

# A new way to finance sports: Corporate income tax allowance for sports

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## Abstract

The Hungarian sports financing system has fundamentally changed in recent years. A new, unique element has been introduced: the corporate income tax allowance for prominent team sports. This type of sponsorship has a wide range of aims: to give more resources to the well-known and popular sports; to increase private donations to sporting organizations; to create jobs; and last but not least to reduce the black market in this area of the economy. The new tax allowance for spectacular sports started on July 1 2011 and the regulations were changed in 2013. In this paper I would like to give a detailed insight into the mechanism of the sports sponsoring system and, with the usage of empirical data, I will show the development of the Hungarian sporting organizations as a result of the new financial structure. Moreover, I want to show how it is possible to save from these benefits for the future.

**Keywords:** non-profit, sports financing, donation, corporate income tax.

**JEL codes:** K34, L30.

## Introduction

A new, unique element has been introduced in 2011 to the Hungarian sports financing: the donation for certain sports objectives by corporate tax benefit (TAO<sup>2</sup> system). The aim of this type of sponsorship was complex: to give more resources to the well-known and popular sports, to modernize the sports infrastructure, to increase private donations to sporting organizations, to create jobs and last but not least to whiten this area of the economy. Only certain sports receive the tax benefit and these are chosen by the government: football, handball, ice-hockey, basketball and water polo. The five national

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<sup>2</sup> TAO (társasági adó) – corporate profit tax.

sports' federations have many new tasks as a result of this: to control and give permissions, to help organizations, and to draft new directives. The position of auditors has also become more complex as they require more time and staff to cope with this new element. The scheme appears to work, as it can be seen in the increasing numbers of young athletes, the building of new sports halls, the increasing funds for trainers, and the cost for the government is minimal.

It should be mentioned that this tax allowance is not planned to last forever. The government gave just five years for these organizations to develop a better environment for sports activities and to make these branches of sports more popular.

My aim is to show the intricacies of the sponsoring system, the way sporting organisations have developed following this change, and that the positive effects could be long-term, with the help of strategic planning.

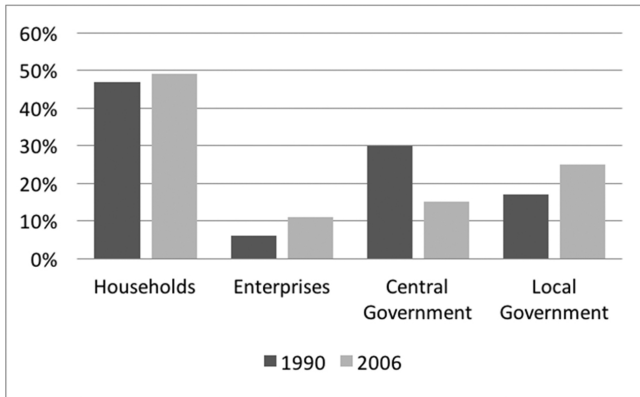
### **Theoretical background**

According to Andreff (2006. 271) "sports and money enjoy a long-lasting and necessary mutual relationship, where sport is competitive, it offers a sports spectacle that requires finance for its organization, but can bring in substantial income". He also claims that amateur sports are increasingly subject to a purely financial rationale, although almost all sporting organizations from Hungary are non-profit organisations.

The financing system of sports differs across countries. In the USA professionals and college sports take the spotlight, while in Europe the stress is on public sports. The level of financing is also different: in Europe around 0.5–3.5% of GDP is spent on sports; in Hungary it was 0.6% in 1990 and this increased to 0.7% by 2006 (Keserű–Dénes 2007).

The main contributors to sports are households, and local governments provide more money to sports than the central government (Andreff 2006). The central government's support was stronger in 1990, but it decreased in 2006 and the share of other types of financing increased (Figure 1).

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*Source: author's own design based on Andreff (2006) and Keserű-Dénes (2007).*

**Figure 1. Resources of sports financing in Hungary**

According to Török (2009) the contribution of households is low in Hungary and although sponsorship capital is present to an ever-increasing extent, it does not yet satisfy the demands.

