



საქართველოს სოციალური ინსტიტუტი  
CIVIL SOCIETY INSTITUTE



**“Strengthening the Legal Framework for Citizen Action through Freedom of Association” Project**

# Legislative Environment Regulating Charity Activities in Georgia

---

Study Report

This material has been produced with the financial assistance of the European Union under the project “Strengthening the Legal Framework for Citizen Action through Freedom of Association,” implemented by the European Center for Not-for-Profit Law. The contents of this material are the sole responsibility of Civil Society Institute and can under no circumstances be regarded as reflecting the position of the European Union or the European Center for Not-for-Profit Law.

Tbilisi 2007

# Legislative Environment Regulating Charity Activities in Georgia

## Introduction

In October-December 2007 Civil Society Institute conducted a study on granting a charity status to organizations and implementation of tax benefits associated with this status in practice.

Main objective of the study is to identify legislative environment regulating charity activities and determine whether the system set up by this environment is consummate. In particular, whether there are legislative obstacles hindering further development of charity activities in the country and donations to the charity organizations.

A low number of registrations of charity organizations in the country preconditioned conduct of present study. From January 2005 (i.e. from the day when new charity regulations entered into force) until today 44 charity organizations in total are registered in Georgia, 33 out of which operate in the capital, and 11 in the regions. Further, a study of development of welfare organizations conducted by CSI in 2007 demonstrates that a share of donations received from the business sector is very low among this type of organizations as well. Grants are major source of income for majority of these organizations and donations make up only a small portion of income. Out of 104 interviewed organizations, business donations make up 50-100% of income for only 5 organizations, 15-50% for 6 organizations, and 5-15% for 10 organizations. Remarkably, only 9 welfare organizations out of these have a charity organization status.

Based on the preconditions reviewed, we found it reasonable to study:

1. Factors contributing to a small number (44 organizations) of registrations of charity organizations in last 2 years;
2. Trends of charity donations;
3. What should be done in order to increase these donations and direct them to development of public benefit organizations;
4. How rightly are the charity organizations registered, whether there are any obstacles;
5. How efficiently do the transparency and reporting mechanisms work;
6. How efficient are the tax administration mechanisms of these regulations;
7. Whether it is necessary to improve legislative mechanisms or develop additional sub-statutory regulations.

Qualitative research was applied as a research method. Three expert groups were involved in the study: 1) representatives of organizations having charity status; 2) representatives of business organizations with charity experience; 3) employees of structural units of tax agencies, who are in charge of granting/revoking charity organization status and who deal with reports that under the law should be submitted by charity organizations to a tax agency.

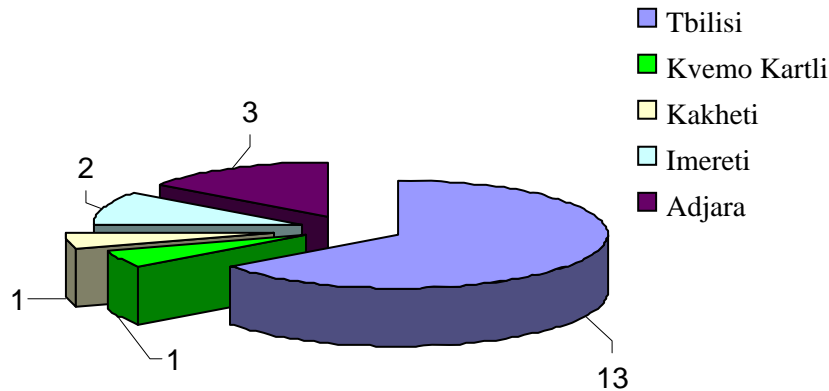
Three types of questionnaires with open-ended and leading questions, which were separately elaborated for all three groups, were applied as an instrument of the study. Quantitative part of questionnaires was processed through the SPSS program.

## 1. Data on the Target Groups

### Scope of the study

20 charity organizations were interviewed out of the charity organizations target group, 65% out of which (13 organizations) are Tbilisi-based, and 35% (7 organizations) are regional organizations. Diagram #1 demonstrates operational areas of organizations by separate regions.

