

Asia Pacific Philanthropy Consortium

Philanthropy and Law in South Asia

**Recent Developments in
Bangladesh, India, Nepal, Pakistan and Sri Lanka**

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Introduction

Philanthropy and Law in South Asia² was published in 2004 to bring together detailed information on the legal regulation of philanthropy and the nonprofit sector in Bangladesh, India, Nepal, Pakistan, and Sri Lanka, and to propose reforms to the legal frameworks in those countries.

The authors of Philanthropy and Law in South Asia represent legal, accounting, consulting, academic and other fields concerned with state-nonprofit relations in South Asia. The original project was funded by the Asia, Ford, Himalaya and Myers foundations and set a standard in description and analysis of the complex legal frameworks of regulation of philanthropy and the nonprofit sector in these countries.

Three years later, virtually the entire group that wrote Philanthropy and Law in South Asia came together again, this time in New Delhi, to analyze developments in the legal and policy regulation of philanthropy and the nonprofit sector in South Asia in the years since the original volume appeared.

The 2007 update workshop was supported by the Asia Foundation, Charities Aid Foundation India, and the University of Iowa, and we are grateful for that support. Barnett Baron arranged for the Asia Foundation funding of the 2007 workshop and immediately understood and supported the updating of the PALISA process; we are grateful for his continuing support of these initiatives.

The workshop was convened with the extensive and dedicated assistance of Charities Aid Foundation India and the Asia Pacific Philanthropy Consortium, and we are

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² Philanthropy and Law in South Asia (ed. Mark Sidel and Iftekhar Zaman) (Asia Pacific Philanthropy Consortium, 2004), is available as a book, on diskette, and online at <http://asianphilanthropy.org>.

grateful for their fine efforts. In particular, we acknowledge with gratitude the efforts of Priya Viswanath (Executive Director of CAF India), Puja Bhalla (Senior Manager, Development Support and Consulting at CAF India), Rory Tolentino (Executive Director of APPC), and Jeanette Bandiola (Finance and Administrative Officer at APPC), as well as their colleagues. In Iowa City, Nellie Viner has provided superb research assistance on this project before and after the August 2007 meeting.

This report describes and analyzes new developments in these legal frameworks, generally from about 2004 through mid-2007. Country teams wrote each of the country reports contained in this integrated report – Sumaiya Khair and Iftekhar Zaman for Bangladesh, Noshir Dadrawala and Sanjay Agarwal for India; Anil Kumar Sinha and Sapana Pradhan Malla for Nepal; Zafar Ismail and Qadeer Baig for Pakistan; and Arittha Wikramanayake and Thanuja Jayawardene for Sri Lanka. Mark Sidel edited the country reports and wrote this introduction.³

Themes Emerging from Philanthropy and Law in South Asia in 2007

South Asia is an area of enormous contrasts and diverse contexts, and so readers will find many themes, issues, conflicts and frameworks in the country reports that follow. The situation in each country is different, and has developed in different ways since 2004.

Some countries in this study have undergone more domestic strife and some less; some were the unfortunate victims of the 2004 tsunami, and some suffered less. In some countries the government has shown a more welcoming, cooperative, even facilitative attitude toward the nonprofit sector and philanthropy, while in other countries conflict between the sector and the state has increase – and in some countries, we see elements of both increasing conflict and strengthened cooperation. Many developments in the five countries reflect what Barnett Baron correctly terms “growing government awareness of and wary cooperation with the nonprofit sector,” as well as concerns about terrorism that may be acted upon in different ways in different countries.

With those important caveats relating to the different contexts, circumstances and developments in each of these five countries, certain themes emerged from the discussions at the August 2007 PALISA workshop in Delhi and from the extensive country reports below. Most of these themes are, inevitably, contradicted by other trends and almost never reflect developments in all five countries, but they do indicate at least a set of concerns that span more than one country in the region, and often most or all states. They include:

³ We are grateful to several other colleagues for participating in or observing the PALISA workshop in Delhi, including Thakur D. Aggarwal of the Asia Foundation (who prepared a useful, separate summary of the discussions for the Asia Foundation), Puja Bhalla and Abhishek Chaturvedi of Charities Aid Foundation India, Alison Granito of Mint (a newspaper affiliated with the Hindustan Times), Vanita Nayak Mukherjee of the Ford Foundation, and Jane Schukoske of the United States Educational Foundation in India (USEFI).

- Continuing, often intense conflict over foreign donations. Governments in the region (particularly India and Bangladesh, but others as well) continue to seek control over transfers of foreign funds for nonprofit and philanthropic use, especially those with potentially political or advocacy connotations. These conflicts take place over government attempts to strengthen the regulation of foreign donations (as in Bangladesh and India), and over nonprofit attempts to ameliorate the effects of that regulation. Government regulation of foreign donations has significant effects on governance and accountability in the nonprofit and philanthropic sector as well.
- New initiatives to regulate the burgeoning microcredit and microfinance sector. In Bangladesh, India and Pakistan, the government has proposed or enacted major new statutes to regulate this traditionally under-regulated sector.
- Continuing activity and debate over the scope of tax exemption for nonprofit and philanthropic entities and tax deductibility for donations. In some countries, such as Bangladesh, Pakistan, Sri Lanka, and perhaps in Nepal, the recent tendency is to liberalize tax exemption and deductibility from a relatively restrictive base. In others, such as India, the tendency now appears to restrict tax exemption and deductions, though originally India started from a relatively liberal tax regime for nonprofits. In some cases, additional attention to fiscal policy is related to concern for money laundering and terrorist finance, as in the new restrictions on tax exemption for anonymous donations in India.
- Continuing debates over for-profit business activities by nonprofit organizations, even those that directly support the charitable or nonprofit missions of those organizations. In Bangladesh, for example, the government recently sought to limit the business activities of the voluntary sector, withdrawing its proposal in the face of a strong and unified voluntary sector.
- The overlay of new money laundering legislation, including “know your customer” or “know your payee” rules in several countries of the region including India, Pakistan, and Sri Lanka. The impacts of new money laundering legal frameworks have yet to be fully felt by the voluntary sector, but generally apply broadly to nonprofits and can be expected to create additional administrative, inspection, and reporting burdens. The expansion of money laundering legislation and rulemaking is a direct reflection of post-2001 concern over terrorist finance and attempts to implement United Nations, Financial Action Task Force (FATF) and other resolutions and norms.
- Intense, even violent conflict over the role and autonomy of the voluntary sector, in the context of broader political conflict in society. This is most clearly apparent in Nepal, where the royal government sought to severely constrain the voluntary sector, and where a people’s movement, along with a new Interim Constitution, has sought to guarantee the right of the voluntary sector and civil

society to participate in national policy life. In Sri Lanka, continuing conflict and insurgency has enveloped the voluntary sector as well.

- New forms of regulation and regulatory bodies are emerging, including proposals or establishment of a new regulatory body in Sri Lanka, and proposals for a significantly revamped, strengthened (and politicized) regulator in Nepal. Calls for a quasi-independent charity regulator are also occasionally, sometimes along the lines of the U.K. Charity Commission experience. The World Bank has proposed such a solution for charity regulation in Bangladesh, for example.
- The continuing reform of company legislation and the channels for nonprofit activity opened under new company acts or amendments. In Sri Lanka, where a new Company Act has come into force, and in Nepal, where company act amendments have been enacted, a company form for nonprofit organizations is now facilitated considerably more than in the past.
- Continuing interest in self-regulation and accreditation mechanisms, though not region-wide. In Pakistan, the sector-operated certification mechanism has been strengthened, and in India the new National Policy on the Voluntary Sector discusses the possibility of establishing a national nonprofit accreditation system.

Bangladesh

Introduction

The nonprofit sector in Bangladesh has experienced vigorous growth in the past few years and is a large source for employment and income generation. One of the reasons why voluntary sector organizations in Bangladesh have continued to grow is their increasing role in advocacy and governance, in addition to their mainstream activities of poverty reduction. However, this is not to say that the sector is without problems; in fact, Bangladeshi nonprofits have come under fire for tax avoidance, engagement in profit-making commercial activities and partisan politics, among other reasons.⁴

The governance and organizational effectiveness of the nonprofit sector in Bangladesh provides for accountability measures at two levels, i.e. external governance and internal governance. The first concerns accountability to the government that endows non-profits with a legal status, as well as a regulatory framework within which they operate. The second relates to internal governance and self-regulation of non-profits themselves.

The chapter on Bangladesh in the earlier Philanthropy and Law in South Asia volume extensively discussed the wide array of statutory regulations that guide, supervise, regulate and control the operations of nonprofits in Bangladesh. This update gives a snap-shot view of the developments that have occurred in the regulation of the nonprofit sector since the publication of the earlier study.

2004 and After: New Developments in the Regulatory and Financial Regime

Attempts at Greater Government Control in Foreign Donations and Related Fields?

In Bangladesh, the relationship between nonprofits and the government has nearly always been characterized by tension and mistrust. This is manifest in the attempts by governments throughout the country's political history to control the activities of voluntary organizations. The most recent such initiative was the proposed *Foreign Donation (Voluntary Activities) Regulation (Amendment) Act* of 2004. The government then in power attempted to introduce this law to amend the earlier *Foreign Donation (Voluntary Activities) Regulation Act 1978* (revised in 1982).

The 1978 Act had allegedly sought to control independent activities of nonprofits by exercising full authority over nonprofit officials, their funds, and, through funding regulation, their activities. It defined "irregularity" to include "incurring expenditure against activities not approved under project, or incurring expenditure against approved activities in excess of budget provision beyond acceptable limits as is determined by government, or violation of the financial discipline of the organization, or any provisions

⁴ The Bangladesh report has been prepared by Sumaiya Khair with additional commentary by Iftekhar Zaman.

of this ordinance or any rules or orders made there under.” This empowered the government to decide in its discretion whether “acceptable limits” have been exceeded and for that matter, what the “acceptable limits” are.⁵

Under the proposed *Foreign Donation (Voluntary Activities) Regulation (Amendment) Act* of 2004, the government sought to prohibit “political activity” by nonprofit organizations. “Political activity” was defined as “accepting membership of, directly supporting or getting aligned with any political party, and includes any activity which may be interpreted as political or, may affect politics or such other activities which may be interpreted to be detrimental to national independence, sovereignty, culture, ethnic and religious sentiment, etc, and shall not include activities like empowerment of poor and disadvantaged, awareness raising, etc, as long as those are not intended towards giving any direct political gain to any political party.”⁶ Some of the concerns in this regard were --who would decide what activities were detrimental to national independence and sovereignty and how would one interpret alignment to a political party?

The proposed bill would also have empowered the government to remove the chief executive or any other official of a registered organization if it was satisfied that they have been “responsible for any irregularity in respect of its funds or for any mal-administration in the conduct of its affairs, or has failed to comply with the provisions of the Ordinance, or the rules made there under, or any order issued by the government in this regard, or has caused the organization to be involved in any political activity, or any activity influencing politics directly.”⁷ The Government was also authorized to cancel the registration of that organization and dissolve it following which, assets can be frozen and liquidator can be appointed to take care of the NGOs’ financial and legal affairs.⁸ In other words, NGOs could be completely taken over.

The draft legislation was severely criticized by NGOs and civil society alike; in response the draft law was withdrawn, pending further consultation. Indeed, one of the reasons that instigated this law was the debate surrounding the increasing prominence of NGOs in national politics and the limits to their activism. There exists considerable confusion regarding what exactly constitutes ‘political activity’ and the extent NGOs can actively engage in such activities. While the term broadly encompasses activities that range from public education to electioneering, it is evident, particularly from official action to deregister and halt activities of selective NGOs for their apparent partisan bias in voter education programmes prior to the 1996 general elections, that advocacy in the

⁵ Shah A M S Kibria, *Farewell to the NGOs: Their Days in Bangladesh are Over?*, The Daily Star (Dhaka), 6 February 2004.

⁶ Ibid.

⁷ Ibid.

⁸ Ibid.

sense of supporting or opposing a political party and campaign funding is the most controversial form of political activity.⁹

Another attempt to regulate the use of funds by nonprofit organizations, including foreign funds, was made in mid-2007. By a decision of the joint forces deployed to assist civil administration and law enforcement under the state of emergency in Bangladesh, the NGO Affairs Bureau (which directly regulates the work of nonprofits) informed the NGO community in July 2007 that NGOs shall be required to spend at least fifty percent of their foreign funds on “visible” development work, such as building and maintaining roads, schools, culverts and excavating canals and that the “joint forces meeting had also decided to close down the non-governmental organisations whose programmes are not beneficial for the people.”¹⁰

The order on the use of foreign funds was almost immediately revoked by a notification following a meeting between the Director General of the NGO Affairs Bureau and a delegation of non-governmental organizations.¹¹ This change of heart demonstrates that despite misgivings about proper fund utilization by NGOs, they have managed to carve out their own political space for negotiation and bargaining. And it also indicates the continuing risk that political or military authorities will seek to limit and restrict that space.

Towards a More Transparent and Accountable System: Certification and Regulation of Micro-Credit Organizations

Despite the large scale of micro-finance operations in Bangladesh, the sector is conspicuously under-regulated. The need for better external governance of the micro-finance sector and micro-finance institutions (MFIs) has long been a priority given that it handles a stock of nearly \$560 million worth of members’ savings.¹²

⁹ The World Bank, *Economics and Governance of Nongovernmental Organizations in Bangladesh*, April 2006 [hereafter World Bank 2006 Report], p. 60. The Report is available at http://www.worldbank.org.bd/external/default/main?pagePK=51187349&piPK=51189435&theSitePK=295760&menuPK=64187510&searchMenuPK=295788&theSitePK=295760&entityID=000160016_20060502090412&searchMenuPK=295788&theSitePK=295760.

On the 2004 draft Amendment, see also *Bangladesh’s Offer: Become GONGOs or Be Ready for Government Takeover*, ACHR Review, 11 February 2004, at <http://www.achrweb.org/Review/2004/0704.htm>.

¹⁰ NGOs Need to Spend 50pc Foreign Funds on Dev Works, The New Age (Dhaka), 19 July 2007, at <http://www.newagebd.com/2007/jul/19/front.html#6>.

¹¹ NGO Bureau Revokes Order on Foreign Fund Use, The New Age, 27 July 2007, at <http://www.newagebd.com/2007/jul/27/front.html#15>.

¹² World Bank 2006 Report, p. 5.

The government enacted the *Micro Credit Regulatory Authority Act* (hereafter referred to as MCRAA) on 16 July 2006.¹³ Under the MCRAA, a Micro Credit Regulatory Authority (the Authority) has been established. The MCRAA requires all organizations (including non-profit organizations, cooperatives, societies and profit-making companies) that micro-credit services to formally apply to the Authority for a license to provide micro-credit. The purpose of this initiative, as indicated in the preamble of the MCRAA, is to ensure transparency and accountability in the operations of micro-credit organizations in Bangladesh. The MCRAA also provides that notwithstanding provisions in other laws impinging on micro-credit, the rules of this Authority shall prevail, making the Authority and the MCRAA the paramount regulatory tool for this sector in Bangladesh.

