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The Review Committee of Government Policy Towards the Third Sector in Israel

A Summary of Recommendations

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Foreword

“The third sector” is a term that may be misleading for those who are not familiar with the myriad organizations that operate consistently, devotedly, and mostly voluntarily to improve society. In the introduction to the report (paragraph 10 below), we defined the third sector for the purposes of the Review Committee’s work. Here, we would wish to emphasize that these organizations are not a mere spin-off (in terms of seniority, importance and contribution) of the other two sectors – the government and business sectors. Third sector organizations are also different from each other, that it is hard to group them together in one blanket “sector.” The above notwithstanding, we decided to use the standard term, in order not to further complicate the public discourse, which already suffers from the lack of a common jargon.

The Committee was set up in 2001 to examine the role of the third sector in Israel and policy toward it, particularly by government authorities, but also by other agencies, such as business organizations. The purpose of the report is to prepare the ground for a focused debate on the issue of policy, both of the third sector organizations themselves, and of the many agencies that impact on their status and function. There is, in our opinion, a real need to revitalize the third sector itself, and the policy towards it.

Our starting point is that third sector organizations make a vital contribution to society in Israel. At a time when the political system in Israel is finding it hard to meet its commitments and the economy is suffering from a recession, it becomes increasingly important to reexamine the third sector’s role and contribution. Although other democratic countries are also suffering from the erosion of their institutional systems, in Israel, the role of the sector and policy toward it have never been properly examined, thereby exacerbating some of the “ordinary” problems, and creating unnecessary obstacles.

The report states: “Israel has no consistent declared policy toward third sector organizations.” We would like to emphasize that in this report, we have no intention of proposing a centralized policy, or a system that might jeopardize the autonomy and creativity of third sector organizations. Our aim is to propose significant amendments to the current, eclectic policy without prejudicing the principle of pluralism, which is the lifeblood of civil society.

Professor Benjamin Gidron, founder and director of the Israeli Center for Third Sector Research at Ben Gurion University of the Negev, masterminded the establishment of this Committee. The Center, under his leadership, is a pioneer of systematic research into third sector organizations in Israel, and has set up the country’s only database on this subject. We would like to take this opportunity to express our heartfelt appreciation of the Center’s activities. The Committee itself made extensive use of the Center’s materials.

I would like to personally thank each of the Committee members – Avi Armoni, Prof. Arie Arnon, Michal Bar, Yoram Gabai, Dr. Bassel Ghattas, Prof. Benjamin Gidron, Prof. Joseph Katan, Ophir Katz, Rachel Liel, Nissan Limor, Amir Machul, Walid Mulla, Ariela Ophir, Dr. Emmanuel Sharon, Varda Shiffer, and Sarah Silberstein-Hipsh – for their time and perseverance, and particularly the

intellectual creativity which they demonstrated during the protracted discussions that went into the making of the report. The Committee thanks all those that appeared before it, prepared material, or gave of their time to discuss findings and recommendations (see Appendix 1). The Committee also thanks those who helped formulate the recommendation but who wish to remain anonymous.

Without the contribution of Michal Bar, doctoral student at the Hebrew University of Jerusalem, who served as the Committee's coordinator, there would have been no Committee, no report, and no recommendations. She had a hand in everything, from the contents of the report to coordination of the Committee's work, and for that we are all grateful. The Committee's report, we all hope, will be the precursor of the development and consolidation of the third sector and of society in Israel.

Professor Itzhak Galnoor
Committee Chair

Feedback, comments, and recommendations on the report should be sent to Michal Bar, Israeli Center for Third Sector Research, Ben Gurion University of the Negev, POB 653, Beer Sheba 84105

Summary of the Committee's Recommendations

This report presents a summary of the recommendations by the Review Committee of Government Policy toward the Third Sector in Israel.

Since the 80s, the number and scope of third sector organizations in Israel has grown rapidly. The above notwithstanding, there has been no public debate regarding the functions of these organizations and their relationship with government agencies. Nor has the government developed a clear policy regarding their place and role in Israeli society, and their relationship with the authorities. Moreover, in recent years, there has been a decline in the status of third sector organizations, particularly of NPOs (amutot), and a problematic and sometimes even negative public image of these organizations has evolved. The Committee maintains that the current policy toward third sector organizations is the product of historical development and comprises an eclectic set of arrangements that are devoid of any internal logic. Some of these arrangements were introduced for a specific organization or group of organizations; others were introduced by one government authority and are not valid for another; and some are inconsistent and even outdated. Hence the need to reexamine existing provisions and offer recommendations to rectify the current situation.

From the start, the Committee decided that its aim was not to recommend a centralized government policy toward third sector organizations or a supervisory and control apparatus that would stifle their independence and creativity. Its aim, in this report, is to propose concrete changes, both general and specific, to current policy, without compromising the principle of pluralism or the autonomy of third sector organizations. It is the Committee's wish to strengthen these organizations and allow them to operate in a framework wherein the rules of the game are clear, transparent, and predefined.

The Committee examined current policy in Israel and elsewhere toward third sector organizations. It focused on eight central issues relating to policy toward third sector organizations in Israel:

- (1) Government policy toward third sector organizations as reflected in the government's attitude toward these organizations, their activities, functions, and contributions.
- (2) Government allocation policy toward third sector organizations: direct support (payment for services purchased from third sector organizations and grants) and indirect support (including tax benefits to third sector organizations).
- (3) Third sector organizations among the Arab population in Israel.
- (4) The legal context in which third sector organizations in Israel exist and operate, particularly supervision and control by the government and other agencies.
- (5) The role of foundations and philanthropy.
- (6) The involvement of the business sector in third sector activity.
- (7) Self-regulation of third sector organizations in Israel.
- (8) Social-change organizations.

On the basis of its findings in each of the above areas, the Committee makes the following recommendations:

Recommendations concerning government policy

1. The Committee believes that there is an urgent need to devise a policy toward the third sector. Such a policy should include:
 - a. Government recognition of the special contribution of third sector organizations to Israeli society and the Israeli economy. This recognition shall be based on a delineation of the specific areas of activity of the government, business and third sectors respectively; on the need for reciprocity in order to achieve common socioeconomic goals; and on the government's public recognition that third sector organizations have special features that must be preserved and fostered.
 - b. A declaration by the government of its intention to regulate the relationship between government authorities and third sector organizations through a clear, declared, transparent and consistent policy, that will in no way compromise the autonomy of third sector organizations.
 - c. Recognition of the importance of public funding for third sector organizations and the urgent need to regulate such funding. Most funding of third sector organizations comes from public sources. The government must recognize the need to regulate the funding of the third sector from both governmental and other sources, and encourage new non-governmental forms and sources of support.
 - d. Recognition of the need for equitable criteria in the funding of third sector organizations that will not compromise their autonomy.
 - e. Full disclosure of information to third sector organizations. The activity of third sector organizations, and in particular of social-change organizations, is contingent on obtaining reliable information regarding current policy. Despite the enactment of the Freedom of Information Law (1998), third sector organizations do not have access to information from government bodies. The government must allow greater access to information that has a bearing on the activities of third sector organizations, within the framework of the law.
 - f. The promotion of capacity building through training workers and volunteers. The government must support the creation of study programs and training frameworks for workers, board members, and volunteers in third sector organizations.

The Manifesto:

2. The Committee recommends that, in the absence of legislation, a declarative document be drawn up, known as: "The Manifesto of Social Organizations," to regulate the relationship between the government and third sector organizations.

The Manifesto shall structure the relationship between the third sector and government for the benefit of Israeli society. It shall be based on understandings and agreements that shall serve as guidelines for government policy toward the third sector. The Manifesto shall specify the obligations of both the government and the third sector toward the public at large. "The Manifesto of Social Organizations" in Israel shall be based on the following principles:

- a. Third sector organizations are vital to the existence and consolidation of a democratic society in Israel. They fulfill functions that are different from those of organizations in the government and business sectors. They offer individuals a chance to participate in public life and to work toward communal and social solidarity through identification with a cause, volunteering and giving.
Third sector organizations have a significant contribution to make in furthering cultural, social, economic and political life in Israel. They offer citizens the chance of helping to shape the provision of services and promote social change, and constitute a fertile ground for new ideas and social creativity. In practice, these organizations implement civil and social rights, and in many cases, serve as the sole advocates of marginal groups. They help prevent poverty, enhance the quality of life, and foster social cohesion, equal opportunities and social diversity. Their activity contributes directly to the modern economy in Israel as in other developed countries.
- b. The government and third sector organizations recognize the need for cooperation based on recognition of their differences and the need to learn from one another on an ongoing basis. The first step in this direction is the creation of an open dialogue based on mutual respect, and confidence-building measures. Such cooperation will not hinder the democratic right of social change organizations to criticize the government and put forth demands to change its policies, which is their main task.

The government's obligations

- c. The government shall recognize the importance of the functions performed by the many organizations that make up civil society in Israel and their contribution to the democratic process, civic participation, the integration of peripheral population groups, the promotion of equality and social justice, and its role in resolving of personal, group and social problems.
- d. The government shall recognize the importance of the autonomy of third sector organizations, and defend their right to promote their goals, develop independent sources of income, criticize government policy and take action to change it.
- e. The government shall recognize the limitations of excessive government intervention in the sector's activity. It shall refrain from any strictures against the fields of activity, modus operandi, internal governance, and employment policies of these organizations, unless otherwise mandated by law or by exceptional circumstances.

- f. The government shall recognize the need to base policy toward populations served by third sector organizations on the principle of equality.
- g. The government shall recognize the need to involve third sector organizations, and consult with them, when formulating policy toward the sector as a whole, or toward specific areas in which they operate.
- h. The government shall recognize the need to create joint ventures with the third sector in order further public, social and economic goals. It shall encourage third sector organizations to participate in various government projects and to contribute ideas, initiatives and private resources for the public interest. Such participation shall be based on frank and transparent dialogue between third sector organizations and government ministries regarding orders of priority, funding criteria, and the nature of public projects.
- i. The government shall recognize the great diversity that characterizes the third sector in Israel regarding type of organization, field of activity, work method and target population. A comprehensive and transparent government policy would recognize, and seek to encourage, this diversity.
- j. The government, as the major funding source of third sector organizations in Israel, shall undertake to regulate funding methods, support criteria (grants and contracts), and oversight mechanisms of government allocations transferred to third sector organizations.

Obligations of the third sector organizations

- k. The activity of third sector organizations shall be anchored in law.
- l. Third sector organizations shall recognize the importance of sound governance, transparency and accountability toward the funding bodies, members of the organizations and the public at large. Such recognition entails a commitment by the organizations to adopt these rules of behavior and quality standards.
- m. Transparency: Third sector organizations shall undertake to provide full disclosure of activities and policies to the organizations' clients, members, volunteers and supporters. As far as possible, these organizations shall consult with their members and other relevant parties, and incorporate their ideas into their policies.
- n. Third sector organizations shall encourage voluntarism and involvement of volunteers in their various fields of activity.
- o. Third sector organizations shall further cooperation with government authorities and public institutions, other third sector organizations, or business organizations, as the case may be.

- p. Given the special nature of their activity and their prerogative to define it through their bylaws, third sector organizations shall be careful to avoid discrimination in accepting members and providing services.
- q. Third sector organizations shall seek to employ workers under fair conditions, and prevent injustice in salaries and work conditions.

The *Manifesto of Social Organizations* shall be drawn up by a team of government representatives and representatives of third sector organizations, with the purpose of creating an infrastructure for policy decisions on a number of issues, as specified below.

Classification of third sector organizations

- 3. The Committee saw fit to differentiate between four types of third sector activity in Israel, as follows:
 - Service-provision within the public sector system
 - Social, communal and civic activity
 - Contractual service provision
 - Social-change activity

The Committee believes that the policy declaration (paragraph 1 above) and the Manifesto (paragraph 2 above) should recognize the different kinds of organizations, their individual needs, and the importance of developing a clear policy for each group.

Recommendations concerning direct support to third sector organizations

- 4. Given third sector organizations' heavy reliance on government funding and policy, the Committee recommends the following measures to enhance their stability and their ability to provide services effectively:
 - a. The regulation of State support, through multiyear contracts that determine the organization's commitment to provide services and the government's commitment to pay for them.
 - b. The creation of alternative sources of funding to help the organizations wean themselves of government funding.
- 5. Payment for "services purchased" comes in two forms: (1) contracts for the provision of services, and (2) contracts for the implementation of joint ventures.
Since each of these contractual relationships entails a different type of interaction between the government and the organization, the Committee recommends that each should have its own separate contracting and review mechanisms.

- a. *Contracts for the provision of services or purchases:* The Committee recommends that any tender put out by the government include criteria for assessing the organization's commitment to social improvement, and that the organization's report include information on compliance with these criteria.
 - b. *Joint venture contracts:* The Committee recommends that the parties to the venture define their objectives, the nature of the partnership and ways of evaluating it. Joint ventures should also include ventures in which the investment is in human resources, creative ideas and specialized knowledge, rather than just financial resources, as long as the organization is working for the public interest, and does not have a profit motive.
6. The Committee believes that a prerequisite of a meaningful public debate on the funding of third sector organizations is total disclosure of relevant information, and the transparency of the decision-making processes.
- Therefore, a clear definition is required of the support granted by the various government authorities (government ministries, local authorities, and other government institutions), the regulations governing each kind of support, and the relevant operating and reporting procedures.
- a. A clear distinction should be drawn between the grants channel and the "purchase of services" channel, without prejudicing organizations that are forced to switch from the "grants" channel to the "purchases" channel
 - b. *Transparency:* The Committee recommends greater transparency in the grants allocation criteria, through encouraging public participation in the process. The Committee recommends publication of the criteria in draft form, to enable the public to express an opinion, or submit an appeal, before the criteria are finalized. Public participation would achieve a number of goals: (1) Information provided by the public would help the formulation of more equitable criteria, particularly in view of the current difficulty in obtaining information from government ministries. (2) Enhanced transparency would render the process more amenable to public control, and therefore, more reliable. (3) Public participation would stabilize the grants criteria, and discourage litigation (by restricting appeals to the specified period).
 - c. The Committee calls on the government to improve publication of its grants program to allow organizations to compare the grants awarded different organizations over the same period. Such a control mechanism is essential for detecting anomalies in the system of government allocations.
 - d. Once a specific ministry has established its grants criteria, it must make them public, to allow appeals to be made where necessary. Decisions concerning the allocation of grants must likewise be made public
 - e. The Committee recommends that the Finance Ministry's Accountant-General, as the purveyor of payments to third sector organizations, publish information about grants that were distributed that year. The information should be listed by granting ministry, field of activity, the specific directive governing the award of the grant, and the size of grant.

- f. The Committee recommends the introduction of a multiyear allocations policy, while maintaining its budget for new organizations. Such a policy would dispense with the need to review the criteria each year. Instead, the criteria could be reviewed every few years (say, once every three years). A cautious multiyear support policy, based on experience, could facilitate long-term planning of activities, direct government support into more diversified channels, and enhance its effectiveness.
- From the perspective of third sector organizations, a multiyear support plan would enable them to assess how much non-governmental support they would need over a period of several years. It would also make it easier for them to obtain matching, multiyear donations from private sources, which are frequently granted only to organizations receiving parallel government support.
- g. Currently, organizations may apply for support only after they have been operating for a period of two years. The Committee recommends cutting the two-year requirement to one year only, in certain instances. In such cases, the government will tighten its requirements for audit reports, evidence of “proper management,” and supervision and control.

Recommendations concerning third sector organizations in the Arab population in Israel

7. Although third sector organizations in the Arab sector in Israel share the same characteristics as other third sector organizations in Israel, they suffer from their own problems that hinder their establishment and operation. Therefore, the Committee considered it appropriate to devote a separate section to third sector organizations among the Arab population in Israel.
8. Third sector organizations in the Arab sector are instrumental in helping the development of the Arab population, which has, for many years, suffered from discrimination and marginalization. This discrimination has not spared Arab third sector organizations and prevents them from realizing their potential.
- The Committee urges the government to publicly declare that Arab third sector organizations must receive the same treatment as other third sector organizations in Israel from all government authorities.
- In order to encourage civil activity and prevent discrimination toward third sector organizations in the Arab sector in Israel, the Committee makes the following recommendations:
- a. The various registration and oversight requirements of third sector organizations in the Arab sector should be reviewed, to eliminate discriminatory and anomalous requirements.
 - b. The government shall refrain from invoking extraneous mechanisms, such as emergency regulations, in its dealings with Arab third sector organizations.
 - c. On the basis of the above declaration, government ministries shall be instructed to allow Arab third sector organizations to act freely and independently, so that they, too, can provide advanced services to their public.

- d. To promote government projects via Arab third sector organizations, the government shall increase its funding to Arab organization (both grants and contracts). Likewise, the government shall encourage Arab third sector organizations to submit applications for approval as “public institutions under paragraph 46a of the Income Tax Ordinance.”
- e. In developing consultation mechanisms with third sector organizations, special attention shall be paid to Arab third sector organizations, and attempts shall be made to encourage their participation in legislative processes and in policy changes by the government ministries in matters that affect them.
- f. The Committee recommends that Arab third sector organizations place greater emphasis on self-regulation and intra-sectoral activity. They should be encouraged to participate in the establishment of “proper management” criteria for third sector organizations and other activities aimed at increasing transparency and sound management, as well as study and training programs.

Recommendations concerning taxation and indirect support

- 9. Indirect support in the form of tax concessions is an extremely important tool for conferring legitimacy on third sector activity, diversifying sources of funding and encouraging giving by the public. The Committee recommends that the government adopt a policy of tax concessions to encourage and enhance the culture of giving in Israel. To this end, it proposes the following measures, some of which will entail changes in the law:
 - a. Curtailment of the political factors that play such a large part in determining the acceptance or rejection of applications, and replacing them with objective rather than personal considerations. The Finance Minister shall draw up the criteria for determining whether an organization qualifies as “a public institution under paragraph 46a of the Income Tax Ordinance” (tax credits on donations), which shall then be approved by the Finance Committee for a period of three years. The Income Tax Commission shall be responsible for annually reviewing applications for recognition as a public institution, and the Income Tax Commissioner shall be the only person entitled to approve such applications.
 - b. The Income Tax Commissioner shall publish an annual report entitled “Public Institutions and Tax Relief on Contributions (paragraph 46a of the Income Tax Ordinance),” with detailed information on third sector organizations that applied for recognition as "public institutions," organizations whose applications have been accepted, and those whose application have been rejected (in the latter case, the reasons for the rejection must be specified).
 - c. Despite improved information in recent years by the Tax Authorities on the tax treatment of third sector organizations, there is still insufficient information on the eligibility criteria for the status of “public institution,” public institution under paragraph 46a of the Income Tax Ordinance, and other tax concessions. The Committee recommends that the Income Tax Commission publish a clear and user-friendly review of eligibility criteria, inspection

and oversight procedures and the information referred to in paragraph 9b above. Likewise the Tax Commission should undertake to disseminate and explain this information to third sector organizations.

- d. The current list of public objectives (for which organizations are entitled to tax concessions) is somewhat limited and subject to political influences. The Committee recommends the list be updated and expanded to include not only service-provision organizations, but also civil society organizations, social-change organizations, and organizations catering to disadvantaged populations (the Arab population, new immigrants, etc.).
- e. Third sector organizations must be encouraged to apply for the status of “public institution” under paragraph 46a of the Income Tax Ordinance at their own initiative, but also with State encouragement. The application process must be simplified and shortened in order to encourage applications by organizations that are deterred by complex, bureaucratic procedures.
- f. The Committee recommends incorporating tax credits for donations to third sector organizations directly into the employee’s paycheck, as a means of encouraging public contributions to third sector organizations – an option that is used today on a small scale only. Such a system would simplify the process of giving for many citizens and would increase the number of donations to third sector organizations from the public.

10. *Recommendation concerning exemption from local/municipal taxes*

The Committee deplores the inconsistency in the level of rates exemptions granted third sector organizations, and the decisions governing such exemptions. The entire issue must be reviewed and standardized, in order to determine clear and equitable criteria.

11. *Recommendations concerning surplus expenditure*

The Committee deplores the fact that third sector organizations are taxed for surplus expenditure at a higher rate than are business organizations (90% and 45% respectively). This high tax rate limits an organization’s ability to mobilize volunteers (and to pay travel or personalized expenses). Moreover, business organizations that are showing a loss are entitled to deduct surplus expenses against future taxable income, while third sector organizations are not.

- a. The Committee recommends that the tax rate on surplus expenditure for third sector organizations be brought in line with that for business organizations.
- b. The Committee recommends that third sector organizations, like their business counterparts, be permitted to deduct surplus expenses against other taxes incumbent on third sector organizations. The deterrent objective of the tax will not be compromised as a result of such a change.

12. *Recommendation concerning deduction of inputs*

The Committee believes that depriving third sector organizations – particularly those that are not labor-intensive or that rely on donations – of the possibility of deducting inputs, is counterproductive. The Committee proposes a review of the policy for deduction of inputs and the introduction of differential regulations.

13. *Recommendation concerning employers' tax*

The Committee maintains that employers' tax discriminates against third sector organizations vis-à-vis business organizations, and urges its immediate abolition.

Recommendations concerning supervision and control of third sector organizations

14. The Committee believes that the integrity and honesty of third sector organizations (as of public and business organizations) are both a social concern and existential necessity, for the sector itself and for society as a whole. The third sector's ability to act independently and to represent civil society genuinely is contingent on its integrity. Moreover, third sector organizations should try to project an untarnished public image. In Israel, there are many bodies that supervise the activity of third sector organizations, including the Office of the Registrar of NPOs, government ministries that allocate funds, the tax authorities and the State Comptroller. The issue of supervision, which is central to the existence of the third sector in Israel, raises many questions concerning the balance between the degree of government intervention versus the sector's accountability to the public. Another question is whether third sector organizations that do not receive government funding should be subjected to the same oversight as those that do. Other questions pertain to the powers of the supervisory bodies and methods of supervision.