Giving allowances to support sports is not a unique Hungarian initiative; in the UK amateur sporting associations could receive an 80% to 100% corporate tax discount, and for specific donations, a 28% tax refund is also possible. Furthermore, in the UK 30 sports are supported under the sports development program (Vácz 2010. 45), while in Hungary only five sports are supported.

Földesi (2006) mentioned that organizational restructuring occurred several times between 1994 and 2004, but they were not accompanied with relevant changes in the approach to sports at top and middle managerial levels. Neither a modernized sports model, nor a Hungarian national sports strategy on which a new model could be built have been developed in that period.

### **Research methodology**

The aim of the research is to show the effects and consequences of a newly introduced tax allowance system for football, basketball,

handball, ice hockey and water polo. The empirical data on the transmitted resources shows the size and importance of donations, whereas the data on the number of licensed athletes indicates the number of people affected and the support per capita as a comparative measurement among the previously mentioned five team sports.

The information for the analysis was gained by various methods, such as collection of secondary data, in-depth interviews, and participant observation.

Most empirical data related to the corporate income tax (CIT) allowance of sporting organizations has been received from the reports of the National Sports Institute and the Ministry of Human Capacities.

Following a review of the literature and current trends, interviews were made with a tax expert and with the head of the water polo team of Ferencvárosi Torna Club. Both have encountered the procedural difficulties of the new sponsorship system. The interviews were made in 2013, two years after the introduction of this new way of sponsorship. The questions were centred around the changes of sponsorship and their personal and professional experiences in the previous and present support systems. Their answers helped a lot in revealing the mechanism of the new structure with its benefits and drawbacks.

### **Overview of the Hungarian sports financing system between 1990 and 2011**

The Hungarian recreational sports can receive normative state support through tenders of public foundations and particular state decisions (András 2006).

Support from public foundations like the Gerevich foundation and the former Wesselényi Miklós foundation<sup>3</sup> played a fundamental role in sports' financing because they had a stable income from lottery tax.

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<sup>4</sup> The Gerevich sports grant is given by the Hungarian Olympic Committee. The Wesselényi Miklós Sport Közalapítvány was ceased and its tasks and assets were given to the Hungarian Olympic Committee.

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Later, as Kelemen (2004) pointed out, such sources ceased and therefore sources of finance became harder to find. Between 2007 and 2011 local governments sponsored both recreational and professional sports. This consisted of values between 0.66% and 2.19% of the local budget for bigger cities, including the costs of sports establishments (Gyömörei 2012. 18).

Before 2011 private firms could also support the Hungarian sports life from their revenues, since it was deductible from the profit as a marketing or PR cost. Another form of sponsorship was through foundations – where the conditions were the same as for other types of foundations and almost all sports clubs had at least one. Around 100–150% of donations were deductible from the tax base (Simon 2004), depending on whether it was a public benefit or a prominently public benefit organization and on the length of sponsorship. From 2012 the varying amounts of deduction came to an end and the tax base could be reduced by 20% – or in the case of permanent donations by 40%, while 100% of the donated amount is considered an eligible cost (Fülöp 2015). In some cities local governments granted a local tax allowance to companies sponsoring a sports club. Sporting non-profits got between 4% and 6% of the total third sector support yearly between 2005 and 2012, whereas in 2015 support amounted to about 12% (KSH 2016). Finally, sports clubs and organizations could also have their own sources of finance from business activities or from selling tickets, etc.

### **The new way of financing sports in Hungary**

On July 1 2011 the Act LXXXII of 2011 on the Amendment of Certain Acts on Sports Support made it possible for businesses to finance prominent sporting organizations from their corporate income tax commitments under given conditions. For the professional sporting organizations another Act (CLXXVIII) was introduced with effect from December 17 2011 (after its approval by the European Commission). The prominent sports mentioned in this paper are: handball, football, basketball, water polo and ice hockey, because these five sports account for more than 75% of all licensed sportsmen (more than 175 000 people)

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and they are the most popular. These funds could be used for training of the young generation, personal costs and investments to create or modernize sports infrastructure.

