly big companies to create their own corporate foundations. A company can assign the tax directly to its own foundation. However, this practice has been criticised a lot. Foundations acting within big companies also have to comply with legislative standards and they have to use financial means only for precisely defined goals. The actual legislative regulation of the assignment mechanism is very transparent, and it is subjected to several stages of control. The total annual volume of the tax assigned by legal entities reached more than 32 million EURO nowadays. From the point of view of public finance, when compared to other public expenditure it is not a high amount and therefore the tax assignment does not threaten the stability of public finance in the Slovak Republic. However, the case studies realised in Slovakia proved that the benefit of the assignment mechanism is significant.

The number of assigning legal entities in 2016 exceeded 54,000 companies. When compared to the first year of the application the number is more than 6 times bigger. The volume of assigned tax by legal entities nearly doubled for the monitored period. The results of the regression analysis confirmed the direct dependence

between corporate tax revenue and the volume of assigned tax of legal entities. The model has proven that 32 % changes of the volume of assigned tax depend on the amount of corporation tax revenue (the amount of tax liability of all legal entities in the Slovak Republic). The volume of assigned tax is influenced by other external and internal factors. Internal factors, political will, power and impact of non-profit organisations are very important. The impact of political factor was obvious in the Slovak Republic in the period from 2010 to 2011 when there was the decrease of assigning legal entities. The number of recipients - non-profit organisations also had a positive trend. Their number rose four times in the period from 2004 to 2016.

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