15. For the purpose of its recommendations, the Committee differentiated between six supervisory and control mechanisms:

- a. The internal mechanism: board of directors, audit committee and external auditor (CPA).
- b. The Registrar of NPOs and Endowments: appointed to ensure compliance with the NPO Law and the Trust Law.
- c. The tax authorities: responsible for determining the tax status granted to third sector organizations.
- d. The allocating authorities: responsible for exercising professional supervision of the funded activity and ensuring compliance with the terms of the grant.
- e. The State Comptroller.
- f. Funding agencies (foundations, private donors, etc.)

16. *Internal supervision and control of third sector organizations*

Since the Committee recommends minimal government intervention in the affairs of third sector organizations, the Committee believes that a distinction must be drawn between organizations that receive public funds (whether direct or indirect) and those that do not. This

does not imply that the government has the right to intervene in the affairs of an organization it supports. Each organization should be allowed to manage its internal affairs, as long as it operates transparently and does not engage in criminal activity or abuse its status. Since third sector organizations are engaged in a collective voluntary activity that is not part of government activity, they should not be subjected to undue government control. Organizations that wish to reduce contact with the government to a minimum must be allowed to do so. Therefore, the Committee upholds a policy that allows organizations as much freedom as possible, including the freedom to make mistakes and learn from them. For example, apart from the requirements to submit statutory reports, the State has no right to interfere in the way an organization manages its funds, unless it suspects it of criminal activity. Likewise, the State has no right to intervene in an organization's internal supervisory and control mechanisms, which should be part of the organization's ethos. The Committee believes that the discourse on the issue of supervision and control should be opened by examining NPOs that do not receive public funds.

17. *Supervision and control of NPOs that do not receive State funds*

- a. The internal audit body of NPOs that do not receive State funds is the audit committee or some similar body. These NPOs are also obliged to appoint an accountant to audit the financial report and express an opinion concerning the financial report that is presented to the general assembly for approval.

An NPO is a voluntary body composed of members who agree to act together. Members of an NPO are required, *inter alia*, to declare their willingness to accept its bylaws and resolutions. As long as the members do so, no external supervision or control of their activity is required by law.

The Committee believes that supervision and control of an NPO's affairs should be vested in the audit committee and its members (the general assembly) who should submit detailed reports (see paragraph 18 below).

- b. The interpretation of the NPO Law (particularly by the Registrar of NPOs himself) as granting the Registrar broad powers of control is erroneous, particularly in the case of NPOs that do not receive public funds. The Committee believes that, through rigorous application of the statutory requirement of transparency, an NPO's internal apparatus (audit committee, board, general assembly and members) can act as its supervisory and control body.
- c. Steps should also be taken to enhance the knowledge and accountability of the members, board, or audit committee of an NPO concerning management of the NPO and relevant statutory requirements (see below, section entitled: Self-regulation of third sector organizations).
- d. To ensure compliance with the provisions of the NPO Law, NPOs should be required to establish a management apparatus with defined powers. Since the third sector today also operates as a public trustee, the public must be protected and feel safe in the knowledge that its trustees are acting properly, in diligence and good faith. The current law provides only general guidelines concerning the obligation of board members to act in good faith.

These guidelines fall short of the requirements of diligence and good faith stipulated by the new Companies Law.

The Committee recommends that the accountability of directors and salaried executives of nonprofit organizations be defined by law. This can be done through the mandatory establishment of a management apparatus with defined powers that is able to run the organization, in accordance with the policy determined by it. In this way, an internal system of checks and balances is created within the organization between the public and professional levels.

18. *Transparency and reasonable disclosure*

An organization that works for the benefit of the public or certain sections thereof must be open and transparent to its members and to the public at large. Transparency means reasonable disclosure, and keeping members, clients, and all interested parties informed of its activities. Today, NPOs are required to submit a financial report on income and expenditure to the Registrar of NPOs. This report does not include information regarding the NPO's goals, activities, volunteer staff or means of attaining its goals. The Committee recommends:

- a. That the requirement of proper disclosure be anchored in law in order to prevent abuse and that an NPO be required to submit an annual activity report on the above aspects of its activity, in addition to the financial report.
- b. That the Registrar of NPOs be obliged to publish a detailed annual report (similar to that published by the Registrar of Government Companies) with information on each NPO, its goals, its senior executives, and a summary of its financial reports. This publication must be made accessible to the public via the Internet.

19. *Supervision of third sector organizations by government ministries*

In principle, the situation of an NPO that receives State funds is no different from that of an NPO that does not, since in the final analysis, both are funded from public sources. There would, therefore, appear to be no reason to establish separate supervisory and control mechanisms. In actual fact, however, the grant or allocations is usually earmarked for a specific activity, and it makes sense to allow the provider of the funds to ensure that proper use is being made of his money.

The Committee believes that the body responsible for the allocation of direct or indirect public funds should also be responsible for ensuring that the recipient organization meets the conditions and regulations stipulated at the time. For example, the tax authorities should be responsible for tax concessions granted to third sector organizations (indirect support) while the government ministries and local authorities should be responsible for the grants they provide (direct support).

It is therefore imperative that the conditions of the grant be clear and transparent both prior to, and during, a contractual relationship between the donor and recipient organizations.

20. The Committee is aware of the fact that this recommendation, which entails a number of supervisory mechanisms, may lead to duplication. This duplication is, however, inevitable since, for the supervision to be effective, it must be carried out by the funding body best suited

for the purpose. It follows that an NPO that receives public funds has a duty to report its compliance with:

(1) the general requirements of an NPO, and (2) the requirements of the funding agency.

21. The above notwithstanding, the absence of procedural consistency, and the lack of coordination between supervisory mechanisms dealing with similar issues, leads to overlap and duplication, causing unnecessary expense, and bureaucracy.

The Committee recommends reviewing, standardizing, and rationalizing current procedures for the benefit of government ministries and third sector organizations alike.

22. Recommendation concerning supervision and control by the Registrar of NPOs

The evidence reviewed by the Committee points to friction between the Registrar of NPOs and the NPOs, particularly regarding the interpretation of the law and the granting of “proper management certificates.” The NPOs complain that the Registrar interprets the laws as granting him broad discretionary powers without a governmental, parliamentary or public oversight apparatus.

Dependency on the Registrar hampers the NPO’s ability to function properly. The NPOs report delays in receiving funds to finance their activities. They complain that the Registrar, rather than acting in an advisory capacity, acts in a supervisory capacity that can be challenged through legal means only.

The Registrar, for his part, believes that he is merely obeying legal and governmental directives to ensure proper management of NPOs. He believes that intervention and supervision are necessary at this stage, until sound management norms are firmly established, after which it should be possible to relax the reins.

Third sector organizations are, by definition, more vulnerable than other organizations. Some of them are even in conflict with government authorities, a situation that raises doubts as to whether the motives for State intervention are free of extraneous considerations. Without entering into the subject of whether the standard of governance of NPOs is satisfactory, the Committee maintains that the Registrar’s involvement in matters of internal governance should be limited, to prevent abuse of his position for political ends. In view of the above, the Committee, while reluctant to recommend abolition of the position of Registrar, proposes the following measures:

- a. Subordination of the powers of the Registrar to a public committee that will supervise his work.
 - b. Assumption by the third sector of internal audit functions, including the determination of proper management norms and criteria that will be binding on the organizations.
23. The Committee recommends that the public committee overseeing the activities of the Registrar of NPOs determine policy guidelines for the Registrar and draw up normative requirements of enforcement, accountability and transparency.
- Half the members of this committee shall comprise government representatives including the Registrars (of NPOs, companies or endowments, as the case may be), representatives of the Justice and Finance Ministries and of other relevant ministries, while the other half shall be made up of public figures, professionals, academics and representatives of organizations. The

committee shall be set up by law, or by a government resolution, and shall be headed by an independent public figure.

The committee shall publish an annual activity report and its decisions shall be published in the government's official gazette. Before appointing a registrar, the relevant ministry must consult with the public committee. All statutory registrars shall be subject to the Committee's decisions concerning third sector organizations and shall be obliged to implement these decisions and report to the Committee, at its discretion.

24. The question was raised as to why the Registrar of NPOs is accountable to the Minister of the Interior, whereas the other statutory registrars are accountable to the Minister of Justice. Although the Committee believes the issue worth discussing, it decided to refrain from doing so within the purview of its work.

Recommendations concerning the promotion of foundations and philanthropy

25. The promotion of foundations, by offering new and varied resources, is an excellent way of weaning the third sector of its dependence on the State. The economic contribution of foundations today is an important supplement to the government budget. Foundations review applications, supervise activities, and demand reports on output. The absence of significant economic incentives for independent foundations' activity shows that their contribution is not sufficiently appreciated by the government. Therefore:

- a. The Committee recommends the institutionalization of the concept of "philanthropic foundation." A corporation which specializes in providing grants to NPOs may qualify as a "philanthropic foundation," provided it meets specified conditions. Decisions on grants and grantees will be entrusted to a public body, and the donor or his family shall have no say in the matter. For recognition as a philanthropic foundation, the organization must be an independent, registered corporation, with a minimum, specified amount of domestic assets. A foundation's money shall be deposited under conditions specified by the Knesset Finance Committee. Its total contributions in Israel shall not be less than the interest on the net investment (after deduction of management expenses). Management expenses shall not exceed a specific percentage of the contributions. Foundations shall publish rules for the submission of applications, operating guidelines, decisions concerning the awarding of grants, and an annual report.

A person or company that contributes to a recognized philanthropic foundation shall participate in determining the foundation's objectives, and shall be entitled to tax relief on the full amount of the contribution. A corporation recognized as a philanthropic foundation shall be exempt from paying tax on the returns on its investment.

Appropriate measures to promote foundations could encourage giving by Israelis and Jews living abroad, in their lifetime or through bequests. Naturally, foundations that wish to retain their autonomy need not apply for recognition. Although such foundations are not entitled to the benefits that are reserved for recognized philanthropic foundations, they may apply for the status of public institution if they meet the statutory requirements.

- b. The Committee recommends publication of a list of all recognized foundations, with information about them, their fields of activity, eligibility for grants and conditions for receiving grants. Such a publication would also encourage coordination between the various foundations and provide better coverage of their fields of activity.
- c. Today, there is little cooperation between foundations, due to competition among themselves and with third sector organizations over sources of funding. The Committee recommends the establishment of forums to promote cooperation and coordination among foundations, and between them and third sector organizations.

Recommendations concerning involvement of the business sector in third sector activity

- 26. The Committee believes there is much scope for cooperation between the business and third sectors. In order to encourage such cooperation, each side must be informed of the advantages inherent in such cooperation. Joint forums should be set up to enable the two sectors to get to know the other, and to build mechanisms of cooperation (such as databases, mediation organizations) between the two sectors that would lead to joint ventures.
- 27. Amendment No. 10 of the Securities Regulations (Immediate and Periodical Reports, valid as of 31.12.2001) concerning a business company's duty to submit a report on contributions it made, is an important step toward encouraging companies to give to third sector organizations as well as promoting transparency toward the public.
- 28. The government shall encourage greater involvement by business companies in social-voluntary activity, by granting tax relief on donations, and by conferring tokens of public recognition, such as commendations and awards, on companies that are involved in the community.
- 29. The Committee recommends that third sector organizations find ways of publicly recognizing business corporations that are models of social responsibility.

Recommendations concerning the self-regulation of third sector organizations

- 30. *The Voluntary and Nonprofit Sector* is the only umbrella organization of third sector organizations in Israel today, and embraces several hundred NPOs, including most of the large national organizations.
 - a. The Committee favors the establishment of a nation-wide federation that would be divided into sections according to field of activity. As many organizations as possible should be encouraged to join this federation and its sections.

- b. The Committee believes that one way of encouraging self-regulation among third sector organizations is by granting them a special status. Today, the sector is not represented in State or public organizations that handle its affairs. Moreover, third sector organizations, or their umbrella organization, have been granted neither recognition nor status, unlike employers' and workers' organizations, whose status is recognized by law, or by agreements with the government. Their representatives are not invited to forums to discuss issues relating to them, and they have to struggle to make themselves heard. Representation of third sector organizations will entail the establishment of internal democratic mechanisms for electing representatives and for creating consensual positions.
- c. In recent years, "The Voluntary and Nonprofit Sector" has begun developing internal tools for the third sector. These tools include the adoption of a code of ethics, the establishment of criteria of excellence, and the conferral of awards on organizations that meet these criteria. Such tools, albeit fairly novel in Israel, have been in existence in the West for over two decades. So much so, that a proper management award has become a basic condition for ties between government, public and business organizations. The quality standards and processes of accreditation are not determined by the State or the Registrar of NPOs, but by a self-regulatory body and by standards committees in the various sectors, whose decisions are binding on the entire sector. This type of supervision (self-regulation) is as effective as supervision by government authorities.
- d. The Committee recommends that third sector organizations encourage the trend toward the establishment of quality standards. The Committee believes that in order to preserve its autonomy, the third sector, and its component organizations, must be careful to maintain standards of integrity and sound management. Self-regulation (the development of tools by the third sector for monitoring its activity) would not only enhance the quality of third sector activity and its public image, but would also prevent intervention by extraneous – particularly political – elements. At the same time, a broad range of training programs is necessary to help organizations prepare for standardization and review their performance on a regular basis.
- e. The Committee recommends that government ministries recognize the aforementioned quality standards.
- f. Self-regulation is a key factor in the consolidation of third sector organizations. Self-regulation can be encouraged by extending the educational activities of the umbrella organization to include: subsidized consultations, counseling and training activities, and the establishment of mediation forums between the third and other sectors.
- g. The Committee believes that self-regulation of the third sector in Israel has a key role to play in developing training courses and specialties in third sector management, voluntarism and philanthropy. So far, there is only one academic course in Israel for training directors of third sector organizations. Umbrella organizations can help promote educational programs and training courses, and provide study incentives.

Recommendations concerning social-change organizations

31. Although social-change organizations form only a small percentage of third sector organizations in Israel, they are instrumental in promoting civil society. The Committee emphasizes that social-change organizations are a vital part of civil society in Israel, and their development contributes directly to the consolidation of democracy.

Social-change organizations receive only little direct or indirect support from the government. Most of them have difficulty in finding alternative sources of funding, and their existence is precarious. The Committee recommends increasing government funding of these organizations, especially in the form of indirect support (tax concessions).

- a. Since social-change organizations are rarely awarded the status of “public institutions” under paragraph 46a of the Income Tax Ordinance, they do not receive the tax benefits this status entails. As stated above, the Committee recommends extending the list of public purposes to include social-change organizations, including those that focus on special issues (such as civil rights), or special population groups (new immigrants, Arabs, the disabled, etc.)
- b. Whereas service-provision organizations develop close ties with government agencies due to their joint activity, the attitude of government ministries and agencies toward social-change organizations ranges from total disregard to wary cooperation. While some government ministries consult frequently with social-change organizations, others deny their right to speak in the name of the various population groups they represent. The Committee recommends establishing mechanisms of consultation with third sector organizations on legislation (including ordinances) and policy- changes relevant to the populations and issues they represent. A government ministry that wishes to introduce a bill affecting third sector organizations must first consult with the relevant organization.

Part I: The third sector in Israel – definition and background

Introduction

1. This report presents the findings of the Review Committee set up to examine policy toward the third sector in Israel. The third sector is a general term that embraces organizations that belong neither to the public nor to the business sectors. This simple definition, which is used in many countries throughout the world, groups together organizations that are heterogeneous in terms of size, field of operation, function and background. This explains why these organizations tend to be defined more by what they are not (non- governmental organizations [NGOs], or nonprofit organizations [NPOs]) than by what they are. They are also referred to as voluntary organizations, since members can join or leave at will, and because they recruit and employ volunteers.

In most countries, these organizations have a special legal status that distinguishes them from organizations in the other two sectors, reflecting the view that they are special organizations whose activity should be regulated by law. In Israel, third sector organizations include associations (Amutot), public benefit companies and endowments – all organizational frameworks that are defined as such in the country's codex of laws. In addition to this codex, the country has developed a complex system of regulations governing the behavior of the authorities that fund and supervise third sector organizations.

2. From a legal-formal perspective, this cluster of organizations is treated as a separate group and defined as a "sector." From a substantive perspective, these organizations play a key role in the development of society, democracy, and the economy. These are crucial functions in a period of swift technological growth, global economy, the privatization of public services, and a decline in the power of national governments.

Democratic societies see third sector organizations as upholders of the principle of citizens' freedom of organization and association. Third sector organizations are a reflection of pluralism in society, while representing specific groups within it. They foster policy initiatives and innovations, and encourage active participation in policy-making processes. As such, they serve also as mediators between government and the individuals and groups of which society is composed. Likewise, these organizations cultivate personal and community leadership and enterprise, and permit individuals to operate in intimate community frameworks, in which they can express their unique identity through volunteering and giving.

Third sector organizations may be established or utilized not only by citizens, but also by government authorities (and even political parties), when it is impossible or undesirable to use a public framework, and where the existence of a "semi-public" framework facilitates the transfer of resources for an agreed-upon goal.

3. The third sector is the clearest expression of the operation of civil society. Civil society operates in the sphere between the State, the free market, and primary family frameworks. It encompasses social activities that are not under the purview of the State. Under certain circumstances, actors from the State, the market, or intimate frameworks (families) may enter or leave this sphere. Participation in civil society is voluntary and covers a wide range of activities. The main feature of civil society is independence from the State, and its main actor is the public. Civil society reflects and implements group, community and even private interests, which the State is unwilling, or unable, to meet.¹

Civil society encourages pluralism and tolerance, a sphere where groups and organizations are allowed to operate independently of political affiliation. It is an inclusive domain, designed to prevent marginalization. The above notwithstanding, this domain has its own standards and rules, and monitors its activity independently of government sanctions. Moreover, civil-society activity fosters interaction between citizens and groups, and is meant primarily to promote public, rather than individual, interests. It is characterized by freedom, equality, cooperation, empowerment, trust, cooperation, solidarity and tolerance. In an era in which the State finds it hard to meet its citizens' needs, civil society and the third sector have an important role to play in meeting these needs, and in contributing ideas, volunteers, and other resources to society as a whole. Third sector organizations also monitor government agencies in their efforts to reduce social marginalization, foster solidarity and create social capital.

4. Third sector organizations operate in three main, partly overlapping, areas:
 - a. They provide services that are not generally provided by other sectors, or that are designed for specific population groups.
 - b. They act as advocacy and social-change agencies.
 - c. They represent specific or collective interests (primarily through membership organizations).

The characteristics that enable third sector organizations to fill these roles are made possible by contributions from the business and private sectors, income from the sale of services, allocations and grants from the public sector, volunteer activity, and a self-regulatory apparatus that encourages organizational flexibility.

5. Since the 80s, the number and scope third sector organizations in Israel have grown rapidly. Despite this growth there has been no public debate regarding the functions of these organizations or their relationship with government agencies. Nor has the government developed a clear policy regarding their place and role in Israeli society, and their relationship with government authorities. Moreover, in recent years, there has been a decline in the status of third sector organizations, particularly of NPOs (amutot), and a problematic and sometimes even negative public image has evolved. The Committee maintains that the current policy toward third sector organizations is the product of historical development and consists of an eclectic set of arrangements that are devoid of any internal logic. Some of these arrangements were introduced

¹On the definition of civil society, see: B. Gidron, M. Bar, and H. Katz, 2002. "Characteristics of organized civil society in Israel," (in Hebrew) *Sotziologia Yisraelit* 4(2), 369-400.

for a specific organization or group of organizations; others were introduced by one government authority and are not valid for another; and some are inconsistent and even outdated. Hence, the need to review existing provisions and offer recommendations to remedy the current situation.

The aims of the report and the Committee's work

6. The Committee's aim was not to recommend a centralized government policy toward third sector organizations or a supervisory and control apparatus that would stifle their independence and creativity. Nevertheless, it reached the conclusion that the social price of chaos – including the dangers of arbitrary and discriminatory political intervention – was too high in all respects. Its aim in this report, therefore, was to propose concrete changes, both general and specific, to current policies, without compromising the principle of pluralism and the autonomy of third sector organizations. It is the Committee's wish to strengthen these organizations and to enable them to operate in an environment where the rules of the game are clear, transparent, and predefined.
7. The Committee examined current policy toward third sector organizations in Israel and elsewhere. Due to the extreme complexity of Israel's third sector, with its myriad organizations, fields of activities, and links with the public and private sector, the Committee was unable to review it in its entirety.² It therefore chose to focus on eight central issues relating to policy toward third sector organizations:
 - (1) Overall government policy toward third sector organizations as reflected in the government's attitude toward these organizations, their activities, functions, and contributions.
 - (2) Direct government support for third sector organizations (payment for services purchased and grants), and indirect support (including tax benefits to third sector organizations).
 - (3) Third sector organizations among the Arab population in Israel.
 - (4) The legal context in which third sector organizations in Israel exist and operate particularly supervision and control by the government and other agencies.
 - (5) The role of foundations and philanthropy in Israel.
 - (6) The involvement of the business sector in third sector activity.
 - (7) Self-regulation of third sector organizations in Israel.
 - (8) Social-change organizations.
8. This report is divided into two parts. The first part provides background information on third sector organizations in Israel (economic structure, sources of income, employment policies, scope of incorporation, areas of specialty, and operational functions). This information constitutes the bedrock on which the report's conclusions and recommendations rest. The second part of the report deals with policy toward third sector organizations, and the

² For example, the Committee did not deal with the relationship between local government and third sector organizations or related policy. Nonetheless, we believe that this is an extremely important subject that should be thoroughly reviewed at some future date.

Committee's conclusion and recommendations, based on the eight topics the Committee chose to focus on in its discussions.

9. During its discussions, the Committee heard reports from officials in the government, business and third sectors, and from experts and researchers in the field. These reports gave the Committee a deeper understanding of the current situation, and helped it formulate its conclusions and recommendations.