As of 26 July 2007, about 4,000 micro-finance institutions had applied for licences under the MCRAA. Of those, only about 700 fulfilled the primary criteria of having at least 1,000 borrowers and 4 million Taka (40 lakhs, approx. US\$60,000) in loans. The Micro Credit Regulatory Authority has decided to grant licenses to 120 micro-finance institutions in the first phase while the rest of the short-listed MFIs are expected to receive licenses soon afterwards.¹⁴

The Micro-Credit Regulatory Authority: Organization, Governance, Administration, and Funding

The Authority established under the MCRAA is an independent legal entity that can sue and be sued its own name.¹⁵ It will be managed by a Board of Directors which shall be entrusted with the same powers and functions as that of the Authority. The Board of Directors will be comprised of the Governor of Bangladesh Bank, by virtue of his position, who will also be the Chairman of the Board of Directors; a total of six government nominees who may include government officials; and an Executive Vice-Chairman, by virtue of his position, who shall also be the Member Secretary of the Board of Directors. Board members will generally serve for three years, but shall be entitled to remain in their posts until successors are appointed and begin service.¹⁶

¹³ The MCRAA went into effect on 27 August 2006. The Act and general information on it are available at <http://www.microfinancegateway.com/content/article/detail/37487>.

¹⁴ 120 NGOs to Get Micro-Credit Licence, *The New Age*, 26 July 2007, at <http://www.newagebd.com/2007/jul/26/busi.html#1>.

¹⁵ The Authority has the right to amass both moveable and immoveable properties, keep them in its possession or hand them over as the case may be. It can also enter into agreements and perform other necessary activities. Section 4(2), Micro Credit Regulatory Authority Act, 2006.

¹⁶ Sections 5 and 6 of the Act. Under separate sections of the Act (secs. 46 and 47), the Authority is permitted to bestow any of its power/authority given under the MCRAA to the Executive Vice Chairman or any of its officials through a written order. No legal proceedings shall be drawn against the Chairman, any member or official/employee of the Authority for any action affecting any person provided that it is carried out in good faith.

The Executive Vice-Chairman, having at least the status of a Joint Secretary in the Bangladeshi government, shall be appointed by the government. The Executive Vice Chairman, as chief executive of the Authority, shall be responsible for the implementation of all decisions of the Board of Directors and shall carry out all activities as directed by the Board.¹⁷

The Authority is entrusted with the following responsibilities:

- Issuance and, where necessary, cancellation of certificates to micro-credit organizations for running micro credit programmes aimed at poverty alleviation;
- Preservation, examination and analysis of data on the establishment and field level supervision of micro-credit organizations;
- Overseeing merger of micro credit organizations;
- Audit of accounts of micro credit organizations upon the request of financing agency;
- Providing necessary information sought by financing agencies;
- Micro-credit policy formulation;
- All other necessary steps required to undertake these activities, discharge the above-mentioned activities, including appointment of officers, advisors, experts and employees whose terms of service shall be determined by the Board of Directors.¹⁸

The Authority must also submit an annual report to the government describing its activities during the year; the annual report will also be tabled at the Parliament.¹⁹

The resources of the Authority will include government grants, certificate fees, fines recovered from errant organizations, annual fees paid by micro-credit organizations, and grants received from foreign sources with permission from the government. Accounts shall be maintained and recorded in an annual report for inspection by the Auditor General.²⁰

Certification of Micro-Credit Organizations

The MCRAA clearly stipulates that no micro-credit organization shall be entitled to operate without proper certification by the Authority. Where organizations had been engaged in micro-credit services prior to the Act, they may continue operations but must submit an application to the Authority for certification within six months of the Act

¹⁷ Section 10(3) of the Act.

¹⁸ Section 9 and 11 of the Act.

¹⁴ Section 45 of the Act.

²⁰ Sections 12 and 14 of the Act.

coming into force. The certification requirements also apply to organizations that provide micro-credit and also carry out other kinds of poverty alleviation activities.²¹

A person intending to form an organization to provide micro-credit services shall apply to the Authority and pay a fee for issuance and renewal of the required certificate. The Authority is required to verify the application and, if satisfied, to issue the certificate within a specified period.²² Where the application is not acceptable, the Authority must apprise the applicant in writing and within a prescribed time, indicating the grounds for refusal. But the applicant is provided an opportunity to be heard. Where the application is rejected, the aggrieved applicant may, within thirty days of being notified of the decision, file an application to the Authority for reconsideration of the application. The order issued by the Authority in lieu of this application shall be deemed to be final.²³

The Authority is required to publish a list of registered micro-credit organizations with full information on their names, addresses and local jurisdictions in the official government gazette. A list of the organizations receiving certificates shall be submitted to the Bangladesh Bank and the government. In the event the certification of an organization is suspended or scrapped, the information shall be made public through national, or if necessary, local dailies.²⁴

Under section 17 of MCRAA, the Rules to be issued by the Authority under the MCRAA shall deal with the Authority's jurisdiction, the terms and conditions of the certificates issued to micro-credit organizations, procedural issues, registration and annual fees, as well as such important matters as capital adequacy requirements. When issuing a certificate the Authority may impose any condition consistent with the Act or the Rules framed under it. The Authority also reserves the right to change any condition at any time. Organizations shall be obliged to abide by the changes in conditions.

Formation and Activities of Micro-credit Organizations

According to the MCRRA a micro-credit organization is one that is registered under the Societies Registration Act 1860, the Trust Act 1882, the Voluntary Social Welfare Agencies (Registration and Control) Ordinance 1961, the Cooperative Societies Act 2001 and the Companies Act 1994 and certified under the MCRAA.

As delineated in section 21(1) of MCRAA, the principal task of micro-credit organizations is to run micro-credit programmes in accordance with the terms and conditions prescribed by the MCRAA. The activities of micro credit organizations, as recognized in section 24 of the Act, are to:

²¹ Sections 15 and 34 of the Act.

²² Sections 15 (2) and 16 of the Act.

²³ Section 16 of the Act.

²⁴ Section 21 of the Act.

- Provide loans to the poor to make them self reliant;
- Provide advice and other support to the poor for engaging in economic activities;
- Accept deposits from their members;
- Open bank accounts to offer micro-credit facilities;
- Receive loans or grants from banks or other sources for developing funds;
- Invest surplus funds, if any, in sectors approved by the Authority;
- Receive service charges for credit services at rates to be determined by the Authority; and
- Offer loan recipients and their families various insurance services and social development oriented loan facilities.

No micro credit organization shall, without approval of the Authority, undertake any programme or enter into any transaction or engage in any business or service contrary to the provisions of this Act. And no micro credit organization shall be permitted to change amend, extend or scrap its constitution without prior approval of the Authority.²⁵ Various other provisions of the Act govern the internal management of micro-credit organization, the disqualification and removal of members of the management body.²⁶

Financial Obligations of Micro-credit Organizations

All micro-credit organizations are required to maintain their accounts in the manner prescribed by the Authority. They shall prepare their annual budget for the next financial year ahead of the end of each fiscal year. The balance sheet indicating the annual profit and loss shall be prepared and a copy of the same shall have to be submitted to the Authority.²⁷

While every micro-credit organization shall have a reserve fund, no amount shall be spent from that fund without the prior permission of the Authority. Deposits shall be received only from members; deposits so received shall be entered into passbooks or acknowledged by way of receipts as the case may be. No micro-credit institution shall be entitled to use or invest deposits in any head other than that resolved by the Authority. No approval shall be given for investment of deposits in any head that is linked to individual interest.²⁸

²⁵ Sections 2(3) and 20 of the Act.

²⁶ Sections 27-29 of the Act.

²⁷ Section 24 of the Act.

²⁸ Sections 30, 32(3) of the Act.

Under section 31 of the Act, dividends cannot be offered by micro-credit organizations without the approval of the Authority, and a micro-credit institution which enjoys tax exemption or receives other financial assistance from the government cannot distribute dividend in any event.

Certified micro-credit institutions are required by law to protect the interests of their financing agencies.²⁹ Loans or grants received from a financing agency may only be used for the purposes pledged and the organization must report as prescribed by the financing agency. Micro-credit organizations must also extend cooperation in the inspection and examination of records or documents.³⁰

If any micro-credit institution has reason to believe that it may not be able to pay the liabilities of its clients or finds itself in a situation which compels the suspension of its payments to its clients, it must appraise the Authority of the situation in writing and comply with instructions issued by the Authority.³¹

Offences and Penalties; Closure of Micro-credit Organizations

The operation of a micro-credit programme without proper certification or continuing to run such programmes despite the cancellation of certificate, or upon violation of the Act, shall amount to an offence. Deliberate misrepresentation of facts, presentation of false information, defiance of the Authority's directives, misuse of power for direct or indirect gain or causing of indiscipline in the functioning of the institution are also punishable offences. Fines or imprisonment or both may be imposed.³²

The High Court Division of the Supreme Court may order the closure of any micro-credit organization on the basis of a petition by the Authority. Closure may be ordered if the certificate of the institution is cancelled, the institution is unable to bear its liabilities, or the institution is penalized for infringement of the provisions of the MCRAA.³³

The Politics Within the NGO Community

The Bangladesh chapter in the 2004 Philanthropy and Law in South Asia briefly outlined the emerging conflicts within the apex coordinating body for NGOs, the

²⁹ For the purposes of the MCRAA, "financing agency" means any micro credit organization or any government or non-government or foreign organization offering loans or grants to any micro credit organization.

³⁰ Section 23 of the Act.

³¹ Section 44 of the Act.

³² Section 35 of the Act.

³³ Section 26 of the Act.

Association of Development Agencies in Bangladesh (ADAB). These ongoing tensions finally resulted in the parallel formation of a national NGO coordinating committee under separate leadership. Criticisms were leveled against ADAB for its apparent involvement in partisan politics to the extent that inclusion in ADAB depended on the patronage of powerful NGOs that commanded greater influence on account of their size, resources and political connections. Thus, ADAB membership for smaller NGOs was only ensured if they conformed to the political ideology of the larger organizations.

This sense of exclusion propelled non-ADAB local NGOs to mobilize their strength and develop an apex body independent of ADAB. The Federation of NGOs in Bangladesh (FNB, <http://www.ngofederation.net>) that was formed out of these developments primarily aims to:

- Protect the interests of NGOs and create a favourable environment for their operations;
- Strengthen the image of NGOs for the people and the government;
- Ensure accountability and transparency in NGO activities;
- Ensure co-ordination and collaboration amongst NGOs;
- Develop close relations with different donor and international agencies for building capacity in small NGOs.

Since its inception the FNB has been engaged in advocacy and lobbying with the Government for development of the NGO sector.

Continuing Controversies over NGOs in Business

In Bangladesh, there is growing concern over the involvement of NGOs in private sector businesses. Indeed, many people think that NGOs are slowly but steadily moving away from their core mission of poverty reduction and into commercial activities, as many NGOs are found using their management resources to oversee commercial activities.³⁴ Confusion remains regarding whether an organization shall be exempt from tax on the surpluses generated by its commercial activities.

The popular view is that NGOs should essentially keep their non-profit businesses separate from their development work, that they should not be permitted to use subsidized capital to enter into or operate businesses and that they should pay taxes on their for-profit activities at the same rate as other businesses.

But new attempts are underway to regulate the utilization of funds by NGOs, including funds derived from business activities, including a decision at a recent meeting of the joint forces deployed to assist civil administration and law enforcement under the

³⁴ World Bank 2006 Report, p. 52. For a discussion of the key Bangladeshi judicial case on this issue, Ahmed v. Brac Bank, see Sidel, *Courts, States, Markets and the Nonprofit Sector: Judiciaries and the Struggle for Capital in Comparative Perspective*, 78 *Tulane Law Review* 1611 (2004), available at <http://myweb.uiowa.edu/sidel/>.

state of emergency in Bangladesh. Referring to a notification from the Army Headquarters, the NGO Affairs Bureau informed the NGO community in July 2007 that NGOs shall be required to spend at least fifty percent of their foreign funds on “visible” development work, such as building and maintaining roads, schools, culverts and excavating canals and that the “joint forces meeting had also decided to close down the non-governmental organisations whose programmes are not beneficial for the people.”³⁵

The order on the use of foreign funds was almost immediately revoked by a notification following a meeting between the Director General of the NGO Affairs Bureau and a delegation of non-governmental organizations.³⁶ This change of heart demonstrates that despite misgivings about proper fund utilization by NGOs, they have managed to carve out their own political space for negotiation and bargaining. And it also indicates the continuing risk that political or military authorities will seek to limit and restrict that space.

Progress in Nonprofit Tax Exemption and Charitable Deductibility

Prior to 1992-93, the Income Tax Act extended a hundred percent tax deduction to charitable donations to NGOs. Wholesale tax abuse led to this being withdrawn, albeit with a few *ad hoc* exceptions. However, the 2005 budget re-expanded tax exemption to include all philanthropic and educational institutions approved by the government and in principle made donations to those organizations tax deductible. This new provision for tax deductions for charitable contributions is expected to increase the flow of resources to the non-profit sector as a whole.³⁷

Under the new scheme NGOs shall submit a written application to the National Bureau of Revenue profiling their activities, and the Bureau shall decide whether the contributions in question qualify for a tax deduction. Needless to say, this process requires careful scrutiny and strict monitoring since it involves considerable discretion in delineating what constitutes an eligible philanthropic or educational institution.³⁸

The Benefits and Pitfalls of Government Grants to NGOs

A considerable portion of external assistance to NGOs comes through the government under various projects that involve both donor funds and the government’s own revenues. A recent World Bank study estimates that an average of twenty percent of external assistance is disbursed to NGOs through the government, averaging nearly \$82

³⁵ NGOs Need to Spend 50pc Foreign Funds on Dev Works, The New Age (Dhaka), 19 July 2007, at <http://www.newagebd.com/2007/jul/19/front.html#6>.

³⁶ NGO Bureau Revokes Order on Foreign Fund Use, The New Age, 27 July 2007, at <http://www.newagebd.com/2007/jul/27/front.html#15>.

³⁷ World Bank 2006 Report, pp. 4, 47.

³⁸ *Ibid.*, pp. 47-48.

million a year from loan sources. A recent example of the government using its own resources to contract with NGOs is the \$17 million allocation to PSKF in the 2004-2005 budget, provided to NGOs to scale up a pilot programme to assist the extreme poor.³⁹

The immediate past government set up the Bangladesh NGO Foundation through a gazette notification of the Ministry of Finance on 11 December 2004. The aim of this initiative is to provide small NGOs with financial assistance to conduct their activities. NGOs having programmes in not more than 10 *upazilas* (sub-districts) and with an annual turnover of not more than 50 million Taka (approx. US\$750,000, including grants from the NGO Foundation) are eligible for this program.⁴⁰

The government allocated a total 1 billion Taka 1 billion (approx. US\$15 million) for the NGO Foundation out of which 500 million (approx. US\$7.5 million) was disbursed during the 2004-2005 financial year. The NGO Foundation offered 20 million Taka to nearly 100 small NGOs to undertake welfare-oriented, employment generating and poverty alleviation activities.⁴¹

Indeed, the creation of the NGO Foundation and the endowment granted to it demonstrate official acknowledgement of NGO effectiveness and a willingness on the part of the government to work with NGOs. And this line of action has the potential of “providing a significant boost to private philanthropic contributions to NGOs.”⁴²

However, there are problems with regard to government contracting NGO services. Some of the key issues identified by the 2006 World Bank report include delays, corruption in selecting NGOs and assigning contracts, and dampening of NGO advocacy efforts. There is also concern that government donations may well involve “greater political demands,” and create a “patron-client” relationship with the government.⁴³

Financial Management of NGOs

Nonprofits’ financial management systems have always been a key concern in Bangladesh, given the absence of coherent and uniform accounting standards and the fact that accounting systems in the sector have largely been developed pursuant to donor requirements. The Palli Karma Shahayak Foundation (PKSF), the umbrella group for micro-finance, has established specific accounting standards at an international level for financial reporting by nonprofit organizations.

