

# Guidelines for Laws Affecting Civic Organizations

Second Edition, Revised and Enlarged



OPEN SOCIETY INSTITUTE



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Prepared for the Open Society Institute  
in cooperation with the  
International Center for Not-for-Profit Law

by

Leon E. Irish  
Robert Kushen  
Karla W. Simon

with the assistance of the staff of the  
International Center for Not-for-Profit Law



OPEN SOCIETY INSTITUTE

*New York*

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Published by  
Open Society Institute  
400 West 59th Street  
New York, NY 10019 USA  
www.soros.org

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Distributed by  
Central European University Press

Nador utca 11, H-1051 Budapest, Hungary  
E-mail: ceupress@ceu.hu  
Website: www.ceupress.org

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#### Library of Congress Cataloging-in-Publication Data

Guidelines for laws affecting civic organizations / prepared for the Open Society Institute in cooperation with the International Center for Not-for-Profit Law by Leon E. Irish, Robert Kushen, Karla W. Simon; with the assistance of the staff of the International Center for Not-for-Profit Law.—2nd ed., rev. and enl.

p. cm.

Includes bibliographical references.

ISBN 1-891385-31-3 (pbk.)

1. Nonprofit organizations—Law and legislation. 2. Associations, institutions, etc.—Law and legislation. I. Irish, Leon E. II. Kushen, Robert. III. Simon, Karla W. IV. Open Society Institute. V. International Center for Not-for-Profit Law.

K652.G85 2004  
346'.064—dc22

2003070240

Design by Jeanne Criscola | Criscola Design  
Printing in the United States of America by Herlin Press, Inc.  
Cover photograph by Robert Lisak

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# Preface

## Background to the Guidelines

The governmental and political structure of an open society may take many forms, but fundamental to them all is the principle that the state exists to serve the people, not the people to serve the state or the party that controls it. Achieving such a society requires laws that protect the rights of individuals to express their views freely and to come together freely to organize their efforts in pursuit of a common objective. The freedoms of expression, association, and peaceful assembly are the hallmarks of an open society. Law alone cannot create an open society, but no open society can exist unless the law gives meaningful protection to these and other fundamental freedoms. The law must recognize the right of individuals to join together to pursue shared interests or to pursue shared notions of the public good, free of state interference. Individuals should be able to form groups that range from ad hoc neighborhood organizations created to solve problems of dirty streets to large assemblies of individuals coming together to protest environmental degradation. Informal organizations, without separate legal existence, constitute the majority of organizations that make up what some call the “independent” sector, the “third” sector, or the “not-for-profit” sector (as distinct from the governmental and for-profit sectors), and what the Guidelines refer to as the “civic” sector. In order adequately to guarantee that the fundamental freedoms of expression, association, and peaceful assembly are pro-

tected, the laws of any open society must protect the freedom to form and operate such groups.

The law must, however, go further. Protecting fundamental freedoms requires that there be a legal framework permitting the establishment of organizations with legal personalities distinct from those of their creators, members, or employees and legal protection for the entire range of activities of these separate associations, foundations, societies, clubs, and other institutions.<sup>1</sup> Civic organizations of this type are essential to the creation and existence of an open society.<sup>2</sup>

The purpose of the Guidelines is to set standards for laws permitting, protecting, and regulating civic organizations that choose to obtain legal personality. They are based on extensive theoretical analysis and wide-ranging practical experience in countries around the world. The practical purpose of the Guidelines is to enable any concerned individual to evaluate an existing law governing civic organizations or to draft a better one.

The most important underlying premise of the Guidelines is that laws should exist in all open societies to enshrine and protect the freedoms of expression, association, and peaceful assembly for all citizens. At the same time, there must also be laws that protect the public from possible abuses by civic organizations. The regulatory burdens imposed on civic organizations must reflect a balancing of the rights of individuals to exercise their freedoms and the need for protection of the public.

Voluntary regulation—the way in which the sector polices itself—plays a very important role. Thus, although the Guidelines recognize the legitimacy of official regulatory mechanisms to protect the public, they also stress the need for mechanisms of voluntary regulation created by civic organizations themselves. Finally, any burdens imposed on civic organizations should be commensurate with the benefits those organizations seek or receive from the state.

## Nature and Purpose of the Guidelines

The Guidelines do not present a model law for the civic sector. The legal systems of the world differ too greatly, and local traditions for drafting laws are too varied to craft a model law. The Guidelines also do not attempt to describe the variety of civic organization laws that exist.<sup>3</sup> Nor do they seek to tally up “majority” and “minority” positions. They instead reflect the knowledge of many experienced professionals about the kinds of laws and administrative systems that are conducive to the creation and proper regulation of the civic sector.

Some of the principles are procedural, not substantive. The Guidelines and the accompanying discussion sections and examples explain the nature of various problems

and the possible alternative methods for dealing with them. In many instances, practices are so varied and the views of experts so divergent that no single position is taken; rather, options are described, together with their advantages and disadvantages.

The civic sector has enormous diversity. Laws frequently distinguish organizations that principally serve the private interests of their members—generally referred to as mutual benefit organizations (MBOs)—from those that serve the public at large—public benefit organizations (PBOs).<sup>4</sup> But there is great diversity within these broad categories, as well as some overlap. Within the civic sector there are advocacy groups that serve very narrow interests as well as those that serve very broad segments of society. Are the former really MBOs? There is also great diversity in the civic sector, which includes groups representing oppressed people and opera aficionados, women's rights groups and gardening clubs. Some civic organizations have both MBO and PBO dimensions, such as professional societies that look inward to the needs of their members in addition to serving a self-regulatory function to protect the public. Some civic organizations are large, but many are small. All of them, however, contribute to a vibrant open society.<sup>5</sup> The aim here is to suggest principles that, if enacted into law, would permit, encourage, protect, and, to the extent appropriate, regulate the diverse organizations that make up the formal civic sector.

The Guidelines are aspirational and do not present practical advice about survival in a repressive legal regime. They cannot overcome the absence of the rule of law. If the recommendations in the Guidelines cannot be accepted today by some societies, perhaps they can at least inspire a useful dialogue.

## Sources and Methodology

The Guidelines have been developed through formal and informal consultations with lawyers, civic organization leaders, and state officials in countries around the world, many of them in developing and transition countries. However, much of the information and experience reflected here is drawn from countries having long and uninterrupted experience with civic organizations. On the other hand, there has been no conscious effort to reflect the laws and regulatory systems of any specific country or group of countries. In particular, the Guidelines are drawn as much from civil law traditions as from the common law.

The authors have sought to make the Guidelines as user friendly and accessible as possible. The Guidelines are intended to present key issues affecting civic organizations in a logical sequence. With respect to each topic, a general principle or guideline is enunciated, followed by a more detailed discussion. Country examples and more tech-

nical points have been largely relegated to the endnotes. This three-layered presentation—guideline, discussion, and endnotes—is designed to enable the reader to read quickly through the guidelines, consider issues of particular interest in greater depth by reading the discussion, or delve into the details of the issue by reading the endnotes. The Guidelines are not intended as a prescriptive document. In reality, the subject matters dealt with are complex and many sound views are possible on many of the issues presented.

OSI, ICNL, and the authors acknowledge with sincere gratitude the input of many individuals, too numerous to mention here, who have contributed to the development and articulation of the Guidelines. In particular, thanks go to the Columbus School of Law at the Catholic University of America for providing research funds to support the work on this volume by Professor Karla W. Simon and her research assistants.

# 1

## Relationship of Civic Organizations to Society

There are many reasons why a country should want to have laws that assure the existence of a strong, vigorous, and independent civic sector. The most important of these is to protect the internationally recognized freedoms of expression, association, and peaceful assembly. These freedoms are enshrined in international and regional agreements that bind most countries. In addition, the constitutions<sup>6</sup> and the laws of many countries protect these fundamental freedoms.

Individuals should not be required to establish a formal legal entity under a domestic civic organization law in order to exercise one or more fundamental freedoms.<sup>7</sup> However, laws that permit groups to establish themselves as entities with legal personality strengthen these freedoms.<sup>8</sup> Most persons are not sufficiently important or influential for their individual voices to be heard or their individual actions to matter, but if they can band together to form, for example, an advocacy organization for the protection of the environment or a humanitarian organization to assist refugees, then their collective actions can make a difference. Only by allowing and protecting both informal and formal civic organizations do the laws of a country give real meaning to the freedoms of expression, association, and peaceful assembly.<sup>9</sup>

In addition to protecting fundamental freedoms, there are several other reasons why societies should adopt laws that help to support a vigorous and independent sector of formal civic organizations. These include encouraging pluralism, promoting respect for the rule of law, supporting democracy, promoting economic efficiency, and addressing “public sector market failure.”

There are many differences among the members of any society; individuals and groups have diverse interests and needs. Civic organization laws help individuals and groups pursue their varied interests (e.g., sports, folk music, or the preservation of a particular language or culture). By encouraging the pluralism that results from permitting formal civic organizations to exist, a society demonstrates that it values and respects diversity among its members. In a word, the society endorses the principle of tolerance.

Not only is diversity desirable, it is unavoidable. In many societies, people come from different ethnic backgrounds, speak different languages, and practice different religions. They are of different genders, ages, professions, and avocations. These differences can be expressed in a legal or an illegal manner. Rather than drive a group underground and sharpen social antagonism, good laws for the civic sector allow the group legal existence and special benefits under the law, as long as the group meets basic standards of responsible behavior. In other words, civic organizations provide an essential safety valve for social pressures and energies that inevitably build up in any society. Moreover, civic organizations provide an opportunity for persons of different ethnic, racial or religious backgrounds to work together to further common interests, and thus can help serve as a bulwark against intercommunal violence.<sup>10</sup> The existence of numerous and diverse civic organizations is characteristic of, and in itself helps promote, peaceful and stable societies where there is respect for the rule of law.

The success of democracy over time requires the pluralism, social stability, and respect for the rule of law that is promoted by legal support and protection of the civic sector. Democracy is an inherently imperfect and often messy form of government. It can be frustrating and inefficient. It is the only form of government, however, that ensures the government will generally serve the interests of the people, rather than vice-versa. For democracy to succeed, each segment of society must believe that state institutions can generally be trusted and that it will have a chance to influence decisions through elected representatives, or even gain a majority voice in the government. A vigorous civic sector that is protected and accountable helps to build the pluralism, social stability, public trust, and respect for the rule of law that are necessary for the long-range success of democracy.