Definition of the third sector for the purposes of the Committee's work

10. As stated above, it is easier to define the third sector by what it is not (nonprofit, nongovernmental) than by what it is. Such a definition, despite its flexibility, does not cover all third sector organizations, since in Israel, as in many other countries, the boundaries between the public and the private, and between profit and nonprofit organizations are blurred. The John Hopkins Center for Civil Society Studies in the United States has launched a comparative research project in an attempt to develop a conceptual framework for clarifying the nature and composition of the third sector. In the mid-90s, Israel was added to the 30 countries participating in this project. The main tool developed by the research project was a "structural-operational definition,"³ which stipulates that in order to qualify as third sector organizations, the organizations must be:
 - a. *Formal organizations*, namely organizations that are, to some degree anyway, institutionalized. While an organization need not be officially incorporated, it must be organized and stable, and cannot be informal or provisional.
 - b. *Private organizations*, that is, organizations that are institutionally different from organizations in the public sector, and that are not subordinate to governmental or municipal agencies.
 - c. *Nonprofit organizations*, that do not distribute profits to their founders, directors, or members, but which invest surplus funds in the organization itself, to further the organization's objectives.
 - d. *Independent organizations*, which are self-regulated, and are not controlled by external agencies.
 - e. *Voluntary organizations*, that have some degree of volunteering and giving, even if minimal (unpaid board members, for example).
 - f. *Open organizations*, which can be joined or left at will.

³ L. M. Salamon and H.K. Anheier, 1998, *The Emerging Sector Revisited*, Baltimore: John Hopkins University, Center for Civil Society Studies.

11. In its review, the Committee focused on organizations that met these six criteria.⁴ It decided not to include political parties in this definition. Although political parties, as voluntary bodies mediating between the government and the citizen, are part of civil society, they are nevertheless discrete entities that, in Israel anyway, have a totally separate legal and tax status. Moreover, political parties in Israel are supported by public funds, via the Parties Financing Law, which confers on them a different status to that of third sector organizations, and exposes them to different oversight and control mechanisms.
12. Another group of organizations that has not been directly included in the recommendations of this Report are organizations whose existence and activity – including funding provisions – are anchored in a specific law. This category includes institutes of higher education (under the National Council of Higher Education Law, 1958) and the Health Funds (under the State Health Insurance Law, 1995). By contrast, almost all other third sector organizations are not governed by specific laws, and their relationship with government institutions, including funding provisions, are not anchored in separate statutory provisions. The Committee's recommendations are addressed to this group.⁵

The third sector in Israel – historical review⁶

13. The roots of Israel's third sector stretch back to the associations and voluntary organizations of the Diaspora, which were motivated by the religious precepts of charity and benevolence. This system, based on giving and voluntarism by members of the community, has been in existence in various forms since the middle ages, and has provided a local infrastructure for community welfare services. It provided welfare services for various needy groups (widows, wayfarers, brides, the sick, etc.) as well as education services. This system also helped define the identity of members of the community of which it was an integral part.
In Arab society, too, the value of philanthropy has a cultural and religious base. The Islamic, Christian and Druze religions all stress the importance of charity, as is borne out in their rules and customs (cf. Islam's "al-qazat"). The roots of this tradition stretch back to the ethical code of nomadic Arab society even before the emergence of Islam.
14. The early Jewish settlement in Palestine in the late 19th century drew its strength from the Jewish community's ability to cater to its collective needs, and from the Jewish tradition of

⁴ For a discussion of the structural-operational definition and its adaptation to the Israeli situation, see: B. Gidron and H. Katz, 1998, *The Third Sector in Israel – Boundaries, Characteristics and Processes: A Preliminary Analysis*, The Israeli Center for Third Sector Research, Ben Gurion University of the Negev, Beer-Sheba.

⁵ The Committee thereby recognizes that most higher education institutions, health funds, and trade unions are third sector organizations. The above notwithstanding, since these are special systems (in Israel) whose relationship with the State has been regulated by law – we did not see fit to single them out in these recommendations.

⁶ B. Gidron, 1997. "The Evolution of Israel's Third Sector: The Role of Predominant Ideology," *Voluntas* 8(1), pp. 11-38; Y. Yishai, 1998, "Civil Society in Transition: Interest Politics in Israel," *Annals of the American Academy of Political and Social Science*, pp. 147-162; I. Silber and Z. Rosenhek, 1999, *The Historical Development of the Israeli Third Sector*, The Israeli Center for Third Sector Research, Ben Gurion University of the Negev, Beer-Sheba.

supporting the needy in near or distant communities. This system of social services blended into the political framework of the Jewish community, whose various ideological sectors were competing for hegemony over the emergent State. Each camp set up its own network of services in the fields of health, education, welfare, employment and housing. The organizations providing these services, such as the health funds (Histadrut, Maccabi, Leumit), vocational schools (Amal), and women's organization (WIZO, the Working Mothers Association, Na'amat) were "Ottoman associations" – the legal framework for voluntary organizations at the time. These associations effectively constituted the third sector of the pre-State period. Their most important social function was the provision of welfare services to the Jewish population, alongside, and sometimes instead of, the Mandatory Palestine government. The system was financed by two main sources: members' fees, and funds raised by the Zionist movement abroad.

During this period, Palestine's Arab population also had its share of third sector organizations. From the mid-19th century on, organizations, mostly of a religious character (such as "the Christian Association" and the "Islamic Association") provided social, educational, and cultural services; they operated mainly in the cities. After the First World War, these organizations grew both in number and scope, as other organizations emerged alongside the religious organizations to tackle the poverty and destruction left by the First World War, and to strengthen Arab-Palestinian identity and independence against the British Mandate and Zionism. After the Arab Uprising of 1936-1939, these organizations declined.⁷

15. Upon the establishment of the State in 1948, an extensive system of welfare services was already in place throughout the country. This sectoral system, however, was not congruent with the concept of "statism" that was so integral a part of government policy under Israel's first prime minister, David Ben-Gurion. This policy, which aimed at transferring the functions of these sectoral organizations to the State, was wholly successful in some areas (labor exchanges, the water system) and only partly successful in others (mainly the education system, which, with the abolition of "streams," came partly under State jurisdiction). Although other areas, such as health and housing, retained their former sectarian structure, changes took place here, too. The State took over funding of these services, thereby establishing its right to intervene in their activities and policies.

Alongside the diehard organizations of the yishuv period, after the 50s new organizations began proliferating, particularly those providing welfare services neglected by the State (Akim, Alyn, The Israel Cancer Association, etc.). These grass-roots organizations often had ties with government ministries, which supported them financially, and helped them in other ways. They were perceived as complementing, not replacing or challenging, the activity of the government ministries, and were mostly supported by public funds.

16. Since the 80s, we have seen an enormous surge in the number and scope of civil organizations in Israel. The NPO Law, which was passed in 1980 (it was first debated already in the 50s)

⁷ For details of the historical development of the third sector in Arab-Palestinian Society in Israel, see: A. Zeidan and A. Ghanem, 2000, *Giving and Volunteering in Arab-Palestinian Society in Israel*, The Israeli Center for Third Sector Research, Ben Gurion University of the Negev, Beer-Sheba.

simplified the registration of new organizations. The burgeoning of the third sector in Israel in recent years is the result both of external influences and internal changes (a trend toward greater openness and individualism within Israeli society). As expectations of the State declined, recognition of the need for alternatives to the State grew. Over the past twenty-two years, 30,000 new associations have been registered (an average of 1,600 per year). Unlike organizations in the previous era, the new associations are not exclusively service-provision agencies. Some of them are advocacy or funding organizations (foundations), while others focus on issues neglected by the Welfare State. Usually, these are small organization that do not rely on public funding, and are often based on volunteer personnel.

17. The third sector “explosion” has facilitated the government’s privatization policy and has contributed to the decline of the Welfare State. In many fields, third sector organizations have become an alternative or complement to State services, acting as sub-contractors in providing services that were previously provided by the State.
18. The diminishing power of political parties as mediators between society and government, and the development of the electronic media, have also contributed to the proliferation of new, extra-parliamentary organizations. However, by far the most important factor in this process is a growing awareness of civil rights and the importance of organized self-expression, as well as the emergence of new social forces. All these factors have helped shape the structure and nature of Israel’s third sector, and have contributed to the growth of civil society.

Typology of third sector organizations

19. Third sector organizations may be corporate or non-corporate bodies that are recognized by law.

Corporate bodies (associations and public benefit companies) and non-corporate bodies (public endowments) focus on different kinds of activities. For example, corporate bodies provide services, while non-corporate bodies award grants.

This difference between corporate and non-corporate bodies is reflected also in their internal governance mechanisms, accountability of members, directors, and executives, internal and external audit procedures, and duty of disclosure, inter alia.

The corporate and non-corporate entities most frequently encountered in the third sector are:

- *The association (amuta)*, governed by the Associations (Amutot) Law (1980).
- *The public benefit company*, governed by the Companies Law (1999).
- *The public endowment*, governed by the Trust Law (1979).

The legal framework

20. The passage of the 1909 Law of Ottoman Associations sanctioned the establishment of legal associations – known as “Ottoman associations” – for the implementation of nonprofit activity. Until the passage of the Associations Law in 1980, most nonprofit activity in the pre-State or post-State period was carried out according to this Ottoman Law. Today, the Law of Ottoman Associations applies only to existing Ottoman associations that have not yet been registered under the new law, or to entities not covered by the new law (such as workers’ or employers’ organizations).
21. The British Mandatory government imported the British Companies Ordinance, which provided for the establishment of nonprofit companies. After many changes, this ordinance was finalized as the Companies Ordinance (new version) (1983). This ordinance, which coined the term “public benefit company” (paragraph 32), no longer required companies to add “Limited” to their names. The Companies’ Ordinance was replaced in 1999 by the new Companies Law, which incorporated some of the provisions of the Companies’ Ordinance.
22. The Charities Ordinance and the Charitable Endowments Ordinance (Public Trustee) were both passed during the British Mandate, to regulate public endowments. These were superseded in 1979 by the Trust Law.

Incorporation and registration

23. *Associations (amutot)*

An association (*amuta*) may be set up by two or more people for a legal purpose that is non-profit distributing. An Amuta must be registered with the Registrar of Amutot, and is considered a “corporate body” with both rights and liabilities from the day it is registered. The Registrar of Amutot has the right to accept or reject an application, subject to judicial oversight. Once an Amuta is registered, it must act through its institutions (the general assembly, the board [or executive], and audit committee [or audit body]). Membership of an Amuta is personal and non-transferable.

An Amuta may accept the “prototype bylaws” appended to the law, or draw up its own bylaws, provided that these do not contradict the provisions of the law.

24. *Public benefit companies*

Under the Companies Law (1999), any person may set up a business company that distributes profits.

A public benefit company is a company set up solely for a public purpose that does not distribute profits to its shareholders. It must be registered with the Companies Registrar, and is considered a “corporate body,” with both rights and liabilities, from the day it is registered. The Companies Registrar has the right to accept or reject an application, subject to judicial oversight.

Once a company is registered, it must act through its institutions (the general assembly and the board of directors). The audit committee of a company (unlike of an Amuta) is responsible

to the board of directors, not the general assembly. The law stipulates that all companies must have a CPA.

Membership of a company is usually through ownership of stocks and shares. Membership is not personal, since shares are transferable, unless the company's bylaws state otherwise.

25. ***Public endowments***

A public endowment is a kind of trust set up to further public goals. Any person may set up a public endowment. Since a public endowment is not a corporate entity, it does not require a permit from the Office of the Registrar of Endowments.

A person wishing to set up an endowment must draw up a written document (the endowment writ), stating his intention to set up the endowment and specifying its goals, assets and conditions. A public endowment is one with a public purpose. A trustee of a public endowment is bound by the provisions of the 1979 Trust Law, as well as by the conditions of the endowment writ.

Governance and accountability of the managing bodies

26. ***Amuta***

An Amuta is managed by a board of directors, which has authority in all residual matters (that is, all matters that do not come under the purview of the general assembly or any other of the Amuta's institutions). The duties of board members, as stipulated by the Amutot Law, are extensive. Board members must act for the good of the association, and in accordance with its purposes, bylaws, and resolutions. Their responsibilities, albeit not defined by law, are vast. The Amutot Law does not specify the duties and responsibilities of the Amuta executives.

27. ***Companies***

According to the Companies Law, a company is managed by its board of directors, its director-general, and its executives. The Companies Law clearly defines the prerogatives, duties and responsibilities of each of the above categories. A private company (a public benefit company is considered a private company, since its shares are not traded on the stock market) need not have a director-general or executives, but simply a board of directors. In such cases, the board of directors is solely responsible for running the company.

28. ***Public endowments***

A public endowment is managed by its trustee(s). The Trust Law clearly defines the trustee's duties regarding investment and utilization of the assets of the trust, subject to the founder's conditions. The law also defines the trustee's responsibilities, including personal responsibility for any damage to the assets or beneficiaries of the endowment.

The Third Sector in the Israeli Economy⁸

29. In 2001, the number of third sector organizations registered in Israel (with the Amutot Registry or Endowments Registry) totaled 34,000.

The third sector accounts for almost an eighth of all economic activity in Israel. In 1997, salaried positions in the third sector represented approximately 206,000 full-time positions, or 9.7% of the non-agricultural workforce (see Table 1), while salaried and non-salaried (volunteer) positions together represented about 245,000 full-time positions, or about 11.5% of the non-agricultural workforce. In the same year, the number of third sector employees, including part-time employees, totaled about 310,000.

Table 1: The economic impact of the third sector in Israel, 1997⁹

| Occupation | Full-time positions | Percentage of non-agricultural workforce |
|--------------------|----------------------------|-------------------------------------------------|
| Salaried | 206,305 | 9.7% |
| Voluntary | 39,070 | 1.8% |
| Total | 245,375 | 11.5% |
| | | |
| Expenditure | NIS millions | Percentage of GNP¹⁰ |
| Total | 52,908 | 14.3% |

Source: Department of Social Services, Central Bureau of Statistics

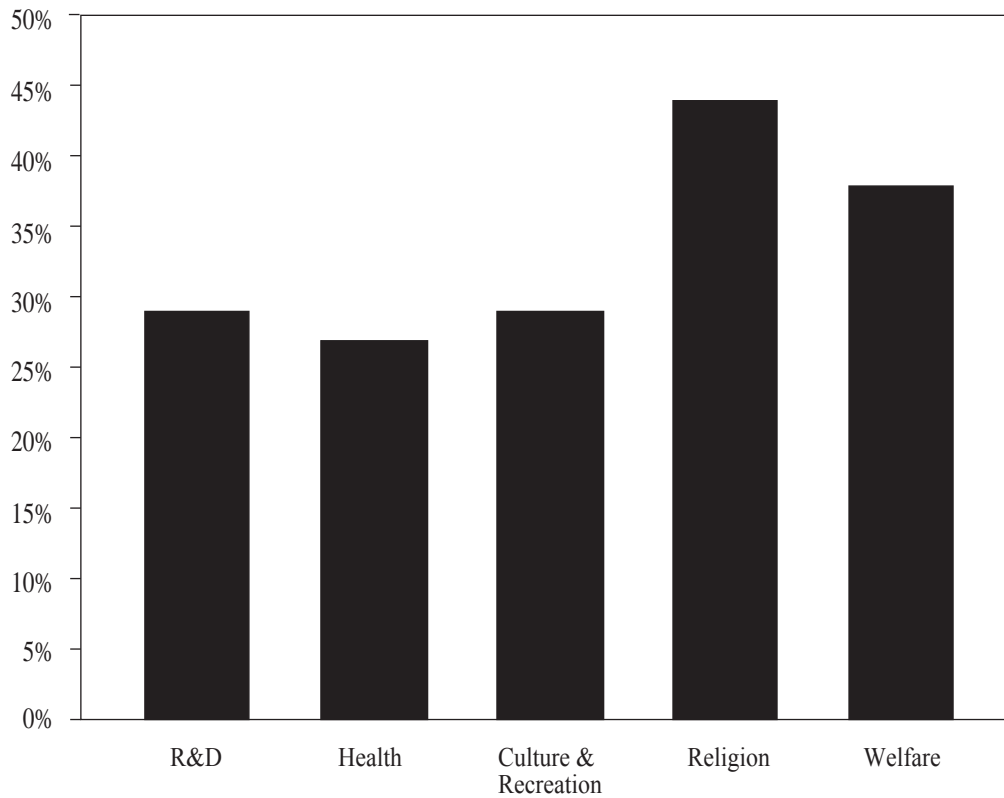
30. Current expenditure of third sector organizations in 1997 totaled approximately NIS 53 billion, or 14.3% of the GDP. In specific fields of service provision, particularly State-funded welfare services, their economic impact is even more significant. In 1995, the third sector accounted for 44% of all full-time positions in health in Israel, 35% of all positions in education, and 30% of all positions in culture, recreation, religion and welfare (see Figure 1).

⁸ The most recent data on the economic scope and activity of the third sector in Israel are data from 1995 (provided by the Israeli Center for Third Sector Research) and data from 1997 (provided by the Central Bureau of Statistics). Unfortunately, more up-to-date data has not been released to the public. As we shall see below, one of the main problems with which third sector organizations and researchers have to contend in Israel is the problem of lack of information, and the difficulty of obtaining it from government institutions.

⁹ These data include also institutes of higher education and the health organization (health funds and public hospitals). As stated, the report does not relate to these organizations, although from a legal point of view they are third sector organizations.

¹⁰ The GDP for the purposes of international comparison includes net taxes on imports.

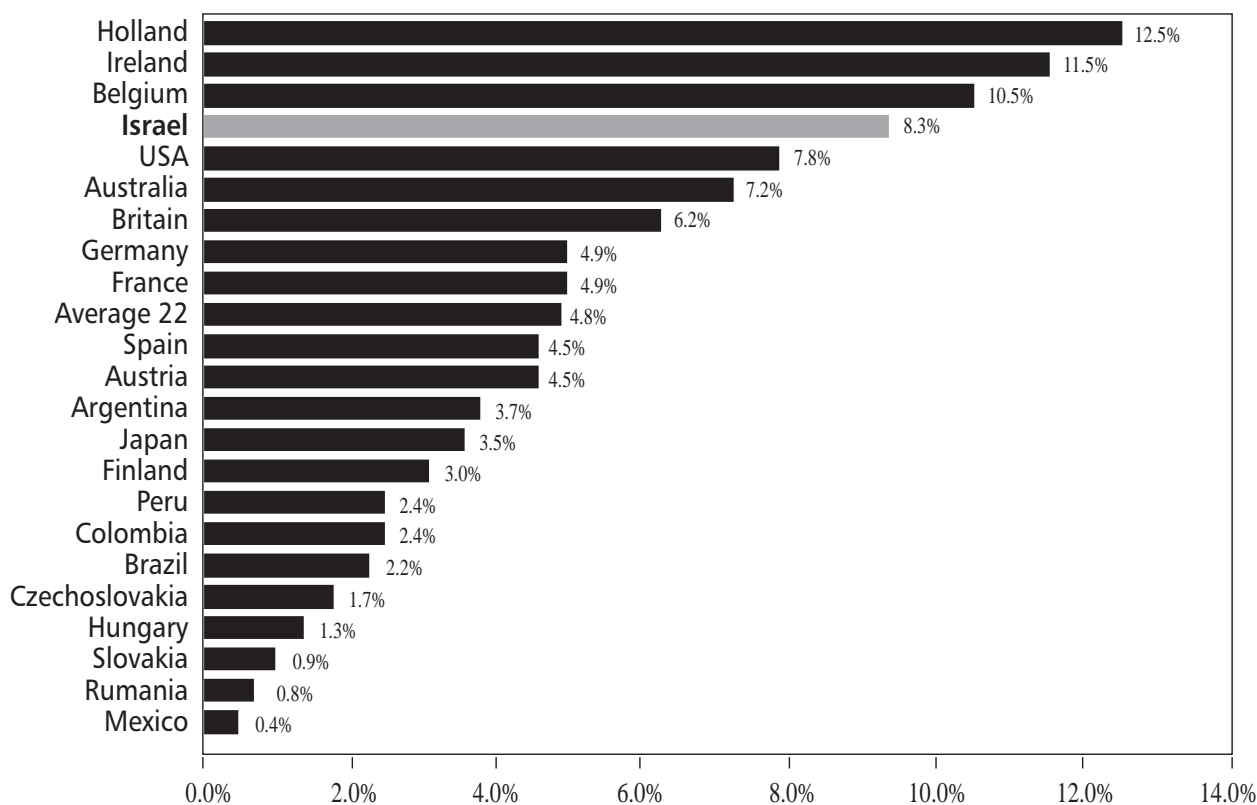
Figure 1: Third sector occupations as a proportion of all occupations, in selected fields, 1995
Percentage of all occupations in the chosen field



Source: Database of the Third Sector in Israel, Israeli Center for Third Sector Research

31. In Israel, the third sector's share in the total economy is one of the highest in the world. In terms of its relative size, it ranked fourth out of 22 countries (after Holland, Ireland, and Belgium). Its share of the (non-agricultural) workforce is almost twice the average for 22 countries, and higher than that of the United States and Great Britain, which are generally considered as having especially large third sectors (See Figure 2).