The aims of the new sports financing system are complex (Hadas 2012):

- to reduce the government's direct involvement in the sponsorship of these sports and take the first steps toward a privately financed sporting arrangement;
- to increase the range of possible supporters of sports;
- to 'whiten' the monetary transactions in this field and create a transparent system;
- to create the possibility for everybody to do sports under better conditions or in new establishments;
- to increase the participation of the citizens in sporting activities;
- to create jobs in the field of sports e.g. staff in new establishments, trainers, managers.

Under these laws companies could sponsor sporting organizations from their corporate tax and get a tax allowance on their sponsorship. The conditions were profitable for those companies who were subject to corporate tax, as a saving of up to 70% could also be achieved in the sponsor's CIT liability. The sporting organizations are satisfied with the initiatives, but the preparations and the operations are difficult for the supported organizations, the sports federations and the National Sports Institute as well. The administrative and managerial tasks increased, demanded a degree of professionalism and were more time consuming.

Companies also benefit from the tax allowance for sponsors, because they can gain 7% or 23% on their donations. Companies can register the sponsorship as expenditure in their balances and at the same time they can lower their corporate income tax liability by 70% of the value of the sponsorship provided. Table 1 presents an example for the net result of the financial savings from the CIT allowance.

Furthermore, the donor company earns the right to pay a lower CIT advance for the next financial year, which is calculated from their present CIT base (decreased by the amount of the support given).

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Additionally, donor companies cannot have registered public debt according to the Hungarian Tax Authority.

**Table 1. Example of financial savings from CIT allowance (in HUF)**

	10% CIT		19% CIT	
Profit before tax without sports sponsorship	1000	1000	1000	1000
Sports sponsorship provided		65		117
Profit before tax = CIT base	1000	935	1000	883
Calculated CIT	100	94	190	168
CIT sports allowance (70%)		65		117
Payable CIT	100	28	190	50
Financial savings (CIT without sponsorship – CIT with sponsorship – provided sponsorship)		$100 - (65 + 28) = 7$		$190 - (117 + 50) = 23$

*Source: Hadas 2012*

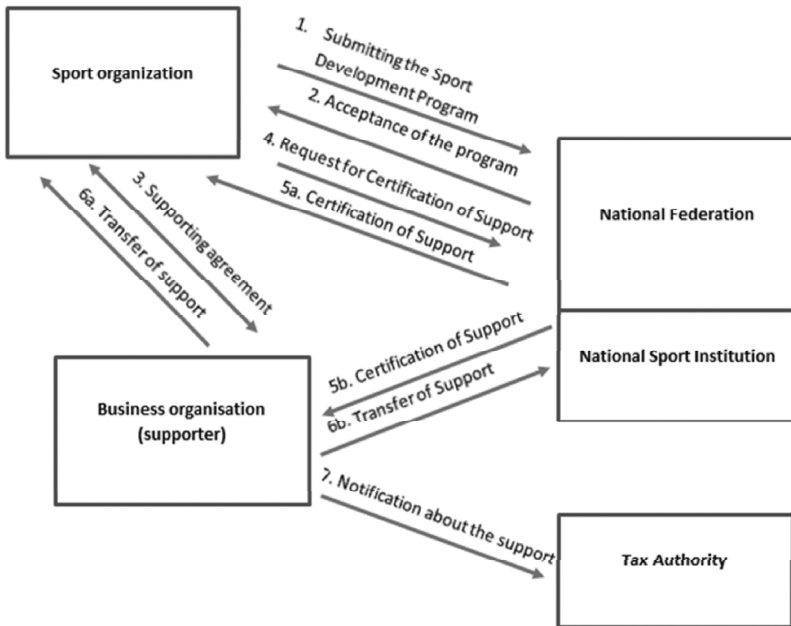
The sponsoring companies' tasks are not complicated. After choosing the sports program to support, they have to sign the support contract, then transfer the money to the sports organization's account(s) and notify the tax authority about the transfer within eight days. The sponsors take no risk in supporting an organization in this way, because they don't have to control the utilization of the money. Therefore, many companies, provided they expect positive financial results, are potential supporters.