Civic organizations play another vital role in democracy. They allow individuals and groups to mitigate the majoritarianism that can otherwise make a democratic government insufferable for marginal groups that are never able to win sufficient backing to see their ideas and values reflected in the policies of the state. For these groups, civic

organizations offer a key way in which they can peacefully pursue their interests and goals without interfering with, or being suppressed by, the wishes of the majority.

Civic organizations can often provide public goods and services more efficiently—that is, with higher quality and lower costs—than state authorities. There are many reasons for this. One is the fact that civic organizations often pay less or employ fewer people than a governmental agency to accomplish the same objective. There is the fact of volunteerism itself. To the extent that private individuals devote time and energy through civic organizations to the solution of public problems on a free and voluntary basis, there can be a cost savings to the government. More importantly, to the extent that civic organizations rather than a monolithic state authority provide public goods and services, there can be cost savings that result from competition among organizations seeking to provide such services. Finally, there is the factor of market knowledge. A small, local civic organization is far more likely to know the real needs of the people to be served and how best to meet those needs than a large and often distant state organ. Many states have begun to recognize the superior efficiency of civic organizations in many situations.<sup>11</sup>

The phenomenon of market failure is well known in discussions of the private, business sector. However, there is often “market failure” in the provision of generally needed public goods or services, such as parks or highways.<sup>12</sup> An essential role for government is to identify those areas of market failure where there is a real need for public goods and to meet those needs. State and for-profit entities, however, simply cannot and do not anticipate and provide all of the public goods and services that are desired by the citizenry.

For example, Hungary may have a large number of citizens who are passionately interested in Japanese art and who would be willing to provide substantial funds and services to assure the creation of a museum for such art. It is unlikely that state officials will be able to identify this or thousands of other desires and interests of society and meet those needs in a responsive, adequate, and evenhanded manner, and there may be insufficient economic incentives for the private sector to step in. Laws that permit individuals and groups to come together to establish civic organizations to alleviate this “public sector market failure,” play a vital role in enriching society and assuring that those public goods and services to which individuals are willing to devote their own resources will be provided.

In addition, many countries are making a concerted effort to involve the civic sector in service provision in certain areas (e.g., elder care and care for those living with HIV/AIDS). In some regions this movement is in accordance with the doctrine of “subsidiarity.”<sup>13</sup> In others, declining state budgets force governments to abandon programs that are then continued, to the extent possible, by the civic sector. There are both virtues and problems associated with these changes, which are discussed more fully in Section

11.3. They are, in any case, increasingly relevant in considering the role civic organizations should play in society.

Finally, many countries are moving toward market economies, and the existence of a well-developed civic sector provides indirect support for the success and growth of a market economy. Market economies tend to flourish best where pluralism, social stability, public trust of institutions, and respect for the rule of law exist.<sup>14</sup> Laws for the civic sector foster these societal values.

While not all countries will subscribe to each of these basic rationales for having laws that permit formal civic organizations to exist, the reasons described here indicate why it is useful for any society to allow formal civic organizations to exist and to protect them from undue intrusion in their affairs. The remainder of the Guidelines will focus on the ways in which legal systems can provide for and encourage formal civic organizations in order to promote the goals described in this chapter.

# 2

## Relationship of Civic Organization Laws to Other Laws

### SECTION 2.1 Relationship of Civic Organization Laws to International Law Guaranteeing Fundamental Freedoms

**The rights to establish and operate a formal civic organization are an inherent part of the rights to freedom of association and expression that are guaranteed under international law.**

#### DISCUSSION

Article 19 of the Universal Declaration of Human Rights of 1948 (Universal Declaration)<sup>5</sup> states that “[e]veryone has the right to freedom of opinion and expression.” Article 20 protects the right of individuals to “peaceful assembly and association.” Although the Universal Declaration did not have binding effect when it was unanimously adopted by the General Assembly of the United Nations in 1948, it has come to have normative force.

In addition, many of its provisions have acquired binding legal status by being included in subsequent multilateral treaties, including the International Covenant on Civil and Political Rights (ICCPR), the European Convention for the Protection of Human Rights and Fundamental Freedoms (European Convention), the African Charter on Human and Peoples' Rights (African Charter), the American Declaration of the Rights and Duties of Man (American Declaration), and the American Convention on Human Rights (American Convention). The discussion below focuses on the ICCPR, as the most widely subscribed binding human rights instrument of relevance, and the European Convention, as the instrument with the best developed jurisprudence.<sup>16</sup>

For instance, the ICCPR creates direct binding obligations for the 149 countries that are Party to it.<sup>17</sup> Articles 19, 21, and 22 of the ICCPR guarantee the rights of expression, peaceful assembly, and association, respectively.<sup>18</sup> By its terms, the ICCPR not only explicitly guarantees rights enjoyed by individuals, but also requires States Party to adopt laws or other measures assuring protection for these freedoms.<sup>19</sup>

The ICCPR was strengthened by adoption in 1966 and the entry into force in 1976 of the First Optional Protocol to the International Covenant on Civil and Political Rights (Optional Protocol).<sup>20</sup> The Optional Protocol allows the Human Rights Committee established under the ICCPR to receive and consider communications from individuals whose rights guaranteed by the ICCPR have been violated.<sup>21</sup>

The European Convention<sup>22</sup> entered into force in 1953 and has been ratified by all 44 states that are members of the Council of Europe.<sup>23</sup> It enshrines the rights of freedom of expression (Article 10), association (Article 11), and peaceful assembly (Article 11). Article 25 of the European Convention establishes a complaint procedure that permits petitions addressed to the European Court of Human Rights from “any person, non-governmental organization or group of individuals claiming to be the victim of a violation.” Accordingly, legal persons such as formal civic organizations, individuals, and even informal civic organizations may file complaints in the European Court for violations of rights protected by Articles 10 and 11 of the European Convention.

Recent decisions of the European Court of Human Rights make it clear that there is a right protected by international law to establish a formal civic organization and that any such organization, once formed, enjoys the full protection of the European Convention from any interference or restriction by the state. These decisions are discussed in the paragraphs that follow.

In the landmark 1998 decision in *Sidiropoulos and Others v. Greece*,<sup>24</sup> the European Court of Human Rights unanimously held that the refusal by Greek courts to establish a Macedonian cultural association was an interference with the applicants' exercise of their right to freedom of association. The Court unequivocally stated that “the right to form an association is an inherent part” of the right to freedom of association. The Court went on to say, “[t]hat citizens should be able to form a legal entity in order to act collec-

tively in a field of mutual interest is one of the most important aspects of the right to freedom of association, without which the right would be deprived of any meaning.”<sup>25</sup>

Of equal importance is another 1998 decision in *United Communist Party of Turkey and Others v. Turkey*,<sup>26</sup> holding that the action by the government of Turkey to dissolve the United Communist Party of Turkey (UCP) was a violation of Article 11 of the European Convention. The Court stated that “the Convention was designed to maintain and promote the ideals and values of a democratic society.” Since “political parties make an irreplaceable contribution to political debate, which is at the very core of the concept of a democratic society,” they can be shut down only for “convincing and compelling reasons.” Furthermore, political parties are essential to the protection of the freedom of speech, guaranteed in Article 10 of the European Convention.

A third significant decision was rendered in 1999 in *Freedom and Democracy Party (ÖZDEP) v. Turkey*.<sup>27</sup> This decision further clarifies the importance of the freedom of association, linking it specifically to the freedom of expression in Article 10 of the European Convention. In the *ÖZDEP* case, the government of Turkey had dissolved a political party on the grounds that its “programme was apt to undermine the territorial integrity of the State and the unity of the nation.”<sup>28</sup> The Court found that action by the state to be “radical,” noting that the party was “penalized solely for exercising its freedom of expression” because it was dissolved before it began any activities.

The Court in the *UCP* and *ÖZDEP* cases also held that the freedom of association would be largely theoretical and illusory if it were limited to the founding of an association, since the government could immediately disband it. “It follows that the protection afforded by Article 11 lasts for an association’s entire life and that dissolution of an association by a country’s authorities must accordingly satisfy the requirements of paragraph 2 of that provision.”<sup>29</sup>

The *Sidiropoulos*, *UCP*, and *ÖZDEP* cases provide strong international law protection for the right to establish legally recognized civic organizations and the right of those civic organizations to operate with a minimum of limitations and restrictions. They also articulate very clear rules limiting the circumstances in which the freedom of association can be interfered with or restricted.<sup>30</sup>

These decisions under the European Convention have global significance, for Article 11 of the European Convention, protecting freedom of association, is virtually identical to Article 22 of the ICCPR and Article 16 of the American Convention. Under all three instruments, the freedom of association can be restricted by States Parties only in the interests of national security or public safety, for the prevention of disorder or crime, for the protection of public health or morals, or for the protection of the rights and freedoms of others. Any restrictions must be “prescribed by law,” and they must be “necessary in a democratic society” to achieve one of the four listed objectives.<sup>31</sup> In both the *Sidiropoulos* and *UCP* cases, the Court emphasized that exceptions must be “construed

strictly,” that only “convincing and compelling” reasons can justify restrictions, that any restrictions must be “proportionate to the legitimate aim pursued,” and that there must be “relevant and sufficient” evidence for “decisions based on an acceptable assessment of the relevant facts” before a restriction can be justified.<sup>32</sup>

In a recent decision, *Refah Partisi and Others v. Turkey*,<sup>33</sup> the ECHR held, over the strong dissent of three judges, that it was not a violation of the right to freedom of association under Article 11 of the European Convention for Turkey to dissolve a political party that had a long-term policy of setting up a regime based on Sha’ria (Islamic) law within the framework of a plurality of legal systems and that did not exclude recourse to force in order to implement its policy and keep the system it envisaged in place. In its opinion, the Court did not back away from any of the principles it had enunciated in its prior cases, though the evidence and reasoning relied upon by the Court have proven controversial.<sup>34</sup>

The right of individuals to form associations was confirmed by an important resolution of the United Nations General Assembly on “Human Rights Defenders.”<sup>35</sup> This declaration states that “[e]veryone has the right, individually and in association with others, to promote and to strive for the protection and realization of human rights and fundamental freedoms at the national and international levels.”<sup>36</sup> Finally, States Party to the ICCPR are required to adopt such legislation and other measures as are necessary to give effect to the rights to freedom of expression, association, and peaceful assembly, and to assure that every person has effective remedies to redress any violation.<sup>37</sup> States may impose certain narrowly tailored restrictions on civic organizations exercising these rights,<sup>38</sup> but they may not discriminate among *individuals* with respect to the exercise of these rights.<sup>39</sup> This means, for example, that states cannot restrict to citizens the right to create or participate in a civic organization, but must treat all persons within its territory on the same terms.<sup>40</sup> In countries where resources traditionally have been concentrated in the hands of the state, this nondiscrimination principle becomes even more important.