Figure 2: The economic weight of Israel's third sector on an international scale, 1995

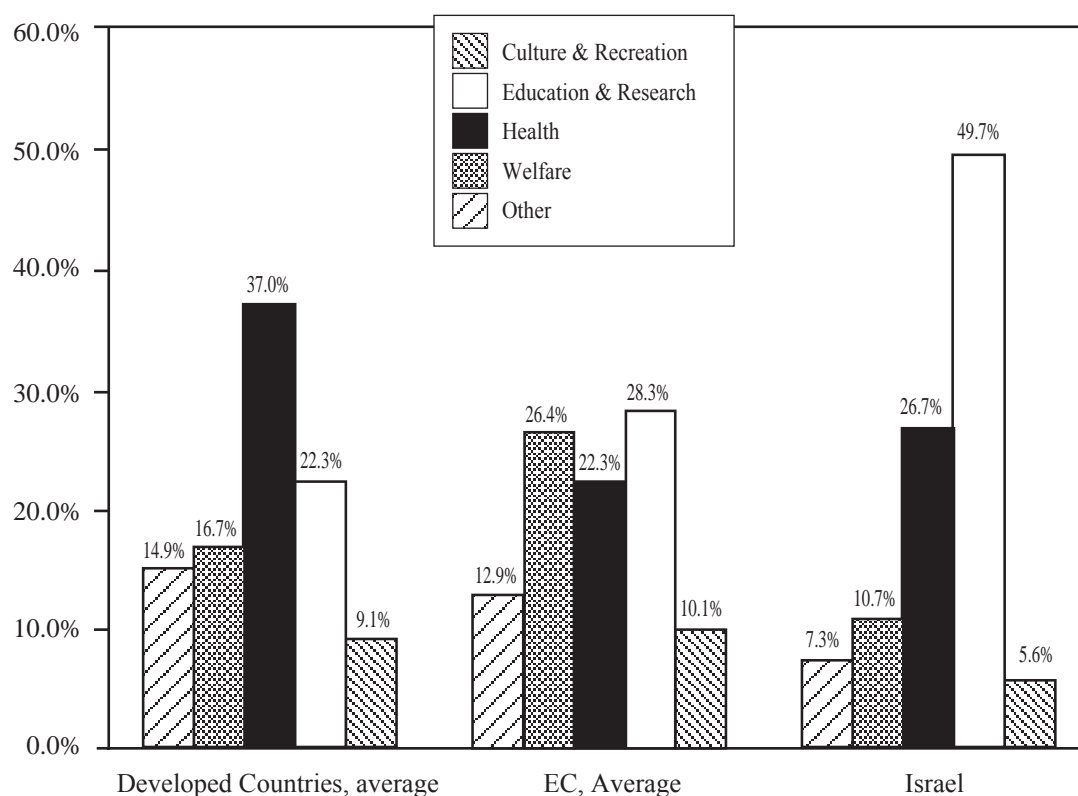


Source: Database of the Third Sector in Israel, Israeli Center for Third Sector Research

Economic structure and funding

- An analysis of the economic activity of the third sector in Israel by field of activity shows a centralized picture. Health and education account for over three-quarters of its economic activity and, together with the social services, culture and recreation, for 93% of its economic activity. This rate resembles, and even outstrips, that of other developed countries (Figure 3). A strong parallel can be drawn between Israel's situation and that of various West-European Welfare States (especially Ireland and Belgium). All reflect a high degree of third sector involvement in the provision of social services, especially in the fields of education, welfare, culture and health.

Figure 3: Occupational breakdown of the third sector by field of activity, in Israel and in other developed countries, 1995

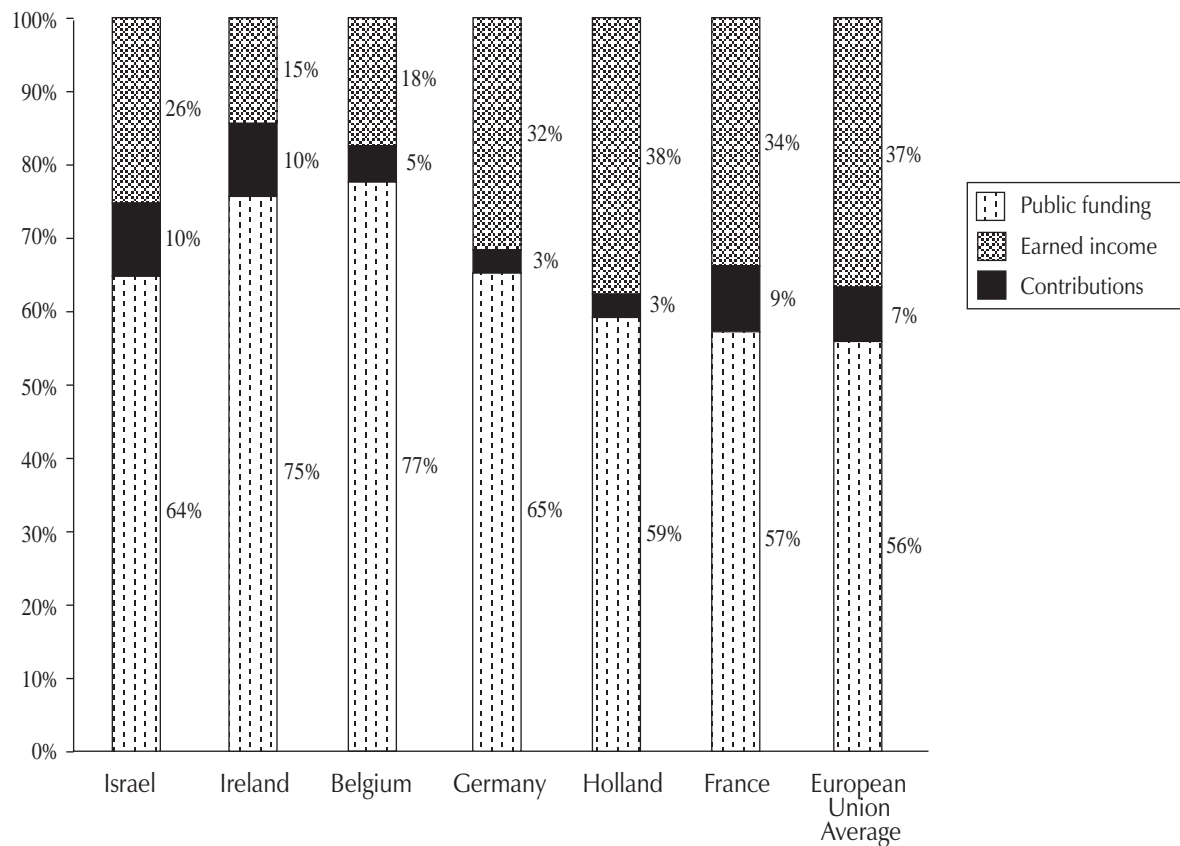


Source: Database of the Third Sector in Israel, Israeli Center for Third Sector Research

33. Most of the funding of third sector organizations in Israel comes from public resources. About 64% of all third sector revenue in 1995, and about 56% in 1997 (NIS 29.4 billion) came from public funds. The above notwithstanding, only about a third of third sector organizations receive public funding (38% in 1998). The number of organizations applying for public funds is much higher.¹¹ It turns out that relatively few organizations receive significantly large government funds..

¹¹ According to data presented by the Registrar of Amutot to the Knesset, about 75% of all organizations seek government support.

Figure 4: Funding of the third sector in Israel and in West European countries, 1995



Source: Database of the Third Sector in Israel, Israeli Center for Third Sector Research

If we focus on specific fields of activity, an uneven picture emerges. Public funding predominates in the fields of health, education, culture, housing and welfare, with the lion's share going to health (NIS 9.5 billion in 1998, mostly to the Health Funds) and to education and research (NIS 10.2 billion in 1998, particularly to higher, vocational, agricultural, and religious education). These fields of activity alone account for over 80% of third sector activity, which explains why the third sector is mostly government-funded. Five of the fields of activity listed in Table 2 (environment; trade unions; recreation and culture; law, advocacy and politics; and religion), rely on earned income while two other fields (international activity and foundations) rely mainly on contributions. However, in nine of the twelve fields of activity, public funding accounts for over 30% of the organizations' income. This shows that although public funding is dominant in five fields of activity only, it plays an important role in other fields, too.

All in all, therefore, we see that the third sector is highly dependent on government funding. This situation is extremely disturbing, given the cutbacks in government expenditure, and the potential loss of autonomy on the part of an organization that relies on public funding.

Table 2: Funding sources of the third sector in Israel by field of activity (%), 1997

| Field of activity | Public funding ¹² | Contributions ¹³ | Earned income ¹⁴ |
|--------------------------------------|------------------------------|-----------------------------|-----------------------------|
| Culture and recreation | 34.3 | 21.4 | 44.3 |
| Education and research | 61.3 | 12.0 | 25.7 |
| Health | 64.4 | 2.3 | 33.3 |
| Welfare | 41.1 | 19.3 | 39.6 |
| Environment | 39.9 | 3.4 | 56.7 |
| Housing and development | 68.9 | 9.9 | 21.2 |
| Civic, legal, and political | 25.8 | 32.2 | 42.0 |
| Foundations & philanthropic activity | 23.8 | 52.6 | 23.6 |
| International activity | 19.7 | 72.4 | 7.9 |
| Religious activity | 30.8 | 30.1 | 37.9 |
| Trade unions | 14.4 | 37.8 | 47.8 |
| Other | 47.4 | 27.6 | 25.0 |
| Total | 55.5 | 12.0 | 32.0 |

Source: Department of Social Services, Central Bureau of Statistics

Philanthropic inputs

34. Although, in Israel, contributions account for only 12% of third sector funding, this percentage is higher than that of all other developed countries, except for the United States (13%).¹⁵ Surveys on contributions and volunteering by the Israeli public show that contributions to third sector organizations by individuals and households total less than half a billion NIS per annum (465 million NIS in 1997).¹⁶

Approximately half the contributions to third sector organizations in Israel come from donors abroad (these contributions are allocated to the organizations' current budgets, not capital investments). About a seventh of all contributions to the third sector come from individuals and households in Israel, while the remainder comes from foundations, and, to a lesser extent, business organizations.

¹² Funding received from the government and local authorities in the form of grants, allocations, and service-provision contracts.

¹³ Contributions from individuals, households, businesses and foundations.

¹⁴ Members' fees, and sale of services and goods.

¹⁵ L.M. Salamon and H.K. Anheier, 1998, *The Emerging Sector Revisited*, Baltimore: Johns Hopkins University, Center for Civil Society Studies.

¹⁶ S. S. A. Lazar, R. Duchin, and B. Gidron, 1999, *Philanthropy in Israel: Types of contribution and volunteering by the public* (in Hebrew), The Israeli Center for Third Sector Research, Ben Gurion University of the Negev, Beer-Sheba

Interestingly, a breakdown by field of activity shows a similar pattern to that of government funding. Over 90% of contributions by Israelis are to organizations in the field of welfare, health and religion, and most organizations that receive contributions are also the recipients of substantial government funding.

Every third person in Israel is engaged in some kind of volunteer activity. Of these, 78% volunteer in third sector organizations.¹⁷

Volunteers work for public authorities as well, especially in fields such as security (the civil guard, the fire department), health, education and welfare (government hospitals, schools, social service departments). Volunteers in third sector organizations contribute approximately 56 million hours per year. Again, volunteers tend to opt for welfare and health organizations, especially large, well-known organizations such as WIZO, Alyn, Yad Sara and the like – organizations that usually already receive generous government funding. In 1997, volunteering in third sector organizations was worth NIS 840 million – a small amount when set against the sector's total economic activity (NIS 53 billion in 1997). Voluntary activity as a percentage of third sector employment is much lower in Israel than in other West European countries (15%, as against 53% in France and England, 39% in Germany and the United States, and 33% in Holland).¹⁸

Fields of activity in the third sector

35. During the 90s, an average of 1,650 new third sector organizations were created each year, and by 2001, Israel had 34,291 registered Amutot, endowments, and public benefit companies. Israel has 502 third sector organizations per 100,000 citizens, placing it “well in the middle” in an international comparison (Belgium, 814 per 100,000 citizens in 1995, the United States, 458 per 100,000 in 1990, and Russia, 109 per 100,000 in 1997). Not all registered organizations in Israel are still active. An active organization is one that is legally registered with the Amutot Registry, the Endowments Registry, or in the Companies Registry, and that has submitted an annual return to the Income Tax Authority, as required by law.

In the 90s, only 35% (about 12,000) of all registered organizations were active, and even this percentage began slowly to decline. This was due, principally, to the following factors: ageing, failure to report the closure of organizations, and the emergence of short term organizations with specific, short-term (political, social or health-related) goals.

¹⁷ Ibid.

¹⁸ L.M. Salamon and H.K. Anheier, 1999, *Global Civil Society: Dimensions of the Nonprofit Sector*, Baltimore: The Johns Hopkins University for Civil Society Studies.

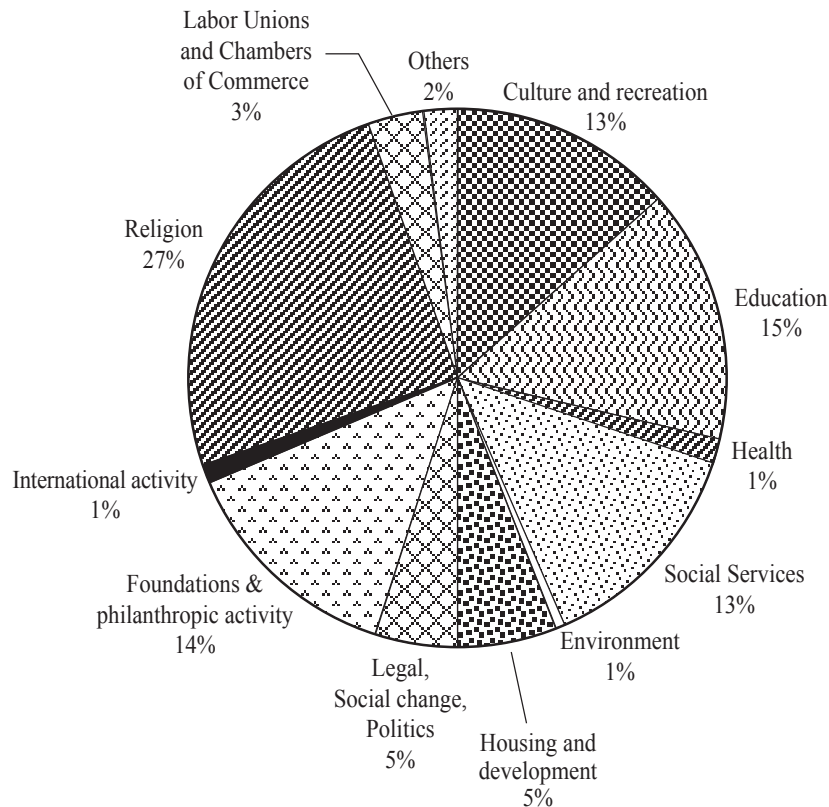
Table 3: Registered third sector organizations by field of activity

| | 1991 | | 1994 | | 1998 | |
|-----------------------------|---------------|-------------|---------------|-------------|---------------|-------------|
| | Number | % of total | Number | % of total | Number | % of total |
| Culture and recreation | 2,067 | 12.4% | 2,741 | 12.6% | 3,886 | 13.5% |
| Education & research | 3,284 | 19.6% | 4,048 | 18.5% | 5,284 | 18.3% |
| Health | 245 | 1.5% | 331 | 1.5% | 425 | 1.5% |
| Welfare | 2,194 | 13.1% | 2,859 | 13.1% | 3,782 | 13.1% |
| Environment | 62 | 0.4% | 93 | 0.4% | 143 | 0.5% |
| Housing & Development | 922 | 6.0% | 1,265 | 6.0% | 1,591 | 6.0% |
| Civic, legal, and political | 657 | 3.9% | 963 | 4.4% | 1,354 | 4.7% |
| Philanthropy | 2,597 | 15.5% | 3,201 | 14.7% | 3,972 | 13.8% |
| International activity | 215 | 1.0% | 270 | 1.0% | 359 | 1.0% |
| Religion | 3,490 | 20.9% | 4,847 | 22.2% | 6,493 | 22.5% |
| Trade unions | 543 | 3.2% | 675 | 3.1% | 887 | 3.1% |
| Other | 452 | 2.7% | 533 | 2.4% | 672 | 2.3% |
| Total | 16,728 | 100% | 21,826 | 100% | 28,885 | 100% |

Source: Database of the Third Sector, Israeli Center for Third Sector Research

36. There is a clear discrepancy between the breakdown of organizations by field of activity, which reflects the heterogeneous nature of Israeli society, and the centralized picture we obtained of third sector economic activity (especially in the field of welfare). During the 90s, no specific field of activity predominated. Religion is the largest category: About a quarter of third sector organization are in the field of religion – a rather high percentage that has remained constant over time (see Table 3, and Figure 5).

Figure 5: Breakdown of third sector organizations by field of activity, 1998



Source: Database of the Third Sector in Israel, Israeli Center for Third Sector Research

37. About three quarters of third sector organizations in Israel are service-provision organizations active in four main fields: religion; education and research; welfare; and culture and recreation. Only about 9% of third sector organizations in Israel are advocacy organizations. The percentage of advocacy organizations rose steeply over the 90s. At the beginning of the 90s, advocacy organizations accounted for only 3% of all new, registered organizations. By the end of the decade, this percentage had risen to 9%. Foundations account for 14% of all registered organizations in Israel.

Summary

37. Most third sector organizations in Israel are independent entities that are only partially State-funded. The fact that about a third of all adults in Israel (32%) volunteer in various frameworks presents an encouraging picture of civil engagement in Israel. Third sector organizations operate in a variety of fields. Since the 80s, civil society in Israel has clearly moved toward greater dynamism, independence, and diversity. It evolved fairly naturally and independently of the State, as soon as the legal opportunity presented itself. The government responded to this situation with resignation, attempts at regulation, and even manipulation. The burgeoning of civil society in Israel is not the result of a concerted government policy to help, encourage or foster third sector organizations. On the contrary, the existing “policy” is an eclectic system of laws, dispositions, and decisions. The Committee related to this issue in its recommendations, as we shall see below.

Part II: Government policy toward the third sector and the Committee's recommendations

Government policy toward the third sector

39. The Israeli government has no declared, clear, or consistent policy toward the Third Sector. There is no comprehensive law or document that defines the attitude of the government authorities to this sector. Instead, a medley of laws, regulations and provisions governing different types of organizations has grown up haphazardly. The government, moreover, has failed to adopt concrete measures to develop a consistent and transparent policy. Instead, a system has emerged that has been shaped by history, interests, constraints and pressures. This is true of most countries, but Israel, unlike most countries, has not even attempted to elaborate a clear or consistent policy toward the third sector and its functions. Although the various laws, ordinances and provisions regulating third sector activity create a de facto relationship between the third sector and the government authorities, they are not based on principles or on a rational and consistent policy.
40. There are other provisions besides the Amutot Law that govern the relationship between the third sector and the State. These, however, tend to vary from one government ministry to another, and from one government authority to another. They lack coordination and continuity, and are not based on guidelines, but on pragmatic and political considerations.
41. The pattern of government funding of third sector organizations reflects a de facto policy. Funding decisions are nevertheless largely influenced by sectoral considerations or by the judiciary's response to a concrete problem. Funding is usually channeled to specific fields of activity (higher education, health), groups of organizations (*yeshivot*), or specific organizations.¹⁹ In any case, when changes were introduced, they were not part of a concerted government plan to devise a comprehensive policy for the entire sector.
42. The ambivalence toward the third sector permeates other areas of the political system, too.²⁰ (1) There is no lobby of MKs to further the sector's interests, and there are very few MKs or prominent politicians who identify with, or work for, the third sector. (2) No national or local

¹⁹ For example, The Wolf Foundation Law was passed for a single foundation only; and the provision exempting workers' organizations and employers' associations from registering under the Amutot Law was designed specifically for the Labor Federation and Association of Industrialists.

²⁰ Talias, M. Katan, Y. & Gidron, B. 2000, *Policy of the Government and the Local Authority toward the Third Sector in Israel*, The Israeli Center for Third Sector Research, Ben Gurion University of the Negev, Beer-Sheba, p. 4.

think tank was ever set up in Israel to discuss various aspects of third sector activity (for example, a State or public committee to devise public policy toward the third sector). (3) Despite the growth of the sector, as we saw in Part I of this report, no national or municipal elections campaign, party platforms or work program in Israel has ever referred to the third sector. (4) None of the basic guidelines of the last four governments has given serious consideration to the subject (except in cases where MKs represent the interests of certain third sector organizations).

43. Why do the interested parties tolerate this vagueness and confusion?²¹

(1) Government officials and politicians fear that the introduction of a clear policy would lend greater legitimacy to the sector's activities, enhance its importance and prestige, and reinforce its demands for a greater share in the financial and political pie. (2) Within certain third sector organizations there is a fear that a clear government policy would lead to greater government intervention in, and supervision of, their activities. (3) Both politicians and third sector activists are happy with the status quo, arguing that the very absence of a clear and consistent government policy enabled the growth of the third sector in the first place. (4) The absence of a clear government policy allows the unimpeded flow of government resources toward third sector organizations, including organizations that advance the interests of political parties that are represented by the government. A clear policy that defines priorities and determines allocations criteria might obstruct the flow of funds to various organizations and destroy the use of funding as a tool for furthering political goals.

44. The absence of a clear-cut government policy toward third sector organizations has not prevented the government ministries from allocating funds to thousands of third sector organizations in various fields. Ministerial support varies from ministry to ministry and from year to year. Government ministries have even initiated the establishment of national and local NPOs. Likewise, a number of ministries have set up special units to encourage voluntary work on a national and local level.

45. The degree of cooperation between the ministries and the third sector organizations varies from ministry to ministry, and ranges from active consultation and cooperation, to sheer apathy. Some ministries or ministry units encourage the participation of representatives of third sector organizations in policy debates, and even occasionally cooperate with them on projects. Other ministries consult with the organizations on an ad-hoc basis, or ask them to supply data or written material, but refrain from institutionalized, permanent work relationships with them.

In conclusion, although the absence of a consistent policy toward the third sector allows it some leeway and latitude, it also opens the way to abuse (duplication of funds, for example). Moreover, such a system is difficult to supervise, and allows political considerations to intrude. The absence of a consistent policy also harms third sector activity and may well hinder the development of civil society in Israel.

²¹ The following is based mainly on *ibid*, pp. 4-6.