**Diagram #1.**



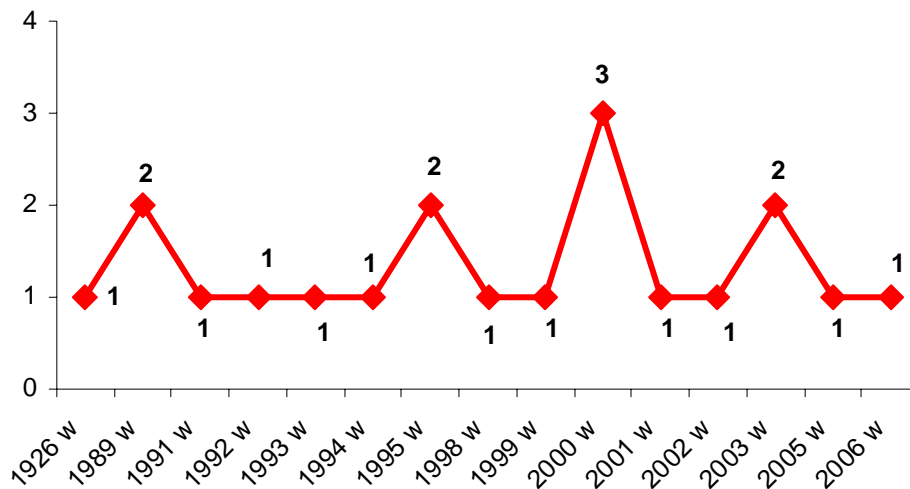
8 business organizations were interviewed out the **business organizations target group**, among them 5 in Tbilisi, and 3 in Batumi.

Within **tax agencies target group**, mainly representatives of regions where the charity organizations were interviewed.

### Date of Establishment

Date of establishment of charity organizations falls within the range of 1926 – 2006. Diagram #2 displays dates of establishment of interviewed charity organizations.

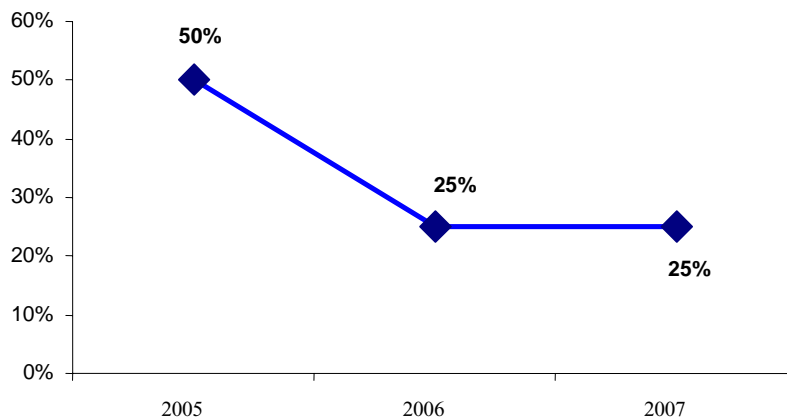
**Diagram #2.**



### Date of Registration

Out of 20 interviewed charity organizations, half received a charity organization status in 2005, i.e. when provisions stimulating charity activities appeared in the Tax Code.

**Diagram #3. Date of registration as a charity organization**



### Legal Form

Majority of interviewed charity organizations has a legal form of legal entity of non-entrepreneurial law, and only one interviewed organization represents a mission of international organization in Georgia.<sup>1</sup>

<sup>1</sup> OXFAM-Georgia.

As regards the business organizations, 5 of them are limited liability companies, 1 – a special partnership, and 2 – joint stock companies.

## Scope of Activities

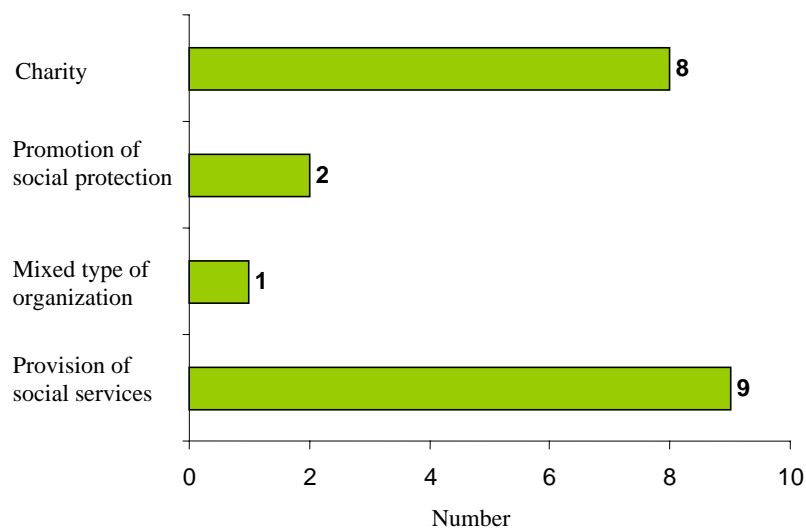
Under the scope of activities, charity organizations were divided in 3 groups, namely:

1) First group of organizations is mainly oriented on material assistance. These organizations render specific assistance to their own beneficiaries. For instance, they organize recitals-readings for specialists of some fields and provide financial aid when needed through the donations, transfer donations to some homeless children's or teenagers' houses, buy clothes for the poor, fund construction of churches, fund the students, pay for persons with low income when they are operated on, etc.