However, the task of finding sponsors is not as simple as it seems. According to Hadas (2012) companies who are using the US GAAP<sup>4</sup> and publicly quoted companies cannot benefit from this support. Moreover, in the first year state-owned companies were also excluded from sponsorship. It was also a problem that managers were interested in the earnings before tax or EBIDTA (earnings before interest, depreciation, taxes and amortization), because they receive their bonuses as a percentage of the company's profit, as a solution to the principal-agent conflict. Family-owned businesses are not interested in it either for similar reasons.

On the other hand, the tasks are more complicated for the supported organizations, and they also have to find the supporters for their accepted

<sup>4</sup> Generally accepted accounting principles of the U.S. Securities and Exchange Commission.

sports development program. To be successful in this program the sports organization has to be able to create a good sports development program, which could be supported by the national federation of the given sports according to their rules. In fact, only experts of the sports financing system know what the expectations of a given federation are, because these directives are not mentioned in the law. Consequently, a program with the same share of costs could be accepted for developing a handball team and could be rejected when it is submitted to a basketball federation.



Source: authors' own design

**Figure 2. Sports financing system with CIT allowance**

Figure 2 shows how the system was working in the case of a successful sponsorship (before the end of 2013<sup>5</sup>). It can be seen that the

<sup>5</sup> From 1 January 2014 the tasks of the National Sports Institute are performed by the National Federations and the Ministry of Human Capacities.



manager of the given project has to control all steps through the process. Moreover, the sporting organization has to report the money received. The controller of the project is not the tax authority who has the resources, but the National Federations, who had no expert at the beginning. In 2014 the National Sports Institute ceased to exist, and since then its tasks are performed by the Ministry of Human Capacities and the National Federations.

The distribution of different tasks is not specified but, it should follow the unwritten rules of the national federations, and it could be modified to a given extent during the final accounting. In the first year almost all programs with reasonable goals and costs were approved. In the following year, the approval system became stricter because of the high number of applications, therefore they gave less support to the questionable organizations.

To benefit from the new financing system, sporting organizations have to be familiar with its rules and they have to find supporters to finance their development plans. Previously the leaders of these clubs needed different skills, therefore they need consultants to become successful. These special advisors could get 3% (from 2012/2013 only 2%) of the funding. At the beginning many advisors had no appropriate professional financial and accounting knowledge, thus the sports organizations did not receive proper assistance. They could ask for more money, but that shouldn't be financed from the funding.

The tax allowance for the support of sports has been reduced since the sports year 2013/2014: 75% of the allowance has to be transferred to the national federation or to the public association of the given sports organization, therefore the after-tax gain decreased to 25%, as shown in Table 2.

The National Sports Institute (NSI) received support from the state as well. After the first year of the new financing system (2011/2012), when it came out that this organization would have a lot of administrative tasks, the government decided that the supporters have to pay 1% of their support to the NSI. From 2014 this 1% is distributed between the National Federations (66.7%) and the Ministry of Human

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**Table 2. Example of sports financing from CIT after 2013 (in HUF)**

Tax base without support	500 000 000
Tax without allowance (10%)	50 000 000
Maximal support	32 710 000
New tax base	467 290 000
New tax	14 019 000
Supplementary support	2 453 250
Savings	817 750
<b>Savings as a percentage of support without supplementary support</b>	<b>10.00%</b>
<b>Savings as a percentage of support with supplementary support</b>	<b>2.50%</b>
<b>The change of support</b>	<b>75.00%</b>

*Source: author's own design based on Fajcsák (2013)*

Capacities (33.3%). This decreased the gain of the supporters from the system, but the measure was so low, that the donor welfare hasn't been reduced.

Although donors could gain by giving money, they need a sports club with an accepted project that should contain a resource-utilization plan. Different expenses could be covered from the CIT allowance, but the share of resources are different according to the aim and the type of sports organization:

- Youth development and education (10%);
- Costs connected to competitions (10%);
- Personnel expenses (50%);
- Training related tasks (for general training 50%, but it could be reduced to 30%, for professional education 25%);
- Modernization and investment of fixed assets. If the investment could be used for given sports events in 20% of its operating hours and for a minimum of 10 days the share is 30%, in case of 16% of operations and 8 days: 50%, in case of 12% and 6 days, the share of own resources advances to 70% except in case when the object of the investment is for sports purposes where a possible 100% ex post financing is used on a yearly basis.