³⁹ World Bank 2006 Report, p. 44.

⁴⁰ See <http://www.asianphilanthropy.org/grant/local/bangladesh/public.html>.

⁴¹ Ibid.

⁴² World Bank 2006 Report, p. 4.

⁴³ Ibid., p. 45.

While PKSF-funded organizations previously operated on a cash basis, they have gradually shifted to accounting on the basis of actual accrual. PKSF has also recently reduced the number of audit firms to undertake the audits of partner organizations in order to maintain and enhance quality.⁴⁴

Recent World Bank Proposals for Reform in the Regulation of the Nonprofit Sector and Philanthropy

The recent World Bank report on nongovernmental organizations in Bangladesh observes that “the legal framework [for NGOs] is outdated, obsolete, and in some cases not in sync with modern NGO regulatory concepts.”⁴⁵ In suggesting reforms to the regulatory framework the report emphasizes the goal of fostering better governance and accountability in the nonprofit sector rather than micro-managing foreign funds. The report focuses on the need to streamline and harmonize existing laws “duplication, overlapping, and contradictory requirements.” It reaffirms certain key principles to be ensured in the regulatory reform process, many of which also underlay the 2004 Philanthropy and Law in South Asia report on Bangladesh:

- Broad discretion should be given to NGOs to structure themselves in ways that suit their goals and purposes.
- Given the broad spectrum of activities undertaken by NGOs, laws should not be written with a particular group in mind but have room for flexibility in application.
- Regulations should be facilitative in that NGOs can scale up their activities in an innovative manner.
- Penalty provisions should be structured to provide gradation of sanctions starting from fines and other intermediate sanctions before settling for board suspension or dissolution.
- Judicial appeals should be allowed to contest any adverse ruling or penalty.
- Tax laws for non-profits need to be simplified and compiled separately, with focus on providing greater incentives for local resource mobilization for the NGO sector.⁴⁶

The World Bank study proposes the establishment of an independent NGO Commission that would assume the functions currently performed *inter alia* by the NGO Affairs Bureau and Department of Social Welfare, among other organizations. The purpose of this Commission would be to oversee the nonprofit sector and to maintain an effective framework for non-profits to operate within.

⁴⁴ World Bank 2006 Report, p. 60.

⁴⁵ World Bank 2006 Report, p. 53.

⁴⁶ World Bank 2006 Report, especially the Executive Summary and chapters 4 and 5.

The Commission would be empowered to deal with matters of incorporation, apex bodies and licensed certification bodies, would take a lead in introducing internationally recognized standards for accounting, reporting and presentation of financial reports by nonprofit organizations. The report recommends that the Commission be composed of commissioners drawn from both the public and the private sectors, and that it report directly to the Parliament to ensure its autonomy, in a form not unlike that of the Charities Commission in the U.K.⁴⁷

⁴⁷ Ibid., pp. viii, 61-63, 65-67, 89-90.

India

Introduction

The last few years have seen significant shifts in the regulation of the nonprofit sector and philanthropy in India. This is partly because of the high profile that nongovernmental organizations now enjoy in India, and partly as an attempt to overhaul the Indian legal and fiscal regulations relating to NPOs – shifts that in some cases lead toward greater control over the nonprofit sector and its activities, and in other cases lead toward greater autonomy for the sector.⁴⁸

There have been developments in a number of areas, and those are highlighted below. They include

- Renewed proposals and debates on amending the Foreign Contributions (Regulation) Act 1976, which governs foreign donations to the Indian nonprofit sector;
- Changes in fiscal policy, particularly taxation, where many exemptions are under review and some have already been modified, as well as changes in the Stamp Act, Value Added Tax Act 2005, and other fiscal legislation;
- Pressures from newer money laundering legislation and related regulations on anonymous donations;
- New proposals to regulate the micro-finance sector;
- Implications of the Right to Information Act 2005 for the Indian voluntary sector;
- and other developments discussed below.

Perhaps the most important and far-reaching change has been the approval and announcement of a National Policy on the Voluntary Sector.⁴⁹ This policy, drafted and finalized after consultations with the nonprofit sector and various government departments, is intended to provide a framework for partnership between government and the voluntary sector. More specifically, the policy is intended to create an enabling environment for the voluntary sector, to enhance their resource mobilization capacity, and to encourage accountability and transparency in the Sector.

It must be noted that this new National Policy on the Voluntary Sector is not law, only a statement of intention. It does not bind the government to a specific timeframe or commit it to pass new laws or amend old ones. Much will depend on these aspects of implementation, both at the central level and in the states. But the National Policy on the Voluntary Sector is a significant step forward.

⁴⁸ The India country report has been written by Noshir Dadrawala and Sanjay Agarwal.

⁴⁹ The National Policy on the Voluntary Sector is available at <http://credall.org.in/images/npvol07.pdf> and <http://www.vaniindia.org/>.

Developments in the Regulation of Foreign Donations

Foreign Contribution (Regulation) Act (FCRA)

FCRA Registration Procedures

One of the major shortcomings in the administration of the FCRA⁵⁰ has been that authorities were not sharing their reasons for rejection of registration, thus creating opacity in the implementation of the Act. This has now changed – the Department routinely shares the reasons for rejection with the applicant.

The FCRA Department has also gone partly online – a nonprofit organization can find out the status of its application for registration or prior permission on the Internet by keying in its application reference.

Online Filing of Form FC-3 for FCRA Reporting

The Ministry of Home Affairs has introduced a facility for the online submission of the annual return (Form FC-3) under the Foreign Contribution (Regulation) Act, 1976. The on-line return can be filed at: http://www.mha.nic.in/fcraweb/fc_online.htm.

Foreign Contributions (Regulation) Bill 2006

Currently, nonprofits in India are regulated by the Foreign Contributions (Regulation) Act (FCRA) 1976. In July 2005, the Foreign Contributions Management (FCMC) Bill 2005 was proposed by the government to replace FCRA 1976. Several consultations took place in the country and representations were made to the government by the NGO sector, professional bodies, and others on perceived problems with the bill.

Subsequently, the Union Cabinet approved the FCR Bill 2006 and presented it in the Rajya Sabha on 18th December 2006.⁵¹ This Bill was subsequently referred to a Standing Committee which appears to have delayed the passage of the new FCRA 2006. The Standing Committee (Home Affairs) invited public representations on the Bill and the issues surrounding it, and was expected to give its final report by the end of March 2007.⁵²

⁵⁰ Foreign Contribution (Regulation) Act, 1976, available at <http://www.accountaid.net>.

⁵¹ Ministry of Home Affairs, Foreign Contribution (Regulation) Bill, 2006 introduced in Rajya Sabha, <http://pib.nic.in/release/release.asp?relid=23453>.

⁵² Foreign Contribution (Regulation) Bill 2006, available at <http://www.accountaid.net> and at <http://www.karmayog.org/fcra/>. See AccountAble 122-126 for a summary of the key changes and AccountAble 127-128 for an analysis, also available at <http://www.accountaid.net>.

Problems and prospects under the Foreign Contribution (Regulation) Bill 2006

A number of issues have been identified by the Indian nonprofit community in the new Bill. Among those identified as problems are:

- Nonprofits registered under the proposed new Act will be required to renew registration every 5 years, which is not the case under the present Act. Registration requests can be turned down for a variety of listed reasons, including the ill-defined threat to the security, strategic, scientific or economic interests of the State.
- The definition of prohibited political activities has been further enhanced to include an organisation's "ideology."
- Administrative expenses of nonprofits should not be more than fifty percent. This term has not yet been defined in the bill, but the nonprofit sector's expectation is that the government will seek to include all salaries under administration, which can lead to additional issues and encourage misclassification and misreporting, which further weakens accountability.
- FCRA provisions would be extended to individuals and the electronic media.
- The FCRA Department would be formally empowered to suspend or cancel FCRA registration – presently, this is done in a roundabout manner. In addition, the provision includes a freeze period of three years during which the FCRA would not be renewed, and the government would acquire the right to manage available foreign contributions (funds and properties) until FCRA registration is re-approved.
- There will be a prescribed fee for registration, renewals and prior permission, which is not the case under the present Act.

But there are some good points under the proposed new Act as well. They include:

- The Home Ministry will be required to give reasons for denying registration or prior permission.
- Nonprofits may operate more than one FCRA account provided all foreign contributions are received only through one specific bank (in the past, no more than one account was allowed).

Many in the Indian voluntary sector believe that the new Bill also runs contrary to the spirit of the new National Policy on the Voluntary Sector, discussed below, which has promised a review of FCRA and its simplification. There can be little doubt that the most critical change on the horizon affecting Indian NGOs is the proposed new FCRA Bill. The Bill makes a significant departure from the original Act, and is now mainly focused on NGOs. As indicated above, prohibited purposes would include political activity, religious conversions, and activities detrimental to the interest of the state.

The definition of foreign source has remained unchanged, but has become untenable in the new deregulated economic environment. A company in which 50% or more shares are held by foreigners is considered a foreign source – the problem is that in

some of the actively traded shares, there is no way to freeze the holding and establish which Indian companies are Indian and which are foreign. A highly controversial provision allows the government to determine what constitutes administrative expenses, and to fix a cap of up to 50% on these. The only positive change appears to be that allowing NPOs to open secondary bank accounts, to manage their foreign contributions better. An active campaign by the NGOs has led to several positive developments – including the Bill being referred to a Standing Committee. As of August 2007, it appears unlikely that the Bill will pass through the Parliament unchanged.

Developments in Fiscal Policy

The Income Tax Act is undergoing a major and wide-ranging review of all the tax exemptions. Some of the resultant changes have already made it to the statute book, while others may do so in the next few years. None of the changes are earth-shattering, but they do indicate a general narrowing of the space for financial management in the voluntary sector.

For instance, as discussed further below, anonymous donations to charitable organizations are no longer exempt under section 11. They will now attract tax at the maximum marginal rate (presently 33.66%). However, religious and religious-charitable organizations have been exempted from this for the time being, in view of widely prevailing practice among devotees of *gupt daan*, or confidential donation, where the donor tries to avoid revealing his or her identity, in order to earn extra spiritual merit.

Income Tax Act

Effect of Finance (No. 2) Act 2004 (introduced with effect from October 1, 2004)

A new provision (3) and (3)(b) to section 12AA of the Income Tax Act gives Commissioner of Income Tax powers to cancel the registration of trusts or institutions where the activities are not genuine or not carried out in accordance with the objects of the trust or institution.

Sub-section (4) and (5) of Section 35AC have been amended giving powers to the National Committee to withdraw approval under section 35AC if the project or scheme is not carried on in accordance with all or any of the conditions subject to which approval was granted or if such association or institution does not furnish after the end of each financial year a report in the prescribed form.

The threshold limit for NPOs filing a tax return along with compulsory audit report has been enhanced from annual income of Rs. 50,000 (approx. US\$1,200) to Rs. 100,000 (approx. US\$2,400). NPOs with a gross income below Rs. 100,000 are not required to file a tax return; earlier, this limit was Rs. 50,000.

Effect of Finance Act 2006 (introduced with effect from April 1, 2007): The Strengthened Policy on “Anonymous Donations”

The Finance Act 2006 has introduced a new section, 115BBC, seeking to tax any income comprising anonymous donations received by any university or any hospital or other institutions referred to under various sub-clauses of Section 10(23C), or any trust or institution referred to under Section 11.

Religious trusts and institutions are exempt from the provisions of this new section. Anonymous donations to trusts and institutions having both religious and charitable objects will not be taxed as long as they are given for religious purposes.

“Anonymous donation” means any voluntary contribution referred to in the now amended Section 2(24)(ia) where a person receiving such contribution does not maintain a record of the identity indicating the name and address of the person making such contribution and such other particulars as may be prescribed. While the object of the new Section 115BBC is to plug laundering of “black money” through anonymous donations made to certain trusts, this new amendment will have a negative effect on charitable organizations that have installed “donation boxes” near cash counters of various up-market shops, shopping malls and other retail outlets.

NGOs issuing expensive “Donor Cards” for various charity events will also have to keep a record of who these cards are issued to against donations, failing which the collections would be liable to tax. NGOs participating in mega events like the “Mumbai Marathon” will also have to keep precise records of every donation, sponsorship and other collections.

Effect of Finance Act 2007

The Finance Act, 2007⁵³ has streamlined the process for approval under section 10(23C) (iv), (v), (vi) and (via) as also Section 35(1)(ii) and (iii). Accordingly an order either approving or rejecting the application is required to be issued within a period of 12 months from the end of the month in which such application was received.

As per amendment of section 12A, organizations seeking income tax exemption will necessarily have to file application of registration under section 11 and 12 from the year they will wish to avail the exemption. They will not be entitled to avail retrospective exemption of income of income tax after satisfying Commissioner of Income Tax. The discretionary power of the Commissioner of Income Tax regarding arbitrary condoning of delay in filing of application is curtailed.

Under the Income Tax Act, registration under section 12A, once granted, was not revoked. However, income was assessed as exempt or not each year. In 2004, the

⁵³ The text of the Finance Act 2007 is available at <http://www.indiantaxsolutions.com/main.php?t=28011990&d=1179328865> and http://www.indiantaxsolutions.com/finance_act_2007.htm.

Government authorized the tax authority to cancel the registration, if an NPO's activities are not genuine or deviate from its objects. The procedure of assessing income as exempt each year remains unchanged.

The government is also now empowered to withdraw approvals granted for tax-incentives on donations under sections 35(1), 35AC, and 35CCA for violation of conditions of approval. However, such revocation will not have a cascading effect on the donors, whose tax deduction for their donation will remain claimable.

Section 80G (5) (vi) provides for deduction in respect of donation to certain funds or institutions from the taxable income of donors if the fund or institution is approved by the Commissioner of Income Tax. Currently there is no procedure for appeal against the order of the Commissioner rejecting the approval of an institution or fund for deduction purposes. Section 253 of the Income Tax Act has been amended to allow an appeal to be filed against such orders of Commissioner before the Appellate Tribunal.

The provisions of Section 13(1)(d)(iii) have been amended with retrospective effect from April 1, 1999 to allow charitable organizations to invest in shares of public sector companies as also to acquire equity shares of a “depository.”