Recommendations concerning government policy

46. The Committee maintains that there is an urgent need to devise a policy toward the third sector. Such a policy would include:
- a. Government recognition of the special contribution of third sector organizations to Israeli society and the Israeli economy. This recognition shall be based on a delineation of the specific areas of activity of the government, business and third sectors respectively; on the need for reciprocity in order to achieve common socioeconomic goals; and on the government's public recognition that third sector organizations have special features that must be preserved and fostered.
 - b. A declaration by the government of its intention to regulate the relationship between government authorities and third sector organizations through a clear, declared, transparent and consistent policy, that will in no way compromise the autonomy of third sector organizations.
 - c. Recognition of the importance of public funding for third sector organizations and the urgent need to regulate such funding. Most funding of third sector organizations come from public sources. The government must recognize the need to regulate the funding of the third sector from both governmental and other sources, and encourage new non-governmental forms and sources of support.
 - d. Recognition of the need for equitable criteria in the funding of third sector organizations that will not compromise their autonomy.
 - e. Full disclosure of information to third sector organizations: The activity of third sector organizations, and in particular of social-change organizations, is contingent on obtaining reliable information regarding current policy. Despite the enactment of the Freedom of Information Law (1998), third sector organizations do not have access to information from government bodies. The government must allow greater access to information that has a bearing on the activities of third sector organizations, within the framework of the law.
 - f. The promotion of capacity building through training workers and volunteers. The government must support the creation of study programs and training frameworks for workers, board members, and volunteers in third sector organizations.

The Manifesto

47. The Committee recommends that the relationships between government and third sector organizations be regulated through a declarative document, known as: "The Manifesto of Social Organizations."

The Manifesto shall structure the relationship between the third sector and government for the benefit of Israeli society. It shall be based on understandings and agreements that shall serve as guidelines for government policy toward the third sector. The Manifesto shall specify the obligations of both the government and the third sector toward the public at large. "The Manifesto of Social Organizations" in Israel shall be based on the following principles:²²

- a. Third sector organizations are vital to the existence and consolidation of a democratic society in Israel. They fulfill functions that are radically different from those of organizations in the government and business sectors. They offer individuals a chance to participate in public life and to work toward communal and social solidarity through identification with a cause, volunteering and giving.

Third sector organizations have a significant contribution to make in furthering cultural, social, economic and political life in Israel. They offer citizens the chance of helping to shape the provision of services and promote social change, and provide a fertile ground for new ideas and social creativity. In practice, these organizations implement civil and social rights, and in many cases, serve as the sole advocates of marginal groups. They help prevent poverty, enhance the quality of life, and foster social cohesion, equal opportunities and social diversity. Their activity contributes directly to the modern economy, in Israel and in other developed countries.

- b. The government and third sector organizations recognize the need for cooperation based on recognition of their differences and the need to learn from one another on an ongoing basis. The first step in this direction is the creation of an open dialogue based on mutual respect, and confidence building measures. This cooperation shall not prejudice the democratic right of social-change organization to criticize the government and present it with demands for policy changes, as their role warrants.

The government's obligations

- a. The government shall recognize the importance of the functions performed by the many organizations that make up civil society in Israel and their contribution to the democratic process, civic participation, the integration of peripheral population groups, the promotion of equality and social justice, and the resolution of personal, group and social problems.
- b. The government shall recognize the importance of the autonomy of third sector organizations, and defend their right to promote their goals, develop independent sources of income, criticize government policy and take action to change it.

²² In formulating the principles, the Committee referred to three conventions signed in recent years between the government and the third sector in Britain (1998), Canada (2001) and Ireland (2000): Compact: *Getting it Right together: Compact on Relations between Government and the Voluntary and Community Sector in England*, Home Office, Britain, 1998; *An Accord between the Government of Canada and the Voluntary Sector*, 2001; *Supporting Voluntary Activity: White Paper on a Framework for Supporting Voluntary Activity and for Developing the Relationship between the State and the Community and Voluntary Sector*, Ireland, 2000.

- c. The government shall recognize the limitations of excessive government intervention in the sector's activity. It shall refrain from any strictures against the fields of activity, modus operandi, internal governance, and employment policies of these organizations, unless otherwise mandated by law or by exceptional circumstances.
- d. The government shall recognize the need to base policy toward populations served by third sector organizations on the principle of equality.
- e. The government shall recognize the need to involve third sector organizations, and consult with them, in formulating policy toward the sector as a whole or toward specific areas in which they operate.
- f. The government shall recognize the need to create joint ventures with the third sector in order to further public, social and economic goals. It shall encourage third sector organizations to participate in various government projects and to contribute ideas, initiatives and private resources for the public interest. Such participation shall be based on frank and transparent dialogue between the third sector organizations and the government ministries regarding orders of priority, funding criteria, and the nature of public projects.
- g. The government shall recognize the great diversity that characterizes the third sector in Israel regarding type of organization, field of activity, work method and target population. A comprehensive and transparent government policy would recognize, and seek to encourage, this diversity.
- h. The government, as the major source of funding of third sector organizations in Israel, shall undertake to standardize funding methods, support criteria (grants and contracts), and oversight mechanism.

Obligations of the third sector organizations

- a. The activity of third sector organizations shall be anchored in law.
- b. Third sector organizations shall recognize the importance of sound governance, transparency and accountability toward the funding bodies, members of the organizations and the public at large. Such recognition entails a commitment by the organizations to adopt these rules of behavior and quality standards.
- c. Transparency: Third sector organizations (particularly those that represent specific populations before government ministries) shall undertake to provide full disclosure of activities and policies to the organizations' clients, members, volunteers and supporters. As far as possible, these organizations shall consult with their members and other relevant parties, and incorporate their ideas into their policies.
- d. Third sector organizations shall encourage voluntarism in their various fields of activity.

- e. Third sector organizations shall further cooperation with: government authorities and public institutions, other third sector organizations, or business organizations, as the case may be.
- f. Given the special nature of their activity and their prerogative to define it through their bylaws, third sector organizations shall be careful to avoid discrimination in accepting members and providing services.
- g. Third sector organizations shall seek to employ workers under fair conditions, and prevent injustice in salaries and work conditions.

The *Manifesto of Social Organizations* shall be drawn up by a team of government representatives and representatives of third sector organizations, with the purpose of creating an infrastructure for policy decisions on a number of issues, as specified below.

Typology of third sector organizations

48. The Committee differentiates between four types of third sector activity in Israel, as follows:

- Institutionalized Service provision
 - Social, communal and civic activity
 - Contractual service provision
 - Social-change activity
- a. *Service provision within the public sector system:* In this kind of third sector activity, the organization undertakes to provide a service which the government funds and monitors. This kind of activity is anchored in law or in a long-term government compact. Examples of institutionalized service-provision organizations are universities and colleges (which provide higher education), health funds and public hospitals, (which provide health services), and various organizations that provide religious services. All these are technically third sector organizations. Except for general recommendations regarding transparency, reporting and supervision, the Committee's recommendations do not cover these organizations
 - b. *Social, communal and civic activity:* This kind of activity is undertaken by independent organizations, and is not governed by a specific law. Examples of such organizations are clubs, immigrant associations, community organizations, and cultural and recreational organizations. These organizations do not usually try to effect social change, and some of them are even supported by government ministries.
 - c. *Contractual service provision:* In this kind of activity, the organization provides a service that is partially or wholly funded by the government. Unlike (a) above, this kind of activity is not anchored in a permanent arrangement, but rather in an ad-hoc contract with government ministries. Examples are organizations that provide services in the fields of education, welfare, and culture.

- d. *Social-change activity*: This kind of activity does not usually depend on direct government funding. Social-change activity is initiated by citizens, not the government, and is independent of the government or the services it provides. Examples of social-change organizations are advocacy groups, organizations that try to influence social policy, organizations that are involved in extra-parliamentary political activity aimed at influencing public policy, or organizations that provide special services the government authorities fail to provide.

Recommendation: The Committee recommends that the policy declaration (paragraph 46 above) and the Manifesto (paragraph 47 above) recognize the different kinds of organizations, their individual needs, and the importance of developing a clear policy for each group.

Direct support for third sector organizations

49. Government support to third sector organizations stems from several key objectives, the importance of which is determined by the political and administrative cadres:
 - a. The wish to economize, to eliminate bureaucracy, and bypass restrictions on recruitment of personnel and utilization of resources. This development is a by-product of the government's privatization policy, which began in the mid-80s. The main manifestation of this policy has been a tendency to outsource services (which the government ministries are bound by law to provide) to non-governmental organizations, such as third sector organizations. The establishment of many service-provision organizations has been initiated by the government and local authorities themselves. These organizations, which are wholly funded by the government, effectively constitute one of its executive arms. They are subject to close government oversight, and are accountable to it.
 - b. The wish by political cadres in government ministries to support third sector organizations that further their own political, sectoral, or regional goals.
 - c. The government's wish to help organizations that fulfill an important function that the government itself is not prepared to fulfill, such as organizations providing services to special population groups (the disabled), or organizations providing specific services in fields such as education, culture, the environment, etc.
50. Government support to the third sector suffers from the same lack of clarity that overall government policy toward the third sector does.
Direct public funding of third sector organizations may take the form of:
(1) Purchase of services from third sector organizations, and (2) grants to specific organizations or projects. Each of the two categories shall be discussed below.

Purchase of services

51. Occasionally, the State wishes to provide a service partially or wholly funded by itself through a third party – an NPO or even a business organization. A contract is drawn up between the government and the organization, which entails a commitment by the organization to provide a certain service, and a commitment by the government to pay for it. The contract specifies the nature of the service, the standard of service required, the population eligible to receive the service, timetables, payment schedules, and financial and substantive oversight by the funding agency over the organization providing the service, and the service itself. The organization in question may supply other services or engage in other activities that are funded by other sources.
52. Purchase of services is the most common form of State support for third sector organizations. State-purchased services may be divided into three categories:
 - a. *Legislated support for services which the government is bound by law to provide.* This kind of support is anchored in law (the law that defines the service and the Budget Law). The service may be provided by the government itself, a third sector organization or a business company. Examples of services that receive legislated support are health and education, and long-term nursing care. Services provided through external agencies are usually anchored in long-term arrangements.
 - b. *Multiyear support:* Multiyear support is granted for services the State is duty-bound to provide for its citizens (higher education, boarding schools, nursing homes). These services are provided by extra-governmental agencies (usually third sector organizations) that receive partial government funding.
 - c. *Other services:* These services are offered by extra-governmental organizations and are wholly or partially financed by the government (in the case of partial funding, the balance must be provided by the organization itself). This type of purchase is not anchored in law. Since the government's ability to purchase such services is contingent on the Budget Law, contracts for the purchase of such services are necessarily of short duration. Examples of such services are: courses for new immigrants, training courses for the unemployed, summer camps for disabled children in community centers, and professional advancement courses for civil servants.

Table 4: Government purchase of services, 1998

| Purchase of services, 1998 | | | | |
|-----------------------------------|-----------------------------------------------------|--------------|-----------------------|--------------|
| Area of activity | Legislated support & multiyear contracts | | Other services | |
| | NIS million | % | NIS million | % |
| Culture and recreation | 731 | 3.4 | 24 | 2.0 |
| Education & research | 9,738 | 45.4 | 471 | 39.8 |
| Health | 9,400 | 43.9 | 48 | 4.0 |
| Welfare | 586 | 2.7 | 367 | 31.0 |
| Environment | - | - | 5 | 0.4 |
| Housing & development | - | - | 64 | 5.4 |
| Civic, legal, and political | - | - | 10 | 0.9 |
| Foundations & philanthropy | - | - | 115 | 9.7 |
| International activity | - | - | 0.2 | 0.02 |
| Religion | 498 | 2.3 | 33 | 2.8 |
| Trade unions | - | - | 46 | 3.9 |
| Other | 473 | 2.2 | 2 | 0.1 |
| Total | 21,426 | 100.0 | 1,185 | 100.0 |

Source: Database of the Third Sector in Israel, Israeli Center for Third Sector Research

53. Table 4 shows that the government transfers large amounts of money to third sector organizations for payment of services provided. In the field of health, “legislated services” and “multiyear support” consist basically of transfers of health taxes to the health funds for services they provide to the public. In the field of education, the bulk of transfers are funneled into higher and independent (religious) education.
54. Most legislated support to third sector organizations is given to a handful of organizations, via special frameworks, such as the Council of Higher Education. This form of funding expresses the third sector’s traditional role as an executive arm of the State. Needless to say, such organizations are extremely dependent on State funding. Their obligation to meet the stipulations of the law, the government, or the supervisory body considerably restricts their autonomy.
55. Transfers for the purchase of “other services” are significantly lower than transfers for legislated services and multiyear support. Nonetheless, while government expenditure for legislated services and multiyear contracts has remained constant, in recent years there has been a perceptible rise in payments for “other services.” This is the result of the emergence of new

services and the expansion of existing ones, and of the trend toward privatization, particularly in the fields of education and welfare. Over the past two decades, the government has delegated several of its educational and welfare services to extra-governmental agencies (including third sector organizations). About 70% of government transfers to third sector organizations for “other services” go to education (39%) and welfare (31%). In 1998, government transfers to Arab third sector organizations for “other services” totaled approximately NIS 44 million, or about 4% of all transfers to third sector organizations for “other services.”

Recommendations concerning purchase of services

56. Given the third sector’s heavy reliance on government funding and policy, the Committee recommends the following measures to enhance the stability and efficiency of third sector organizations:

- a. The regulation of State support, through multiyear contracts that determine the organization’s commitment to provide services, and the government’s commitment to pay for them.
- b. The creation of alternative sources of funding to help the organizations wean themselves of government funding.

57. Payment for "services purchased" comes in two forms: (1) contracts for the provision of services, and (2) contracts for the implementation of joint ventures.

Since each of these contractual relationships entails a different type of interaction between the government and the organization, the Committee recommends that each should have its own separate contracting and review mechanisms.

- a. *Contracts for the provision of services:* In this type of contracting arrangement, the government contracts an organization (usually through a bidding process) to provide a service as well and as cheaply as possible. This type of contracting arrangement suffers from two major drawbacks: (1) It fails to take into account the entrepreneurial added value of the social commitment that typifies third sector organizations, and thereby invalidates it; (2) the standard of the service is monitored only at the start of the contract, and the lack of reporting requirements means that there is no way of ensuring that the initial standard is maintained throughout. The Committee therefore recommends: (1) that the criteria in the tender relate also to the organization’s commitment to social goals, and (2) that the organization be required to report on its compliance with these criteria (see below, reporting requirements to ensure quality of services throughout the contract period).
- b. *Joint venture contracts:* The term joint venture has entered the discourse of government ministries following an amendment to the Mandatory Tenders Law, exempting organizations which invest at least 50% of the cost of the venture, from issuing a tender. This exemption, however, does not take into account investments in human resources, creative ideas and social entrepreneurship. Moreover, the government has failed to develop a tool for defining and evaluating these “partnerships” (joint ventures are still subject to approval by a

ministerial purchases committee). The government uses service-provision contracts and tender mechanisms (despite the exemption) for “joint ventures” too.

The Committee recommends that the parties to the venture define their objectives, the nature of the partnership and ways of evaluating it. Joint ventures should also include ventures in which the investment is in human resources, creative ideas and specialized knowledge, rather than just financial resources, as long as the organization is working for the public interest, and not for profit.

Grants²³

58. Grants are offered to organizations (1) to promote the policy of the government ministry that provides them or (2) in response to external initiatives. They may be given for specific projects, or as a general subsidy. Grants are provided from the State budget, or from other sources, and are usually accompanied by some form of oversight and control.

The distribution of grants is institutionalized and identical for all ministries, to ensure equitable criteria for all applicants. Grants are awarded to “public institutions” in the fields of education, culture, religion, science, art, welfare, health, and sports, and are usually designed to finance professional activity.

59. This procedure, which operates via "Grant Committees" in accordance with paragraph 38a of the Budget Law, replaces the “special allocations” system, which was used by ministers to finance third sector organizations of their liking and had strong political overtones.²⁴ The new system forces government ministries to establish grant allocation criteria, which must be approved by the Attorney General and published in the press. Likewise, government ministries are required to set up “Grant Committees” to discuss the merits of each application, on the basis of recommendations by the professional departments. A list of organizations whose applications were approved is published in the government’s official gazette. All government ministries follow an identical grants allocation procedure, in the form of a signed agreement

²³ In reviewing the situation and formulating its recommendations on this issue, the Committee referred to a document submitted to it by attorney Amon De Hartog, “Strengthening the Principle of Equality in State Support of Public Institutions.”

²⁴ This support, it transpires, was largely influenced by political considerations, and was defined as inequitable, to put it mildly. For example, in *MK Ya’ir Tsaban v. the Minister of Finance et al.* (High Court Petition 59/88), the court determined that “for formal purposes, clear and transparent criteria for allocating financial support must be drawn up, and suitable control mechanisms set in place to ensure the money is being used for the purpose for which it was intended.” It likewise determined that “as far as the substance of the law is concerned, before the government authorities allocate funds, they must be convinced that the purpose for which the funds are assigned is one that the State has an interest in supporting.” In actual fact, the High Court of Justice did not intervene in this case, since the distribution of “special allocations” was entrusted to the Knesset via the Budget Law. In a similar case, *Yehuda Ressler v. Minister of Finance et al.* (High Court Petition 1593/90) the court expressed its opinion that the facts brought by the petitioner concerning the allocation of special funds gave much cause for concern, and that, but for the fact that the Knesset had anchored them in the Budget Law, a decree nisi would most certainly have been granted. In 1992, following public pressure for reform, an amendment to the 1985 Budget Principles Law was introduced, forbidding the funding of “special” institutions under the Budget laws.

whereby the ministry undertakes to fund the third sector organization, and the organization undertakes to use the funds for the intended purpose. The Attorney General has instructed local authorities that award grants to third sector organizations to adopt the same grants allocation procedure.

A study of the scope of government grants and the fields to which they are allocated (Table 2) shows that by far the lion's share is channeled to educational and research institutions (53.4%), with cultural and religious organizations in second and third place (16% and 13% respectively). Between 1991 and 1998, grants more than doubled in real terms, from NIS 600 million in 1991, to almost NIS 2.6 billion in 1998 (over NIS 1.3 billion when controlling for inflation). In 1998, grants awarded Arab third sector organizations totaled approximately NIS 40 million, or only 1.5% of all grants awarded to third sector organizations.

60. Although the government spends far less on grants than on contracts for services, grants still constitute a substantial source of income for many third sector organizations. Since grants are awarded through the annual budget, activities that require medium- or long-term financial commitments are penalized. Multiyear grants would rectify this situation. The above notwithstanding, transfers of grants, unlike transfers for purchases of services, are flexible, free of government intervention, directed at more innovative projects, and sometimes also help cover current expenses.

Table 5: Government grants to third sector organizations

| Field of activity | Grants | | Grants from the Bequest Fund | |
|-----------------------------|-------------|--------------|------------------------------|--------------|
| | NIS million | % | NIS million | % |
| Culture and recreation | 425 | 16.4 | 3.2 | 4.4 |
| Education & research | 1393 | 53.6 | 5.0 | 6.9 |
| Health | 17 | 0.7 | 2.4 | 3.3 |
| Welfare | 98 | 3.8 | 40.3 | 55.4 |
| Environment | 26 | 1.0 | 0.5 | 0.7 |
| Housing & development | 43 | 1.6 | 3.4 | 4.7 |
| Civic, legal, and political | 10 | 0.4 | 0.5 | 0.7 |
| Foundations & philanthropy | 158 | 6.1 | 10.4 | 14.3 |
| International activity | 2 | 0.1 | 0.2 | 0.3 |
| Religion | 338 | 13.0 | 1.2 | 1.7 |
| Trade unions | 71 | 2.7 | 4.1 | 5.6 |
| Other | 16 | 0.6 | 1.4 | 1.9 |
| Total | 2596 | 100.0 | 72.7 | 100.0 |

Source: Database of the Third Sector in Israel, Israeli Center for Third Sector Research

61. The reform in the grants allocation procedure has done little to alter the political considerations governing the allocations of grants.²⁵ The problem lies in the decision-making process. Not only does the government lack a centralized databank on needs in various fields, it has not even attempted to map these needs, or compile accurate data on the scope of government support for third sector organizations (the published information does not cover all forms of direct and indirect support). As a result, the allocations criteria determined by law have become virtually meaningless. The lack of information, and the intrusion of political considerations, makes it hard to determine equitable criteria. Consequently, priorities are usually determined by the political leanings of the granting minister, and the goal of eliminating the arbitrariness of “special allocations” has not been attained.²⁶

Support from non-budgetary sources (bequests and other sources)

62. Direct government support is also provided through the Bequests Committee, which allocates monies from bequests transferred to the State via the Justice Ministry’s Public Custodian. Bequests are divided into designated bequests (bequests designated by the donor for a specific purpose), and non-designated bequests (where the State is authorized to decide the purpose of the bequest). Money from the Bequest Fund is allocated according to a written procedure published in the government’s official gazette. A public committee, presided over by a judge, periodically decides the objectives of the bequests, subject to government priorities. Applications for grants from the Bequests Fund are sent to the relevant government ministry. The ministry and the Budgets Department deliver their recommendations concerning the application and the scope of the grant to the Bequests Committee for a final decision.
63. Since its establishment in 1990, the Bequests Committee has received about NIS one billion from the Public Custodian. In practice, only about half this sum was allocated, due to: (1) The Committee’s commitment to supporting long-term projects; (2) its wish to allocate grants to fields that lie outside the scope of designated bequests; and (3) the NPOs’ inability to meet the testator’s conditions (in the case of designated bequests). Moreover, only 15% of applications to the Bequests Committee were approved. The Bequests Committee attribute this low percentage to the large number of applications for limited resources, and its wish to allocate fixed sums to organizations espousing long-term causes it perceives as being high on the national agenda, such as the Authority for the War on Drugs.
64. Even taking into account that this form of government funding carries much less weight than the others, the amounts allocated to third sector organizations (particularly for innovative

²⁵ A. DeHartog, 1999, *State Support for Public Institutions: Legislation versus Reality*, Floersheimer Institute for Policy Studies, Jerusalem (in Hebrew).