2) Second group of organizations is mainly oriented on provision of social services to various target groups. These organizations set up permanent day or night shelters for various welfare groups, assist beneficiaries in social adaptation, through various recognized methods assist beneficiaries in developing skills for independent life, etc.

3) Third group of organizations is mainly oriented on promotion of field of social protection. These organizations use donated means to fund projects and programs that contribute to overcoming poverty in the country, improving field of social protection, protecting human rights, etc.

### Diagram #4. Main scope of activities of interviewed organizations

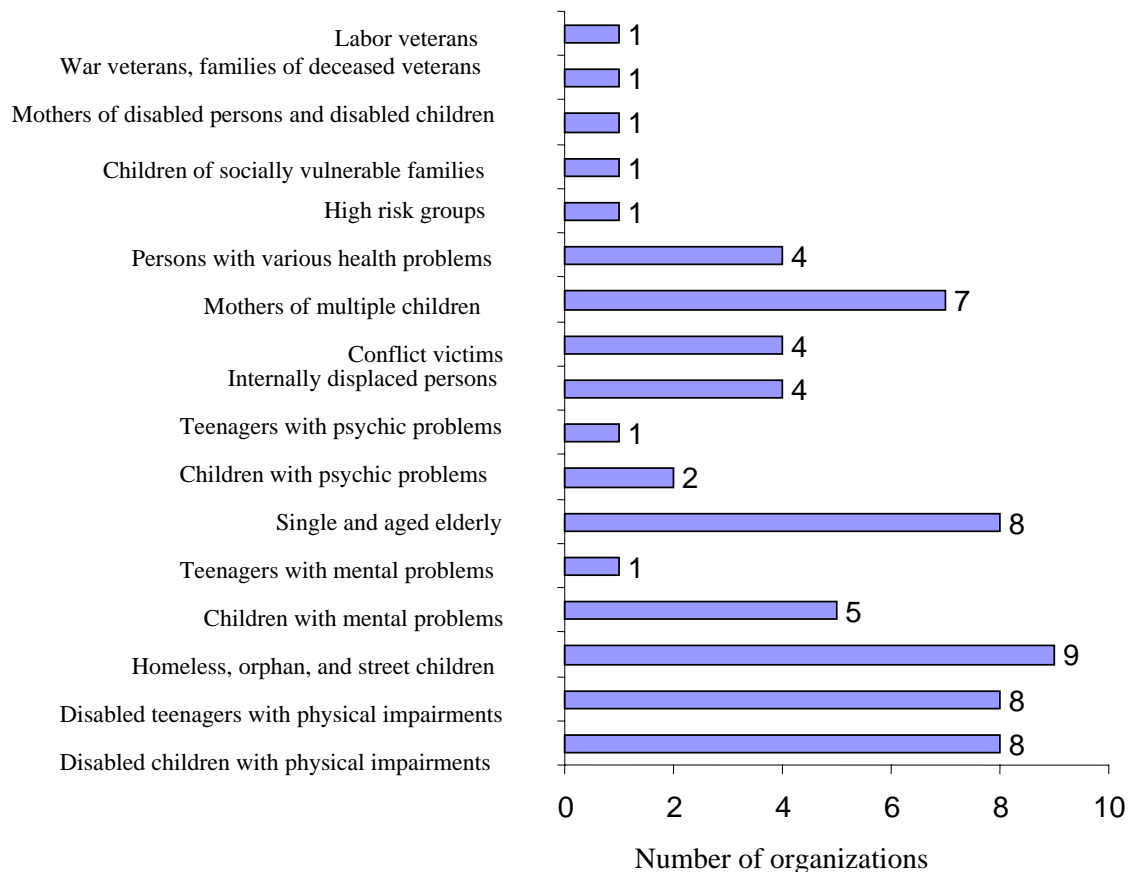


As for the business organizations, interviewed organizations represent various business sectors: banking, hotel, pharmacological, construction, trade, and consulting services. Interviewed organizations represent small and medium businesses.

## Beneficiaries

Various social welfare groups are the beneficiaries of interviewed charity organizations. Each organization serves several target groups simultaneously. Diagram #5 demonstrates distribution of organizations by target groups.

**Diagram #5. Distribution of organizations by target groups**



## 2. General Evaluation of Procedure for Granting Charity Organization Status

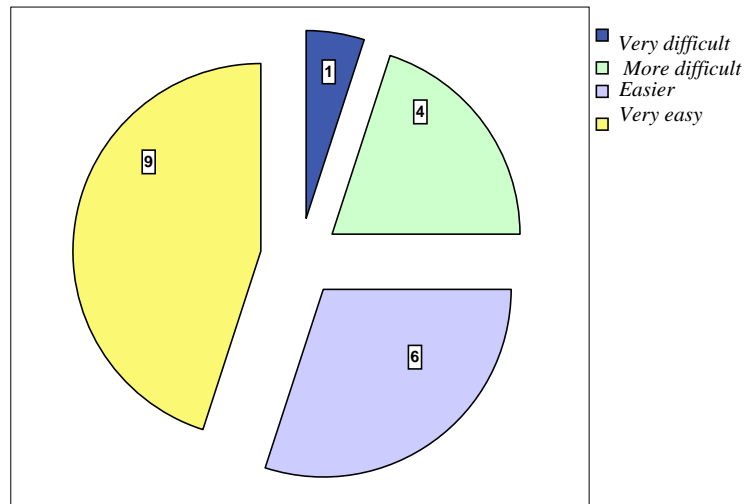
### 2.1 Awareness about Regulation of Charity Activities

Previous studies conducted by CSI demonstrated that organizations and business do not possess much information about regulation of charity activities and respective benefits. Present study confirmed that even organizations having charity status do not possess full information about additional obligations associated with having a status. The business is less informed also. The study identified cases when the business assisted charity organizations without using the existing benefits.

### 2.2 Evaluation of Procedure for Granting Status

Representatives of charity organizations found the procedure for granting a status to be simple and did not encounter any serious problems when undergoing through it. Diagram #6 displays evaluation of registration procedure by the charity organizations.

**Diagram #6.**



As the diagram demonstrates, for majority of organizations (15) process or registration as a charity organization is either easy or very easy. Only 5 organizations evaluated this process as difficult or very difficult. These difficulties are: procedures dragged in time, inattentiveness and low qualification of employees of tax agencies. More particularly, two organizations noted that during the registration process tax agency required a document not foreseen under the law: 1) document certifying death of a founder; and 2) audit report.<sup>2</sup>

*Representatives of charity organizations state that they do not have substantial comments with respect to this provision of the law concerning procedure for granting a status. As for the employees of tax agencies, despite a small experience in granting a charity organization status, they still believe that the law should define more clearly what a charity organization and charity in general means.*

### **3. Separate Issues of Procedure for Granting Charity Organization Status**

#### **3.1 Requirement of One-year Experience**

Pursuant to the law, organizations with at least one year experience of charity activities may receive a charity status. A study revealed that interviewed charity organizations meet this requirement of the law. However, opinion of employees of tax agencies about this issue divided twofold: one part of the interviewed stated that representatives of tax agencies do not encounter any legal or other type of problems during examination of granting charity status. Article 32 clearly defines a list of documents to be submitted by the applicant organization, and the status is granted in line with the defined rules. The other part of employees stated that they encounter difficulties in assessing the experience of applicant organizations. According to them, tax agencies under current legislation are

<sup>2</sup> The law requires for the audit report to be submitted. It seems that the respondent was not aware of this.

unable to verify whether an applicant organization pursued charity activities during last year. On the other hand, sometimes activities of applicant organizations do not meet the law requirements.

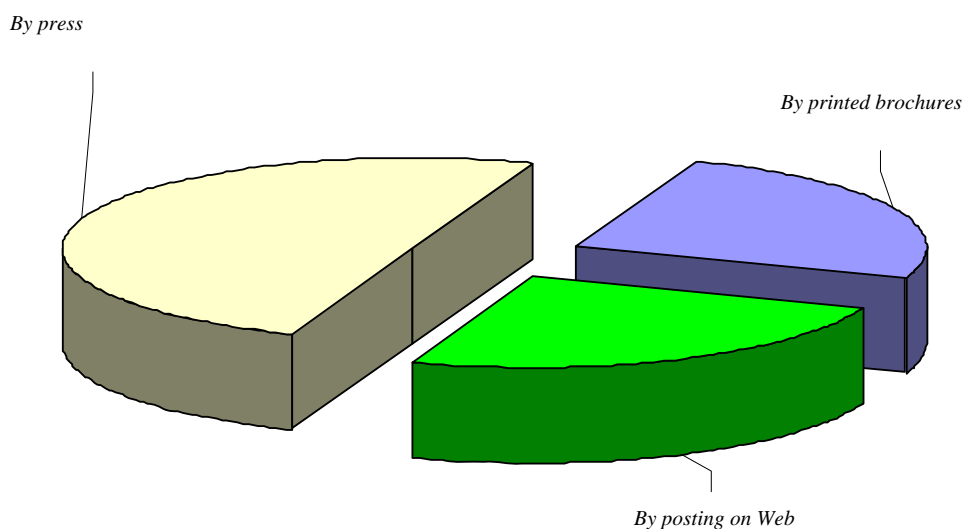
It is noteworthy as well that at current stage it is hard to make concrete conclusions as employees of tax agencies have a very small experience in granting a charity status to organizations. Thus, it is hard to make conclusions based on generalized experience, and the issue requires additional expert studies.

### 3.2 Transparency and Reporting Mechanisms

Under the study results, reporting mechanisms foreseen by the law do not work efficiently. 45% of organizations (9) do not fulfill obligations prescribed under the law *to publish last year's program activity report and financial documents (balance and profit/loss report) in the periodic press.*<sup>3</sup> However, majority of organizations notes that their activity reports are available for any interested person upon request.

Among those who publish program reports, half do not resort to a mechanism of information dissemination prescribed under the law. Diagram #7 displays mechanisms of dissemination of information on last year's activities of charity organizations carried out through donations.

**Diagram #7.**<sup>4</sup>



The fact that business organizations directly address organizations to learn what their donations were spent for and do not wait for publication of reports in the press, stresses how formal this form of reporting established under the law is. Moreover, fact that charity organization status was never suspended due to non-publication of program report proves the same. However, during the research

<sup>3</sup> Three organizations received status just recently and reporting deadlines are not yet missed.

<sup>4</sup> One organization did not name a mechanism of information dissemination.

process we received information about a pending suspension process motivated by the fact that organization did not submit program report to a tax agency.

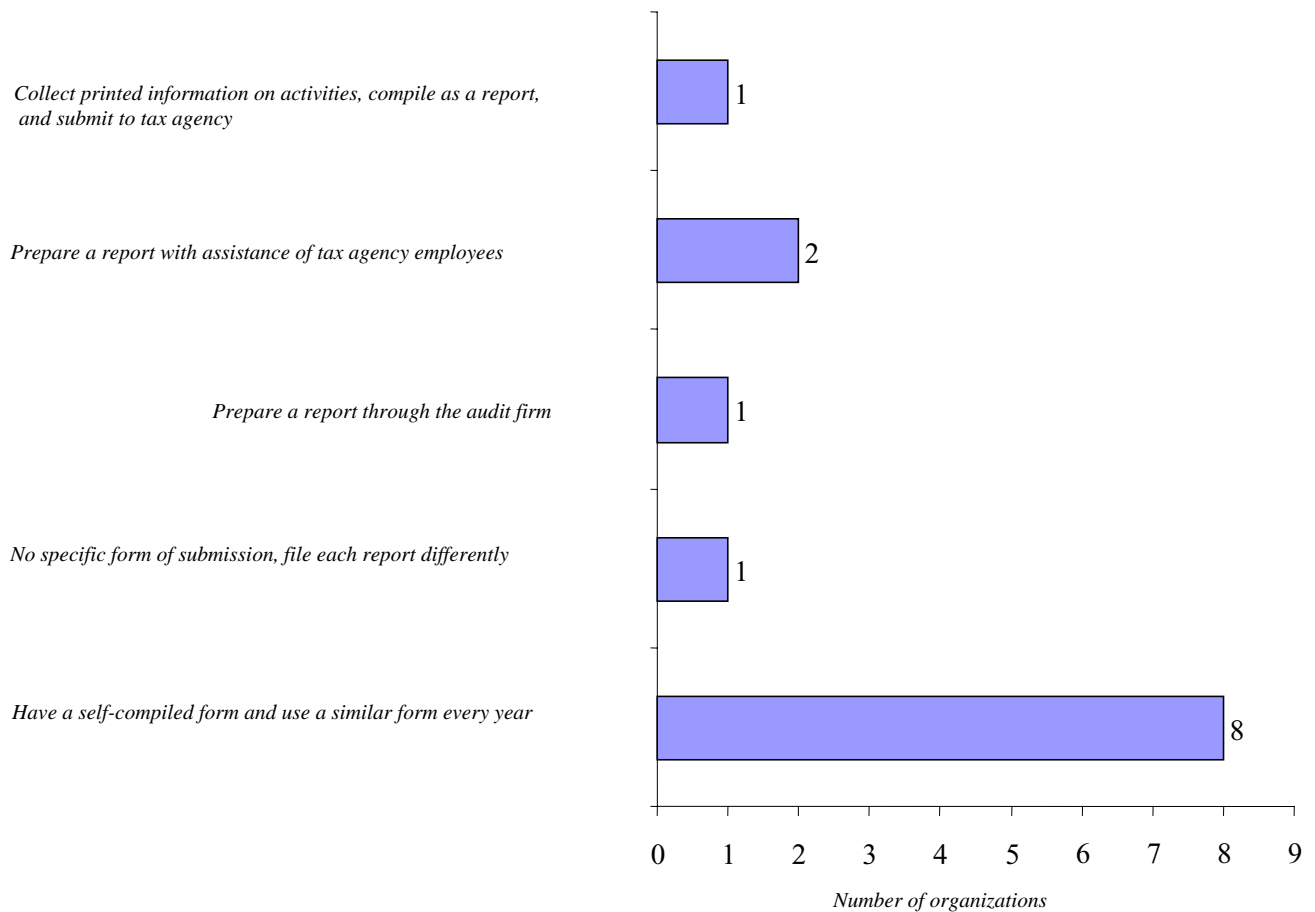
Circumstances described above provide a ground to assume that non-transparent activities of charity organizations are one of the causes of distrust between the business and charity organizations, i.e. the business has to control its funds transferred to charity organizations on its own and therefore prefers funding organizations founded by it or whose representatives are its acquaintances.