## SECTION 2.2 General Principles

### A. Acquisition of legal status should not be a prerequisite for the exercise of rights to expression, peaceful assembly, and association.

#### DISCUSSION

The fact that civic organizations may be formed as legal entities does not mean that citizens are required to form legal entities in order to exercise their freedoms of expression, association, and peaceful assembly. On the contrary, most civic organizations are in fact

informal entities. They are not technically part of the subject matter of the Guidelines. Because informal civic organizations form the largest part of the civic sector, however, protecting them from state interference is at least as important for the realization of fundamental human rights as is protecting formal civic organizations. This requires providing the individuals involved in informal civic organizations strong legal protection in the exercise of their rights guaranteed under the ICCPR and other relevant conventions.

Many small civic organizations do not choose to become legal entities by formally establishing themselves. *See* Section 3.2 for a discussion of establishment procedures. Although there are clear advantages to having legal personality, in some countries those advantages are not great for small organizations, and they do not want the burden of filing annual reports or the possibility of legal interference with their activities that can accompany formal legal status. In other countries, repressive governments may not allow certain types of organizations to formally establish themselves.

**B. Laws governing the establishment of civic organizations as formal legal entities generally establish legal personality for the entity and confer limited liability on it and the individuals associated with it. Other privileges (such as access to tax preferences and state contracts) may be conditioned on the establishment of a formal civic organization.**

#### **DISCUSSION**

The acquisition of legal personality means that the formal civic organization has the ability to enter into contracts, leases, and other legal relationships and is itself liable (to the extent of its assets) for the obligations it undertakes. Frequently, this organizational liability is accompanied by a limitation on the liability of the individuals that are associated with the organization (e.g., founders, officers, board members, and employees). The general rule is that a new legal person—the formal civic organization—takes on legal rights and obligations flowing from its activity; the individuals associated with it do not. Even with limited liability, however, these individuals remain liable for their own acts or omissions in certain circumstances. *See* Section 4.3.

Tax preferences are discussed in Chapter 9 and access to state contracts is discussed in Section II.2.

**C. Formal civic organizations should generally have the same rights and obligations as other legal persons and should generally be subject to the same civil and criminal law duties and sanctions that are applicable to other legal persons, except to the extent that specific limitations are provided by law. General rules for the establishment of branches, subsidiaries, representative offices and other affiliates of legal entities should apply to civic organizations.**

## DISCUSSION

Upon establishment (*see* Section 3.2), a civic organization acquires “legal personality” and becomes a “legal person.” Having acquired a formal legal status separate from its founders, it should have the right to enter into contracts, hire employees, buy and sell real and personal property, invest assets, lease machinery, equipment, and office space, maintain bank accounts, and so forth, in its own name. Similarly, a civic organization should be allowed to associate with other legal persons, to form another legal person (e.g., an association of associations), and to enter into a commercial partnership or joint venture as long as doing so is consistent with the purposes and powers of the organization. These are the rights of other legal persons in most legal systems.<sup>41</sup>

Formal civic organizations should also be subject to the same general duties and sanctions that apply to other legal persons. For example, civic organizations are generally subject to the same employment laws as other legal entities. Thus, a civic organization’s employees might be entitled to a minimum wage, have the right to form unions and strike, and be subject to various employment-based taxes.<sup>42</sup> Civic organizations should be required to follow the general accounting laws.<sup>43</sup> As another example, civic organizations should be subject to provisions in the bankruptcy law of a country that provide for the voluntary and involuntary termination of legal entities that have liabilities in excess of their assets.

For rules regarding the establishment of branches of foreign civic organizations, *see* Section 10.1.

### **D. All acts or decisions affecting formal civic organizations should be subject to appropriate administrative and judicial review.**

## DISCUSSION

Essential to the development of the rule of law is the right of all legal persons in the society, including civic organizations, to appeal administrative decisions that affect them to independent courts. Arbitrary and unfair decisions affecting civic organizations—such as a wrongful refusal to establish a civic organization—will occur more often in a system that does not provide for administrative decisions to be appealed to independent courts. There should be no need to have any provisions in the specific civic organization law dealing with these issues, for they should be provided for in the general laws governing judicial and administrative appeals. Nevertheless, where provisions in the general laws for administrative and judicial review are not sufficient, it may be necessary for the civic organization law specifically to provide for such review.<sup>44</sup>

**E. In any federal system, careful consideration must be given to which sets of legal rules governing civic organizations should be enacted and administered at the national level and which at the state, provincial, or local level.**

#### **DISCUSSION**

Constitutions typically determine the subject matters that are within the jurisdiction of each level and branch of the government. It is difficult to suggest a guideline or best practice regarding the way a constitution should allocate jurisdiction over civic organizations, for there is great variety in actual practice. It is important, however, that there be coordination between different levels of government to assure that areas on which there should be meaningful legislation do not escape attention. At the same time, involving too many different governmental bodies in the regulation of civic organizations may result in undue administrative burdens and should be avoided.



# 3

## Legal Existence of Civic Organizations

### SECTION 3.1 Establishment

**A. Laws may require that certain specific acts must occur to create a formal civic organization.**

#### **DISCUSSION**

In order to acquire the status of a legal entity and to have limited liability, legal systems generally require that an organization be formally established.<sup>45</sup> For a civic organization to become established as a legal entity, the founders ordinarily must hold a founding meeting and adopt the governing documents of the organization.<sup>46</sup> Some countries require that a notary public notarize documents of the organization, including the minutes of the founding meeting and the governing documents adopted by it, before they will be accepted for establishment. In some countries, notarial action is sufficient to create a legal entity, but notarial action, by itself, frequently does not confer limited liability.

**B. The establishment of a civic organization should require filing only a small number of clearly defined documents.**

**DISCUSSION**

The principal documents that should be required for establishment are the governing documents of the organization (e.g., charter or statute, deed of trust, bylaws, articles of incorporation, etc.). Those documents should, as specified in the civic organization law, state the nature and purpose of the organization; provide for an adequate governance structure; identify the founders, board members, and managers; state the location of the principal headquarters; and identify the general representative(s) of the organization. All formal civic organizations should be required periodically to update necessary information, such as the names of the general representative(s) and the address of the organization.<sup>47</sup> The updating of administrative matters (address, representatives, etc.) should be automatically accepted and should not require any review or any renewal of establishment. *See* Section 3.3.

**C. Civic organization laws should be written and administered so that it is quick, easy, and inexpensive to establish a civic organization as a legal person.**

**DISCUSSION**

The establishment process should be quick, easy, and inexpensive, with a minimum of formalities, enabling all individuals and organizations that desire to form a civic organization to do so. Establishment of a civic organization should be voluntary, not mandatory.

Many countries permit the establishment of a legal entity by mail, which is a generally desirable procedure. If the founders of a civic organization must appear personally before the responsible state organ, consideration should be given to locating offices performing the establishment function at convenient places throughout the country. If a court or courts are used for establishment, the proceedings held to establish an organization should be routine, uncontested, and summary.

**D. The establishment of a civic organization should involve relatively little bureaucratic judgment or discretion as to the permitted purposes of the organization and the means by which it intends to pursue those purposes.**

**DISCUSSION**

The establishment laws should allow the establishment of any organization formed for one or more legal purposes, as long as the appropriate papers are filed. Probably the single most frequent complaint about civic organization laws is that they confer too much discretion on government officials to decide whether to permit establishment of civic organizations. Sometimes this occurs because the legal provisions referring to establishment do not contain clear definitions of the kinds of organizations that may be estab-

lished or the purposes they are permitted to pursue. Sometimes this occurs because the law does not make it clear that the registration of a civic organization whose application is in order is a ministerial, not a discretionary, act.

Decision-making authority regarding establishment should be carefully circumscribed so that it is only concerned with meeting legal requirements, and civic organizations should be entitled to appeal adverse decisions.<sup>48</sup> Difficult definitional issues are almost unavoidable in deciding whether to confer some benefits (e.g., tax exempt status) on a civic organization, and such determinations should generally be made separately from the establishment process itself.<sup>49</sup> To minimize discretionary judgments, the tax authority can be given clear standards for determining eligibility for tax exemptions, and any refusal to grant such exemptions should be appealable. *See* Chapter 9.

Both the establishment procedures and the filing requirements should be simple. It should never be necessary for a civic organization to go to the legislature, or any arm of the legislature, to be created. The agency responsible for the establishment of civic organizations should publish rules, regulations, and forms that explain the establishment process. It should provide assistance to civic organizations that are seeking establishment, including sample documents.<sup>50</sup>

**E. The rules for legal establishment should set short time limits within which the responsible state agency must act (e.g., a maximum of 60 days) and should provide that failure to act on complete applications within the required time results in presumptive approval. In certain situations (e.g., disaster relief), establishment should occur more quickly.**

#### **DISCUSSION**

Filing a completed application for establishment (with all required materials, including governing documents, the minutes of the founding meeting, etc.) should result in prompt action by the responsible state agency. In the absence of such action within a reasonable period specified by law, e.g., 60 days, the establishment should be presumed to occur, and the responsible state agency should be required to issue whatever documents or certificates are typically issued to prove establishment.<sup>51</sup>

**F. The responsible state agency should be required to provide a detailed written statement of reasons for any refusal to establish a civic organization. Decisions to refuse to establish a civic organization should be appealable to an independent court. A reasonable time period should be available for such appeals. Where necessary, the civic organization law should specifically reinforce these rights.**

#### **DISCUSSION**

Refusal to permit establishment should occur during the stated time period and be accom-

panied by a written explanation and an opportunity to correct any defects in the application.<sup>52</sup> The administrative law of many countries will already provide the right to appeal to a court with jurisdiction over appeals from administrative action, but care should be taken to assure that these procedures are adequate and the courts sufficiently independent.