²⁶ See, for example, “Criteria for allocating grants by the Ministry of Labor and Social Affairs to Public Institutions,” (in Hebrew) *Official Gazette* No. 5101, 12 August 2002; “Public institutions that receive grants from the Ministry of Labor and Social Affairs,” (in Hebrew) *Official Gazette* No. 5102, 15 August 2002, and No. 5117, 3 October 2002.

projects) are negligible. Allocations are subject to the whims, if not the political interests, of the government ministries approving them. Most bequests are allocated to current activities or to activities that the State is bound to implement via the State Budget.²⁷

65. Another extra-budgetary source of government support are the funds established through a special Knesset law. These funds may be set up for a general or specific purpose, and the decision concerning the allocation of monies is subject to government policy. Such funds differ from other forms of direct support in that they not require approval in the annual Budget Law. Examples of such funds are: The National Lottery²⁸ and funds operated by the National Insurance Institute,²⁹ as well as grants in kind, such as land, building and equipment which the local authorities make available to third sector organizations. The amount of money accruing from these funds is estimated at tens of thousands of shekels. Although lack of information makes it hard to determine the true extent of this form of support to third sector organizations, it is, no doubt a significant addition to their support base.

The support system: an overview

66. The Committee maintains that the system of government support to third sector organizations is characterized by a lack of cohesion, clarity, information, coordination, and transparency. Moreover, the support system is often used to solve political problems or to benefit preferred sectors.
67. The Freedom of Information Law (1998) obliges every public authority to include in its annual report the names of public institutions it supported and the scope of the support.³⁰ However, providing information is not enough. The way the information is set out is equally important. Today, after several years of partial implementation, the Registrar of Amutot publishes data on government support to public institutions, classified by ministry, organization serial number, and scope of support.³¹ The Committee found that there was no clear distinction between the various types of support on the one hand and contractual relationships on the other, leading to confusion and duplication. The criteria for ascertaining whether a contract or grant was appropriate were unclear and

²⁷ See, for example, "Recipients of funds from Bequests to the State," (in Hebrew) *Official Gazette* No. 5086, 20 June 2002.

²⁸ Monies from the National Lottery are transferred to the local authorities which, in turn, transfer them to third sector organizations that carry out various projects in conjunction with the local authority or alone.

²⁹ The National Insurance Institute runs four different funds that support, inter alia, third sector organizations. These are: The Fund for the Development of Services for the Disabled, The Fund for the Development of Long-term Care Services, The Fund for Demonstration Projects, and the Manof Fund.

³⁰ See paragraph 6(14) of the Freedom of Information Regulations, 1999.

³¹ "Government Support for NPOs (*Amutot*) in 2000," Publications of the Registrar of NPOs, July 2001 (five booklets).

overlapped. Nor was it clear why organizations that had qualified for grants suddenly qualified for support under “purchase of services.”³² The fact that the data on government support are published a year later (information on grants allocations for 2000 were published in July 2001) does not allow the “Grants Committees” to change their mind, or even reevaluate their decisions.

68. A third sector organization must prove that it has been operating for two years before it may qualify for a grant, even if its objectives are approved by the government ministry. This condition acts as a deterrent. The two-year waiting period applies equally to organizations resuming operation, or organizations that are taken over by others. This stipulation hinders the organization’s operation, and may even force it to close down.

Recommendations concerning direct support to third sector organizations (purchase of services and grants)

69. The Committee believes that a prerequisite of a meaningful public debate on the funding of third sector organizations is total disclosure of relevant information, and the transparency of the decision-making processes.

Therefore, a clear definition is required of the support granted by the various government authorities (government ministries, local authorities, and other government institutions), the regulations governing each kind of support, and the relevant operating and reporting procedures.

- a. A clear distinction should be drawn between the grants channel and the “purchase of services” channel, without prejudicing organizations that are forced to switch from the “grants” channel to the “purchases” channel.³³

³² Amnon De Hartog points to a number of inconsistencies in a document submitted to the Committee: “Why is maintenance of children in boarding schools implemented via a tender, whereas government support to boarding schools via a grant? Why is State support for the establishment of *mikvaot* (ritual bathing houses) now in the form of purchase of services whereas formerly it was in the form of a grant? How has State aid for maintaining students in a pre-military academy changed overnight from a grant to a purchase of services? Why is morning care for autistic students funded for by the purchase of service channel, while their afternoon care is funded for by the grants channel?” p. 2.

³³ In the State Comptroller’s Report 53b, the State Comptroller points out, that “A committee appointed by the Accountant General in 1996 recommended guidelines for distinguishing between grants and purchases, according to the Mandatory Tenders Law, 1992, as follows: (a) **Government’s obligation:** Purchase of services applies to services the government is bound to supply. Grants are for all other services and activities. (b) **Scope of funding:** In the case of purchase of services, the government funds the entire activity; in the case of grants, it funds only part. (c) **The initiative behind the activity:** In the case of purchase of services, the initiative comes from the government; in the case of grants, the initiative comes from the organization. (d) **Directives and provisions:** In the case of purchase of services, the organization is subject to government directives and provisions, while in the case of grants it is not. Remarks by the State Comptroller in the past and even more recently show that there is an “overlap” between grants and between purchases of services. Government ministries that are interested in supporting a specific organization – an NPO or government company – do so in one of two ways: (a) through a grant according to paragraph 3a of the law, in accordance with published criteria that apply to that organization only; (b) through purchasing services from a certain organization, without issuing a tender. It was further found that in some cases the name of the organization was specified in the name of the budgetary regulation that sanctioned the support, even though paragraph 3a of the law did not apply to it.” See, *Comptroller’s Report 53a*, 2003, Jerusalem, p. 844.

- b. *Transparency*: The Committee recommends greater transparency in the grants allocation criteria, through encouraging public participation in the process. The Committee recommends draft publication of the criteria, to enable the public to express an opinion, or submit an appeal, before the criteria are finalized. Public participation would achieve a number of goals: (1) Information provided by the public would help the formulation of more equitable criteria, particularly in view of the inaccessibility of information in government ministries. (2) Enhanced transparency would render the process more amenable to public control, and therefore, more reliable. (3) Public participation would stabilize the grants criteria, and discourage litigation (by restricting appeals to the specified period).
- c. The Committee calls on the government to improve publication of its grants program to allow organizations to compare the grants awarded different organizations over the same period. Such a control mechanism. is essential for detecting anomalies in the system of government allocations.
- d. Once a specific ministry has established its grants criteria, it must make them public, to allow appeals to be made where necessary. Decisions concerning the allocation of grants must likewise be made public.
- e. The Committee recommends that the Finance Ministry’s Accountant-General, as the purveyor of payments to third sector organizations, publish information about grants that were distributed that year. The information should be listed by granting ministry, field of activity,³⁴ the specific directive governing the award of the grant, and the size of the grant.
- f. The Committee recommends the introduction of a multiyear allocations policy, while maintaining its budget for new organizations. Such a policy would dispense with the need to review the criteria each year. Instead, the criteria could be reviewed every few years (say, once every three years). A cautious multiyear support policy, based on experience, could facilitate long-term planning of activities, direct government support into more diversified channels, and enhance its effectiveness.
From the perspective of third sector organizations, a multiyear support plan would enable them to assess how much non-governmental support they would need over a period of several years. It would also make it easier for them to obtain matching, multiyear donations from private sources, which are frequently granted only to organizations receiving parallel government support.
- g. Currently, organizations may apply for support only after they have been operating for a period of two years. The Committee recommends cutting the two-year requirement to one year only, in certain instances. In such cases, the government could tighten its requirements for audit reports, evidence of “proper management,” and supervision and control.

³⁴ Thus, for example, youth movements appear in one section, while sports associations appear in another, and so on. In this way, each organization will be able to review the amount of support it receives in comparison with other similar organizations, and thereby to assess the amount of support an organization of its size ought to be getting on a nation-wide basis.

Third sector organizations among the Arab population in Israel

70. Although third sector organizations in the Arab sector in Israel share the same characteristics as other third sector organizations in Israel, they have their own problems that hinder their establishment and operation. Therefore, the Committee considered it appropriate to devote a separate section to third sector organizations among the Arab population in Israel.
71. In 1998, Israel had 1,009 Arab third sector organizations, constituting only 4% of all registered organizations.

Table 6: Registered NPOs in the Arab sector by field of activity, 1998

| Field of activity | No. of NPOs | % |
|-----------------------------|--------------|-------------|
| Culture and recreation | 221 | 22% |
| Education & research | 98 | 10% |
| Health | 12 | 1% |
| Welfare | 116 | 11% |
| Environment | 3 | 0% |
| Housing & development | 138 | 14% |
| Civic, legal, and political | 98 | 10% |
| Foundations & philanthropy | 33 | 3% |
| International activity | 4 | 0% |
| Religion | 250 | 25% |
| Trade unions | 21 | 2% |
| Memoriam | 6 | 1% |
| Other | 7 | 1% |
| Total | 1,009 | 100% |

Source: Database of the Third Sector in Israel, Israeli Center for Third Sector Research

Since the early 80s, there has been a perceptible growth in the number and scope of third sector organizations in the Arab sector (Table 6). The reasons for this are:³⁵

³⁵ A. Zeidan and A. Ghanem, 2000, *Giving and Volunteering in Arab-Palestinian Society in Israel*, The Israeli Center for Third Sector Research, Ben-Gurion University of the Negev, Beer-Sheba.

- a. Continued deprivation among the Arab population in Israel, as a result of the discriminatory policy of State institutions toward it. The growing self-organization of Arab citizens in Israel aims at supplying Arab communities with an alternative to State services, or at pressurizing the State into providing services.
 - b. A rise in the number of young academics in Arab society, who have begun to assume leadership roles at the national and community level. Many of the NPOs were established by young, politically and socially aware intellectuals.
 - c. The Islamic movement, which has established, or helped establish dozens of religious and charitable organizations in various localities.
 - d. NPOs in the Arab sector also provide jobs to Arab academics in Israel who suffer from rampant unemployment, due to the failure to integrate them into the Israeli economy. This has motivated some Arab academics to establish NPOs and mobilize support for them, as a means of creating sources of income.
 - e. Arab advocacy organizations form a higher percentage of civil society organizations than Jewish ones. Of 302 organizations that are active in Arab society, 7.3% are advocacy organizations (as against 5.7% in the Jewish sector). The percentage of service-provision organizations is also high in the Arab society, due to the almost total lack of funding organizations (foundations) in Arab civil society organizations. The prominent fields of activity are: religion, culture, welfare, and housing and development.
In 1998, Arab civil society organizations had 2,323 employees (7.6% of all employees of civil society organizations) – a percentage that is much higher than that of the Jewish sector.
72. Arab third sector organizations in Israel are a major provider of welfare, educational, and health services to the Arab population. As a result of the marginalization of this population over the years, these services developed in the third sector as an alternative or complement to State services. Nonetheless, government support to third sector organizations providing welfare services to the Arab population is conspicuously low. Likewise, the State has failed to recognize the contribution of third sector organizations to providing an answer, albeit partial, to the serious problems of unemployment among the Arab population.
73. The Committee maintains that the main problems hindering the establishment and operation of third sector organizations among the Arab population of Israel are as follows:
- a. The State relates to many Arab third sector organizations as to a “hostile element” potentially dangerous to the State and its activities. One expression of this attitude is recourse to emergency regulations to prohibit the activities of some third sector organizations. This perception prevents the State from recognizing the communal, civic, economic and occupational contribution of these organizations to the development and advancement of Israeli society as a whole.

- b. These organizations suffer from serious financial problems, due mainly to minimal (direct and indirect) government support.
- c. These organizations encounter difficulties when they seek registration as Amutot, when they apply to the Registrar for “certificates of proper management” and when they apply to government ministries for contracts or grants.
- d. Arab organizations are subjected to intensive and sometimes invasive inspections concerning their goals, structure, and modus operandi. Frequently these inspections are different and more thorough than those required of organization in the Jewish sector.

Recommendations regarding third sector organizations in the Arab population in Israel

74. Third sector organizations in the Arab sector are instrumental in helping the development of the Arab population which has, for many years, suffered from discrimination and marginalization. This discrimination has not spared Arab third sector organizations and prevents them from realizing their potential.

The Committee urges the government to publicly declare that Arab third sector organizations must receive the same treatment as other third sector organizations in Israel from all government authorities.

In order to encourage civic activity and prevent discrimination against third sector organizations in the Arab sector in Israel, the Committee makes the following recommendations:

- a. The various registration and oversight requirements of third sector organizations in the Arab sector should be reviewed, to eliminate discriminatory and anomalous requirements.
- b. The government shall refrain from invoking extraneous mechanisms, such as emergency regulations, in its dealings with Arab third sector organizations.
- c. On the basis of the above declaration, government ministries shall be instructed to allow Arab third sector organizations to act freely and independently, so that they, too, can provide advanced services to their public.
- d. To promote government projects via Arab third sector organizations, the government shall increase its funding to Arab organization (both grants and contracts). Likewise, the government shall encourage Arab third sector organizations to submit applications for approval as “public institutions under paragraph 46a of the Income Tax Ordinance.”.
- e. In developing consultation mechanisms with third sector organizations, special attention shall be paid to Arab third sector organizations, and attempts shall be made to encourage their participation in legislative processes and in policy changes by the government ministries in matters that affect them.

- f. The Committee recommends that Arab third sector organizations place greater emphasis on self-regulation and intra-sectoral activity. They should be encouraged to participate in the establishment of “proper management” criteria for third sector organizations and other activities aimed at increasing transparency and sound management, as well as study and training programs.

Taxation and indirect support to third sector organizations

75. Israel, like many other countries, has a comprehensive system of indirect support that takes the form of exemptions from various taxes imposed on for-profit organizations, and tax concessions for donors to nonprofit organizations. This effectively means that the State is prepared to forego income from tax, in recognition of the importance of NPOs – especially those that provide services of public importance.

76. Israeli tax laws for third sector organizations do not distinguish between the different types of nonprofit incorporation. All nonprofit organizations are subject to the same laws regarding taxation, tax exemptions, and tax exemptions on contributions. The two main laws governing taxation are the *Income Tax Ordinance [New Version]*, which grants tax exemptions to "public institutions", and the *1975 Value Added Tax Law*, which grants VAT exemptions to NPOs that meet the following two conditions: The corporation is a non-profit institution and the transaction performed by this body is not a commercial transaction..

The difference between the two aforementioned laws is that the Income Tax Ordinance focuses on the institution’s **objectives** (the public interest). In assessing the tax status of an organization, the Income Tax Authority examines whether the profit source is consistent with the organization’s goals. This is true irrespective of whether the profit derives from returns on financial or physical assets. As long as the investment carries no risk, the organization’s NPO status is intact.

The VAT Law, on the other hand, emphasizes the nature of the **transaction** (profit-seeking or not), rather than the nature of the organization itself. Thus, an organization that has an exemption on income tax may have to pay VAT on certain transactions or activities it carries out. For example, if an NPO carries out a transaction or activity that competes with the business sector, it is obliged to pay VAT on profits accruing therefrom. This condition was designed to prevent discrimination between the third and business sectors.³⁶

Accordingly, third sector organizations are classified into two, partly overlapping, categories: **public institutions**, under the Income Tax Ordinance or **nonprofit organizations**, under the VAT Law.

77. *Exemptions from income tax*

- a. *Public institutions and public objectives*: According to Paragraph (2)9 of the Income Tax Ordinance, an organization defined as a “public institution” operating for a public objective is exempt from tax. The dual criteria (a non-profit-distributing organization operating in

³⁶ Even tangential transactions, such as leasing out real estate or granting loans, are subject to VAT.

the public interest) reflect the legislature's view that tax concessions are governed by social and economic considerations. In other words, tax exemption is part of a policy that supports third sector organizations because of their public function. Underlying this policy is the belief that the State is not the sole provider of public services to its citizens, and that other agencies should be encouraged to assume this role via tax concessions. The government's renunciation of revenue from income tax is, therefore, tantamount to a government subsidy to organizations it wishes to promote. Not all nonprofit organizations are entitled to tax concessions, only those whose activities the legislature wishes to promote.

The legislature lists six criteria for entitlement to income tax exemption. The formal legal definition of a public institution is "an association of at least seven people, most of whom are unrelated, or an endowment, most of whose trustees are unrelated, that exists and operates exclusively for a public purpose, and whose assets and income serve the public interest only, and which file annual reports on assets, income and expenditure with the Income Tax Authorities, according to the regulations stipulated by the Minister of Finance."³⁷

"Public purposes" are defined as "religious, cultural, educational, scientific, health, welfare, and sports-related purposes, or any other purpose approved by the Minister of Finance as being in the public interest."³⁸ On various occasions, the Minister of Finance has added other categories to this list: Saving for secondary and higher education; activities for the security of Israel and related objectives; municipal services to localities in Judea and Samaria, the Gaza strip, and the Ramat Ha-Golan region; prevention of road accidents; growth incentives to counteract unemployment; the Genesis Fund for the promotion and development of the Negev; help to disadvantaged localities; immigrant absorption; assistance to veterans; the promotion of integrity and sound administration in the civil service; the promotion of settlement across the Green Line; preservation of the environment; and the protection of civil rights in Israel. All these objectives, which are recognized in case law, administrative dispositions or ministerial decrees, share the following features: (1) They serve the public as a whole, indiscriminately; (2) they are unconditional (there is no linkage between receipt of service and payment for it); and (3) they are long-term objectives that focus on specific fields, rather than specific cases.

- b. *The non-commercial nature of the activity.* For income of a public institution to qualify for tax exemption, it must not accrue from commercial activity. This condition is examined only after the Income Tax Authority has ascertained that the organization qualifies as a "public institution" under the Income Tax Ordinance, or that its modus operandi and implementation of its objectives meet the established criteria. The above reflects the legislature's belief that a public institution should pay tax on commercial income, even if its main aim is to serve the public.³⁹

³⁷ Paragraph 9(2) of the Income Tax Ordinance.

³⁸ Paragraph 9(2) of the Income Tax Ordinance.

³⁹ The regulations published by the Finance Minister in March 1997 state that an activity is not considered a commercial activity if it is congruent with the institution's objectives. Thus, income from sales or from services that are an integral part of the institution's objectives are exempt from tax. In light of the above, determination of whether an organization meets the criteria of a public institution is carried out in two stages. First, it must meet the structural

78. *Tax exemptions for donors to public institutions*

Paragraph 46 of the Income Tax Ordinance grants a tax exemption to a person or company donating money to a public institution recognized by the Finance Ministry and approved by the Knesset Finance Committee. The donor is granted a 35% tax exemption on the contribution, provided this sum does not exceed 30% of the donor's taxable income. In 2001, an addendum to the regulations stated that contributions over the tax year must total at least NIS 350 and not exceed NIS 2,017,000. These limits are updated on a yearly basis.⁴⁰ The contribution may also be monetary equivalents.⁴¹

Through this form of tax exemption, the State achieves at least two goals: (1) It encourages contributions to third sector organizations, thereby increasing the income of public institutions the government wishes to promote; (2) It allows citizens to channel some of their taxable income into areas of their choice.

Tax exemption is not contingent upon the donor's identity, but rather on that of the recipient organization, which must be a public institution as defined by the Income Tax Ordinance and recognized as such by the Finance Minister and by the Knesset Finance Committee. The involvement of the Finance Ministry and Knesset Finance Committee renders the entire process vulnerable to political influences that are not devoid of personal interest.⁴² Furthermore, the Knesset has no control over the Finance Minister's prerogative of adding new categories to the list of "public objectives."

79. According to the Income Tax Authority's Department of Public Institutions, in 2002, 15,000 organizations were recognized in Israel as nonprofit organizations under the VAT Law. About 12,000 organizations were recognized as public institutions under paragraph 9 (2) of the Income Tax Ordinance, of which 3,800 qualified for tax concessions on contributions

requirements (it must have a minimum number of members, for example), legal objectives as reflected in its founding documents, and non-profit-distributing stipulation, as reflected in its bylaws. Only after the organization has met these criteria will the second stage be implemented: assessment of its work methods and ways of achieving its objectives, according to the specified criteria.

⁴⁰ As stated, this is an **exemption from the amount of tax** the taxpayer would have had to pay. This method is different from the method used in the USA for example, in which the amount of the contribution is **deducted from taxable income**, a method that can place the taxpayer in a lower tax bracket.

⁴¹ For example, the Income Tax Ordinance exempts a gift to a public institution from capital gains tax, and paragraph 61(a) of the Capital Gains Tax Law grants a tax exemption on the transfer of the right to an estate to a public institution recognized under paragraph 46 of the Income Tax Ordinance. As far as the recipient organization is concerned, the Income Tax Authority considers a donation of fixed assets as a cash contribution, and the organization must include them in its reports on total contributions received.

⁴² For example, in early 1998, it was reported that the Income Tax Commission had decided not to renew the tax exemption on contributions to the Amitai Association for Sound Government. The Association had been granted a tax exemption for about four years, on the grounds that it was furthering an educational objective, and the decision to revoke the exemption appeared to have political overtones. The Income Tax Commissioner claimed that the association did not meet any of the seven criteria for tax exemption as defined by the Income Tax Ordinance. In response to this move, opposition MKs rallied a majority for a draft bill permitting tax exemptions on contributions to such associations. When the Finance Ministry discovered that the bill was about to go through, it retracted its threat to abolish the tax exemption, and declared that the association's activity was covered by paragraph 9 (2) of the Income Tax Ordinance.

(paragraph 46 of the Income Tax Ordinance). In 2001, tax relief on contributions and on real estate totaled NIS 120 million. However, the lack of data on other benefits granted public institutions makes it impossible to ascertain the true extent of indirect support to third sector organizations in Israel.

80. Less than a third of all recognized public institutions are entitled to recognition as public institutions under paragraph 46 of the Income Tax Ordinance (tax credits on contributions). The number of organizations applying for recognition as public institutions under paragraph 46 of the Income Tax Ordinance is fairly stable. It is particularly low in the Arab sector (Table 7). Only 43 Arab organizations are recognized as public institutions under paragraph 46 of the Income Tax Ordinance.

We may infer from the above that many third sector organizations that have obtained recognition as public institutions are reluctant to apply for recognition as public institutions under paragraph 46 of the Income Tax Ordinance. Many are deterred by the lengthy inspection processes to which they are subjected by the Tax Authority, and the difficulty of obtaining the approval of the Knesset Finance Committee. Applications by Arab organization for recognition as public institutions under paragraph 46 of the Income Tax Ordinance form a mere 1.5%-3.5% of all applications. This rate is doubtlessly a realistic reflection of how the Arab organizations assess their chances of obtaining such recognition. Over the past two years, the Finance Committee has been asking organizations applying for permits as public institutions under paragraph 46 of the Income Tax Ordinance to submit “a certificate of proper management” from the Registrar of NPOs. The low number of applicants also reflects the fact that many organizations are unaware of this option, and of the financial potential it harbors.

Table 7: Numbers of Applications for recognition as public institution under paragraph 46 of the Income Tax Ordinance (tax relief on contributions) and Permits Granted by Year

| | Number of organizations applying for recognition as public institutions under paragraph 46 of the Income Tax Ordinance (tax relief on contributions) | | Number of permits granted | |
|------|------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------|----------------------------|---------------------------------|
| | Third sector organizations | Arab third sector organizations | Third sector organizations | Arab third sector organizations |
| 1997 | 350 | 6 | 103 | 2 |
| 1999 | 300 | 6 | 75 | 2 |
| 2000 | 284 | 10 | 174 | 2 |
| 2001 | 400 | 6 | 192 | 3 |

Source: The Department of Public Institutions and Nonprofit Organizations in the Income Tax Authority

81. Most indirect support is granted to organizations in the fields of education and research, religion, and welfare, and to foundations (Table 8 below). This trend is a reflection of the eligibility criteria, and the political considerations that govern these criteria. It is not surprising, therefore, that the distribution pattern of indirect support closely follows that of direct support: The same political factors govern both kinds of support.

Table 8: Indirect support for third sector organizations

| | Tax Rebates to donors | |
|-----------------------------|------------------------|--------------|
| | Eligible organizations | % |
| Education & research | 774 | 24.6 |
| Religion | 606 | 19.3 |
| Foundations & philanthropy | 469 | 14.9 |
| Welfare | 450 | 14.2 |
| Culture and recreation | 311 | 9.9 |
| Health | 79 | 2.5 |
| Civic, legal, and political | 80 | 2.5 |
| Housing & development | 35 | 1.1 |
| International activity | 19 | 0.6 |
| Trade unions | 19 | 0.6 |
| Environment | 13 | 0.4 |
| Other | 298 | 9.4 |
| Total | 3,153 | 100.0 |

Source: Database of the Third Sector in Israel, Israeli Center for Third Sector Research

Recommendations concerning taxation and indirect support

82. Indirect support in the form of tax concessions is an extremely important tool for conferring legitimacy on third sector activity, diversifying sources of funding and encouraging giving by the public. The Committee recommends that the government adopt a policy of tax concessions to encourage and enhance the culture of giving in Israel. To this end, it proposes the following measures, some of which will entail changes in the law:
- a. Curtailment of the political factors that play such a large part in determining the acceptance or rejection of applications, and replacing them with objective rather than personal considerations. The Finance Minister shall draw up the criteria for determining whether an organization qualifies as “a public institution under paragraph 46a of the Income Tax Ordinance” (tax credits on donations), which shall then be approved by the Finance

Committee for a period of three years. The Income Tax Commission shall be responsible for annually reviewing applications for recognition as a public institution, and the Income Tax Commissioner shall be the only person entitled to approve such applications.

- b. The Income Tax Commissioner shall publish an annual report entitled “Public Institutions and Tax Relief on Contributions (paragraph 46a of the Income Tax Ordinance),” with detailed information on third sector organizations that applied for recognition as "public institutions," organizations whose applications have been accepted, and those whose application have been rejected (in the latter case, the reasons for the rejection must be specified).
 - c. Despite improved information in recent years by the Tax Authorities on the tax treatment of third sector organizations, there is still insufficient information on the eligibility criteria for the status of “public institution,” public institution under paragraph 46a of the Income Tax Ordinance, and other tax concessions. The Committee recommends that the Income Tax Commission publish a clear and user-friendly review of eligibility criteria, inspection and oversight procedures and the information referred to in paragraph 9b above. Likewise the Tax Commission should undertake to disseminate and explain this information to third sector organizations.
 - d. The current list of public objectives (for which organizations are entitled to tax concessions) is somewhat limited and subject to political influences. The Committee recommends the list be updated and expanded to include not only service-provision organizations, but also civil society organizations, social-change organizations, and organizations catering to disadvantaged populations (the Arab population, new immigrants, etc.).
 - e. Third sector organizations must be encouraged to apply for the status of “public institution” under paragraph 46a of the Income Tax Ordinance at their own initiative, but also with State encouragement. The application process must be simplified and shortened in order to encourage applications by organizations that are deterred by complex, bureaucratic procedures.
 - f. The Committee recommends incorporating tax credits for donations to third sector organizations directly into the employee’s paycheck, as a means of encouraging public contributions to third sector organizations – an option that is used today on a small scale only. Such a system would simplify the process of giving for many citizens and would increase the number of donations to third sector organizations from the public.
83. *Recommendation concerning exemption from local/municipal taxes:*
The Municipal Taxes and Government Taxes [Exemptions] Ordinance (1938) sets forth provisions for exemptions from municipal and local-council rates. These provisions state that any used building or land owned by a charitable organization is exempt from taxes provided the building or land serves a public purpose (hospital, shelter, convalescent home, orphanage, nursery school, school, teachers’ college, school for the blind, public library, and the like) and is not used for profit. Therefore, an NPO’s exemption from payment of rates depends on the kind of activity it exercises. An exemption from rates is not granted automatically, but

only after an application has been submitted and processed by each local authority, according to its regulations.

84. The Committee deplores the inconsistency in the level of rates exemptions granted third sector organizations, and the decisions governing such exemptions. The entire issue must be reviewed and standardized, in order to determine clear and equitable criteria.
85. As well as enjoying various tax exemptions and concessions, third sector organizations are also liable to “special taxes,” as follows:

Table 9: Summary of taxes and benefits for third sector and business organizations (2002)

| | “Public institution” | “NPO not recognized as a public institution” | Business company |
|------------------------------------------------------------|------------------------|----------------------------------------------|-----------------------|
| <i>a. Liabilities</i> | | | |
| 1. Income tax | | | |
| Income from business | 36% | 36% | 36% |
| Income from dividends, interest, and linkage differentials | 25% | exempt | exempt |
| Income from interest | 35% | 35% | exempt |
| 2. Tax on expenditure | | | |
| Salary tax | 9% | 9% | exempt |
| Employers’ tax | 4% | 4% | exempt |
| Surplus expenses | 90% | 90% | 45% |
| <i>b. Exemptions and benefits</i> | | | |
| 1. Tax on income | | | |
| Income from sources other than business | exempt | liable | liable |
| Passive income (interest, rent) | exempt | liable | liable |
| Capital gain | exempt | liable | liable |
| 2. Tax on expenditure | | | |
| VAT on sales | exempt | exempt | 18% |
| VAT on purchases | liable | liable | Exempt, may be offset |
| 3. Fringe benefits | | | |
| Tax relief on donations to public institution | - | - | yes |
| <i>c. Taxation of real estate</i> | | | |
| Betterment tax | Full/partial exemption | liable | liable |
| Purchase tax | Partial exemption 0.5% | liable | liable |
| Sales tax | Full/partial exemption | liable | liable |

Source: Income Tax Authority, Professional Division, Department of Public Institutions

86. *Taxation on surplus expenditure*

This is a 90% tax on expenditure that exceeds the amount permitted under the Income Tax provisions. The purpose of this tax is to prevent abuse (attributing non-deductible expenses to the NPOs, or using fringe benefits as a way of circumventing the prohibition on distributing dividends).⁴³

87. *Recommendations concerning surplus expenditure:*

The Committee deplores the fact that third sector organizations are taxed for surplus expenditure at a higher rate than are business organizations (90% and 45% respectively). This high tax rate limits an organization's ability to mobilize volunteers (and to pay travel or personalized expenses). Moreover, business organizations that are showing a loss are entitled to deduct surplus expenses against future taxable income, while third sector organizations are not.

- a. The Committee recommends that the tax rate on surplus expenditure for third sector organizations be brought in line with that for business organizations.
- b. The Committee recommends that third sector organizations, like their business counterparts, be permitted to deduct surplus expenses against other taxes incumbent on third sector organizations. The deterrent objective of the tax will not be compromised as a result of such a change.

88. *Deduction of inputs*

The VAT Law (1975) states that a nonprofit organization is not entitled to deduct inputs for tax invoices issued it from salary tax. Nevertheless, NPOs are required to pay full VAT on acquired inputs, and, unlike business organizations, are not entitled to receive a partial refund of the VAT they paid from the cost of inputs.

89. *Recommendation concerning deduction of inputs:*

The Committee believes that depriving third sector organizations – particularly those that are not labor-intensive or that rely on donations – of the possibility of deducting inputs, is counterproductive. The Committee proposes a review of the policy for deduction of inputs and the introduction of differential regulations.

90. *Employers' tax:*

The Employers' Tax Law (1975) obliges third sector organizations to pay employers' tax at the rate of 4% of their employees' salaries. Although employers' tax originally applied both to third sector and business sector organizations, as a means of raising taxes on salary expenses,

⁴³ For example: (1) Refreshments, travel abroad, personalized expenses, gifts, entertainment, and telephone expenses; (2) sums disbursed by the NPO that are ordinarily non-deductible expenses, such as benefits granted to employees (rather than to a specific employee) or car-running expenses for employees (rather than for a specific employee); (3) sums the organization paid into the severance fund, if they exceed the deductible amount had it been exempt from tax as an NPO.

in 1992, business organizations were exempted from the tax, while third sector organizations continued to pay it.⁴⁴

91. *Recommendation concerning employers' tax:*

The Committee maintains that employers' tax discriminates against third sector organizations vis-à-vis business organizations and urges its immediate abolition.

Supervision and control

92. As stated above, the third sector comprises three types of organizations:

Associations (amutot), incorporated according to the Amutot Law (1980).

Public benefit companies, incorporated according to the Companies Law (1999)

Public endowments, which operate according to the Trust Law (1979).

Each of these types of organization has its own internal and external governance and audit mechanisms. Some of these mechanisms are statutory, while others are stipulated by agencies outside the organization.

93. *Internal audit and oversight*

a. *Associations (amutot)*: The Amutot Law states that an Amuta must appoint an audit committee from among its members (the general assembly). Furthermore, an Amuta with an annual turnover of NIS 970,000 or more (in 2002 terms) must appoint a CPA to audit the annual report and submit his opinion of the report to the general assembly. Each Amuta is also bound by law to submit a series of reports to the Registrar of Amutot, including a copy of an approved financial report, minutes of meetings, and notification of changes in the board, the audit committee, etc.

b. *Public benefit companies*: The Companies Law stipulates that each company must appoint a CPA to audit its affairs. Moreover, the board of a publicly-owned company is obliged to appoint, from among its members, an audit committee as well as an internal auditor. The above notwithstanding, the board of a private company (and for our purposes, a public benefit company is a private company, since it is not registered on the stock exchange) is entitled, but not obliged, to appoint an audit committee or internal auditor for the company.

A company is also subject to reporting requirements. Reports must include an annual report, submitted to the Registrar of Companies, and including details required by the Companies Law, a financial report, and a report on the company's affairs, submitted to the Registrar of Endowments, as stipulated by the Trust Law.

⁴⁴ See Employers' Tax Law, 1975, and Employers' Tax Provision (change of tax rate) (1992).

c. *Endowments*

The Trust Law does not stipulate audit or oversight requirement for a Trustee of a public endowment, apart from the Trustee's obligation to submit a financial report and report annually to the Registrar of Endowments on the endowment's affairs, and to obtain court approval for certain activities, as stipulated by the Trust Law.

94. *External audit and oversight*

External audit and oversight mechanisms may be stipulated by law, or may be required by certain funding bodies and government authorities, or by the organizations themselves, as described below:

- a. Many organizations that receive grants from foundations appoint a CPA to audit their books and the annual report, even if they are not obliged to do so by law (if their annual turnover is less than that stipulated by law).
- b. For the same reasons, many organizations hire an internal auditor, even though not legally required to do so.
- c. Funding bodies, including government agencies, may carry out inspections of organizations they fund through external CPAs, in addition to the accountants appointed by the organizations themselves.
- d. Organizations that are funded by State authorities (and recently also by other public and institutional bodies) are required to obtain a certificate of proper management from the Registrar of Amutot, in addition to the requirements of the funding body. Certificates of proper management are sometimes granted only after a comprehensive and invasive inspection by the Registrar of Amutot.
- e. The State Comptroller monitors organizations receiving support from the State and budgeted organizations.⁴⁵

The registrars

95. *The Registrar of Amutot*

The Registrar of Amutot is empowered by the Law of Amutot to accept or reject applications for registration, to intervene in certain cases in the activity (or lack thereof) of the Amuta's institutions, and even to appoint, in special cases, board members, accountants and others. The Registrar of Amutot may demand to see all the Amuta's reports and documents, and in unusual cases, even demand "clarification of details of the financial report."⁴⁶ He is authorized

⁴⁵ See Chapter entitled "Oversight of Amutot," (in Hebrew) State Comptroller's Annual Report, 52b, 2002, in connection with the Ministry of Interior's oversight activities.

⁴⁶ According to paragraph 38a of the NPOs Law.

to appoint a third-party investigator (other than the Registrar or his employees) to investigate the Amuta's activities, and may, under certain circumstances, request that the Amuta be dismantled.

The Registrar is also authorized by a government decision of 1998 (not by the Law) to grant a certificate of proper management.⁴⁷ In recent years, most of the Registrar's time has been taken up by the exercise of these new powers.

The increase of the Registrar's powers of oversight has aroused opposition on the part of many third sector organizations, which accuse him of overextending his authority.

96. *The Companies Registrar*

The Companies Law empowers the Companies Registrar to decide whether an application to register a company complies with the dictates of the law. His main role is to ensure compliance with the various statutory reporting requirements, and he is authorized to demand that the company submit documents, ledgers, and the like, for his inspection.

The Companies Registrar does not have the right to inspect companies or award them certificates of proper management.

97. *The Endowments Registrar*

The Trust Law grants the Endowments Registrar certain powers over a public endowment or public benefit company (which, for this purpose, is considered a kind of public endowment). Both types of organizations must report to him, and he is authorized to order an investigation if he has reason to believe that they have contravened a provision of the Trust Law, or if details or documents submitted to him are incorrect or incomplete.

The Endowments Registrar is not authorized to inspect public endowments or public benefit companies or award them certificates of proper managements.

Recommendations concerning supervision and control

98. The Committee believes that the integrity and honesty of third sector organizations (as of public and business organizations) are both a social concern and existential necessity, for the sector itself and for society as a whole. The third sector's ability to act independently and to represent civil society genuinely is contingent on its integrity. Moreover, third sector organizations should try to project an untarnished public image. The issue of supervision, which is central to the existence of the third sector in Israel, raises many questions concerning the balance between the degrees of government intervention versus the sector's accountability to the public. Another question is whether third sector organizations that do not receive government funding should be subjected to the same oversight as those that do. Other questions pertain to the powers of the supervisory bodies and methods of supervision.

⁴⁷ Government decision No. Bet Quf/128 of 23.9.1998.

99. For the purpose of its recommendations, the Committee differentiated between six supervisory and control mechanisms:

- a. The internal mechanism: board of directors, audit committee and external auditor (CPA).
- b. The Registrars of Amutot and Endowments: appointed to ensure compliance with the Law of Amutot and the Trust Law.
- c. The tax authorities: responsible for determining the tax status granted to third sector organizations.
- d. The allocating authorities: responsible for exercising professional supervision of the funded activity and ensuring compliance with the terms of the grant.
- e. The State Comptroller.
- f. Funding agencies (foundations, private donors, etc.)

100. *Minority opinion of Nissan Limor and Sarah Silberstein-Hipsh:*

Paragraphs 98-110, on the Committee's recommendations regarding supervision and control, do not address the issue of self-regulation, via a body from within the sector itself that would serve as a vital link in the supervision and control of third sector organizations.

In the third sector, as in the business sector, self-regulation (supervision by an independent body within the sector itself and not by the government) is a topic that is gaining currency. Experience shows that, to date, self-regulation has been fragmentary and unsatisfactory. On the other hand, the statutory creation of an oversight mechanism by a government authority is a cumbersome process that places a heavy financial burden on both the State and society, and does not provide a suitable answer. In view of the above, it is not surprising that the idea of self-regulation by a public body from within the sector itself is gaining ground.

By nature, statutory provisions are open to diverse interpretations, and loopholes can always be found. Consequently, supervision becomes less effective, and often litigation must be resorted to in order to clarify the meaning of the law. In many cases, the court gives its verdict a posteriori, when the sanction no longer has much meaning.

For our purposes, a law is meant to allow an authority to act, or to set limits to an organization's activities. It is designed to provide an answer to critical situations (such as a market slump) that require State intervention. The law cannot provide an answer to every possible situation or dynamic that evolves. Precisely in the third sector, which requires a large measure of freedom, public, social, and economic mechanisms must be given free rein. Experience in Israel and elsewhere shows that over-regulation not only does not help, it hinders. The attempt to use the law as the main means of improving governance of NPOs has not been successful. Too rigorous supervision paralyzes the organization's institutions. Nor have sanctions and penalties proven to be the answer. There is a growing body of research literature on this theme, and the laws of incorporation have been amended accordingly. Israel, however, has been extremely slow to assimilate new approaches toward the third sector, for various reasons, most of which the Committee has discussed.

We propose consolidating the trend reflected in recommendation 120 regarding the self-regulation of third sector organizations in determining standards and accreditation processes. Accreditation by a public body from within the third sector together with other public bodies that are involved in the sector, in a transparent manner, is a suitable tool for self-regulation. Self-regulation makes it possible to avoid obstacles and prevent mistakes in time, without having to rely on government mechanisms. Transparency and disclosure of organizations

that comply with regulations is an effective way of granting public recognition to nonprofit-distributing organizations that promote public objectives. Equally, transparency and disclosure serve to acquaint organizations, the public, and donors, of those organizations that fail to meet the proper management requirements of third sector organizations.

Therefore, we propose replacing paragraph 99 above with the following:

For the purpose of its recommendations, the Committee differentiated between seven supervisory and control mechanisms over third sector organizations:

- a. The internal mechanism: board of directors, audit committee and external auditor (CPA).
- b. Self-regulation of the sector through the appointment of a public body from within the third sector itself, responsible for determining quality standards and setting in motion an accreditation procedure.
- c. The Registrars of NPOs and Endowments: appointed to ensure compliance with the NPO Law and the Trust Law.
- d. The tax authorities: responsible for determining the tax status granted to third sector organizations.
- e. The budgetary authorities: responsible for exercising professional supervision of the funded activity and ensuring compliance with the terms of the grant.
- f. The State Comptroller.
- g. Funding agencies (foundations, private donors, etc.)

101. *Internal supervision and control of third sector organizations*

Since the Committee recommends minimal government intervention in the affairs of third sector organizations, the Committee believes that a distinction must be drawn between organizations that receive public funds (whether direct or indirect) and those that do not. This does not imply that the government has the right to intervene in the affairs of an organization it supports. Each organization should be allowed to manage its internal affairs, as long as it operates transparently and does not engage in criminal activity or abuse its status. Since third sector organizations are engaged in a collective voluntary activity that is not part of government activity, they should not be subjected to undue government control. Organizations that wish to reduce contact with the government to a minimum must be allowed to do so. Therefore, the Committee upholds a policy that allows organizations as much freedom as possible, including the freedom to make mistakes and learn from them. For example, apart from the requirements to submit statutory reports, the State has no right to interfere in the way an organization manages its funds, unless it suspects it of criminal activity. Likewise, the State has no right to intervene in the organization's internal supervisory and control mechanisms, which should be part of the organization's personal ethos. The Committee believes that the issue of supervision and control is particularly relevant for NPOs that do not receive public funds.

102. *Supervision and control of NPOs that do not receive State funds*

- a. The internal audit body of NPOs that do not receive State funds is the audit committee or some similar body. These NPOs are also obliged to appoint an accountant to audit the financial report and express an opinion concerning the financial report that is presented

to the general assembly for approval.⁴⁸ An NPO is a voluntary body composed of members who agree to act together. Members of an NPO are required, inter alia, to declare their willingness to accept its bylaws and resolutions. As long as they do so, no external supervision or control of their activity is required by law.

The Committee believes that supervision and control of an NPO's affairs should be vested in the audit committee and its members (the general assembly) who should submit detailed reports (see paragraph 103 below).

- b. The interpretation of the Law of Amutot (particularly by the Registrar of Amutot himself) as granting the Registrar broad powers of control is erroneous, particularly in the case of Amutot that do not receive public funds. The Committee believes that, through rigorous application of the statutory requirement of transparency, an Amuta's internal apparatus (audit committee, board, general assembly and members) can act as its supervisory and control body.
- c. Steps should also be taken to enhance the knowledge and accountability of the members, board, or audit committee of an NPO concerning management of the NPO and relevant statutory requirements (see below, section entitled: Self-regulation of third sector organizations).
- d. To ensure compliance with the provisions of the Law of Amutot, organizations should be required to establish a management apparatus with defined powers. Since the third sector today also operates as a public trustee, the public must be protected and feel safe in the knowledge that its trustees are acting properly, in diligence and good faith. The current law provides only general guidelines concerning the obligation of board members to act in good faith. These guidelines fall short of the requirements of diligence and good faith⁴⁹ stipulated by the new Companies Law. The Committee recommends that the accountability of directors and salaried executives of nonprofit organizations be defined by law. This can be done through the mandatory establishment of a management apparatus with defined powers that is able to run the organization, in accordance with the policy determined by it. In this way, an internal system of checks and balances is created within the organization between the public and professional levels

103. *Transparency and reasonable disclosure.* An organization that works for the benefit of the public or certain sections thereof must be open and transparent to its members and to the public at large. Transparency means reasonable disclosure, and keeping members, clients, and all interested parties informed of its activities.⁵⁰

⁴⁸ The obligation to appoint a CPA applies only to associations with an annual turnover of over a certain ceiling (about NIS 1 million in 2002).