Problems were not identified with respect to financial documents to be submitted foreseen under the law. All participants of tax relations have to submit financial reports annually, and therefore a form is standardized and filling by charity organizations and processing by tax authorities does not cause any difficulties. Nevertheless, the law also obliges charity organizations to publish financial documents of activities (balance and profit/loss report) in periodic press and ensure availability to all interested persons. According to the employees of tax authorities, charity organizations should make financial documents available and employees of tax authorities are not obliged to issue requested information, i.e. ***according to the study results, in spite of obligations prescribed under the law, transparency and publicity of these documents depends solely on a good will of charity organizations.***

As for the program reports that charity organizations have to submit to the tax authorities, they are not standardized and therefore cause certain difficulties. In particular, tax agencies have difficulties with analyzing non-standardized reports. Charity organizations either do not submit a program report at all or a form compiled by them is much generalized. Non-existence of standard forms reduces a responsibility of charity organizations for non-fulfillment of obligations, while employees of tax authorities experience difficulties with systematizing information on the activities of charity organizations. According to the interviewed, forms of program reports should be clearly defined by the law, or otherwise a reporting obligation should be cancelled.

Organizations that work with the donors are in a much advantageous position, as they use standard forms that are used for the tax authorities as well. Nevertheless, there are organizations that submit program reports each time in a different manner.

**Diagram #8.**



Elaboration of standard forms of program reporting will also assist in identification of applicant organization's activities during the decision-making process on granting a charity status. In case standard forms of program reporting exist, it will be easy to develop criteria determining whether an organization pursues charity activities in reality or not. This will assist in maintaining objectivity during the status granting and removing procedures.

Fulfillment of additional obligations foreseen under the law will make the process more transparent and will increase a level of awareness of business organizations on the activities of charity organizations.

#### **4. Motivation to Receive Charity Organization Status**

As Diagram #3 shows, majority of organizations was registered during the year when a law entered into force. Obviously, such a big number of registrations implies high motivation. Majority of representatives of charity organizations noted during the interviews that new provisions in the law should have stimulated business organizations in terms of receiving tax benefits, thus they should have directed more funds towards organizations enjoying charity status. Basic motive of receiving charity organization status lied in a fact that status was expected to attract funds from the business

organizations. Remarkably, during the first year business provided much more assistance to charity organizations than in subsequent years. In the opinion of representatives of charity organizations, during the first year this amendment of the law was too popularized, and in subsequent years emphasis was shifted to different issues.

More than half of interviewed organizations (12) note that they have somehow benefited after receiving a status. For approximately fourth of organizations (6) status was of no use, and 2 organizations could not provide answer as they have just received a status.