**G. There should be no extraneous requirements for establishment, such as a minimum endowment requirement for an association or other membership organization or a burdensome minimum membership requirement. Minimum endowment requirements for grantmaking organizations should be nominal.**

#### **DISCUSSION**

It is not generally necessary to require proof that an organization has the financial wherewithal to accomplish its stated purposes. High minimum endowments (also called “patrimony”) for grantmaking organizations may limit establishment to well-connected or wealthy founders, and a requirement that an organization have sufficient funds at the outset to accomplish all of its purposes frequently is a pretext for government officials to decide whether they think the organization is worthwhile. If the organization is able to raise funds and provide the intended goods and services, it will have proved its value. If it is not able to do so, it will fail.<sup>53</sup>

**H. The permitted purposes stated in the law for formal civic organizations should embrace all activities that can legally be engaged in by individuals.**

#### **DISCUSSION**

For basic establishment of a civic organization, any purposes that would be legal if engaged in by an individual should be allowed. As discussed more fully below, it may be appropriate to limit special privileges and benefits (e.g., tax benefits) to civic organizations that principally engage in certain public benefit activities. Any such law, however, should ordinarily have a broad list of purposes that constitute public benefit activities and there should be a catchall category so that the law will be flexible.<sup>54</sup>

**I. Civic organizations should be allowed to have perpetual existence (or limited existence, if chosen by the founders).**

#### **DISCUSSION**

Flexibility of duration is implicit in freedom of association. The flexibility can be accomplished in two different ways. Some legislation permits the governing documents of organizations to state a time of duration, or that the organization will exist until a certain goal is achieved. Other legislation simply permits the governing body of an organization to choose to cease activity, dissolve, and liquidate when it has accomplished its purposes or wants for any other reason to cease to operate.

**J. Both natural and legal domestic or foreign persons should be entitled to create civic organizations. Consideration should be given to allowing minors to participate as members in civic organizations.**

**DISCUSSION**

Existing civic organization laws around the world allow individuals to establish civic organizations, but some laws do not allow other legal persons, such as corporations, associations, or organs of the state, to create a civic organization. It is highly desirable to allow all legal persons to establish civic organizations.<sup>55</sup> This permits, for example, a foundation to be created by a corporation interested in allocating some corporate profits to improve the communities in which the corporation operates. It also permits like-minded entities to form umbrella groups to pursue matters of mutual interest, such as:

- an association of civic organizations formed to provide useful services and training to its members or to articulate the interests of its members, or
- an association of the arts agencies of various city governments formed to articulate their common interests to the national government and to provide services and training to members.

With respect to civic organizations formed by public bodies, *see* Section 11.1.

International law requires that foreigners be allowed to form a civic organization on the same terms as citizens of a country.<sup>56</sup> On the other hand, it is reasonable to require that any civic organization, including any foreign organization, have a general representative, upon whom official notices can be served, who is a citizen and resident of the country.

Although there reasonably may be a requirement that founders must have reached the age of legal majority, or that a majority of the governing board be adults, the law should have special provisions to allow membership, or even seats on the governing board, for minors. This is especially important in civic organizations that pursue the special interests or perspectives of young people.<sup>57</sup> Whether and the extent to which the acts of minors (e.g., signing contracts) are effective or binding should be determined by reference to the particular country's laws dealing with legal capacity.

**K. The law should clearly state the rights and duties incurred by a civic organization during the period of creation, including issues about transfers of property.**

**DISCUSSION**

The law should clearly state which obligations incurred between actual creation and formal establishment will be considered to carry over to the organization once it becomes a legal entity. Laws of many jurisdictions have special rules with regard to the activities of organizations in the process of formation and the rights and obligations that can be incurred by or transferred to an organization during the process of formation.<sup>58</sup> These

laws differ, but here, as in so many areas of the law, it is more important that the law be clear than that it be one way or the other.

**L. Individuals should be allowed to create a civic organization by testamentary act (e.g., by will).**

**DISCUSSION**

Allowing civic organizations to be formed by testamentary act is an important way in which the law can encourage private property to be left for a public purpose.<sup>59</sup> In many countries, individuals with large fortunes enjoy them during their lifetimes and then leave some or all of their assets for charitable purposes at death. Although testamentary gifts can be made to existing civic organizations, experience in many countries indicates that some individuals prefer to make testamentary gifts to organizations they create themselves. While very wealthy individuals have created well-known civic organizations in this fashion—e.g., the Ford Foundation or the Gulbenkian Foundation—even individuals of modest wealth engage in this practice. Tax laws can provide powerful incentives for these purposes. *See* Section 9.2.

**M. Both mutual benefit and public benefit organizations should be allowed to exist.**

**DISCUSSION**

Most civic organization laws allow persons to form formal civic organizations to pursue issues and activities that are primarily for the mutual benefit of a defined group of individuals. For example, most professional associations are formed to provide services, facilities, or training to members, to advocate on behalf of members' interests, or to provide self-regulation for the profession. One of the strengths of civil society is that individuals are free to form sporting clubs, singing groups, or whatever sort of social organizations that best enable them to pursue their shared interests. Such mutual benefit organizations (MBOs) are as deserving of legal existence and protection as organizations operated primarily for the benefit of the public or some segment thereof (public benefit organizations or PBOs).<sup>60</sup>

The question of whether MBOs should have the same benefits and privileges as PBOs (e.g., the right to receive tax deductible contributions and access to government grants and contracts) should not be confused with the question of whether MBOs should be allowed to obtain legal personality. *See* Chapter 9 for a discussion of tax preferences.

MBOs should be permitted to engage in public benefit activities if they choose, but the establishment of an MBO should not depend on a judgment as to whether it meets some definition of the public good. Its establishment should be allowed so long as its proposed activities are legal. Additionally, in the laws of some countries, the concept of "fixed" membership has been used to deny a membership organization the right to work for the

interests of anyone other than its members. This rule serves no legitimate purpose and is undesirable. *See* Section 6.1D.

**N. As a general matter, membership in a civic organization should be voluntary; no person should be required to join or continue to belong to an organization.**

#### **DISCUSSION**

Notwithstanding the general principle stated in this Guideline, in certain situations it may be appropriate to make membership in an organization compulsory. For example, if a government delegates to a professional society (e.g., a legal, medical, accounting, or other professional society) the power and responsibility to license members for the practice of a profession and to discipline malpractice, then it would be appropriate to require membership in that society as a condition of practicing the profession in question.<sup>61</sup> Ordinarily, however, mandatory membership in an NGO umbrella organization would violate the freedom of expression and the freedom of association.

Membership in licensing organizations for the professions is not fully voluntary, and they thus differ from most of the organizations discussed in the Guidelines. Nevertheless, many of the rules contained in the Guidelines would apply to such organizations. In some countries, membership in trade unions (trade unions are not addressed explicitly by these Guidelines), may also be made mandatory in a unionized workplace.

## **SECTION 3.2 Responsible State Agency**

**A. The state agency or court vested with the responsibility for establishing civic organizations should be adequately staffed with competent professionals and be evenhanded in fulfilling its role.**

#### **DISCUSSION**

There is considerable variety among legal systems in the choice of the responsible state agency that is empowered to establish civic organizations. In some countries, civic organizations must seek establishment with the ministry responsible for the subject matter of their proposed activity.<sup>62</sup> Some countries vest establishment responsibilities in the courts.<sup>63</sup> In some countries, a single ministry is in charge of establishing and supervising civic organizations.<sup>64</sup> In some countries, the local branches of a single ministry (e.g., the ministry of justice)<sup>65</sup> perform the principal establishment functions. There are advantages and disadvantages to each system.

If a multiminsty system is used, different ministries tend to develop different standards for establishment, some of them quite lenient and others quite strict; no

ministry develops real expertise in dealing with civic organizations, establishment of civic organizations being essentially a sideline activity for each ministry; some organizations have difficulty finding a ministry that will claim jurisdiction over their proposed activities; and forum shopping is possible.

Courts may be thought of as preferable to administrative agencies for establishing civic organizations because judges are supposed to be careful and fair in administering laws. This is not uniformly true, however, and in practice there have been drawbacks to utilizing courts. Some courts treat establishment as if it were a trial under the civil law, which inevitably results in delays. Because establishment is performed in a court, the attorney for the state may intervene, which may also bring delays. In addition, there is often no requirement that a court's refusal to establish a civic organization be accompanied by a statement of reasons that can be appealed to a higher court. These problems can be remedied by appropriate amendment of the law to require simple, quick, and well-documented procedures if courts are to be used. Another problem cannot be fixed so easily. Courts generally are not staffed, and judges not trained, to provide supervision and oversight of civic organizations.

The use of one ministry has the advantage of centralizing expertise about civic organizations in one agency, but sometimes the approach taken by the ministry to civic organizations is too colored by the principal mission of the ministry. For example, a ministry of justice may be too involved with administrative details and a ministry of the interior may be excessively concerned about security risks. If the local branches of a ministry are involved with establishment duties, there will always be difficulty in achieving national uniformity of decision-making. This can be ameliorated in the case of denials of establishment by allowing administrative appeals to the central office, but no appeals will be taken from excessive leniency, thereby raising the possibility of forum shopping.

There is no uniformly correct answer to the question of where to place authority for establishment of civic organizations; the system chosen will depend on the legal and political traditions and realities of the country involved. Any of the described arrangements can be made to work well by able people of good will, and any arrangement can also be administered badly or incompetently. In the end, the problems of establishment can best be served by having establishment criteria that are as few, simple, and objective as possible.

**B. Where it is thought appropriate to establish a separate governmental agency to determine whether an organization qualifies for "public benefit" or "charitable" status, such agency should be an independent, mixed commission.**

## DISCUSSION

Some of the problems of agency expertise, regulatory capacity, and bias can be solved if supervisory powers over civic organizations are delegated to a specialized agency or com-

mission whose members consist not only of government officials but also of representatives of the public and civic organizations themselves. Moldova has created such a commission, using the Charity Commission of England and Wales as a model.<sup>66</sup> Other countries are considering the creation of such an agency.<sup>67</sup>

The general purposes of such a commission are to establish civic organizations, determine the public benefit status of civic organizations, supervise legal compliance, provide education and training to ensure compliance, and impose sanctions in case of any violations of the law. By housing all the status and supervisory functions for PBOs in a single agency, it is possible to develop expertise in a staff whose only function is to deal with civic organizations.

The existence of a single agency eliminates all too frequent interministerial conflict and inconsistency, especially if each concerned ministry is represented on the commission. Such an agency can also improve the understanding of the laws affecting civic organizations and the professionalism of civic organizations by offering courses and training sessions. When the decisions of such an agency are reviewable by a court, it can help eliminate the problem of the agency becoming too heavy-handed and intrusive, on the one hand, or too lenient, on the other.

Even if establishment authority is left where it has traditionally been placed, with the courts or one or more ministries, consideration should be given to creating a single agency or commission to determine and monitor public benefit status. Such an agency or commission can have representation for each concerned ministry and, ideally, from the public and the PBO sector itself. By having citizens who are not part of government sitting on the agency or commission, there can be greater public assurance that decisions will be made on principle and with consistency.

### SECTION 3.3 Amendments to Governing Documents

**A civic organization should be allowed to amend its governing documents, without having to entirely re-establish the organization. Amendments should be filed with the responsible state agency.**

#### DISCUSSION

Under the laws of some countries it is necessary to completely re-establish a civic organization if any amendment is made in its name, its purposes, the location of its home office, the name of its registered agent, etc. This is an unnecessary and unduly burdensome requirement. It should be possible for the civic organization simply to file papers indicating the change and submit an amendment to its governing documents where that is appropriate.<sup>68</sup>

It should also be possible for a civic organization to amend its governing documents to change its activities or purposes. As an example, consider a civic organization set up to fight infantile paralysis in a country where that disease is virtually eliminated. It might want to amend its governing documents so that its purpose becomes the prevention of hereditary diseases in children;<sup>69</sup> such an amendment should be possible. The responsible state agency should be notified of the change.

However, there should generally be some restrictions on the ability to change purposes. For example, if the legal system of the country confers special benefits on one class of organizations (e.g., PBOs), the law should preclude changing the purposes or activities of the organization to those of another type of organization (e.g., an MBO) if the result would be to divert money or assets derived from public contributions or tax benefits to an organization that would not ordinarily be entitled to receive such benefits (or to the members of such an organization). In addition, an agency might, for example, refuse to approve a change in the purposes of a PBO if the change, though one for public benefit, would have the effect of diverting money given for the original purpose to a different one.

Finally, a formal civic organization should generally not be given free rein to convert to for-profit status. The civic organization should either be required to be terminated, with its assets distributed according to law, or all of its assets accumulated while it was a civic organization must be used for appropriate not-for-profit purposes. *See* Section 3.7. The individuals involved can then establish a new for-profit entity to carry out for-profit activities.

## SECTION 3.4 Amendment in the Event of Impossibility or Deadlock

**There should be procedures by which the responsible state agency can approve the amendment of the governing documents of an organization even if the organization cannot do so by its own independent action.**

### DISCUSSION

(a) *Impossibility*: Sometimes an organization finds that it cannot make a desired amendment to its governing documents because the founder is dead. For example, a foundation created by a will or other testamentary document may have been committed to engage in some activity that is no longer possible or legal.

In cases such as these, it should be possible for the governing board or an attorney representing the state to go to a specialized commission or a court to obtain permission to amend the governing documents to allow new lawful activities as close as

possible to those desired by the founders or the testator, or to alter the desired purposes or structure of the organization if members of the organization or its governing board desire the change.<sup>70</sup> When the only other alternative is reversion of the property to the heirs, such amendments are ordinarily deemed appropriate. Similar issues may arise because of the dissolution of a founder that is a legal entity.

(b) Stalemate or deadlock: It is also appropriate for the laws to specify a procedure under which a civic organization that has reached a situation of stalemate or deadlock can proceed to court for resolution of the issue. For example, if a governing board is evenly split on an important issue affecting the survival or principal activities of a civic organization and repeated attempts to resolve it have been unsuccessful, the civic organization (or at least one set of members of the divided board) should be allowed to go to a court or to a specialized commission to seek a determination as to an appropriate further course of action.<sup>71</sup> Similarly, if there are an insufficient number of independent directors to constitute a majority to resolve a conflict-of-interest question, the organization should be able to seek the guidance of a court or specialized commission.

## SECTION 3.5 Public Registry

**There should be a single, national registry of all civic organizations that is accessible to the public.**

### DISCUSSION

It is important that a registry of all formal civic organizations be maintained and that the public has access to it. For their own protection, citizens need to be able to check whether a purported civic organization is actually established as a legal person. The public would also benefit from being able to find out what the purposes of the organization are, where its headquarters are, who is on its governing body, who its legal representative is, etc.

If the public has access to the registry of civic organizations, it can provide additional and useful oversight and bring to light possible problems that may have been overlooked by the government. In addition, all agencies of the state need to be able to determine which civic organizations are established and what their purposes, powers, and limitations are.

To facilitate the interests of both the public and the state, there should be a single national registry of civic organizations.<sup>72</sup> It may be appropriate for civic organizations to be established in various locations in a particular country and to maintain public registries in each location, but all local establishments (and terminations) should be consolidated periodically into a national registry open to all.<sup>73</sup>

At a minimum, the national registry should contain limited but clearly defined information about the names, addresses, general representatives, purposes, activities, and so forth, for all civic organizations in the country. More information, including the organization's governing documents and its application for establishment, should be available on request either from local or provincial registries or the national registry itself.

## **SECTION 3.6 Mergers and Divisions**

**There should be clear rules allowing, but not compelling, civic organizations to merge, divide, or modify themselves in ways that are permitted for other legal entities. There may be restrictions, however, on the ability of civic organizations to merge with for-profit entities or on the ability of PBOs to convert to MBO status through merger or division.**

### **DISCUSSION**

The decision by civic organizations to merge or split up should generally be voluntary.<sup>74</sup> It is appropriate to require that a decision of this magnitude be made by the highest governing body of a civic organization (e.g., the assembly of members or the governing board) and to require a vote by a supermajority of that body (e.g., 2/3 or 3/4).

## **SECTION 3.7 Termination, Dissolution, and Liquidation**

**The highest governing body of a civic organization, upon application, should be permitted to terminate the organization's activities voluntarily, go through legal dissolution proceedings, and liquidate the organization's assets pursuant to the decision of a court. Determinations to involuntarily terminate or dissolve a civic organization should be ordered by or be appealable to independent courts. A reasonable time period should be available for such appeals. Where necessary, the civic organization law should specifically reinforce these rights.**

### **DISCUSSION**

Voluntary termination, dissolution, and liquidation of a civic organization should be allowed pursuant to reasonable procedures designed to protect creditors and other stakeholders of the organization. In some cases, e.g., when a PBO intends to dissolve, the law may reasonably require that notice be given to the responsible state agency or to the state

attorney, in order to ensure appropriate distribution of the assets of the PBO in accordance with the organization's governing documents or the requirements of the law.<sup>75</sup>

As to involuntary termination and dissolution, if one or more ministries or state agencies are given discretion to terminate or dissolve a civic organization, seize its assets, or take over its operations, this can have a chilling effect on the independence and activities of civic organizations. In order to assure a vigorous and independent civic sector, the law should provide for intermediate sanctions (e.g., fines) for various types of violations. *See* Section 8.7 for a further discussion of sanctions. Termination of legal existence and dissolution of a civic organization should be the last resort. It should be possible for the state to take such action only for the most serious and blatant violations, and then, except in cases involving the most urgent threat of irreparable harm, only after the civic organization has been given an opportunity to correct its behavior.<sup>76</sup>

If a state agency is given the right to terminate establishment administratively, there should be a right of judicial appeal from such a decision, and termination should not become effective until the appeal is completed or the time for appeal has lapsed. A better solution for terminations would in all cases require that the state agency or the state attorney apply to the court for a judicial termination of the organization.

Upon termination, the assets of an organization should go to another civic organization with a similar purpose pursuant to the terms of the terminating organization's governing documents or a resolution of the highest governing body. In the absence of such direction, a court of competent jurisdiction should issue an order as to the appropriate distribution of the assets. Except in the case of civic organizations that have never received significant public funds or benefits, the law should also ensure that the assets of the dissolved civic organization may not revert to the founders, members, officers, members of the governing board, or employees. *See* Section 5.4. If there is no appropriate organization to receive the assets of a dissolved civic organization, the law may require that the assets revert to the state, which should be required to use them for purposes similar to those of the dissolved civic organization.<sup>77</sup>



# 4

## Structure and Governance

There are essentially four different types of internal governance rules for formal civic organizations: 1) those that are required by law; 2) those that are required by voluntary regulation through umbrella organizations or otherwise; 3) those that are required by donors and other supporters; and 4) those that are purely discretionary. This chapter deals only with mandatory rules required by law. Other mandatory aspects of internal reporting and supervision are considered in Section 8.1 and voluntary regulation is considered in Chapter 12. Internal governance rules required by donors arise principally as a result of contractual arrangements and are covered in Section 8.5.

### SECTION 4.1 Mandatory Provisions for Governing Documents

**Basic rights, limits, and powers of civic organizations should be defined by law. In addition, certain minimum provisions necessary for the operation and governance of a civic organization should be required in an organization's governing docu-**

**ments. The requirements may be different for membership and nonmembership organizations.**

## **DISCUSSION**

The law should stipulate certain rights, powers, and limitations for civic organizations. For example, in most cases it should provide for the limited liability of officers, members of the governing board, and employees. The law should clearly state that a formal civic organization has the power to enter into contracts, own property, sue and be sued, just like any other formal legal organization. The law should also contain a prohibition on the distribution of profits.

In addition, the governing documents of a formal civic organization should be required to include clauses pertaining to certain essential matters.<sup>78</sup> The governing documents should be required to include any limitations imposed by law, such as a prohibition on the distribution of profits.<sup>79</sup> The law should require that the documents state the purpose(s) of the organization and set forth its basic governance structure. For example, the governing documents should identify the highest governing body of the organization (assembly of members or governing board) and stipulate the minimum number of times it must meet each year. A minimum number of members of a governing body may be defined, although this number should be kept quite small (e.g., three).<sup>80</sup> The basic powers of the highest governing body should be spelled out, together with any restrictions on its power to delegate duties to others. For example, the governing documents might appropriately reserve to the highest governing body the right to amend the governing documents or to merge or terminate the organization. Nonmembership organizations are often required to have additional governing organs because they are not accountable to members.

The law should not create inefficient and burdensome governance structures, particularly for smaller organizations. The law should otherwise allow an organization to create additional bodies (such as a supervisory or advisory board or an audit commission) if the founders or highest governing body so desire. *See* Section 4.2. More sophisticated governance structures can appropriately be required of large civic organizations, such as requiring public benefit organizations of a certain size to establish an audit commission or have their financial reports audited by an independent, chartered accountant.

Usually the founders are given considerable discretion to design the internal structure and governance of a civic organization to suit its particular needs, so long as they are spelled out in the governing documents. For example, the founders might stipulate that one-third of the members constitutes a quorum for the annual general meeting or that a supermajority (e.g., 2/3 or 3/4) is required for voluntary termination of the organization. Governing documents for membership organizations should also be required to contain membership rules, such as requirements for membership, rules governing suspension or expulsion, etc.

Apart from general legal requirements, it may often be necessary to include cer-

tain limitations or prohibitions in the governing documents in order to obtain tax benefits or receive grants from certain donors. For example, the purposes may need to be limited to public benefit activities, and it may be necessary to restrict the distribution of profits and of assets on dissolution.

## **SECTION 4.2** Optional Provisions for Governing Documents

**A formal civic organization (through its founders or its highest governing body) should have broad discretion to set and change the governance structure and operations of the organization within the limits provided by law.**

### **DISCUSSION**

A structure must be set out in the governing documents outlining basic matters concerning the purposes and governance of the organization.

On the other hand, because organizations change and grow over time, there also needs to be flexibility on nonessential matters. It should not be necessary to amend the governing documents to make relatively small changes in the organization (e.g., creating a finance committee). Therefore, the highest governing body of an organization should be allowed, consistent with the terms of the law and its governing documents, to adopt rules, regulations, or resolutions that govern the details of operation.<sup>81</sup> It should also be able to increase or decrease the number of directors from time to time, perhaps within limits specified by law and in the governing documents, and to create or eliminate officer positions. The highest governing body should have the authority to create subsidiary governing bodies (e.g., committees), and delegate some of its duties and authorities to them, consistent with the law, as it deems necessary.

## **SECTION 4.3** Liability of Founders, Officers, Board Members, and Employees

**A. Founders, officers, members of the governing or management boards, and employees of a formally established civic organization should not be personally liable for the obligations of the civic organization.**

### **DISCUSSION**

Founders, officers, board members, and employees of a formally established civic organ-

ization are ordinarily not liable in their individual capacity for the debts, liabilities, or other obligations of the organization. They may, of course, become liable by private contract, such as when a board member guarantees a loan incurred by the civic organization. Trusts generally stand on a different footing. Since a trust is not a legal person as such, the trustees are personally responsible for all of the acts or omissions committed on behalf of the trust. The same is often true for the members of a society or association, which are also not legal persons.

Individuals do remain responsible for their individual acts even when the organization they work for has derivative liability. For example, if an employee of a civic organization injures a third party while negligently driving a vehicle belonging to the organization, in some legal systems the civic organization employing that person may be responsible for the harm caused if the employee was driving the vehicle in the course of, or for a purpose arising out of, his or her employment. This is the doctrine of *respondet superior*. The fact that the civic organization may be derivatively liable, however, would not relieve the individual of liability as well.

**B. Officers and board members should ensure that the organization operates within the requirements of the law (e.g., the Civil Code, the Labor Code, and other general laws) and should be liable to the organization and/or to injured third parties for willful or negligent performance or omission.**

#### DISCUSSION

Civic organizations have primary responsibility for their own acts, but the officers and board members may also bear responsibility if they act in a willful or negligent manner in their oversight of the organization. The officers and board members should not be liable if they act reasonably and in good faith.<sup>82</sup> However, if a willful or negligent act or omission of an officer or board member injures a third party, that person should ordinarily be entitled to sue the individual as well as the civic organization.

Some countries (e.g., England) apply a standard of ordinary negligence to the conduct of a fiduciary, while others (e.g., the United States, in most states) hold a fiduciary liable only for gross negligence. Under either approach, a fiduciary will not be liable simply because he was wrong, so long as he satisfies the “business judgment rule” described in endnote 82.

If the civic organization is required to pay damages to a third party because of the wrongful act of an individual, it should have a right to sue the officers, board members, or employees for dereliction of duty. Many legal systems allow the claim by the civic organization against the officers or board members to be tried in the same suit as the claim by the third party. To prevent an injured third party from being without remedy if the civic organization has been dissolved or becomes bankrupt, the third party should have the right to sue the offending officers, board members, or employees directly.

Although civic organizations can often buy “errors and omissions” insurance to cover the defense costs as well as the liability of officers, board members, or employees, such insurance generally does not extend to willful or negligent acts or omissions.

## **SECTION 4.4 Duties of Loyalty, Diligence, and Confidentiality**

**A. Officers and board members of a civic organization should be required by law to exercise loyalty to the organization, to execute their responsibilities to the organization with care and diligence, and to maintain the confidentiality of nonpublic information about the organization.**

### **DISCUSSION**

This rule is similar to the rule for officers and board members of other legal persons. It may be provided for in the law governing civic organizations, in a law separate from the law governing civic organizations, or it may simply be an established doctrine in the legal system.<sup>83</sup>

**B. The civic organization itself, or any affected person in the society, should be allowed to sue for redress of any violations of these duties.**

### **DISCUSSION**

Not only do civic organizations have the right to sue to protect their interests, in some legal systems the public prosecutor or state attorney has the right to bring civil actions on behalf of a civic organization.<sup>84</sup> Because many civic organizations are small, weak, and unable to defend their own rights, especially in cases requiring the expense and burden of bringing a lawsuit, this can be a desirable feature.

A lawsuit may only be brought by someone who has the right to bring such a suit, which is often determined by the degree of the person’s interest in the outcome. Rules differ among legal systems, but most systems require that a plaintiff show a direct and personal interest before he or she can initiate a lawsuit.

## **SECTION 4.5 Prohibition on Conflicts of Interest**

**A. The law and internal regulations should require that officers, board members, and employees of a civic organization avoid any actual or potential conflict between their personal or business interests and the interests of the civic organization.**

## DISCUSSION

Because of the many differences in the structures and activities of civic organizations and because of the innumerable ways that individuals may be involved with a civic organization and with another entity that relates to the civic organization in some way, it is nearly impossible to stipulate with specificity the kinds of conflicts of interest that should be avoided. One good approach is to prohibit conflicts of interest in general terms and allow courts to determine on a case-by-case basis whether there has been a violation.<sup>85</sup> Civic organizations could also be required to adopt specific internal conflict-of-interest rules in light of their particular facts and circumstances.

In some legal systems the obligation to avoid or correct a conflict of interest is an established doctrine of law that has general application to anyone in a fiduciary position, and thus no special rules are required for civic organizations.

### **B. Potential conflicts should, at minimum, be disclosed.**

## DISCUSSION

Officers, board members, and employees of a civic organization should be required by law and internal regulation to disclose any potential interest they might have that might be adverse to the interest of the civic organization. Thereafter, an organization can choose a number of ways to address the potential conflict, including waiver, recusal, or additional review.

For example, it is generally appropriate for an organization to require a person with a conflict of interest to disclose it and then to recuse him or herself from the discussion of and decision-making about the relevant issues. Thus, if an individual who sits on the board of a civic organization is also an officer of a local bank, the individual could be required to recuse him- or herself from any decisions by the civic organization about where it should establish its banking business or obtain a loan.<sup>86</sup> A conflict-of-interest transaction may be authorized or approved if a sufficient number of independent directors agree to waive the conflict of interest. When independent directors do not constitute a majority, it should be possible for the organization to seek guidance from a court or the responsible state agency as to how the conflict should be resolved. Any approval or authorization for a conflict-of-interest transaction must be made in writing.

In addition to procedural rules, the law should provide that financial transactions between a civic organization and its officers, board members, or employees must be concluded at fair market value or on terms more favorable to the civic organization. *See* Section 5.3.

**C. A civic organization should be entitled to sue its officers, board members, or employees for redress of any harm caused by a conflict of interest or return of any profits resulting from the improper behavior.**

**DISCUSSION**

This right should be part of the general laws applicable to all legal persons, including civic organizations.



# 5

## Prohibition on Direct or Indirect Private Benefit

The formal civic sector is distinguished by what it is not. It is not governmental and it is not for-profit. That is, profits, if earned, cannot be distributed as such to founders, members, board members, employees, etc.

This principle of nondistribution is the single most important legal feature distinguishing formal civic organizations from for-profit entities (and from cooperatives as well). In order to make this principle meaningful, however, it is necessary to have rules that preclude indirect as well as direct distribution of profits, and that preclude such a distribution either during the lifetime of the organization or upon dissolution. In addition, to the extent that a formal civic organization has received direct or indirect benefits from the public (e.g., donations, state grants or contracts, or tax exemption), its assets are not simply private but are, to some extent, derived from public sources. Assets derived from public sources should never inure to the personal benefit of the founders, officers, board members, members, or employees of a civic organization.

## SECTION 5.1 Prohibition on the Distribution of Profits

**Profits of a formal civic organization should not be permitted to be distributed as such to any person.**

### DISCUSSION

Formal civic organizations may have profits from investment of their capital and from the conduct of other ongoing economic activities. *See* Section 6.3. It is permissible for profits from an economic activity to be used by an MBO to provide benefits to its members, but it should be impermissible for any civic organization to distribute profits as such (e.g., as dividends). Profits could be reinvested in the for-profit activities that sustain the civic organization because the profits would be retained within the organization itself.

## SECTION 5.2 Prohibition on Private Inurement

**A. Employees, as well as officers, board members, and members of a civic organization should be permitted to be paid appropriate compensation for work actually performed for the organization, including appropriate fringe benefits and reimbursement for appropriate expenses.**

### DISCUSSION

Despite the frequent reference to the civic sector as the “voluntary” sector, and although many civic organizations receive valuable assistance from volunteers, it is quite acceptable for employees of a formal civic organization to be paid a reasonable salary and to receive normal employee benefits (e.g., health and pension benefits).<sup>87</sup> Persons employed by civic organizations may also be reimbursed for reasonable expenses incurred on behalf of the organization.

There is a strong and salutary tradition that board members of a civic organization serve on a voluntary basis and without compensation. This tradition should be continued and strengthened. However, in those infrequent cases where board members are required to attend frequent meetings and devote many hours to the organization, it may be in the best interests of the organization to pay appropriate compensation to them for their time, and such payments should be allowed.<sup>88</sup> Further, to the extent that board members render other services to the civic organization (e.g., legal or accounting services), it is permissible for them to be remunerated at no more than normal market rates. Any such arrangement must be approved in advance by independent members of the board and without the participation of the affected board member. In all cases, board members and

other volunteers are permitted to receive reimbursement for reasonable expenses incurred on behalf of the organization.

What constitutes appropriate compensation, fringe benefits, and expenses incurred on behalf of the organization can only be determined on a case-by-case basis. It would generally be inappropriate for any agency of the state to intrude into the affairs of a civic organization by making these determinations.<sup>89</sup> In the interests of good governance and the integrity of the sector, however, it is good practice for any civic organization to adopt a policy permitting only appropriate compensation, fringe benefits, and expenses. Groups of like-minded civic organizations can adopt guidelines on these issues for their member organizations. Useful benchmarks are often what is paid to government officials or university employees with comparable responsibilities. *See* Chapter 12.

**B. A civic organization should be prohibited from providing special personal benefits, directly or indirectly (e.g., scholarships for relatives), to any person connected with the organization (e.g., founder, officer, board member, employee, or donor). Benefits may be made available to members of an MBO if they are made available on a nondiscriminatory basis to all members (e.g., special educational programs or life insurance plans).**

#### **DISCUSSION**

It is difficult to write precise rules in this area because the ways in which officers and board members might seek to obtain improper benefits from a civic organization are various and legion. Moreover, it is often difficult to detect or correct abuses. For example, if an organization provides special life insurance benefits to all members, it may be permissible for the president to receive those benefits as well. However, if an organization provides such insurance to any member who has a rare illness or disease, but only the president or one of his or her family members has such an illness or disease, providing the benefit to him or her may be improper. This is an area where it may be necessary to put general standards in the law and let the responsible state agency and the courts apply them on a case-by-case basis.

### **SECTION 5.3 Prohibition on Self-Dealing**

**A. Any transaction (e.g., sale, lease, or loan) between a civic organization and any person connected with it (e.g., founder, officer, board member, member, employee, or donor) should be able to be consummated only after legitimate negotiation and only at a price and on terms that are not disadvantageous to the organization.**

## **DISCUSSION**

“Self-dealing” is a term used to describe situations where those in a position to influence or control an organization cause it to undertake a transaction that constitutes an unreasonable benefit to an individual, often to the detriment of the organization. For example, the founder of a civic organization might cause it to purchase an asset from him or her at an inflated price, or he or she might purchase an asset from the civic organization at a price that is only a fraction of its real value. Such transactions are similar in purpose and effect to an influential person causing a civic organization to pay excessive expenses, such as buying an expensive automobile for the sole use of the chief executive officer of a civic organization. These transactions drain assets out of the civic organization, tarnish the image of the sector, and should be prohibited.<sup>90</sup>

### **B. It may be appropriate to prohibit entirely certain kinds of potentially abusive transactions.**

#### **DISCUSSION**

Some types of transactions are by their nature of so little relevance to the mission of a civic organization or so likely to involve abuse that they should be prohibited altogether. One example might be loans by a civic organization to officers or board members. Sometimes more detailed and specific prohibitions are adopted for certain public benefit organizations.<sup>91</sup>

### **C. A civic organization should be entitled to sue for redress of any harm caused by self-dealing.**

#### **DISCUSSION**

Such a remedy would not need to differ from the remedy that is frequently available to other legal persons, including for-profit entities. “Restitution” is available in some legal systems. Generally speaking, this process involves returning the parties as nearly as possible to the positions they would have been in had the transaction not occurred. This process may involve rescission of the transaction plus transfer to the civic organization of any profits made by the offending individual.

## **SECTION 5.4 Prohibition on the Reversion of Assets**

**A. No civic organization that has received significant funding from the public or the state should be permitted to distribute assets to its founders, officers, board members, employees, donors, or members upon its liquidation.**

## DISCUSSION

The law should permit a public benefit civic organization, in its governing documents or by resolution, to designate another similar PBO to receive any assets remaining after the payment of all liabilities.<sup>92</sup> Alternatively, and as a last resort, the assets should revert to the state. In many countries, an agency of the local administrative body is the preferred recipient in such instances and must use the assets for similar purposes. Where the state is the founder of a civic organization, the law will typically require that the assets revert to the state upon liquidation of the organization. Contractual obligations to donors may also require reversion of certain donated funds and assets to them.

**B. An exception permitting distribution of assets to members upon dissolution and after the payment of all liabilities of the civic organization may be appropriate in the case of an MBO that never received significant contributions from the public (i.e., persons not affiliated with it as founders, donors, officers, board members, employees, members, or donors) or significant grants, contracts, or tax benefits from the state.**

## DISCUSSION

Some MBOs never benefit from state or public support. When they are terminated and their assets are distributed in liquidation, it should be permissible for the assets remaining after payment of liabilities to be distributed to the members. For example, if a sailing club is formed, and sailboats are purchased using member contributions, when the club is disbanded, it should be permissible for the boats and other assets of the club to be distributed to members in some equitable fashion.



# 6

## Activities of Civic Organizations

### SECTION 6.1 Public Benefit Activities

A. Civic organization laws should allow organizations to qualify as “public benefit organizations” for the purpose of receiving special benefits from the state, such as special tax benefits or the right to compete for certain state contracts. Qualification may be accomplished through an application procedure to a specific state agency, such as the department of revenue, or a special commission set up specifically for that purpose.

#### DISCUSSION

The distinction between PBOs<sup>93</sup> and MBOs is somewhat arbitrary and is usually applied when a civic organization seeks special tax or other benefits, such as the ability to bid on certain state contracts. A civic organization should not be classified as a PBO unless its purposes are primarily or exclusively for public benefit and unless it seeks such status.<sup>94</sup>

See Chapter 9 for further discussion of this issue. Authority to make the determination of PBO status may rest with the responsible state agency, with a special commission set up for this purpose, or with the tax authority. See Section 3.2B.

Because of the special benefits that attach to PBO status, decisions made with respect to this issue, no matter who makes them, must be appealable to a court. Some general guidance for making the distinction between PBOs and MBOs can be found in the Appendix: Glossary of Terms.

### **B. The regulatory burdens borne by formal civic organizations should be commensurate with the benefits they obtain from the state.**

#### **DISCUSSION**

As stated above, the PBO classification will ordinarily entitle a formal civic organization to special benefits, which bring with them additional regulatory burdens. The burdens of additional scrutiny to which a PBO is subject should be related to the additional benefits it receives from the state. Moreover, a civic organization should retain the freedom to decide whether to obtain this special status and subject itself to the additional regulatory burdens. Thus, PBOs may be required to file more detailed reports on all their activities with a general supervisory agency (see Section 3.2B), with tax agencies (Section 8.3), and with the state agencies from which they receive contracts (Section 11.2). These requirements will be in addition to any licensing that may be required (Section 6.5) and any required reporting to licensing agencies (Section 8.4).

### **C. Determinations of public benefit status should not be time limited.**

#### **DISCUSSION**

Some countries feel that it is necessary for PBOs to reapply for PBO status after one year or three years. In general, if there is adequate supervision of PBOs after they are established and granted PBO status, they should be permitted to maintain it indefinitely, without reapplication. For a discussion of supervision of PBOs, see Section 8.2.

### **D. All civic organizations should be permitted to engage in public benefit or charitable activities.**

#### **DISCUSSION**

Classification as a PBO for purposes of receiving special benefits should not be a precondition for engaging in the widest scope of activities. In particular, an MBO should be permitted to undertake activities affecting the public—for example, a gardening club that decides to replant a public park or a professional association of physicians that decides to open a clinic for homeless people. However, if the organization elects not to become

a PBO, it is ordinarily not required to meet the general accountability requirements applicable to PBOs. Nevertheless, it remains subject to any applicable licensing or regulatory requirements for its activities that directly affect the public (e.g., minimum standards imposed by the ministry of health for operating a medical clinic). *See* Sections 6.5 and 8.4. Furthermore, status as a PBO may be necessary to qualify to receive grants from grantmaking foundations and donor agencies, such as the Department for International Development (United Kingdom) and the Swedish International Development Agency.

## SECTION 6.2 Public Policy and Political Activities

**A. Civic organizations are key participants in framing and debating issues of public policy, and, just as is true for individuals, they should have the right to speak freely on all matters of public significance, including existing or proposed legislation, state actions, and policies. Likewise, civic organizations should have the right to criticize (or praise) state officials and candidates for political office. There should be no restrictions on the right of civic organizations to carry out public policy activities, such as education, research, advocacy, and the publication of position papers.**

### DISCUSSION

As this Guideline makes clear, it is impermissible under international law to prohibit civic organizations from expressing policy judgments or political opinions. To do so would be to violate the rights to freedom of expression and freedom of association. Furthermore, civic organizations have an important role to play in a democratic society by enhancing public debate on the issues of the day.<sup>95</sup> It is therefore appropriate to provide civic organizations the right to engage in the broadest array of nonpartisan political activities.

In contemporary practice, different countries have different rules for determining whether a civic organization engaging in certain public policy activities would qualify for full PBO status. As discussed in the previous section, common law countries exclude some organizations from receiving “charity” status, i.e., from being considered as PBOs, if their intended purposes include some forms of campaigning for or against specific legislation or endorsing or opposing candidates for political office.<sup>96</sup> On the other hand, PBOs that are not “charities” are sometimes permitted to undertake such activities, but they may not be entitled to the highest level of tax benefits as a result.<sup>97</sup> Common law restrictions on the activities of “charities” are typically drawn narrowly; in contrast, civil law jurisdictions have a long history of public engagement by civic organizations and generally allow civic organizations greater freedom to engage in lobbying activities.<sup>98</sup> This permissive tradition of civil law jurisdictions is preferable.

**B. Formal civic organizations should be permitted to engage in public interest litigation.**

**DISCUSSION**

Rules regarding the right to bring a legal action are crucially important to the ability of formal civic organizations to use lawsuits for advocacy purposes, and in some countries, organizations that engage in public interest litigation qualify for status as PBOs.<sup>99</sup> For example, an environmental organization might want to challenge the fact that a particular factory has received a permit to discharge pollutants into a stream. In many legal systems, the civic organization could only act by representing a particular person or persons whose property is adversely affected by the pollution in the stream. The individual would have to bring the suit in his or her own name, however. This procedure should not be the only one available. A formal civic organization should also be able to bring a suit in its own name by demonstrating that its interests or those of its members are directly affected.

**C. It may be appropriate to limit civic organizations with respect to activities such as fundraising to support candidates for public office or establishing candidates to qualify for public office.<sup>100</sup>**

**DISCUSSION**

This Guideline assumes that there are separate laws governing political parties, political fundraising, elections, and political campaigning, and it is intended to insure the integrity of such laws.<sup>101</sup>

## **SECTION 6.3 Economic Activities**

**A civic organization should be permitted to engage in lawful economic activities provided that it is organized and operated principally for appropriate noncommercial purposes, and that no profits or earnings are distributed as such to founders, officers, board members, employees, or members. Such activities may be engaged in provided that any applicable requirements for licensing and permits are met.**

**DISCUSSION**

Allowing civic organizations to engage in trade or business activities can provide them with a source of income that is sorely needed in places where there is an insufficient tradition of charitable giving or no private wealth to support civic organization activities. At the same time, the law must not be so permissive as to allow commercial enterprises to establish themselves as civic organizations in order to avoid taxation.

The test set out in the first part of the Guideline concerns the extent to which a civic organization should be permitted to have economic or business purposes. It is known as the “principal purpose” test.<sup>102</sup> It looks to whether the principal activities and expenditures of the organization are for noncommercial purposes. Under it, a civic organization that consistently spent more than half of its resources in an active trade or business activity (not including those economic activities that are in direct furtherance of the organization’s noncommercial purposes) would be subject to termination as a civic organization.<sup>103</sup>

A more stringent test—the “exclusive purpose” test—may be appropriate for PBOs. Under this standard, if nonpublic benefit purposes constitute more than an insubstantial part of the purposes of an organization, it cannot qualify as a PBO.<sup>104</sup>

Even when a PBO’s purposes are exclusively for public benefit, its activities may include economic activities. In many situations the most effective way to achieve a public benefit purpose involves economic activities. For example, it may be feasible to operate a not-for-profit medical clinic, school, opera company, or museum only by charging fees to those who use them, with exceptions for the poor. The most effective way to promulgate knowledge and understanding for a public benefit purpose may be to sell an art magazine or a magazine on nature and conservancy. The fact that economic activities are a substantial, or even the predominant, way in which the public benefit purposes of a PBO are achieved should not preclude it from being classified as a PBO.<sup>105</sup>

Under the principal purpose test, not all revenue-generating activities are considered “economic” activities. All formal civic organizations generally have a bank account(s) on which they earn interest, and many have endowments that are invested in stocks, bonds, and other financial instruments, on which they earn dividends, interest, rents, royalties, other types of investment income, or capital gains. These types of investments are generally recognized as “passive” activities or ones that are essentially noncommercial or noneconomic, and they are generally permitted for all formal civic organizations.<sup>106</sup> Such activities may be taxed when engaged in by certain types of MBOs, such as a mutual investment fund, but they should never be taxed in other cases.

There are other kinds of revenue-producing activities in which formal civic organizations may engage on an irregular or occasional basis, such as raffles or charity auctions. Such activities do not constitute regular activities and are principally a form of fundraising. They should be subject to appropriate rules discussed in Section 7.2, but generally should not be treated as economic activities as that term is used here.

Grants, contracts or subsidies received from foundations, trusts, state bodies or international organizations ordinarily should not be treated as revenue from economic activities, though it is sometimes necessary to distinguish between fees for service and grants. The basic test in making the distinction between grants and fees for service is whether any benefits received by the grantor are purely incidental. If persons other than

the grantors are the primary beneficiaries of the funds received, then the funds may be regarded as grants or donations and not treated as revenue from economic activities.<sup>107</sup>

The activities that are at issue in this Guideline are the active trade or business activities of civic organizations that are carried out on a regular or permanent basis. Some of these may be activities that are carried out simply for the purpose of raising revenue for the organization. An example might be an educational organization selling noodles to raise money to support its programs. Other economic activities may be in direct furtherance of the purposes of the organization—so-called “related” economic activities. They might include, for example, the publication and sale of a magazine to promote art and culture. To the extent such economic activities are simply the economic means chosen to achieve a not-for-profit purpose, they should not disqualify the entity for status as a civic organization even if they constitute the principal activity of the organization.

Sometimes it is permissible for unrelated economic activities to be conducted directly by the civic organization itself and sometimes it is permissible to conduct such economic activities only indirectly, e.g., by a wholly owned subsidiary. Practice with respect to what is permissible in this regard varies widely.<sup>108</sup>

Commingling of assets and activities can be prevented by requiring that all economic activities be accounted for separately, and that there should be sufficient resources to allow for proper oversight of an organization that is conducting business activities. Requiring the creation and operation of a separate legal entity creates additional complication and expense. Accordingly, the creation of a subsidiary to conduct business activities should be permissible but not mandatory.

If some economic activity is permitted, the tax consequences of that activity must be considered. This is discussed in Section 9.3. The issue of distribution of profits from economic activities to various people associated with the civic organization, mentioned in the second part of the Guideline, is discussed in Sections 5.1 and 5.4. Licenses or permits for economic and other activities of civic organizations are discussed in Section 6.5.

## SECTION 6.4 Economic Development Organizations

**Laws should allow civic organizations to participate in economic development activities, such as microcredit, small business incubation, etc., through the borrowing and lending of funds. Economic development activities should be considered to be public benefit activities.**

### DISCUSSION

Many civic organizations play an important role in the economic development of countries by participating in activities such as small business incubation, policy development,

and the extension of microcredit. Recipients of these small loans are often entrepreneurs too poor to qualify for traditional bank loans.<sup>109</sup> Microcredit is an effective way to combat poverty, enabling those without access to lending institutions to borrow money to start small businesses and finance other community development projects.

Laws, such as banking and usury laws, should be amended to permit microcredit organizations to operate effectively.<sup>110</sup> In addition, economic development activities serving the poor and disadvantaged, including microcredit, should be considered to be public benefit activities, as that term is used in Section 6.1.<sup>111</sup> This would also lead to tax preferences for such organizations, as discussed in Chapter 9.

## SECTION 6.5 Licenses and Permits

**Any civic organization engaging in an activity that is subject to licensing or regulation by a government agency (e.g., health care, education, social services to those living with HIV/AIDS) should be subject to the same generally applicable licensing and regulatory requirements and procedures that apply to similar activities of individuals, business organizations, or public agencies. If a permit is required for certain activities (e.g., a parade permit), including public policy activities, civic organizations should not be subject to requirements for obtaining permits that are more stringent than those applicable to individuals, business organizations, or public agencies. Licensing and permit requirements should not be used to stifle legitimate activities of civic organizations, including legitimate public policy activities.**

### DISCUSSION

If a civic organization wants to open a home for elderly persons, it will usually be required to obtain a license to do so, and it should generally be held to the same standards of professionalism, sanitation, and so forth, as apply to any other organization (including a state body) or individual desiring to operate such a home. The same rules should apply to any other activity for which the state has generally applicable rules and regulations, such as environmental protection.<sup>112</sup> An exception should be made for microcredit institutions, which are inherently different from for-profit financial institutions.

Permits may be required for certain specific activities of civic organizations just as they are for informal groups, individuals, and business organizations. For example, it may be necessary to obtain a permit to hold a fundraising concert in a public park.



# 7

## Fundraising

After establishment, fundraising is perhaps the most important issue for civic organizations. In regions lacking a strong history or present practice of charitable giving by individuals and companies, civic organizations live a precarious life and many rely predominantly on foreign sources of funding (e.g., from private foundations, corporations, or bilateral or multilateral aid organizations) or on grants or contracts from their own governments. While none of these sources of funding are objectionable by themselves, the creation of a strong and independent civic sector depends in part on diversified funding (including economic activities, as discussed in Chapter 6). Overreliance on foreign funding should be avoided, and private domestic funding and other support should be encouraged.

Private domestic support includes funding from individuals and local businesses—either directly or through foundations established by them. It also includes volunteer efforts by individuals, which can be encouraged through the support of local businesses allowing released time for volunteer work. A strong partnership between local businesses and civil society is beneficial to both sides: civic organizations can obtain money, goods, or services from business, and business enterprises can receive recognition as responsible public citizens, not mere profit-making machines.

Another way in which businesses and civic organizations can cooperate is through “sponsorship” of civic organization activities. In a sponsorship relationship, a business typically finances a project or an event carried out by the civic organization in return for public recognition and tax benefits. For example, a business may support a civic organization (e.g., a youth soccer league) primarily for the purpose of promoting its corporate name and public image (e.g., “The [Corporate Name] Youth Soccer Championship”). In some cases, it may be appropriate to categorize the activity as advertising rather than as a contribution to the civic organization. Many countries recognize that, within broad limits, advertising expenses can be legitimately deducted when calculating the net profits of a business, so no new tax rule is required.<sup>13</sup> