

Public benefit organisations 1/27/21

Having the status of a public benefit organisation (“PBO”) not only demonstrates that the organisation is working for the public good but also motivates the PBO to raise donations and receive various tax and other advantages. Donations are a key source of various PBO public benefit projects, while donors can claim tax advantages. The Ministry of Finance (“MOF”) has issued an informative report on the activities and development of PBOs. This article offers a brief summary and looks at what companies think about this relief and whether it has promoted PBO operations.

The MOF report

The Corporate Income Tax (“CIT”) Act mandates the Cabinet of Ministers to assess the impact of relief on donations received by PBOs and in the event of adverse effects, to draw up proposals for necessary amendments together with PBO industry associations by 30 November 2021.

According to a report the MOF has presented to the Cabinet of Ministers, most of the components of Latvia’s welfare index, donation index or happiness index are below the European average. These areas would need an additional contribution, with high expectations attached to the PBO (NGO) sector.

Although donation activity has a philanthropic nature, it would be crucial to additionally stimulate donors who are prepared to take part in tackling important public problems with various advantages. Donors and voluntary workers are key subjects involved in public benefit activities, and those may be individuals and entities.

According to the Charity Aid Foundation’s data for 2018, Latvia ranks 137th on the donation index of the 144 countries that took part in the survey. Donation is driven by various factors: donation traditions, income levels, and largely tax relief. The MOF report states that the transition to the new CIT model saw corporate donations drop by 34% in 2019.

The government should encourage PBO activities in the specially chosen areas through legislation by making efficient use of all funding sources available to the non-public sector – especially donations by creating an attractive tax relief system for donors, but also gifts, legacies, subsidies, municipal support, and business revenues.

MOF proposals

A new **PBO Bill** as well as amendments to the **CIT Act** and the **PIT Act** are to be drafted and presented to the Cabinet of Ministers for debate by 1 April 2022. **The Associations and Foundations Act** is also to be amended. Unfortunately the MOF report contains no initiatives to offer more income tax relief for donors but it outlines the following issues and desirable improvements:

1. Systematise and simplify the grant of PBO status. PBO status allows donors to claim tax relief and PBOs to apply for advantages set by the state and municipalities. **The PBO Act** defines a PBO, what activities are considered public benefit activities, and how PBO status is granted. The MOF report states that even though the law makes it possible to identify PBO characteristics, the wide scope for interpretation blurs the understanding of how PBOs are intended to operate, so there are some organisations that fail to meet PBO substance requirements but are still operating as such. Thus, there are plans to adjust the PBO definition and to channel PBO activities into qualifying areas

specified by the state. The law should eliminate ways of PBO status being used for building the welfare of its members (this does not apply to giving benefits to socially vulnerable groups) or optimising taxes. There are plans to eliminate issues around the legal form in the activities of a social entity or PBO.

2. Ease the administrative burden on PBOs. There are plans to set up two-tier PBOs (PBO1 and PBO2) following the principle that more advantages mean more obligations. PBO2 wishing to qualify for CIT and PIT relief for donors, **real estate tax** exemptions and other benefits will have to meet higher regulatory, transparency and other requirements, including the supervision and monitoring of performance indicators. The Public Benefit Commission ("PBC") will consider PBO2 annual reports as well as statements of revenue and expenditure. There are also plans to evaluate statements to be filed with various state and municipal institutions as well as other regulatory authorities monitoring the use of financing provided to PBOs, and to maximise the harmonisation of requirements for information to be included in those statements. The Latvian parliament has adopted a special PBO Act and the Cabinet of Ministers has issued seven regulations to lay down procedures for granting PBO status and determining PBO activities for this group of organisations. The activities of a PBO as a legal entity are governed by the Associations and Foundations Act or the Religious Organisations Act according to its legal form. PBOs are governed by the Accounting Act with relevant Cabinet rules and tax laws. The MOF has summarised the issues that arise in completing the list of donations and gifts, as well as the forms of business reports and future business plans, and will try to find a solution.

3. Increase the effectiveness of PBO supervision. PBO status is granted and removed by the State Revenue Service ("SRS") based on an opinion issued by the PBC. This commission is headed by the SRS, with representatives of several ministries and public organisations. The main condition for granting PBO status is whether the organisation's activities give a significant benefit to the public at large or only to some part of it. Special attention is paid to the question of whether an association aims to satisfy the private interests of its members or founders. There are plans to increase the PBC's involvement in decisions on granting PBO status and monitoring PBO activities, while laying down new rights and obligations of the PBC members. The annual reports of PBO2s and of any PBO whose business revenue exceeds 50% of total revenue will be evaluated each year by the PBC.

4. Develop a PBO assessment matrix including financial and non-financial indicators and prescribing a single approach to minimise the number of cases where PBO status is removed and to create shared assessment practices.

5. Resolve issues around PBO business. In practice, business revenue is a large percentage. The provision of the Associations and Foundations Act for the conduct of business as an auxiliary activity is interpreted broadly. Proposals for amending the law to allow a PBO generate business revenue exceeding 50% (even 100%) of total revenue under certain conditions, while improving the monitoring and accounting process. As stated above, a PBO with business revenue over 50% of total revenue will be evaluated by the PBC. The PBO may need to change its legal form and apply for public status as a limited company. In accounting, PBOs will have to separate their business revenue and expense accounts from other PBO activities to ensure the traceability of sources for covering expenses. Under certain conditions NGOs and PBOs may be liable to pay CIT. There are also plans to prescribe administrative liability for abusing PBO status by trading as a PBO.

6. Ensure public awareness of PBO activities and results to encourage public engagement in the organisation's activities. Unlike most member states, in Latvia the information on PBO financial results and qualitative results is limited and is not available in aggregate. Creating a single platform would popularise PBO activities and results, provide operational transparency, and promote the development of a philanthropic culture and public engagement.