10 out of 12 organizations indicated the amount they received as donation during one year after receiving a status. Table below provides an average index of these amounts for all organizations together, minimal and maximal volumes of donations annually.

**Table #1. Donations received by charity organizations during a year, contributed after granting a status**

	<i>Amount</i> <i>GEL</i>	<i>Targeted donations expressed in</i> <i>amounts</i>
<i>Average volume</i>	154,275	7,165.50
<i>Minimal volume</i>	250	500
<i>Maximal volume</i>	1,000,000	17,000

A tendency was revealed during the research process, according to which organizations whose major field of activities is provision of material assistance, receive more funding from the business or private persons than service provider organizations. 50-100% of income of service provider organizations account for grants, while 50-100% of income of organizations purely oriented on material assistance<sup>5</sup> – donations from private persons.

Pursuant to the study results, 80% of funds transferred for charity purposes are used for charity activities. Only 20% are used for organizations’ administrative expenses, and only when 50-100% of income of organizations accounts for donations. In case a big portion of organizations’ income accounts for grants or state orders, donations are spent only on specific charity activities. This is a general conclusion and making a more detailed financial analysis is impossible as organizations themselves do not have fully delimited their own administrative and programmatic expenses, not to say about amounts spent on each beneficiary.

## **5. Business Involvement in Charity and Use of Available Benefits**

Business sector carries out charity activities; however it should be noted that charity activities carried out by business are not always placed under the regime established by the Tax Code. Assistance of business organizations is often directed not only at charity organizations, but private persons and organizations that operate in various spheres and do not have a charity status. A financial plan of several business organizations contains a number of charity contributions to be spent in various spheres according to a specific plan. Big portion of business organizations provides assistance to socially vulnerable groups, disabled children, single elderly, and homeless and uncared-for children. However, often this assistance goes directly to the beneficiaries and therefore

---

<sup>5</sup> Organizations that provide its own beneficiaries with humanitarian assistance, food and clothing, raise funds to solve health-related problems of specific beneficiaries, provide beneficiaries with single monetary assistance, etc.

benefits that business organizations should receive due to transferring amounts to organizations having charity status are not applicable. Further, the business is not sufficiently informed about existing benefits. There are cases when business assists organizations with charity status but does not receive any benefits.

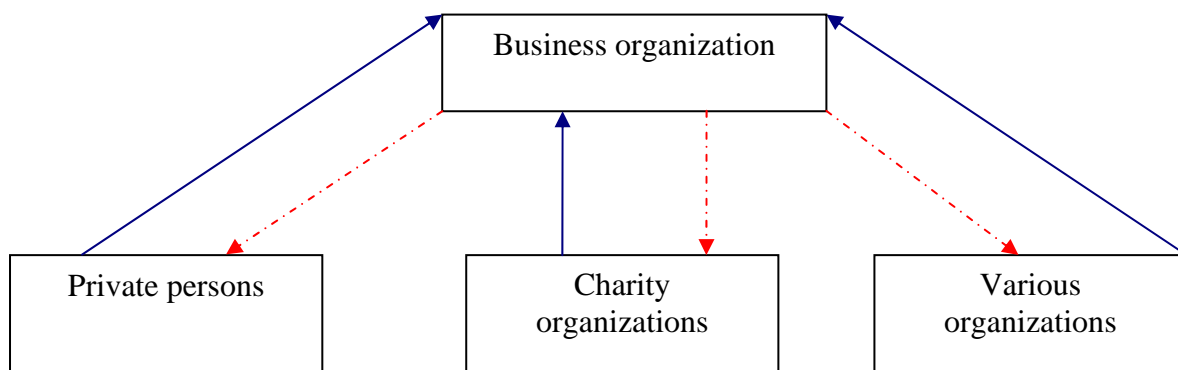
Business organizations that exercise the right to deduction note that in this respect they have not experienced any problems with the tax authorities. Nevertheless they believe that deduction rate should be increased at least up to 12 per cent.

Right to deduction for provided material assistance is of much relevance also. The business often assists organizations or beneficiaries directly by providing them with their own produced goods. Hence, several respondents believe that business should enjoy the right to deduction for respective value of such goods.

Previous and other researches studying corporate social responsibility of business sector identified three models of relations between the business and organizations receiving assistance.

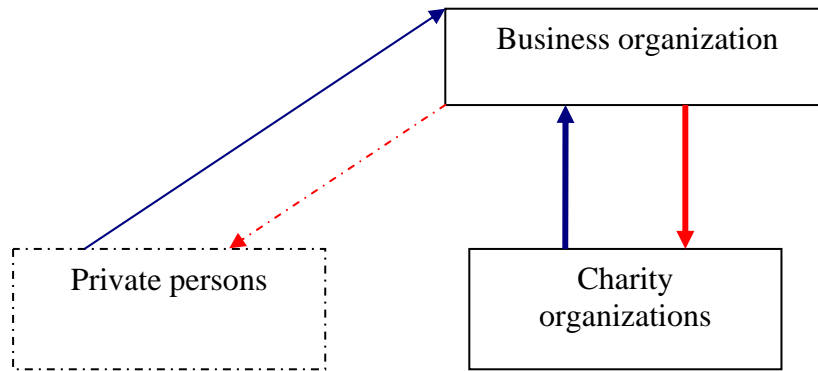
**First model** is a simplest one, when business organizations do charity work only upon request of private persons, charity organizations, or other organizations. In this case they are viewed from one angle – charity work done by business is single-time and non-systemic.

**Model #1.**



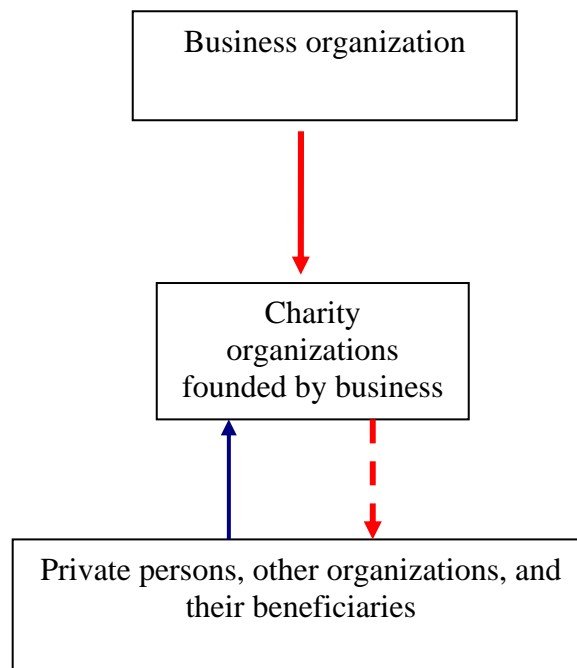
In the **second model**, business organizations do charity work with respect to organizations having charity status. Managers of organizations are personally acquainted with representatives of business organizations and therefore they do not experience any difficulties in establishing relations with them. In such instances businesses assist private persons as well, but more rarely. Regardless of the fact that no funding system is developed yet, business sector recognizes assistance of charity organizations as a priority. Notably, service provider organizations attract charity funds through private contacts with business more than any other type of charity organizations.

**Model #2.**



In the **third model**, the business itself has founded a charity organization and allocates certain amounts on an annual basis to fund this organization. In such instance all charity activities are carried out through the foundations established by the business.

**Model #3.**



It can be concluded based on the models described above that amendment made to the Tax Code in 2005 indeed stimulated business organizations to do more charity work. Yet, business prefers funding organizations established by it rather than other charity organizations due to a higher level of awareness about organization's activities. On one hand, this circumstance points at low degree of trust of business sector towards charity organizations, and on the other hand poses threat to sustainability of charity organizations. If tendencies under the third model develop further and all large business organizations establish their own foundations that will receive charity status and

funding from business, then other charity organizations, and especially welfare oriented organizations will have hard times in attracting small amounts as they are from the business.

## **6. Key Findings and Identified Needs**

According to the interviewed target groups, amendments made to the Tax Code in 2005 stimulated charity activities. However, existence of available benefits is not sufficient for further development of charity work in the country.

The following specific findings and needs were revealed during the research process:

- Actors involved in charity activities – non-entrepreneurial and business organizations – do not possess relevant information on the regulation of charity activities and existing benefits. Even organizations having charity status are not fully informed about the requirements and obligations associated with this status. Adequate information campaign is clearly needed.
- Effective legislation does not foresee equivalent deduction of material assistance provided for charity work from the expenses. Study demonstrated that existence of such deduction mechanism is of significance for participants of charity activity process. We believe it is necessary to elaborate respective changes in legislation.
- There is a certain disbalance between benefits related to charity status and additional obligations. There is an idea that additional benefits should be introduced for organizations having a charity status. For instance, exemption of economic activities related to charity objectives from the profit tax.
- Charity system in effect obviously requires determination of standard forms of program reporting. There is an evident need to elaborate such forms and approve it through additional regulation.