⁴⁹ Paragraph 27 of the Law of Amutot states: "Board members must act for the good of the association and in

⁵⁰ As the State Comptroller points out in Report No. 47, "Sometimes, the members or directors of an NPO form business ties with individuals or companies that are close to them (known as "connected parties"). The Law of Amutot does not provide an all-inclusive definition of who or what is considered a connected party, and of what constitutes proper disclosure of activities involving them. It does not specify the duty of good faith of Amuta

Today, Amutot are required to submit a financial report on income and expenditure to the Registrar of Amutot. This report does not include information regarding the Amuta's goals, activities, volunteer staff or means of attaining its goals. The Committee recommends:

- a. That the requirement of proper disclosure be anchored in law in order to prevent abuse and that an Amuta be required to submit an annual activity report on the above aspects of its activity, in addition to the financial report.
- b. That the Registrar of Amutot be obliged to publish a detailed annual report (similar to that published by the Registrar of Government Companies) with information on each Amuta, its goals, its senior executives, and a summary of its financial reports. This publication must be made accessible to the public via the Internet.

104. *Supervision of third sector organizations by government ministries*

In principle, the situation of an NPO that receives State funds is no different from that of an NPO that does not, since in the final analysis, both are funded from public sources. There would, therefore, appear to be no reason to establish separate supervisory and control mechanisms. In actual fact, however, the grant or allocation is usually earmarked for a specific activity, and it makes sense to allow the provider of the funds to ensure that proper use is being made of his money.

The Committee believes that the body responsible for the allocation of direct or indirect public funds should also be responsible for ensuring that the recipient organization meets the conditions and regulations stipulated at the time. For example, the tax authorities should be responsible for tax concessions granted to third sector organizations (indirect support) while the government ministries and local authorities should be responsible for the grants they provide (direct support).

It is therefore imperative that the conditions of the grant be clear and transparent both prior to, and during a contractual relationship between the allocating authority and the recipient organizations.

105. The Committee is aware of the fact that this recommendation, which entails a number of supervisory mechanisms, may lead to duplication. Such duplication is, however, inevitable since, for the supervision to be effective, it must be carried out by the funding body that is best suited for the purpose. It follows that an NPO that receives public funds has a duty to report its compliance with: (1) The general requirements of an NPO, and (2) the requirements of the funding agency.

106. The above notwithstanding, the absence of procedural consistency, and the lack of coordination between supervisory mechanisms dealing with similar issues, leads to overlap and duplication, causing unnecessary expense, and bureaucracy.

members and directors toward the Amuta and its other members, in the case of ties with connected parties. There is a need to clarify the issue of a conflict of interests between office holders within the Amuta, and the legality or otherwise of transactions with them.”accordance with its objectives, articles and the decisions of the general assembly.”

The Committee recommends reviewing, standardizing, and rationalizing current procedures for the benefit of government ministries and third sector organizations alike.

107. *Supervision and control by the Registrar of Amutot*

The evidence reviewed by the Committee points to friction between the Registrar of Amutot and the Amutot, particularly regarding the interpretation of the law and the granting of “proper management certificates.” The Amutot complain that the Registrar interprets the laws as granting him broad discretionary powers without a governmental, parliamentary or public oversight apparatus.

Dependency on the Registrar hampers the Amutot’s ability to function properly. The Amutot report delays in receiving funds to finance their activities. They complain that the Registrar, rather than acting in an advisory capacity, acts in a supervisory capacity that can be challenged through legal means only.

The Registrar, for his part, believes that he is merely obeying legal and governmental directives to ensure proper management of Amutot. He believes that intervention and supervision are necessary at this stage, until sound management norms are firmly established, after which it should be possible to relax the reins.

108. Third sector organizations are, by definition, more vulnerable than other organizations; some of them are even in conflict with government authorities. This raises doubts as to whether the motives for State intervention are free of extraneous considerations. Without entering into the subject of whether the standard of governance of Amutot is satisfactory, the Committee maintains that the Registrar’s involvement in matters of internal governance should be limited, to prevent abuse of his position for political ends. In view of the above, the Committee, while reluctant to recommend abolition of the position of Registrar, proposes the following measures:

- a. Subordination of the powers of Registrar to a public committee that will supervise his work.
- b. Assumption by the third sector of internal audit functions, including the determination of proper management norms and criteria that will be binding on the organizations.

109. The Committee recommends that the public committee overseeing the activities of the Registrar of Amutot, determines policy guidelines for the Registrar and draws up normative requirements of enforcement, accountability and transparency.

Half the members of this committee shall comprise government representatives including the Registrars (of Amutot, companies or endowments, as the case may be), representatives of the Justice and Finance Ministries and of other relevant ministries, while the other half shall be made up of public figures, professionals, academics and representatives of organizations. The committee shall be set up by law, or by a government resolution, and shall be headed by an independent public figure.

The committee shall publish an annual activity report and its decisions will be published in the government's official gazette. Before appointing a registrar, the relevant ministry must consult with the public committee.⁵¹ All statutory registrars shall be subject to the committee's decisions concerning third sector organizations and shall be obliged to implement these decisions and report to the committee, at its discretion

110. The question was raised as to why the Registrar of Amutot is accountable to the Ministry of the Interior, whereas the other statutory registrars are accountable to the Ministry of Justice. Although the Committee believes the issue worth discussing, it decided to refrain from doing so within the purview of its work.

The promotion of foundations and philanthropy

111. Philanthropic foundations have a decisive role to play in the development and consolidation of the third sector in Israel. They are particularly important for third sector organizations that rely on public funds or self-generated income to cover current expenditure (such as museums or hospitals). Such organizations may use contributions from foundations to help develop new projects, purchase new equipment or assume new functions. Usually, foundations are better able to raise funds than are isolated organizations.
Philanthropic foundations play a major role in the development of social investments. In a developed civil society, philanthropic foundations create a healthy alternative to government frameworks. In addition to their role in developing social investments, foundations also contribute to more modest objectives, such as providing scholarships or research grants for specific fields of activity, or long-term support to organizations that are unable to obtain funds from other sources (for example, social-change organizations).
112. Although investment in social infrastructure has always been the main activity of foundations and other extra-governmental bodies in Israel, these bodies have always been closely linked to the government and the political establishment. For example, many public buildings in local authorities are financed by the "National Lottery" and in the past by the Jewish Agency. On the other hand, some development projects within the educational system are financed by foundations such as the C.R.B. Foundation and Rashi Foundation – from funds that are not part of current public budgets.
113. In Israel, the Hebrew term "keren" ("foundation" or "fund") is sometimes used as a front for activities that are not consistent with what is usually thought of as those of a philanthropic foundation. Hospital "research funds," for example, are often not used to fund research, but to hire personnel, beyond the allocated quota. Moreover, such research funds cannot be considered foundations, since the funds are not assigned to a specific field, and the interest

⁵¹ A proposal was raised before the Committee that appointment of a Registrar of Amutot by a minister be made contingent on prior approval by the public committee, or alternatively, that the Registrar of Amutot be chosen through an external tender, by a subcommittee appointed by the public committee.

accruing therefrom is not used to support the relevant research activity. Rather, the so-called research fund is an annual public allocation that “circumvents the budget,” and is called a “foundation” for reasons of convenience only. Consequently, the money of many “foundations” is used primarily to expand the activity of the public sector. Moreover, decisions regarding the scope and target of the investment are largely influenced by local and national politicians, whose considerations are not always consonant with the nature and goals of the said activity. This situation is a clear manifestation of the politicization of philanthropy in Israel.

114. The promotion of foundations, by offering new and varied resources, is an excellent way of weaning the third sector of its dependence on the State. The economic contribution of foundations today is an important supplement to the government budget. Foundations review applications, supervise activities, and demand reports on output. The absence of significant economic incentives for independent foundations shows that their contribution is not sufficiently appreciated by the government.

115. **Recommendations concerning foundations**

a. The Committee recommends the institutionalization of the concept of “philanthropic foundation.” A corporation which specializes in providing grants to NPOs may qualify for recognition as a “philanthropic foundation,” provided it meets specified conditions. Decisions on grants and grantees will be entrusted to a public body, and the donor or his family shall have no say in the matter. For recognition as a philanthropic foundation, the organization must be an independent, registered corporation, with a minimum, specified amount of domestic assets. A foundation’s money shall be deposited under conditions specified by the Knesset Finance Committee. Its total contributions in Israel shall not be less than the interest on the net investment (after deduction of management expenses). Management expenses shall not exceed a specific percentage of the contributions. Foundations shall publish rules for the submission of applications, operating guidelines, decisions concerning the awarding of grants, and an annual report.

A person or company that contributes to a recognized philanthropic foundation shall participate in determining the foundation’s objectives, and shall be entitled to tax relief on the full amount of the contribution. A corporation that is recognized as a philanthropic foundation shall be exempted from paying tax on the returns on its investment.

Appropriate measures to promote foundations could encourage giving by Israelis and Jews living abroad, in their lifetime or through bequests. Naturally, foundations that wish to retain their autonomy need not apply for recognition. Although such foundations will not be entitled to the benefits that are reserved for recognized philanthropic foundations, they may apply for the status of public institution if they meet the statutory requirements.

b. The Committee recommends publication of a list of all recognized foundations, with information about them, their fields of activity, eligibility for grants and conditions for receiving grants. Such a publication would also encourage coordination between the various foundations and provide better coverage of their fields of activity.

- c. Today, there is little cooperation between foundations, due to competition amongst them and with third sector organizations over sources of funding. The Committee recommends the establishment of forums to promote cooperation and coordination among foundations, and between them and third sector organizations
116. *Minority opinion of Emanuel Sharon:* In my opinion, the sweeping tax concession granted to donors of philanthropic foundations on the full amount of their donation is unjustified. I propose that tax credits on donations to philanthropic foundations be brought in line with those on donations to public institution under paragraph 46a of the Income Tax Ordinance.

Involvement of the business sector in third sector activity

117. In recent years, there has been a trend toward increased involvement of the business sector in the community. One manifestation of this trend is the business sector's support for the activities of third sector organizations in various fields.
- In Israel, as in the West, the business sector's former emphasis on charity and giving has been replaced by an emphasis on partnership and involvement. Involvement by the business sector in social action is motivated primarily by business considerations (promotion of the firms' interests) rather than by philanthropy per se. For example, involvement in social action may be a way of improving a firm's image or reaching out to new target communities. Social involvement may also be used as a means of improving dialogue and cooperation between the various departments of a firm. Nevertheless, the significance of business sector involvement in third sector activity, for society as a whole, and for the third sector in particular, transcends purely commercial considerations.
118. In the past, the relationship between the business and third sectors was a donor/ recipient one. Now, it is more of a partnership to further social objectives, with both sides clearly interested in promoting such activity. As stated, the partnership takes the form not only of financial contributions, but also of involvement in activities, organizing workers' volunteer work, and the like.
- The Committee maintains that in Israel this trend is still in its infancy, and has a long way to go before it is fully accepted by the business sector. This is because the business and third sectors are ignorant of each other's characteristics, values, goals and activities. This ignorance often leads to wariness, negative stereotyping, and reluctance to cooperate. Third sector organizations often fear that partnership with business organizations will threaten their autonomy. Business organizations, for their part, are unwilling to cooperate with an organization they consider impractical, and find it hard to understand why third sector organizations are so sensitive to the issue of autonomy.

Recommendations concerning involvement of the business sector in third sector activity

119. a. The Committee believes there is much scope for cooperation between the business and third sectors. In order to encourage such cooperation, each side must be informed of the advantages inherent in such cooperation. Joint forums should be set up to enable the two sectors to get to know the other, and to build mechanisms of cooperation (such as databases, mediation organizations) between the two sectors that would lead to joint ventures.
- b. Amendment No. 10 of the Securities Regulations (Immediate and Periodical Reports, valid as of 31.12.2001) concerning a business company's duty to submit a report on the scope of philanthropic contributions it made, is an important step toward encouraging companies to donate to third sector organizations as well as promoting transparency toward the public.
- c. The government shall encourage greater involvement by companies in social-voluntary activity, by granting tax relief on donations, and by conferring tokens of public recognition, such as commendations and awards, on business companies that are involved in the community.
- d. The Committee recommends that third sector organizations find ways of publicly recognizing business corporations that are models of social responsibility.

Self-regulation of third sector organizations

120. Various countries around the world have established self-regulating bodies within the third sector. These bodies unite organizations within the sector, work to promote common aims vis-à-vis government institutions, and seek to regulate the sector's activity through internal supervision, guidance, and control mechanisms. In Israel, such bodies are conspicuous by their absence. Although the third sector covers a wide range of organizations specializing in diverse fields and with different orientations, this diversity should not hinder working together to promote common issues.

The Voluntary and Nonprofit Sector is the only umbrella organization of third sector organizations in Israel today, and embraces several hundred NPOs, including most of the large national organizations.

Recommendations concerning the self-regulation of third sector organizations

- a. The Committee favors the establishment of a nation-wide federation of NPOs that would be divided into sections according to field of activity. As many organizations as possible should be encouraged to join this federation and its sections.

- b. The Committee believes that one way of encouraging self-regulation among third sector organizations is by granting them a special status. Today, the sector is not represented in State or public organizations that handle its affairs. Moreover, third sector organizations, or their umbrella organization, have been granted neither recognition nor status, unlike employers' or workers' organizations, whose status is recognized by law, or by agreements with the government. Their representatives are not invited to forums to discuss issues relating to them, and they have to struggle to make themselves heard. Representation of third sector organizations will entail the establishment of internal democratic mechanisms for electing representatives and for creating consensual positions.
- c. In recent years, "The Voluntary and Nonprofit Sector" has begun developing internal tools for the third sector. These tools include the adoption of a code of ethics, the establishment of criteria of excellence, and the conferral of awards⁵² on organizations that meet these criteria. Such tools, albeit fairly novel in Israel, have been in existence in the West for over two decades. Indeed, a benchmark of proper management has become a basic condition for ties between government, public and business organizations. The quality standards and processes of accreditation are not determined by the State or the Registrar of NPOs, but by a self-regulatory body and by standards committees in the various sectors, whose decisions are binding on the entire sector. This type of supervision (self-regulation) is as effective as supervision by government authorities.
- d. The Committee recommends that third sector organizations encourage the trend toward the establishment of quality standards. The Committee believes that in order to preserve its autonomy, the third sector, and its component organizations, must be careful to maintain standards of integrity and sound management. Self-regulation (the development of tools by the third sector for monitoring its activity) would not only enhance the quality of third sector activity and its public image, but would also prevent intervention by extraneous – particularly political – elements. At the same time, a broad range of training programs is necessary to help organizations prepare for standardization and review their performance on a regular basis.
- e. The Committee recommends that government ministries recognize the aforementioned quality standards.

Minority opinion of Rachel Liel: I oppose government recognition of quality standards, since this could turn into a binding norm that would discriminate, albeit inadvertently, against organizations complying with the Law, but eschew accreditation for whatever reason. The determination of a normative ceiling in the form of accreditation could create a situation whereby the government would not be satisfied with compliance with statutory requirements alone, and would have misgivings about organizations that have chosen, for

⁵² For details, see "Code of Ethics for Nonprofit Associations, Nonprofit Institutions, and Nonprofit Organizations"; "Self-Assessment Questionnaire prior to Accreditation, Public Standardization Committee, *The Voluntary and Nonprofit Sector*," April 2002; and "List of NPOs that have Completed the Self-Assessment Stage (Stage A) prior to Accreditation," *The Voluntary and Nonprofit Sector*, July 2001 (all in Hebrew).

whatever reason, not to undergo accreditation. The government would perceive such organizations as attempting to hide issues relating to their proper management. Under such circumstances, the organization would be called on to prove its integrity and sound management simply because it decided to forgo the process of accreditation.

- f. Self-regulation is a key factor in the consolidation of third sector organizations. Self-regulation can be encouraged by extending the educational activities of the umbrella organization to include: subsidized consultations, counseling and training activities, and the establishment of mediation forums between the third and other sectors.
- g. The Committee believes that self-regulation of the third sector in Israel has a key role to play in developing training courses and specialties in third sector management, voluntarism and philanthropy. So far, there is only one academic course in Israel for training directors of third sector organizations. Umbrella organizations can help promote educational programs and training courses, and provide study incentives.

Recommendations concerning social-change organizations

121. Although social-change organizations form only a small percentage of third sector organizations in Israel, they are instrumental in promoting civil society. These organizations are extremely important: They contribute to policy-making processes, they raise new issues on the public agenda, warn of problems, pioneer change, propose explanations and alternatives to the status quo, and provide vital information. Their contribution is reflected also in their pioneering role as initiators of alternative and modern services, or services that have not yet been recognized by the establishment.

The Committee emphasizes that social-change organizations are a vital part of civil society in Israel, and their development contributes directly to the consolidation of democracy. Social-change organizations receive little direct or indirect support from the government. Most of them have difficulty in finding alternative sources of funding, and their existence is precarious. The Committee recommends increasing government funding of these organizations, especially in the form of indirect support (tax concessions).

- a. Since social-change organizations are rarely awarded the status of “public institutions” under paragraph 46a of the Income Tax Ordinance, they do not receive the tax benefits this status entails. As stated above, the Committee recommends extending the list of public purposes to include social-change organizations, including those that focus on special issues (such as civil rights), or special population groups (new immigrants, Arabs, the disabled, etc.)
- b. Whereas service-provision organizations develop close ties with government agencies due to their joint activity, the attitude of government ministries and agencies toward social-change organizations ranges from total disregard to wary cooperation. While some government ministries consult frequently with social-change organizations, others deny their right to speak in the name of the various population groups they represent.

The Committee recommends establishing mechanisms of consultation with third sector organizations on legislation (including ordinances) and policy changes relevant to the populations and issues they represent. A government ministry that wishes to introduce a bill affecting third sector organizations must first consult with the relevant organization.

Appendix I

List of Informants appearing before the Committee

Ms. Talia Aharoni, Director of MA'ALA (Business for Social Responsibility)

Mr. Elie Elalouf, Director, Rashi Foundation

Attorney Amiram Bogat, Registrar of Amutot, Ministry of the Interior

Dr. Bassel Ghattas, Director, the Galilee Society

Attorney Amnon De Hartog, Director, Consultative and Legislative Division, Ministry of Justice

Mr. Yehoshua David, Senior Divisional Director - NPOs, Income Tax Commission

Ms. Sarah Silberstein-Hipsh, Director, Voluntary and Nonprofit Sector
(umbrella organization of nonprofits in Israel)

Mr. Dov Lautman, Chairman of Delta and former president of the Israel Association of Industrialists.

Attorney Davida Lehman-Messer, Deputy Attorney General, Ministry of Justice

Mr. Nissan Limon, Chairman of the Public Committee for Standardization and Accreditation,
Voluntary and Nonprofit Sector (umbrella organization of the third sector)

Mr. Jacky Matza, Director, Professional Division, Income Tax Commission.

Mr. Boaz Aner, deputy director, State Comptroller's Office

Attorney Avi Armoni, Director of "Giloh Foundation", Chairman of "Yadid"

Professor Joel Fleishman, Duke University, USA.

We would like to thank Professor Sami Samooha of the Department of Sociology and Anthropology, Haifa University, and Dr. Neri Horovitz, Head of Senior Civil Service Programs at the Mandel School for Educational Leadership, Jerusalem, for their useful comments at the March 2002 Spring Conference of the Israeli Center for Third Sector Research, at which the project was presented. Likewise, the comments of Carlos Stieglitz, Deputy Director, SHATIL (Support for Advocacy Organizations) were also helpful.

The Committee's work was accompanied by a research project on "Policy toward the Third Sector" in eight countries, funded by the Yad Hanadiv Foundation.

Therefore we under sign:



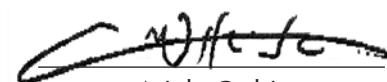
Rachel Liel
member



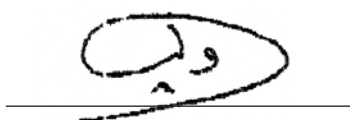
Prof. Itzhak Galnoor, Chair



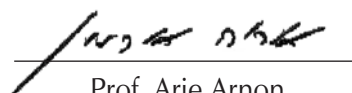
Nissan Limor
member



Ariela Ophir
member



Walid Mulla
member



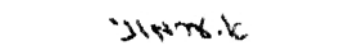
Prof. Arie Arnon
member



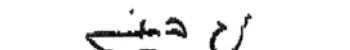
Amir Machul
member



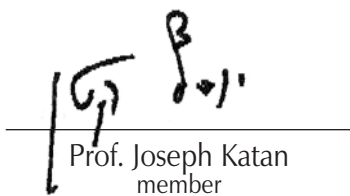
Michal Bar
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Avi Armoni
member



Yoram Gabai
member



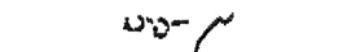
Prof. Joseph Katan
member



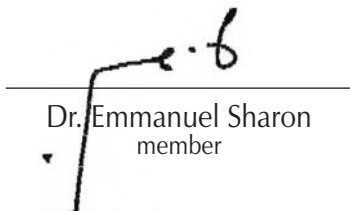
Prof. Benjamin Gidron
member



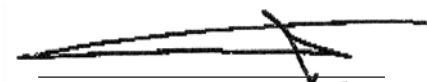
Varda Shiffer
member



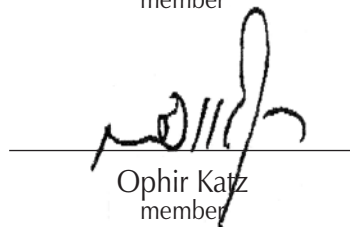
Sarah Silberstein-Hipsh
member



Dr. Emmanuel Sharon
member



Dr. Bassel Ghattas
member



Ophir Katz
member