The proportions are declared in the law and more resources are needed within professional sports organizations than organisations involved in youth development and education. Therefore, many sports clubs prefer to develop the fixed assets or training facilities under the

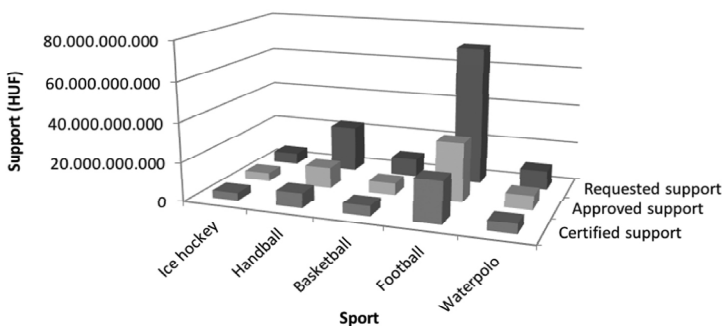
name of a non-profit company whose aim is connected to youth development and give the right to the professional sportsmen to use these assets.

The private support for the five prominent sports is presented in Figure 3. For football the level of support is the highest, but the share of the projects approved by the National Federation is the lowest. Some money remained unused, because not every accepted program was able to find supporters. Therefore, the amount of money on the certifications to the Tax Authority is lower than the maximum possible. The share of approved and certified support is similar for handball, just the amount is lower than for football. Ice hockey has the highest certified proportion (67%), but the lowest level of requested support. Basketball and water polo teams applied for almost the same amounts of money, but in the end, basketball received more than 5 billion HUF certified support, while polo teams a little less at 4.8 billion HUF.

The share of certified support from the approved support hasn't changed a lot in the first three years. In the year 2011/2012 it was 75%, in 2012/2013 it decreased to 74.5% and in 2013/2014 to 73.41%, which means that sporting organizations faced problems in finding sponsors or collecting their own resources. The certified support's share increased significantly in football from 30% in 2011/2012 to almost 40% in 2013/2014. Meanwhile the nominal support increased for each spectacular sports in 2012/2013 and just ice hockey received less in 2013/2014 than in the previous year according to the data provided by the National Sports Institute.

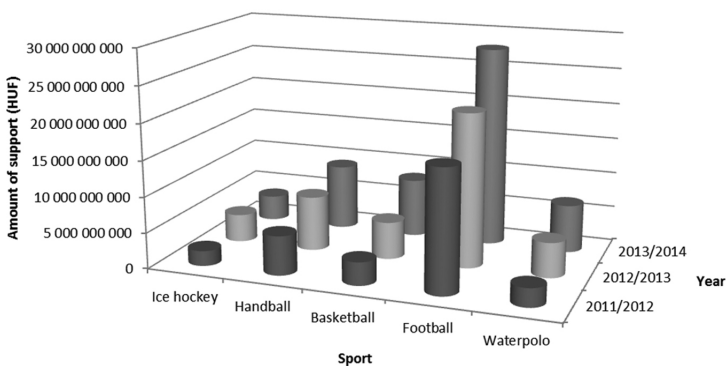
The distribution of the money is deceptive, because the number of athletes is different. Football, the most popular sport, received the highest amount of support (between 17 and 28 billion HUF every year), but the support calculated for one licensed athlete was the lowest in the last two seasons (see Table 3). The reasons are complex. First of all, the cost of playing football is the lowest. All other prominent sports need at least a hall, but soccer can be played in the open air, and this is why many poor children play it all over the world. On the other hand, football alone got more money than the four other sports together, so

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Source: author's own design based on Bardóczy (2013)

**Figure 3. Support from CIT allowance in 2012/2013**



Source: author's own design based on Jánosi (2015)

**Figure 4. The change of certified support in the first three years (2011/2012–2013/2014)**

this amount of money contributed to building and reconstructing football grounds and stadiums.