For obtaining exemption from income tax, a nonprofit organization needs to make an application. Earlier the requirement was that this must be done within one year of its formation. This used to cause hardship, as many smaller organizations do not access legal advice in early years of their operation. This provision has now been relaxed – an NPO need apply only when its income crosses the threshold limit of Rs.100,000 (approx. US\$2,400). It will be then granted exemption from the same year, if the tax authorities are satisfied that it is a genuine charity and meets the exemption requirements.

With this change, the existing provision for condoning delay in applications has been withdrawn. This is a major simplification in the procedures, but may also cause hardship in some cases. An NGO which fails to apply for exemption after crossing the threshold limit may end up paying tax on its surplus for the year. A decision on applications for tax exemption under section 10(23)(c) must now be taken within twelve months from the date of application – in earlier times, delays of up to three years were common.

Application of Income in India Only

In a recent judgment, the Delhi High Court in a recent judgment has ruled that all nonprofits must apply their income only in India. Failure to comply with this requirement could lead to revocation of tax exempt status.⁵⁴

⁵⁴ American Hotel & Lodging Association Educational Institute vs. Central Board of Direct Taxes (2006) 158 Taxman 146 (Delhi), available at <http://www.delhidistrictcourts.nic.in/Nov06/American%20Hotel%20Vs.%20Central%20Board.pdf>. See also M.K. Nambyar Saarf Law Charitable Trust vs. Union of India, WP (C) 7689/2004, CW-7689/2004 (2004), available via <http://courtnic.nic.in/dhcorder/dhccontent.asp>.

The Delhi High Court's Judgment has simply reconfirmed the long-standing view held by the income tax authorities that an important condition for exempting the income of a nonprofit organization from tax is that the income must be applied (spent or used) or accumulated in India. If a part of the income of the organization is applied for a charitable purpose outside India, that income would be liable to tax. However, the rest of the income applied in India would be exempt from tax, if all other conditions are fulfilled.

It may also be noted that the income of a trust created before 1-4-1952, for charitable or religious purposes spent outside India, is exempt if so authorized by a general or special order of the Central Board of Direct Taxes (CBDT). In the case of trusts created on or after 1-4-1952, the further qualification is that expenditure outside India should be for a charitable purpose which tends to promote international welfare in which India is interested. The expression, "in which India is interested," has not been articulated, amplified, explained or defined. The CBDT has been empowered to decide the matter either generally or in individual cases, as they arise by special order.

Indian Stamp Act

The Indian Stamp Act, 1899 was amended in 2004 to raise the threshold level above which stamp duty in the form of revenue stamps is charged on receipts from the earlier level of Rs.500 to Rs. 5,000.

The Stamp Act is a fiscal statute dealing with tax on instruments. The tax is levied in the shape of stamps on instruments recording different kinds of transactions. Since 2004 there has been an increase in the minimum stamp duty payable from the earlier Rs. 20 to Rs. 100. Thus affidavits and minimum stamp duty for declaration of a trust for religious or charitable purpose and where there is no disposition of property has been increased from Rs.20 to Rs. 100.⁵⁵

Value Added Tax Act 2005

Several other tax laws have now merged into VAT Act 2005, including the Sales Tax Act, Motor Spirit Taxation Act, Purchase Tax on Sugarcane Act, and Transfer of Right to Use Act. India subjects certain sales of goods and services to VAT, with a fairly broad range of exempt activities.

The rates range from 1 percent to 12.5 percent, with most goods and services taxed at 12.5 percent. VAT liability arises only if the total turnover of sales is Rs.500,000 (approx. US\$12,000) (Rs. 100,000 (approx. US\$2,400) if the dealer is an importer). An entity (including a public charitable trust) is liable under the VAT Act if

⁵⁵ The text of the Stamp Act may be found at <http://www.vat.maharashtra.gov.in/information/upload/00097INDIAN%20STAMP%20ACT,%201899.htm>.

its sales/purchase turnover in the previous year exceeded Rs. 500,000. The threshold is lower, Rs.100,000, for importers.⁵⁶

Service Tax

The Service Tax has proved to be a bountiful source of revenue: collections have risen 100-fold from Rs. 4 *arab* (approx. US\$100 million) in 1994 to Rs. 2.75 *kharab* (approx. US\$9.35 billion) in 2007. Not surprisingly, the scope of the Service Tax has also been enthusiastically expanded over the last ten years or so, from three services in 1994 to about 100 services now.

Until 2006, the tax was limited to commercial services. However, this restriction has now been dropped. Effectively, this means that an Indian nonprofit is liable to pay service tax (at a rate of 12.36% of the amount of the relevant fee), if it provides any service covered by the Act. Examples include consultancy services, such as studies often conducted by NPOs.⁵⁷

Developments in Registration, Governance, Accountability, and other areas of Regulation

Registration

There have been no significant changes in basic registration requirements in various states. However, several states, such as Karnataka, Madhya Pradesh and Rajasthan have increased the registration fees. Karnataka has also linked the filing fees for various documents with a nonprofit's financial turnover.

This has implications for accounting practices.⁵⁸ Some NPOs may wish to avoid showing their income from grants in the Income and Expenditures Account, and instead show it as a liability adjustment on the Balance Sheet. This practice, widespread in some states, is believed to help an NPO avoid troublesome scrutiny by tax authorities. In this case, it may be seen as helping them avoid paying higher fees to the authorities.

⁵⁶ The text of the VAT Act 2005 is at <http://comtax.bih.nic.in/VATLaws.htm>. There are numerous VAT acts at the state level as well.

⁵⁷ Service tax provisions are available at <http://www.servicetax.gov.in/> and <http://www.servicetax.gov.in/st-actmainpg.htm>.

⁵⁸ Only three states provide for compulsory registration of NGOs. In Tamilnadu all societies beyond a nominal size must register. In Maharashtra and Gujarat, all trust and societies raising funds from public must register.

The Right to Information Act 2005

The right to information is enshrined in the Constitution of India. The Right to Information Act 2005 has now laid down the process of making this right a simple yet powerful and practical option. For just Rs.10/- any citizen of this country, rich or poor, can obtain information concerning the government's action actions and/or decisions. The law requires that information has to be given within 30 days.⁵⁹

NPOs in India are using the provisions of the Right to Information Act to enhance the quality of their advocacy efforts across a wide range of program areas, and to ensure that benefits from government programmes actually reach the people for whom they are intended.

According to Section 2(j) of the Act, "right to information" means the right to information accessible under this Act which is held by or under the control of any public authority and includes the right to inspection of work, documents, records; taking notes, extracts, or certified copies of documents or records; taking certified samples of material; and obtaining information in the form of diskettes, tapes, videocassettes or in any other electronic mode or through printouts where such information is stored in a computer or in any other device.

Information can be demanded from all public authorities, including government bodies and organizations substantially financed by the government, including NGOs. It should be noted that the Act does not cover all NPOs – only those financed substantially by the government are covered.

The penal provisions on the Public Information Officer (PIO) are the real teeth of the Act, which ensure that the PIO cannot treat citizens' demands for information in a cavalier manner. One of the major reasons for the success of the earlier Maharashtra and Delhi Acts on the right of information was the provision for penalizing the PIO if information is not provided within the mandated period. The national Act has drawn significantly from the Maharashtra Act. Under the Act, each state has the right to frame its rules in terms of fees, procedures and forms, which must be consistent with the Act.

Government May “Regulate” - Not “Control”

The Maharashtra State Government had introduced a new Temples/Religious Institutions Management and Regulation Bill 2006 with a view to control some extremely cash-rich temples. However, the Bill was strongly opposed on the principle that “Government may regulate but should not control” religious or charitable institutions and has not yet been enacted.

⁵⁹ The Right to Information Act and additional information on it is available at <http://righttoinformation.gov.in/> and <http://persmin.nic.in/RTI/RTI-Act.pdf>.

National Policy on the Voluntary Sector

In 2007 the government approved National Policy on the Voluntary Sector, drafted by the Voluntary Action Cell of the Planning Commission of India with the participation of the Indian voluntary sector. The Policy is a commitment to encourage, enable and empower an independent, creative and effective voluntary sector, with diversity in form and function, so that it can contribute to the social, cultural and economic advancement of the people of India.⁶⁰

The specific objectives of the policy are:

- To create an enabling environment for voluntary organizations (VOs) that stimulates their enterprise and effectiveness, and safeguards their autonomy;
- To enable VOs to legitimately mobilize necessary financial resources from India and abroad;
- To identify systems by which the Government may work together with VOs, on the basis of the principles of mutual trust and respect, and with shared responsibility;
- To encourage VOs to adopt transparent and accountable systems of governance and management.

With a view to provide an enabling environment for the voluntary sector, the policy states, “It is crucial that all laws, policies, rules and regulations relating to VOs categorically safeguard their autonomy, while simultaneously ensuring their accountability.”

The National Policy also includes a number of other key provisions, including:

The Planning Commission will encourage state governments to review prevailing laws and rules and simplify, liberalize and rationalize them as far as possible. In order to facilitate registration of non-profit companies, the government will examine measures to simplify procedures under section 25 of the Companies Act (1956), including those for license, registration, and remuneration to member-employees.

The government will also examine the feasibility of enacting a simple and liberal central law that will serve as an alternative all-India statute for registering VOs, particularly those that wish to operate in different parts of the country and even abroad. Such a law would co-exist with prevailing central and state laws, allowing a VO the option of registering under one or more laws, depending on the nature and sphere of its activities.

⁶⁰ The National Policy on the Voluntary Sector is available at <http://credall.org.in/images/npvol07.pdf> and <http://www.vaniindia.org/>.

The government will also encourage the evolution of, and subsequently accord recognition to, an independent, national level, self-regulatory agency for the voluntary sector.

Central and state level agencies will be encouraged to introduce norms for filing basic documents in respect of VOs, which have been receiving funding by government agencies and placing them in the public domain (with easy access through the internet) in order to inculcate a spirit of public oversight.

Stocks and shares have become a significant form of wealth in the country today. In order to encourage transfer of shares and stock options to VOs, the Government will consider suitable tax rebates for this form of donation.⁶¹ The government will also simplify and streamline the system for granting income tax exemption status to charitable projects under the Income Tax Act. At the same time, the government will consider tightening administrative and penal procedures to ensure that these incentives are not misused by paper charities for private financial gain.

The government will also review the FCRA and simplify its provisions that apply to VOs, from time to time, in consultation with the joint consultative group to be set up by the concerned Ministry.

The central government has framed guidelines for bilateral agencies to give direct assistance to voluntary organizations for projects of social and economic importance. It controls access to such funds and their utilization, both through the FCRA and through regulation by the Department of Economic Affairs. This system needs to be simplified in consultation with the joint consultative group to be set up by the concerned Ministry.

The government will encourage setting up of Joint Consultative Groups/Forums or Joint Machineries of government and voluntary sector representatives, by relevant central departments and state governments. It will also encourage district administrations, district planning bodies, district rural development agencies, *zilla parishads* and local governments to do so. These groups will be permanent forums with the explicit mandate to share ideas, views and information and to identify opportunities and mechanisms of working together. The government will introduce suitable mechanisms for involving a wide cross-section of the voluntary sector in these Groups/Forums.

There are legitimate concerns regarding the effectiveness of grant-in-aid schemes. Out-dated design of funding schemes, arbitrary procedures, selection of unsuitable VOs, poor quality of implementation, and misuse of funds are some of the reasons for the possible defeat of the objectives of such funding. Concerned government agencies would be encouraged to ensure proper accountability and monitoring of public funds distributed to VOs.

⁶¹ The original PALISA study, Philanthropy and Law in South Asia, also recommended allowing tax-deductibility for donation of shares (p. 155).

No reliable accreditation system is in place at present. The government will encourage various agencies, including those in the voluntary sector, to develop alternative accreditation methodologies. It will allow time for such methodologies to be debated and gain acceptability in the voluntary sector, before considering their application to government funding of VOs.

The government will support and encourage existing, as well new, independent philanthropic institutions and private foundations to provide financial assistance to deserving VOs. It will also promote a dialogue among public and private grant makers so that they may take advantage of the best practices in grant making and fund-raising strategies.

Accountability to all stakeholders and transparency in functioning are key issues in good governance. The voluntary sector is expected to set its own benchmarks in these areas. Since VOs vary in their objectives and activities, it would be impractical to expect uniform norms for accountability and transparency. The government will encourage support organizations, and VO networks & federations to facilitate discussion and consensus building on these issues. It will also encourage such agencies to advise and assist VOs to adopt norms that they find acceptable and useful. The government will recognize excellence in governance among VOs by publicizing best practices.

The government will support and encourage organizations that train aspirants to enter the voluntary sector, as well as those already working in the sector. It will make available physical facilities currently available with its training institutes as a measure of such support.

The government will also encourage and recognize innovative and pioneering work as also commission suitable agencies to prepare and update databases of VOs working in different fields. Websites of various government agencies will also be re-designed to provide links to key documents and databases, including those related to project funding schemes. The government will also encourage involvement of volunteers in public services, such as, at family welfare centers, primary health centers, hospitals, schools, vocational training centers, sanitation campaigns, etc.

Implications of the National Policy on the Voluntary Sector

This National Policy on the Voluntary Sector-2007 is the beginning of a process to evolve a new working relationship between the government and the voluntary sector without affecting the autonomy and identity of VOs. Implementation remains an issue.

Although issues of governance and accountability have remained largely at the discussion stage in India, the National Policy makes several important moves in this regard. The Policy provides for the recognition of an independent, national self-regulatory agency for the voluntary sector; recommends that the accounts of VOs receiving financial support from the government be made available on the internet to

improve public oversight; seeks to develop alternative accreditation methodologies and their eventual application to government funding of VOs; encourages debate on accountability and transparency;⁶² and facilitates dialogue among public and private grant-makers to help sharing of best practices in grant-making and fund-raising.

It also promises a wider review of laws affecting the voluntary sector, including the various state laws for registration and regulation of VOs in order to simplify, liberalise and rationalise these. Registration of section 25 companies, and rules related to remuneration of member-employees are also to be simplified. The government has also promised to examine the feasibility of enacting an All-India law for registering VOs, to enable VOs to operate across India or abroad, without registering under multiple state laws. Such a law would likely provide an additional registration option – VOs would be free to register under any of the existing laws if they wish.

The Micro Financial Sector Bill, 2007

The Micro Financial Sector (Development and Regulation) Bill, 2007 was introduced in the Lok Sabha on March 20, 2007. This Bill seeks to promote the micro-finance sector and regulate micro-finance organizations (MFOs). It was referred to the Standing Committee on Finance on April 27, 2007.⁶³

The draft Bill provides for a number of issues affecting the micro-finance sector. If it is enacted:

The National Bank for Agriculture and Rural Development (NABARD) would regulate the micro financial sector. Every MFO that accepts deposits will need to be registered with NABARD. Conditions for registration include (a) net owned funds of at least Rs 5 lakh (approx. US\$12,200); and (b) at least three years in existence as an MFO. All MFOs, whether registered or not, shall submit annual financial statements to NABARD.

Every MFO that accepts deposits will be required to establish a reserve fund through transfer of a minimum of 15% of its net profit realized out of its thrift and micro-finance services every year.

The central government may also establish a Micro Finance Development Council to advise NABARD on formulation of policies related to the micro financial sector.

NABARD shall constitute a Micro Finance Development and Equity Fund to be utilized for the development of the sector.

⁶² For some recent thinking on this, see AccountAble 129-32, available at <http://www.accountaid.net>.

⁶³ The draft bill is available at <http://www.microfinancegateway.org/files/40399>.

Some issues have been identified in the Bill as well. They include:

- While the Bill promotes the activities of MFOs, there are differing opinions on the cost efficiency of the MFO model.
- NABARD is designated as the regulator of the micro financial sector. However, its dual role as a key participant in the sector and the regulator could lead to conflict of interest.
- Banks and deposit taking non-banking financial companies (NBFCs) have to comply with Reserve Bank of India's (RBI) prudential norms designed to safeguard depositors' funds.
- While the Bill enables NABARD to prescribe norms for MFOs, it specifies some norms which are less stringent than for banks and NBFCs.
- Unlike banks regulated by RBI, the Bill does not exempt registered MFOs from the Usurious Loans Act, 1918 or state laws which cap interest rates.
- The Bill defines "micro financial services" to include insurance and pension services without specifying to whom such services are to be provided. This implies that every insurance and pension company would be regulated by NABARD.

Nepal

Notable Developments and the Legal Regime

The Political Scenario in Nepal

In the last decade Nepal has faced major political instability because of the repeated Parliament dissolutions and the armed conflict engaged in by the Communist Party of Nepal (Maoist) (CPN(M)) for political reform. We begin with a detailed review of political developments since early 2005, because they constitute a historic moment for Nepal, they are complex, and they significantly affect the Nepali voluntary sector.⁶⁴

In a situation of great instability, King Gyanendra dismissed the caretaker government on February 1, 2005 on the grounds that it failed to hold elections or effectively combat the armed insurgency. A state of emergency was declared, many fundamental rights were suspended and hundreds of political leaders and activists, civil society activists and human rights defenders, journalists, professionals and other political or ideological elites were imprisoned based on absolute power claimed by the Council of Ministers that was nominated and chaired by the King.

In early October 2005, the Royal Government announced that municipal elections would be held on 8 February 2006 and parliamentary elections by April 2007. An alliance of seven major political parties (SPA) which had opposed the royal takeover refused to accept the King's executive role, decided to boycott elections called by the Royal Government, and announced a campaign of protest rallies and demonstrations across the country. Nepali civil society gave direct or indirect support to this cause with an expectation of political reform and an end to the bloody war between government forces and the Maoists. On the other hand, the CPN(M) declared that it would disrupt the elections.

On 22 November 2005, the seven-party alliance and the CPN(M) announced their common adoption of a twelve point "Letter of Understanding," including a call for an "end to autocratic monarchy" and the election of a constituent assembly. The "Understanding" committed the CPN(M) to multiparty democracy, human rights and the rule of law, and stated that the armed Maoist forces and the Royal Nepal Army (RNA) would be kept "under the supervision of the United Nations or any other reliable international supervision" during the constituent assembly elections.⁶⁵ The U.N. Secretary-General welcomed this understanding, but it was strongly criticized by the Council of Ministers. The U.N. Secretary-General also encouraged the CPN(M) to extend its unilateral ceasefire and urged the government to declare a reciprocal ceasefire.

⁶⁴ The Nepal update was written by Anil Kumar Sinha and Sapana Pradhan Malla.

⁶⁵ See an unofficial translation of the Letter of Understanding available at <http://www.kantipuronline.com/kolnews.php?&nid-57858>.

In early December 2005, the CPN(M) extended its ceasefire by one month, but the government again rejected calls for it to be reciprocated. On 2 January 2006 the CPN(M) declared that it was ending its ceasefire. Protests planned for January 2006 had been curtailed by curfews and arrests, but in April political party and civil society activists, along with other protesters, challenged the bans and curfew, taking to the streets by the tens of thousands. Unlike the previous seven party alliance (SPA) protests, this time there was tacit understanding with and support from the CPN(M). The protests spread throughout the country. Many leaders avoided arrest, some with the help of civil society, and continued to organize the protests.

On 5 April 2006 the SPA launched a four-day strike, which turned into a nineteen day protest movement of unprecedented proportions (known as the *Jana Andolan-II* or the People's Movement). The Royal Government severely curtailed rights to freedom of assembly and association. Professional associations and other civil society groups formed an alliance for reinstatement of a democratic system. A ban on public gatherings inside the Kathmandu Ring Road was declared and curfews beginning on 5 April. Similar measures were imposed in other cities. These measures, according to the Home Minister, were taken to stop CPN(M) "infiltration" into the capital city of Kathmandu. Several hundred political party and civil society leaders were placed under preventive detention under the Public Security Act, and many others, including juveniles, were held for short periods. The death toll in these protests rose to eighteen, and scores were injured.

This movement and pressure from international community compelled the King to reinstate the dissolved Parliament and transfer sovereignty to the people of Nepal. The reinstated Parliament formed a coalition government and signed a comprehensive peace agreement with the CPN(M) on 21 November 2006 to end more than a decade of fighting. An Interim Constitution of Nepal 2007 was adopted, replacing the Constitution of the Kingdom of Nepal 1991. An interim government was also established with some agreed places for the CPN(M). The Nepali Army and the Maoists agreed to an arms management pact, under which each side has kept part of its weapons and restricted most troops to a few barracks, both under the supervision of monitors from the United Nations. The peace agreement contains several references to the parties' respect for human rights, and agreed to establish a Truth and Reconciliation Commission for which a bill has already been drafted. During this turbulent time, Nepali civil society continued its activities though with difficulties and under various constraints.

The Royal Government versus Civil Society: The Introduction of a Code of Conduct and Amendments to the Social Welfare Council Act 1992 to Strengthen the Role of Government

In the absence of Parliament and the people's representatives, and after King Gyanendra assumed direct executive authority with the formation of his Council of Ministers under his own chairmanship in February 2005, many ordinances that suited the political objectives of the King and the Council were promulgated. These included an ordinance to amend the Social Welfare Council Act 1992, popularly known as the NGO

Ordinance. This proposed ordinance was intended to control civil society and its vibrant activities that were also of a political nature. The government specifically targeted the statutory coordinating body for civil society, the Social Welfare Council (SWC), formed by the Social Welfare Council Act 1992.⁶⁶

The amendments to the Social Welfare Council Act 1992 sought to permit more political appointments and to centralize power and authority so as to enable the Council of Ministers to directly monitor and control the NGOs. This amendment by ordinance was an outcome of Army rule through royal takeover.

The amendments to the Social Welfare Council Act 1992 sought to authorize the Council to issue a Code of Conduct to regulate and control NGOs. In addition, the amendment ordinance provided for other restrictions on civil society:

Tenure of members of the Social Welfare Council opened for political intervention

The amendment ordinance sought to enable the exercise of power by the Council of Ministers over the voluntary sector and to bring SWC Executive Committee directly under the political control of the Council of Ministers. It provided the Council of Ministers with the power, exercisable with full discretion, to terminate nominated office holders of the Social Welfare Council before the expiration of their terms. A provision stipulating a fixed tenure of four years was amended to specify “up to four years” instead of “appointment for tenure of four years.”⁶⁷

Denial of right to hearing in termination

Under the original Social Welfare Council Act 1992, changes to the membership of the Social Welfare Council were subject to a rule of reasonableness and with the right to be heard. These protections were deleted by the amendment ordinance, leaving appointments to the Social Welfare Council open for termination at the discretion of the Council of Ministers or the Minister in-charge.⁶⁸

Transfer of authority of SWC Member Secretary to the Government

The earlier Act provided authority to the Member Secretary of the Social Welfare Council to make various decisions on the work of the Council. The amendment ordinance transferred that authority to the government through the Minister in charge of

⁶⁶ The Social Welfare Council Act 1992 is available at http://www.jica.go.jp/japandesk/nepal/houki/social_welfare_act2049.pdf.

⁶⁷ Amendment made on section 5(3) changed from fixed tenure four years to up to four years, Nepal Gazette, Volume 2, 2062.3.30.

⁶⁸ Section 5(4) amendment proposal 2(3), Nepal Gazette, Volume 2, 2062.3.30.

the SWC.⁶⁹ In the formation of an executive committee for the Council, many of the powers that had been vested in the Council were transferred to the Minister.

The government's intent to substantially tighten control over the sector was further evident from a directive issued on 17 February 2005 (BS 2061.11.06) by the Ministry of Defense to the Ministry of Women, Children and Social Welfare to exercise greater control and regulation of NGOs and international NGOs operating in Nepal through enactment of a Code of Conduct.

During this time, the Social Welfare Council circulated letters to the Chief District Office in each district, the body which statutorily registers and regulates NGOs, directing districts not to renew the registration of voluntary organizations without clearance from the Council. The Council also began auditing the work of organizations for which expenses had to be borne by such organization itself. Intelligence personnel were mobilized to monitor the activities of civil society. Many civil society activists complained that their emails were being scrutinized. Organizations, NGO staff and leaders, and members of civil societies were under threat for months as a result of their work for democracy and human rights.

Governance and Accountability

The Struggle over the Code of Conduct for Social Organizations 2005

The main statute for nonprofit registration and governance, the Societies Registrations Act, emphasized the importance of internal governance provisions for organizations under its remit. There was no provision in the Act that allowed implementation of any Code of Conduct or similar document by the Social Welfare Council or by the registration or regulatory body.

Through the change in the Social Welfare Act through the Royal Ordinance, the Social Welfare Council was empowered to devise a Code of Conduct and to immediately enforce it on social organizations and institutions.⁷⁰ The executive committee of these organizations could be suspended or dissolved where organizations or individuals failed to abide by the Code. This enhanced authority and discretionary power given to the Social Welfare Council provoked a sense of fear among the nonprofit community.

Nonprofit self-regulation and an enabling legal environment had already been discussed fairly extensively among Nepali civil society. As a consequence the NGO Federation of Nepal drafted an NGO Code of Conduct in 2002. Such a code was also envisioned by the Tenth Five Year Plan (2002-2007), including a commitment that a Code of Conduct for proper coordination and smooth functioning of both domestic and international NGOs would be implemented.

⁶⁹ Section 8(5), *ibid.*

As a result of the changes in law and authority granted by the Royal Ordinance to the Social Welfare Council, the Council drafted and announced enforcement of a Code of Conduct for Social Organization and Societies on 10 November 2005 (BS 2062/07/24).⁷¹ The Code included workers and employees, patron, office bearers, members, activists, advisors, specialists and consultants of any NGO within the definition of “social workers.” The Code defined “social organization and societies” to include groups working within the country, meaning that it was applicable to both domestic and international organizations. It attempted to regulate their work and sought to restrict political activities. Though the Code also sought to enhance transparency in nonprofit activities and the proper functioning and financial regularity of nonprofit, the tacit intention behind its enforcement was questioned from various sectors.

The Code required the societies and organizations to provide equal treatment irrespective of religion, caste, sex, or area of residence, but it also restricted “social workers” from political activities in or through their organizations. The Code disallowed the appointment of organizational chairs for more than two consecutive terms. It required that all organizations make their annual report and audit report public. It further required submission of all financial activities to the Council, District Administration Office and District Development Committee, causing inconvenience to those working in remote and grass root level and smaller organizations. For smaller social organization, the Code meant additional financial burden that were not within the reach of many grassroots groups.

The Code restricted all office holders and members from receiving any salary, allowance and any type of financial benefits, even if such person worked for the organization, thereby limiting the number of people who could be involved in the sector. The receipt of financial benefits was made one of the criteria for the disqualification of such member and office holder. The Code also restricted the office holders from working as the resident representative of international social organizations.

The Code also restricted the organization from use of such foreign fund that were provided or allocated to the Government of Nepal under any agreement. It was made mandatory to obtain permission of the Council before accepting any assistance through bilateral, multilateral and other incorporated institutions for any program. In addition, it was made mandatory to provide information regarding the foreign assistance for any project to the local government, resulting to their interference and dictations.

We conclude that under the pretext of coordination, the government, through the Code, sought to subject NGO activities to the control of local governments and the relevant programs of the government, thereby expanding political and bureaucratic intervention and control. The Code also required that all “social workers” abide by the government's policies, programs and codes of conduct, thereby limiting the scope of

⁷¹ The Code of Conduct is available at <http://nepallaw.blogspot.com/2005/11/full-text-of-code-of-conduct-code-of.html>.

nongovernmental works to efforts that support government policies and that were the result of political decisions rather than people's needs as determined through a participatory process. Lack of participation by stakeholders in the formulation of the Code and the restriction of nongovernmental activities to those within the ambit of government policy were key indicators of the Code as a restrictive act of government rather than the government playing a facilitating role toward the sector.⁷²

Both domestic and international federations of NGOs in Nepal raised strong concerns about the unilaterally announced Code of Conduct made possible through the Royal Ordinance. The United Nations office in Nepal, for example, criticized the drafting of the Code without accountability and transparency, and the creation of significant hurdles to the legitimate activities of civil society, instead supporting open, active and participatory dialogue with civil society.⁷³

A writ petition was filed by the NGO Federation at the Supreme Court on 17 August 2005 (2062/05/01) challenging the validity of the Ordinance that led to the Code of Conduct as a result of the action by the Royal Cabinet. The petitioners argued that the amendment was based on the arbitrary exercise of power to control civil society activities. A stay order was issued on 24 November 2005 (2062/08/09) not to implement the Code of Conduct, later vacated by the Division Bench of the Supreme Court. The case remains pending after the repeal of the Ordinance following the reinstatement of Parliament (see below).

By late January 2006, the Supreme Court had not yet ruled on these challenges. After the restoration of Parliament in 2006, the Ordinances introduced with the intent of controlling civil liberties and civil society were repealed on 9 May 2006. One of those Ordinances repealed was the Social Welfare Council Ordinance under which the Code of Conduct had been formulated.

Interim Constitution of Nepal 2007: Freedom of Organization and Policy for Nongovernmental Organizations

As a result of the peace accord between the CPN(M) and the political parties, an Interim Constitution of Nepal 2007 has been promulgated.⁷⁴ Article 12.3(d) of the

⁷² Human Rights Watch, Nepal: Legal Veneer for Repressing Civil Society - Code of Conduct for Social Organizations a Major Step Backward (14 November 2005), http://hrw.org/english/docs/2005/11/14/nepal12021_txt.htm.

⁷³ Letter dated 16 November, 2005 (2062/08/01) to Minister and 25 September 2005 (2062/06/09) to Secretary General of the Social Welfare Council from UN Residential Coordinator; Press Release of 5 October 2005 (2062/06/19) from Ian Martin, Representative of UN High Commission. See <http://www.un.org.np/pressreleases/metadata.php?id=342> for another U.N. statement on these issues.

⁷⁴ The Interim Constitution 2007 is available at www.worldstatesmen.org/Nepal_Interim_Constitution2007.pdf, among other sites.

Interim Constitution 2007 guarantees the freedom to establish “unions and associations” as a fundamental right.⁷⁵

The chapter of the Interim Constitution on “responsibilities, directive principles, and policies of the state” provides in the article on “state policies” that “[t]he State shall pursue a special policy to regulate the operation and management of public and non-governmental organizations established in the country.”⁷⁶ This particular constitutional provision is unclear whether the intention in regulating such nongovernmental groups is for state control, or for the creation of enabling environment, but the provisions appear protective in nature. Other provisions in the Interim Constitution speak to the role of civil society in monitoring the political system (Art. 33(c), and enhancing awareness of human rights (Art. 135(d)).

Developments in Legal Reforms Affecting the Nonprofit Sector

Provision for Establishment of Non-profit-distributing Companies under the Company Ordinance

Some of the areas that have been lacking in the regulation of the Nepalese non-governmental or non-profit sector are laws relating to not-for-profit companies and to trusts. While a law relating to trusts is still being considered, recent changes made in the Company Law include provisions relating to non-profit-distributing companies. Such provisions were introduced by the Company Ordinance 2062,⁷⁷ enacted as the Act of Parliament (Company Act 2063)⁷⁸ and are now a firm part of Nepalese law.

Earlier regulation also lacked provisions permitting NGOs to generate their own income through commercial or other type of activities. This gap has also been filled by a new provision in the Company Act. The new provision stipulates states that with the objective to develop and promote any specific profession or enterprise by those involved in such activities and also for achievement of educational, social, philanthropic, public benefit and welfare objective, such non-profit-distributing companies may be established.

Those running conventional public trusts and other societies and organizations are also allowed to form such non-profit-distributing companies with at least five promoter members. There is no limitation in the number of members, or on the transfer of

⁷⁵ Article 12 also stipulates (in proviso (3), that “nothing in sub-clauses (c) and (d) shall be deemed to prevent the making of laws to impose reasonable restrictions on any act which may undermine the sovereignty and integrity of Nepal, which may jeopardize the harmonious relations subsisting among the peoples of various castes, tribes religion or communities, which may instigate violence, or which may be contrary to public morality.”

⁷⁶ Article 35(19) of the Interim Constitution 2007.

⁷⁷ Company Ordinance 2062, available at http://www.jica.go.jp/japandesk/nepal/houki/pdf/houki2_swo_2062.pdf.

⁷⁸ Published in Nepal Gazette dated CITATION.

membership. The Company Registrar's Office (CRO) has been prescribed as the registration and regulating office for such companies and that, except for the statutory revisions applicable to shares, shareholders and their rights, all other provisions and compliance required for the profit-making company are applicable to such companies.

No share capital is required to form such a company. The source of fund may be the membership fees charged to its members, and donations and assistance received “in accordance with law,” but it is not clear precisely which law will apply to such company since nothing has been prescribed in the Company Act itself. Each member has one vote for appointment of directors. Provisions regarding the board are to be incorporated in the company’s Memorandum of Association. The format of such memoranda has been prescribed in the Act itself.⁷⁹

The Act limits fees for incorporation and management, which are prescribed by the Company Registrar's Office. The office bearers are entitled to a meeting allowance, salary and facilities as similarly prescribed by the CRO, taking into consideration the company's capital availability and income. In the event of liquidation of such company, the balance after payment of all liabilities shall be treated in accordance with the Articles of Association approved by the CRO, and if such provision is not made, the remaining assets and amount shall be transferred to the government. The Act also provides that the procedure for appointment of liquidator and auditors shall be as stipulated in the Company Act.

The law, however, grants authority to the Company Registrar’s Office to cancel the company’s registration if it violates registration and regulatory provisions.⁸⁰ Before such action, an opportunity must be given to clarify why such action should not be taken. Decisions of the CRO are appealable before the Commercial Bench (presently at the Appellate Court).

Words such as “in accordance with law” open a large area for interpretation and are subject to administrative or political control and discretion. For example, the provision that the fees are prescribed by the CRO separately for each such company enhances CRO officials’ discretion and opens the process to government interference or corruption. Similarly, the authority provided to CRO to deregister a company is accompanied by significant discretion to impose administrative as well as political control on the company. Instead of such deregistration, the law should have provided remedial measures and procedures for transparency. A lack of accountability on the part of CRO officials gives rise to misuse of such discretionary power. Though the non-profit-distributing company is allowed to work for social causes, there is no regulatory, reporting or other relationship established between the Social Welfare Council and such companies. In absence of such a tie, the provisions of the Social Welfare Act are not applicable to these companies.

⁷⁹ Schedule 12 of Company Act 2063.

⁸⁰ Section 167 of Company Act 2063.

Recent Initiatives in Law Reform Affecting the Nonprofit Sector

Draft Social Development Act

Legal reforms affecting the Nepalese nonprofit and philanthropy sector have been much discussed, but in the past these have often been targeted to control nonprofit activities rather than to provide a conducive enabling environment for the sector.

In recent months, the Social Welfare Council, which is primarily responsible for the Nepalese nongovernmental sector, has been drafting the Social Development Act 2007 (sometimes also called the Social Services (Development and Promotion) Act). The objective of the draft Act is to consolidate provisions regulating NGOs into a single window for registration, regulation, affiliation, supervision, review, and monitoring. The draft Act has been discussed within small groups of stakeholders but has yet to be broadly debated. The current draft provides for a Council and Executive Committee to govern the nonprofit sector. The Social Welfare Council would be enlarged to such an extent that it might be difficult to hold regular meetings. Political appointments or nominations from among politically affiliated persons have been proposed, which would politicize the Council and its activities. The Council's rights, duties and procedures have been prescribed.

The draft statute seeks to consolidate the legal framework for the nonprofit sector, but conflicts with other statutes and regulations cannot be ruled out. The draft Act provides that the Council may grant revenue facilities and benefits in consideration of the type of activities that NGOs are undertaking, but conflicts with existing law relating to taxation and revenue may prevent implementation or make such new provisions unenforceable. Consolidation through one "window" should be appreciated, but it will require the establishment of such offices in each district and in the various townships. In the absence of such facilities, the draft Act provides that District Development Committees will exercise these roles. The Committees cannot remain isolated from political interference in the regulation of the nonprofit sector.

The draft Act also recognizes the NGO Federation of Nepal, and makes provisions relating to and governing the activities of international non-governmental organizations in Nepal, and the formation of trusts.⁸¹ It also provides penalties for breach and rights to appeal. The draft Act, if enacted, would serve as the supreme law for the social services sector. It must be brought forward for broad and public debate, and with some changes it may act as a consolidated law to facilitate the work of the Nepalese nonprofit sector.

⁸¹ In more specific terms, the draft Act would encourage international NGOs in Nepal to work in partnership with or as the counterpart of Nepalese NGOs. It proposes that the head of an international INGO in Nepal may be an expatriate, but the second in the organization must be a Nepalese citizen. Preference must be given to local experts and volunteers, though expatriates may also be appointed. The draft Act also provides for visas for expatriates and other facilities, which are now scattered in various other legal frameworks resulting in difficulties in implementation and coordination.

Fiscal Regime

Developments in Tax Exemption, Tax Deductions and Credits for Contributors

Prevailing laws have provision for specific exemption from taxes, with such exemptions granted only on a case-by-case basis. The Income Tax Act 2058 (2002)⁸² required non-governmental and not-for-profit organizations to apply for a Permanent Account Number (PAN) and, upon grant of the PAN, to apply for tax exemption by going through prescribed procedures. Conditions are normally prescribed in such exemption certificates. If the organization has income generating activity (other than receipt of donations, contribution, membership fees, and the like), that income is normally also covered by the tax exemption.

Under the prevailing Income Tax Act 2058 (2002),⁸³ tax paying establishments are allowed to book as expense only up to 100,000 Nepalese Rupees 100,000 (approx. US\$1,550), or five percent of taxable income, whichever is lower. This amount is negligible, and corporate establishments have not been not encouraged by such provisions. But some more facilitative provisions have recently been announced: By notification under Provisional Tax Act 2012 (1955), inserting an enabling provision in the Income Tax Act 2058 (2002),⁸⁴ beginning on 16 July 2007 a company may spend and claim as expense a sum up to 1 million Nepalese Rupees (approx. US\$15,500), or ten percent of taxable income, whichever is lower, for the protection and promotion of ancient, religious and cultural heritage in Nepal or for the construction of physical infrastructure for sports open to the public, subject to prior approval of the Inland Revenue Department.

All other tax facilities and benefits have been granted on an ad-hoc basic. Customs duty and value added tax (VAT) have been exempted on various goods imported from abroad which are obtained by an NGO as a commodity grant or by purchase. These decisions are dependent on the content of the agreement under which such items are obtained or received, with the exemption granted at the recommendation of the Social Welfare Council by the Ministry of Finance through notification in the Nepal Gazette. There are no transparent criteria governing decisions on such exemptions.

The prior approval requirement to spend amounts on specific philanthropic purposes may result in difficulties in implementing this new facility. In addition, it is an

⁸² Information on the Income Tax 2002 is available in the Income Tax 2002 Handbook at http://www.ird.gov.np/Income_Tax_Act_2002_Handbook_english.pdf. The Income Tax Act 2058 is available in Nepali at http://www.ird.gov.np/income_tax_act_2058_updated_2062.pdf. Information on tax deductions in the Income Tax Act 2058 is available in English at http://www.ird.gov.np/TDS_English_03_61.pdf.

⁸³ Income Tax Act 2058, Section 12.

⁸⁴ Income Tax Act 2058, Section 12a.

enabling provision to spend, not to give a donation or contribution to tax exempt organizations. In the past, such prior approval requirements have resulted in the enhancement of discretionary power and corrupt practices.

Developments in Resource Mobilization, Fundraising, and Capital Formation

There have been no significant developments in recent years in the regulation of resource mobilization, fund raising and capital formation by nonprofit entities in Nepal. No major steps have taken place to strengthen or enable fundraising and capital formation in an effective manner within the country, thereby increasing dependency on foreign contributions.

The provision for non-profit-distributing companies in the new Company Act 2063 (2006) has allowed such companies engaged in social causes to raise their own funds through commercial activities. In practice, we must wait to understand the types of hurdles these companies must overcome, since there is duplication of activities by establishments incorporated under two different laws, the Societies Registration Act and the Company Act. In addition, Nepalese income tax law does not provide that such non-profit-distributing companies are clearly entitled to exemption from income tax, and this issue must await decision by the Inland Revenue Department. It will therefore, be uncertain whether all such companies or merely some (or individual companies on a case-by-case basis) will have tax exempt status have such entitlement.

Challenges and Recommendations

Nepalese civil society has played a key role in re-establishing democracy, mobilizing to build trust and helping inform people that there is no alternative to a multiparty system. At a time when the government's presence was negligible in many areas of Nepal due to the ongoing armed conflict, it was primarily civil society that filled the gap, providing basic support and services to the general public – though civil society organizations have also faced many severe attacks while undertaking that work.

As a result of the people's movement, the King was forced to return sovereignty to the people and to reinstate the dissolved Parliament. Recognizing the role of civil society, the Interim Constitution 2007 allocated 48 seats in Parliament to civil society, but unfortunately those seats have been distributed among leaders of political parties. This move by the political parties reinforced the message that it wanted activity from their “affiliated” civil society rather than independent performance by the sector. So on the one hand, civil society has been perceived as a threat by the political parties. On the other hand some civil society groups, due to their strong political ties, are silent and unable or unwilling to raise issues of accountability and credibility, expecting incentives due to their political affiliations.

Another serious challenge has been the frequent changes by the government in the leadership of the Social Welfare Council. These shifts of senior personnel have serious implications for the independence and stability of the Council and the maintenance of the

rule of law in the regulation of the social welfare sector. The Council's greatest challenge today is that political interference and to its independence.

A key case in this area, the removal of the previous leadership of the Social Welfare Council after the Royal takeover, and the appointment of a new senior official, has been challenged in the Supreme Court.⁸⁵ The Court determined that this position is not a political post, and that the termination could not have retrospective effect in curtailing a fixed term appointment granted by earlier legislation, and ordered the previous Secretary reinstated. After further procedural conflict, the case remains with the Supreme Court.

This is one example of how the Social Welfare Council has been deeply politicized by successive governments and ministers. Despite the Supreme Court's repeated interventions and interpretation of the post as non-political, such terminations are practiced by every minister regardless of party affiliation. As a result the NGO sector has been beset by political influence; many politically aligned NGOs have been sheltered and preferences and concessions provided because of such political affiliation.

A third significant issue is that there is no clear law to provide for the trust form in the current legal system. The practice of registering a simple trust deed at the Land Revenue Office has now been stopped for no clear reason. Nepal needs statutory reform that includes a law on trusts and enabling regulations to allow it to work independently and without government interference.

Despite a clearly enhanced role for civil society in election and political monitoring, inclusion of marginalized groups and building capacity of parties and candidates, the government's approach towards civil society and its role has yet to be clearly delineated and unambiguously strengthened, including in the tax realm. There remain insufficient incentives for the general public or the corporate sector to donate or contribute to the Nepalese nonprofit sector. Business volume has increased substantially over the past decade, but contribution limits remain the same. Because of such restrictions, recent flood and landslide victims have not received basic support due to lack resources in the local NGOs and the government's weakness in reaching people in remote areas where such support is most needed. Greater incentives are needed to spur more support to the Nepalese nonprofit sector.

⁸⁵ Prabha Basnet vs Government of Nepal, Writ no 2687 of 2062.

Pakistan

Introduction

Since Philanthropy and Law in South Asia was published in 2004, there have been a number of changes both in the regulation of the voluntary sector by the Pakistani state and in the ways in which the sector seeks to govern and manage itself.⁸⁶

Pakistan currently has about 65,000 registered nonprofits of various kinds, with an additional approximately 30,000 groups not registered, and a total of about 45,000 active organizations. There is extensive diversity within the sector, but also a widening gulf between larger NGOs and smaller community-based organizations. The corporate sector has become considerably more active in social development in recent years. And the government has recognized the role of the nonprofit sector in social development and poverty alleviation in the Pakistan Poverty Reduction Strategy Paper.

As discussed in Philanthropy and Law in South Asia, the primary tools used to regulate the nonprofit sector in Pakistan are registration laws and income tax statutes. There have been no significant changes in the registration laws. The shifts mandated by the government have occurred primarily in the tax regime, and primarily through a regulatory notification initiated by the Central Board of Revenue in August 2005.⁸⁷

The voluntary sector itself has focused on the mechanism used to grant recognition and tax exemption to nonprofit sector organizations, through new action proposed and implemented by the Pakistan Centre for Philanthropy following on the Enabling Environment Initiative undertaken in the early part of this decade.

Regulatory Changes

New Provisions in the Income Tax Ordinance Affecting Nonprofit Taxation

The primary shift in the regulatory framework governing the Pakistani voluntary sector was introduced under the Income Tax Ordinance. These shifts are important, not least because they are over-arching in character and apply to all organizations seeking or having been awarded recognition irrespective of the law through which they have been established. These provisions, made public in August 2005, include the following:

- The Central Board of Revenue delegated its authority for granting recognition for exemption from income tax to the Regional Commissioner of Income Tax (RCIT).

⁸⁶ The Pakistan report was prepared by Zafar Ismail and Qadeer Baig.

⁸⁷ S.R.O. 880(I)/2006.

- The recognition of tax exemption to voluntary sector organizations granted for one year was extended to subsequent years (in effect, in perpetuity) unless withdrawn.⁸⁸
- The free surplus that could be held as cash was limited to 25 percent of the total income for the year. The remainder is required to be held in designated securities, mutual funds and recognized investment schemes.⁸⁹
- The recognition of tax exemption granted may be withdrawn, with prior notice and opportunity for being heard, for a variety of reasons. Those reasons may include changes to founding documents without approval of the RCIT, or that the organization has misused funds, propagates political or sectarian dogma, is unable to meet its objectives, has not filed annual returns, or does not provide a performance evaluation report every three years.⁹⁰

In general terms, Section 2(36) read along with Section 61 of the Income Tax Ordinance provides for the availability of tax credits to donors on amounts donated, and exemption on customs duty on import of vehicles, machinery and equipment by voluntary sector organisations. Under clause 58 of II Schedule, voluntary organizations may receive tax exemptions on business income such as house rents, investments in saving schemes, and other income, but only 63 organisations have obtained the exemption thus far.

Discussions of a Draft NGO Bill

As result of Enabling Environment Initiative undertaken by the Pakistan Centre for Philanthropy in 2002-2003, an alternate NGO Bill was drafted by lawyers and civil society organizations. In 2004, the Pakistan NGO Forum objected to certain clauses of the proposed bill and discussions were held between the government and the nonprofit community. Eventually the Pakistan NGO Forum proposed an alternative draft which is still pending with Legislators Standing Committee for a decision.

Government Attempts to Institute a Code of Conduct

In recent years, the Ministry of Social Welfare initiated the formulation of a Code of Conduct to enhance NGO accountability to government. The draft Code of Conduct was leaked to the NGO community before it was finalized, and civil society networks initiated dialogue with the government. After a series of consultations the Ministry of Social Welfare agreed to shelve the idea for the time being. This episode may be said to

⁸⁸ Rule 220A, sub-rule (2), clause (c).

⁸⁹ Rule 220A, sub-rule (3), clause (vii).

⁹⁰ Rule 220A, sub-rule (7).

indicate both the desire of the government to further regulate the sector, and the sector's ability to negotiate with the state.⁹¹

Regulations for Microcredit Programmes Issued

The Micro-Finance Bank Ordinance, 2000 (Ordinance XXXII of 2000), to provide for the establishment of a micro-finance bank to render micro-finance services to poor persons for purposes of alleviation of poverty.⁹² Accordingly, the Khushali (Prosperity) Bank was established by the government to facilitate microcredit funding while the Aga Khan Fund for Economic Development established the first Micro-Finance Bank under this ordinance.

In 2000, when the Asian Development Bank approved the Microfinance Sector Development Program for Pakistan, the country's financial system was barely serving poor and low-income households despite the fact that there was a potential market of over 6.3 million households by conservative estimates. There was no legal and regulatory framework for specialized microfinance banks, though nongovernmental organizations were making a concerted effort to provide micro credit in selected areas on a small scale. The poor were compelled to rely on informal markets. It was obvious that a proper legal framework was needed for formal financial services for the poor. The Pakistan Microfinance Network (www.pmn.org.pk/) played a vital role in researching and negotiating the law with the government and the State Bank.

The Microfinance Institutions Ordinance, 2001 (Ordinance No. LV of 2001) dated 16th October, 2001, was issued to regulate the establishment, business and operations of microfinance institutions by the State Bank of Pakistan.⁹³ The Ordinance provides for the establishment of regulated microfinance institutions at three levels – district, provincial, and national – to integrate microfinance into the broader financial system and to create possibilities for institutional diversity. The ordinance assigns the State Bank of Pakistan authority for licensing, regulating, and supervising microfinance institutions.

The two microfinance banks with licenses to operate nationally have been established since the introduction of the ordinance, and a group of potential investors has completed a market assessment for establishing a microfinance bank to serve the urban poor. The state bank has begun to play a more proactive role to develop a comprehensive system and the capacity to regulate and supervise microfinance institutions effectively.

According to this new regulatory structure, the functions of the microfinance institutions include providing all types of financing facilities to poor persons except for

⁹¹ The Pakistan NGO Forum's alternative Code of Conduct is available at <http://www.civicus.org/new/media/PNF%20Code%20of%20Conduct%20Pakistan.doc>.

⁹² The Ordinance is available at http://www.sbp.org.pk/1_frame/MF_Bank_Ord_2000.pdf.

⁹³ The Ordinance is available at http://www.sbp.org.pk/1_frame/MF_Inst_Ord_2001.pdf.

business in foreign exchange transactions; accepting deposits; and undertaking control and supervision of any organization, enterprise, scheme, trust fund or fund endowment; providing storage and safe custody facilities; and mobilizing and providing financial and technical assistance and training to micro enterprises.

The State Bank, with the approval of the Federal Government, by notification in the official Gazette, makes rules for carrying out the purposes and provision of the Ordinance.

It is hoped that this new regulatory framework for microfinance institutions in Pakistan will quicken the pace of growth in microcredit programmes in Pakistan and provide a framework to rural support programmes and NGOs to implement microfinance programmes at local and national levels.

Money Laundering Law

A Money Laundering Law was enacted in 2005, though its implications for the Pakistani voluntary sector are not yet entirely clear.

Enhancement of the Tax Net

Recently the use of NTN (tax identification) numbers has been made compulsory for voluntary sector organizations, as it is already for businesses and other organizations, in an attempt to strengthen tax compliance and government information on economic activity. The Central Board of Revenue has introduced a simple and easy procedure for securing NTN numbers at city level or through the CBR website. But many NGOs, particularly smaller ones, face some difficulties in registering with CBR as many of them do not have qualified accountants to meet the financial obligations set by CBR.

Progress in Certification and Self-Regulation

As reported in the 2004 edition of Philanthropy and Law in South Asia, the Pakistan Centre for Philanthropy (PCP) and others in the Pakistani nonprofit sector had led a process in which nonprofit certification and self-regulation was substantially strengthened. The certification process established through the Enabling Environment Initiative provided for optional and voluntary certification for voluntary sector organizations in which applicant organizations would be evaluated based on standardised parameters, seeking to create an institutional mechanism for setting sector wide standards in organisational effectiveness.

The process sought to define benchmarks for NGOs in critical areas of internal governance, financial management and programme delivery; promote credible NGOs through inclusion in PCP databases; and build nonprofit capacity to meet certification standards. About 200 larger organizations have taken part in the certification process thus far.

The mechanism used for that certification process by the Pakistan Centre for Philanthropy was revised in 2006. The new mechanism provided that:

- Adherence to the Income Tax Rules would be mandatory
- The definitions of terms and processes used during the certification procedure were defined
- The prerequisites for recognition were defined as the following ten factors:
 - (a) The organisation is registered (under any of the relevant Pakistani registration laws⁹⁴) and has functioned for the last (at least) three years;⁹⁵
 - (b) The organisation is established for religious, educational, health, environment, charitable, welfare or development purposes or for the promotion of amateur sport or for any other purpose of general public benefit;
 - (c) The organisation does not propagate the views of any political party or religious sect;
 - (d) The charter of the organisation prescribes that in case of its dissolution any assets, remaining after the settlement of debts and liabilities, shall be transferred to a body or bodies in accordance with the applicable laws;⁹⁶
 - (e) The charter or other policy documents of the organisation state that it is a non-profit-distributing organisation and that all its income, commodities, property and other assets shall be applied solely towards the promotion of its objectives. Further it prohibits that funds or property of the organisation or any part thereof are paid or transferred directly or indirectly to any of the directors/ staff of organisation or their relatives;
 - (f) All assets of the organisation (fixed as well as investments) are held in the name of or are legally assigned to the organisation or its governing body;
 - (g) The organisation has a functional governing body;

⁹⁴ E.g. The Trust Act, 1882; The Societies Registration Act, 1860; The Voluntary Social Welfare Agencies (Registration and Control) Ordinance, 1961; The Local Government Ordinance, 2001; The Religious Endowments Act, 1863; or The Companies Ordinance, 1984.

⁹⁵ PCP's evaluation system is thorough and requires enough information and history of the organisation to evaluate it on certification standards. For this reason, PCP evaluates only those organisations that have a formal work experience of three years on the least. Organisations younger than this should approach the CBR directly, should they be interested in obtaining tax exemptions under Section 2(36) of the Income Tax Ordinance, 2001.

⁹⁶ These include the Trust Act, 1882; Societies Registration Act, 1860; Voluntary Social Welfare Agencies (Registration and Control) Ordinance, 1961; Local Government Ordinance, 2001; Religious Endowments Act, 1863; and Companies Ordinance, 1984.

- (h) The organisation maintains its accounts with a scheduled bank, savings centre or post office, with these accounts are in the name of the organization;
 - (i) An external auditor has audited the accounts of the organisation for the last three years; and
 - (j) No adverse decree has issued in the last ten years against the organization in any of the civil courts in Pakistan on grounds of fraud or breach of trust.
- The standards against which the NPOs would be examined were in the three domains of internal governance, financial management and programme delivery. These were quantified such that the maximum for of the three were 300, 300 and 400 respectively (an overall possible score of 1000) and the minimum required was 50 percent in each of the three domains. However, certification would be denied to any organization which did not obtain an aggregate of 60 percent on the overall score. The criteria used for measuring the performance in each of the above are shown in Annex 1 (Pakistan).

Sri Lanka

Introduction

The legal and operative framework within which philanthropic and nonprofit activity takes place in Sri Lanka has undergone significant change since the publication of Philanthropy and the Law in South Asia in 2004.

These shifts can be traced to three principal developments. The first is legal, in the form of the enactment of a new Companies Act in May 2007 and several other regulatory developments; the second, the responses by the NGO sector in the aftermath of the natural disaster in the form of the Tsunami of December 2004; and thirdly, political developments arising from the splintering of the Liberation Tigers of Tamil Eelam (LTTE) and the increase in military activity in the north and the east of the country. These developments have had a distinctive impact on the operational environment of nonprofit and philanthropic organizations in Sri Lanka.⁹⁷

Legal and Regulatory Developments

The Companies Act No. 7 of 2007

Sri Lanka has traditionally adopted the law of the United Kingdom in its company law. The Companies Act No. 17 of 1982, which was operative until May of 2007, was fundamentally based on the principles contained in the United Kingdom Companies Act of 1948. However, since the early 1990s, Sri Lanka has focused on modernizing its company law which was effectively based on a law that was over six decades old. After considerable debate and discussion which lasted over a decade, the Companies Act No. 7 of 2007 was enacted by Parliament, introducing a new regime of company law. The new law departs from the law of the United Kingdom and is essentially based on the New Zealand Companies Act of 1993. This change has resulted in a paradigm change to the regulatory framework for companies in Sri Lanka.⁹⁸

The corporate form has been a popular vehicle of choice for most entities that conduct philanthropic activity in Sri Lanka for several reasons. These include: the relatively convenient process for incorporation; the benefits of limited liability and a definite operational framework; a high degree of formality which a trust cannot offer under the law;⁹⁹ and, the ability to benefit from the entity's charitable status. Hence, the

⁹⁷ The Sri Lanka update has been prepared by Arittha Wikramanayake and Thanuja Jayawardene.

⁹⁸ The Companies Act No. 7 of 2007 is available at http://www.lawnet.lk/section.php?file=http://www.lawnet.lk/docs/statutes/Acts_2007/indexs/2007Y0V0C7A.html (via www.lawnet.lk), and at [http://www.drc.gov.lk/App/ComReg.nsf/200392d5acdb66c246256b76001be7d8/\\$FILE/Act 7 of 2007 \(English\).pdf](http://www.drc.gov.lk/App/ComReg.nsf/200392d5acdb66c246256b76001be7d8/$FILE/Act%207%20of%202007%20(English).pdf).

⁹⁹ A trust is an easier method of setting up an entity for the purpose of engaging in philanthropic activity. However, since there is no legal provision for formal registration of a trust, it leads to some discomfort on the mistaken assumption that the lack of formal registration undermines its legality.

repeal of the Companies Act No. 17 of 1982 and its replacement by the Companies Act No. 7 of 2007 has important implications for the NGO sector in Sri Lanka.

The main changes introduced by the Companies Act No. 7 of 2007 which could have a significant impact on entities engaged in the nonprofit sector and work are as follows:

Changes that Impact the Incorporation Process

The new law simplifies the incorporation process for companies. Consequently, companies are no longer required to have a memorandum of association.¹⁰⁰ The registration process has also been streamlined and incorporation can be achieved by merely filling out an application form online. This has reduced the costs of incorporation and virtually eliminated the discretion of the Registrar of Companies in permitting incorporation.

Section 34 of the Companies Act authorizes the Registrar to permit associations seeking to form as companies limited by guarantee to dispense with the term “limited” from their name. This benefit is available to companies that can satisfy the Registrar that their purpose is to “promote commerce, art, science, religion, charity, sport, or any other useful object and intends to apply its profits, if any, or other income in promoting its objects, and to prohibit the payment of any dividend to its members.” Though there theoretically is no bar to a company being able to satisfy these requirements without stating its objects in the articles, it is likely that it will be insisted on in practice. A restriction contained in the articles will however not limit the capacity and powers of a company and not invalidate the acts, contracts or other obligations of the company nor any transfer of property by or to the company.

The elimination of the mandatory requirement of an objects clause has interesting implications for nonprofit entities. On the one hand, it reduces (and arguably eliminates) the possibility of executive interference in the incorporation of entities. On the other hand, the ability for such entities to engage in any activity or to change the scope of activities, at will, may cause some discomfort to donors and beneficiaries.

The new law also permits single shareholder companies, further simplifying the process of incorporation. This provision makes it possible for a donor (whether an individual or an entity) to set up an entity in the corporate form without the need to locate and identify other subscriber shareholders. This would theoretically ensure complete ownership of the entity with the donor.

¹⁰⁰ The memorandum was mandatory under the previous regime. The memorandum had to specify the objects and powers of a company. As a result of its elimination, companies are no longer stifled by restricted objects and can engage in any activity and exercise all powers of a natural person subject to any voluntary restrictions that may be incorporated in the articles. In addition to the objects and powers, the memorandum was also required to state the authorized capital of the company and the par value of the shares. These two requirements have also been eliminated by the new Act, replacing par value with the concept of stated capital.

Changes Bearing on the Administration and Management of Companies

The new law has created a paradigm change in the rights and duties of directors. Under the previous regime, such rights and duties lay in the common law. Moreover, the ability to enforce such rights and duties were based on the “contract” model, flowing from the articles of the entity. The new law has codified the rights and duties of directors, thereby shifting to a model based on statute. The advantage of this new approach is that stakeholders (primarily shareholders and creditors) will now be able to clearly understand their relationship with directors by reference to the law itself and enforce these rights by direct action as provided for in the Act.

The Act also makes a significant change by expanding the concept of directors to include “shadow” directors. Under previous law, the responsibility for the management of the company only applied to those who were appointed to the board of directors. The new Act expands the definition of directors considerably, to include all persons who are in a position to direct the affairs of the entity. This reduces the possibility of abuse by the appointment of paper directors, or “persons of straw,” to avoid liability for compliance with the obligations of directors.

Significant changes have been made in the law in relation to responsibilities for the maintenance of records. The law also makes it mandatory for directors to disclose all interest in transactions with their companies and to obtain the permission of the board. The details of contracts have to be entered into Interests Registers which are available for inspection by shareholders. Failure to comply with such requirements can lead to heavy fines and the rescission of such contracts by the company within a period of six months after it is disclosed to the shareholders.

Explicit provision is made in the law for specified records of companies to be made available to directors, shareholders and the public. Failure to maintain such records and / or to make their available for inspection can result in heavy fines.

All remuneration and benefits paid to directors, whether in their capacity as directors or otherwise, have to be approved by the board after it resolves that it is satisfied that the payment is fair to the company. The directors who approve the payment are required to sign a certificate setting out the reasons for determining that the payment is fair. The particulars must then be entered in the Interests Register. If a payment made without complying with these provisions it can result in personal liability for directors who receive such payments.

Changes Relating to Enforcement

The new Act introduces significant changes to the procedures of enforcement of rights and duties. In a notable shift from the previous regime, the law statutorily creates a right for shareholders to enforce obligations by direct action. No longer are shareholders therefore required to depend on the intervention of the state for enforcement. These

provisions have been backed by the introduction of meaningful sanctions which makes non compliance unprofitable.

The law empowers shareholders (and directors) to seek restraining orders against the company and the directors from contravening the provisions of the articles and the Act. This is a departure from the previous law which required at least five percent of the total voting shareholding of the company to establish *locus standii* for bringing an action against the company and the directors.

The law also recognizes a statutory derivative action. Though this codifies common law on the subject, the provisions in the Act are an expansion of the traditional common law right, by granting *locus standii* to shareholders and directors in a wider set of circumstances.

The Inland Revenue Act No. 10 of 2006

The Inland Revenue Act No. 10 of 2006 has introduced special provisions for the chargeability of income tax on the profits and income of non governmental organizations.¹⁰¹ The provision reads as follows:

Section 102(1)

Where any non governmental organization¹⁰² receives any money by way of a grant, donation, or contribution or by any other means, any amount equal to three per centum of such money shall, notwithstanding anything to the contrary in any other provision (in the Act), be deemed to be the full profits and income in the year of assessment, and such profits and income of such non governmental organizations shall be deemed to arise in Sri Lanka.

Section 102(3)

The profits and income of a non governmental organization shall be chargeable with income tax at the rate of thirty percent.

¹⁰¹ Information on new provisions in the Income Revenue Act No. 10 of 2006 is at [http://www.inlandrevenue.gov.lk/download/Explanatory Notes on Inland Revenue Act No%5B1%5D. 10 of 2006.pdf](http://www.inlandrevenue.gov.lk/download/Explanatory%20Notes%20on%20Inland%20Revenue%20Act%20No%205B1%205D%20of%202006.pdf). The text is at http://www.lawnet.lk/section.php?file=http://www.lawnet.lk/docs/statutes/Acts_2007/indexs/2007Y0V0C10A.html (via www.lawnet.lk).

¹⁰² Defined in sub section (2) as “any organization or association formed by a group of persons on a voluntary basis which is non governmental in nature, dependant on grants, donations, contributions or money received from any other means, locally or from any foreign country or any foreign or local organization and established and constituted for the provision of relief and services of a humanitarian to the poor and destitute, to the sick, orphans and widows, youth and children and generally for providing relief to the needy in times of disaster, which is determined by the Commissioner General as a non governmental organization for the purpose of this section)

The law also provides that where the Commissioner General is satisfied that any non governmental organization is engaged solely in (a) the rehabilitation and the provision of infrastructure facilities and livelihood support to displaced persons in any areas identified by the government for such purposes of such rehabilitation; or (b) any other activity approved by the Minister as being of a humanitarian nature, taking into consideration the nature and gravity of any disaster and the magnitude of such relief required to be provided consequently, the Commissioner General may remit the tax payable by such non governmental organization for that year of assessment.

Regulatory and Other Measures for the Control of Nonprofit Organizations

Partly as a result of the criticism of the efforts of nongovernmental organizations in tsunami reconstruction (see below), the Sri Lankan government has sought to strengthen the monitoring procedures of activities of NGOs by the creation of a National Secretariat for Non Governmental Activity falling under the Ministry of Social Welfare.

All NGOs are required to provide specified information which is vetted by the Secretariat and forwarded to the Ministries of Defense and Foreign Affairs for clearance. New NGO's are also required to obtain clearance from the Ministry of Finance. Registration of NGOs with the Secretariat leads to facilitation of operations including the visas, agreements with line Ministries, and other assistance on the implementation of projects.

The Government has also established District Coordinating Committees, chaired by the District Secretaries or Government Agents of the respective districts to monitor the activities of NGO's. This process is yet underway prior to implementation, with the National Secretariat for Non Governmental Activity in the process of collecting preliminary material.

Apart from the aforesaid measures, a parliamentary select committee has been appointed to probe into the financial accounts certain NGO's involved in rehabilitation work following the tsunami and to make necessary recommendation. These deliberations are underway.

The Tsunami of December 2004 and its Consequences

The tsunami of December 2004 resulted in intense destruction within a large area of coastline of Sri Lanka. The catastrophe attracted hundreds of NGOs to the country. Although these entities created very high expectations in rehabilitating the areas, the ultimate delivery of relief was disappointing and resulted in intense criticism from the government, the media and the public. Apart from the periodic statements made by the government and the media, reputed organizations such as Transparency International have also conducted studies revealing a high level of corruption and inefficiency of NGOs in this process.¹⁰³

¹⁰³ See, e.g. Transparency International Sri Lanka Chapter, Value for Money Audit: A Technical, Financial and Social Review of Selected Tsunami Reconstruction Projects (Colombo, 2006), available at

The situation has been further aggravated by the fact that apart from the criticism on delivery, allegations were also leveled by the government and the media against several NGOs that they were exploiting the situation to smuggle weapons and equipment, including light aircraft for the LTTE under the guise of humanitarian supplies. These factors lead to NGOs being soundly criticized and the public perception of their efficiency, honesty and bona fides reduced to an all time low in Sri Lanka.

Although this development did not result in specific or new legal measures being introduced targeting the non profit sector, it created a general environment of ridicule and contempt for the performance of NGOs and contributed to the government seeking to strengthen the monitoring procedures of activities of NGOs by the creation of a National Secretariat for Non Governmental Activity falling under the Ministry of Social Welfare (see above). What was particularly striking was that the existence of organizations with an undisputedly dubious record of performance prevented a unified response to the criticism by the sector as a whole. The reputational damage has led to considerable pressures for greater regulation of the nonprofit sector.

The Increased Intensity of the Conflict in the North and East of Sri Lanka

The conflict in the north and the east of the country has increased in intensity since the assumption of office by President Rajapakse in November 2005. This has led to the marginalization of an existing Ceasefire Agreement between the government and the rebels, and an increase in military activity on both sides. In addition, the splintering of the LTTE into what is known as the “Karuna Group” has resulted in severe infighting between the two groups, leading to a struggle for domination, particularly in the east of the country.

These developments have had a serious impact on the operational environment of NGOs, particularly within the areas affected by the conflict, for two primary reasons: (a) the two groups have fought each other over the channels through which delivery would be permitted to take place, and (b) the government has been reluctant to permit nonprofits to operate in rebel-held areas. The severity of the consequences is manifested by the several incidents, including the murder of over a dozen aid workers in the east by paramilitary groups and several incidents of abduction of aid workers.

http://www.tisirilanka.org/?page_id=82. For a regional overview of the role of civil society organizations in tsunami reconstruction, see *Philanthropy in Disasters: Tsunami and After* (Asia Pacific Philanthropy Consortium and Charities Aid Foundation, 2005), available at <http://www.usig.org/resources/reportpaperlist.asp?geovalue=Global§orvalue=&topicvalue=>.

Annex 1

Pakistan: Certification Standards for Voluntary Sector Organizations

Category I – Internal Governance

- | <u>No.</u> | <u>Standard</u> |
|------------|---|
| 1.1 | The organisation is not a source of material gain for members of governing body (board). |
| 1.2 | The governing body consists of at least seven members. |
| 1.3 | There is adequate female representation on the governing body. |
| 1.4 | The procedure adopted for the appointment of new board members is democratic. |
| 1.5 | The governing body members serve for a specific term. Provided that this standard shall not apply to trusts. |
| 1.6 | The charter of the organisation stipulates a limit on the maximum allowable period for the chairperson of the governing body. |
| 1.7 | The governing body of the organisation meets at least twice a year. The minutes are kept regularly and circulated to all its members within thirty days of the meetings. |
| 1.8 | The quorum for GB meetings, as specified in the charter, is 1/3 rd . The governing body observes the quorum requirements in its meetings as specified in its charter or other documents. |
| 1.9 | The pattern of absenteeism among the governing body members is random. |
| 1.10 | The organisation has a mechanism to replace the continuously absenting governing body members. Provided that this standard shall not apply to trusts. |
| 1.11 | At least 2/3 of governing body is un-related to each other. Provided that, in case of trusts, this standard shall apply only for renewal of certification. |
| 1.12 | The paid managerial staff is not related to the governing body members. |
| 1.13 | The process to be adopted by the governing body or the general body for amending the charter is participatory. |
| 1.14 | The governing body appoints the Chief Executive Officer (CEO). The governing body is also involved in the appointment of the Senior Management. |
| 1.15 | The governing body approves annual budget as well as reviews the actual expenditure of the organisation. |
| 1.16 | The governing body approves the organisational and financial policies of the organisation. The organisation has shared its policies and procedures with staff. |
| 1.17 | The organisation has a written recruitment policy. |
| 1.18 | The recruitment of the organisation is gender sensitive or proactively promoting employment of women, if the nature of work so allows. |
| 1.19 | The organisation has clearly defined salary structure and compensation packages for its staff. |
| 1.20 | Men and women are comparably paid within their respective categories. They also receive comparable staff development and training opportunities. |
| 1.21 | The organisation has a written personnel policy. |
| 1.22 | The organisation has clearly defined job description statements for its staff. |
| 1.23 | The organisation has a participatory performance appraisal system. |

- 1.24 The organisation has a travel policy.
- 1.25 The organisation has a mechanism to avoid conflict of interest.
- 1.26 The organisation has a grievance settlement policy for its employees and necessary arrangements to actualise it.

Category II – Financial Management

No. Standard

- 2.1 The organisation has a joint signatory system, duly approved by its governing body.
- 2.2 The cheques made payable to a nominated signatory are not signed by him/ her.
- 2.3 All payments exceeding Rs. 10,000 are made through cross cheques.
- 2.4 The governing body authorises the appointment of auditors and opening of bank accounts. The organisation appoints a different external auditor after at most five years.
- 2.5 The organisation conducts its internal audit annually. The internal audit report is shared with the external auditors. Provided that this standard shall apply only to organisations with average annual receipts larger than 10 million.
- 2.6 The balance sheets, income & expenditure statements (or receipts & payments accounts) and cash-flow statements are prepared.
- 2.7 The organisation regularly maintains cashbooks, salary and petty cash records.
- 2.8 The organisation circulates its annual audit report amongst members of its governing body within six months of closure of its financial year.
- 2.9 The organisation duly discloses to the public its expenditure on various heads.
- 2.10 The organisation prepares annual budget. The organisation also prepares variance reports (comparison of actual results with budget) with regular frequency.
- 2.11 The organisation maintains separate bank accounts for funds received from different donors or for different programmes.
- 2.12 The organisation reconciles its accounts with banks at regular intervals.
- 2.13 Cash funds are kept on an imprest basis.
- 2.14 The incoming receipts are banked regularly and at the earliest.
- 2.15 The organisation uses computerised accounting software to perform its accounting function.
- 2.16 The organisation has an appropriate system of receiving and recording procured items.
- 2.17 The organisation maintains fixed assets records.
- 2.18 The organisation has a purchase and procurement policy.
- 2.19 The organisation has a policy on disposal of assets.
- 2.20 The organisation has a policy regarding investments. Provided that this standard shall apply only if the organisation has an accumulated surplus to carry forward from one year to the next that is larger than 25% of its average receipts during the last three years.
- 2.21 The organisation has multiple sources of funding. Provided that this standard shall not apply to organisations that have endowments large enough to support their operations.

- 2.22 The organisation has sufficient resources to continue its operations at current level.
- 2.23 The organisation settles the accounts with an employee leaving the organisation within two months of end of his/ her services.
- 2.24 The organisation deducts at source income and withholding tax in accordance with the tax laws in force. The organisation regularly files its tax return to the competent tax authorities.
- 2.25 The organisation has adequate arrangements in place for custody of accounting records.

Category III – Programme Delivery

No. Standard

- 3.1 The managerial and programme staff, and members of the governing body clearly understand the mission and objectives of the organisation.
- 3.2 The programmes and activities contribute to organisational mission and objectives.
- 3.3 The programmes and services provided by the organisation are need based.
- 3.4 The organisation has collected baseline data for its programmes.
- 3.5 The organisation ensures that the staff is involved in programme/project planning and design.
- 3.6 The organisation networks with other organisations working in the same area (geographic and sectoral).
- 3.7 The programme progress is reviewed by the governing body regularly.
- 3.8 Members of the governing body and senior managerial staff regularly visit programme areas of the organisation. Provided that this standard shall not apply to rights or advocacy organisations, which do not have any programme areas.
- 3.9 Staff meetings are held regularly.
- 3.10 The managerial and programme staff possesses relevant professional experience/ qualifications for delivering the programmes.
- 3.11 The organisation provides professional development opportunities to its employees.
- 3.12 The organisation has appropriate human resource to carry out its administrative and programme activities.
- 3.13 The organisation has put in place mechanism and systems to monitor its programmes and activities.
- 3.14 The organisation has a separate monitoring section or designated monitoring staff.
- 3.15 The organisation has devised measurable indicators to assess and monitor the progress of its programmes.
- 3.16 The organisation defines measurable targets for its programmes.
- 3.17 The organisation has been consistently achieving its targets during the last three years.
- 3.18 The organisation has expanded its services during the last three years.
- 3.19 The organisation obtains regular feedback from the beneficiaries of its services.
- 3.20 The organisation has evaluated its programmes.

- 3.21 The beneficiaries of the organisation are generally satisfied with the services provided.
- 3.22 The organisation periodically prepares and disseminates reports to update stakeholders on its programmes.
- 3.23 The periodic reports contain major programmatic achievements, major financial statistics and future plans.
- 3.24 The organisation has prepared a long-term operational plan. Provided that this standard shall only apply to organisations established at least five years ago.
- 3.25 The organisation does not pay any commission to fund-raising staff members. Provided that this standard will not apply to professional organisations or agencies especially engaged for the purpose.
- 3.26 The organisation is providing services in geographically or socially difficult areas.
- 3.27 The organisation has its own website, which is updated regularly.
- 3.28 The organisation consciously avoids un-hygienic conditions and environment unfriendly practices in its activities.
- 3.29 The organisation's previous donors express satisfaction with the working of the organisation.