Ice hockey is becoming popular in Hungary, and many young people play it with enthusiasm. On the other hand, it is one of the most expensive sports: an ice arena and expensive protectors and equipment are needed to play it in a safe environment.

**Table 3. Support per capita for different sports**

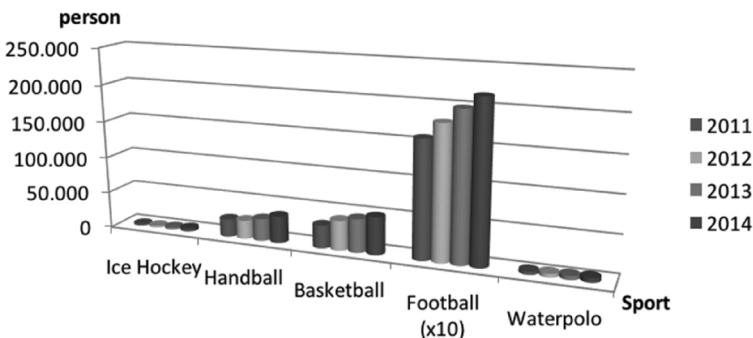
Support per capita	2011/2012	2012/2013	2013/2014
Ice hockey	892 160	1 450 313	949 271
Handball	222 995	278 089	277 010
Basketball	90 644	121 395	171 511
Football	178 735	112 689	134 421
Water polo	573 119	974 580	1 199 718
Average	233 086	150 764	180 486

Source: author's own design based on Jánosi (2015)

As a result of this supporting program the number of athletes increased in these branches of sports between 2011 and 2014 (Figure 5). The biggest increase was registered with the ice hockey teams where the number of licensed athletes increased by 93% and the lowest (36%) at football clubs.

### Experiences of the water polo section of Ferencvárosi Torna Club

Ferencvárosi Torna Club (FTC) is one of the oldest, most successful and most well-known sports organizations in Hungary. The FTC has at least one section from all of the five prominent sports. They have separate men and women sections and have established different sections for youth to be able to receive more support.



Source: author's own design based on Jánosi (2015)

**Figure 5. Changes in the number of athletes (2011–2014)**

The water polo section of FTC received support in every sports year between 2011 and 2013, and they managed to collect around

100 000 000 HUF support from CIT allowances altogether. They had high staff costs: they managed to increase the number of trainers from six to nine and to increase the number of young players by almost 50%.

From the introduction of the new financing system the trainers have received administrative tasks, since they have to collect the required documents (invoices, certificates, list of attendants) at the competitions. To be able to cover the club's own share, the water polo section collects monthly payments from its members.

The club employed an advisor, to be able to exploit all possibilities and to help the process from writing tenders and requiring the support to confirm the costs and investments.

The main problem is that the financing system doesn't allow putting money aside for the future, as the club has to report the whole amount of support in the given sports year. In the second year (2012/2013) the number of athletes achieved the maximum: the club can't increase the number of the athletes without decreasing the level of training because they have only one pool. The only way of expansion is the construction of a new pool, but under the TAO system they are not able to invest in it because of property-issues.

### **Conclusions**

The current sports supporting system from Hungary is working well: the number of athletes is growing, the number of employed trainers has increased and a new sports infrastructure was developed thanks to the increased financial support. This interim period has helped handball, basketball, football, ice hockey and water polo clubs to become independent from direct central governmental support. In this period (2011-2016) the clubs for the five sports could form their sponsor basis with the help of the tax allowance system, and later, when the connections between the clubs and companies become closer, the indirect state support can also be decreased step by step. The aim to increase the number of people involved in prominent sports was fulfilled. From one year to another the number of athletes practicing these sports has increased and it is expected to continue to grow in the

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near future. The question is how the increase in the number of registered athletes can be kept on the long run, given that the number of births is decreasing.

The TAO sports financing system is foreseen to be in place until 30 June 2017. As there is no possibility for saving the money received from sponsors, those clubs which invest in sporting facilities will gain the most from the present financing system, as these will continue to operate after the financing system changes.

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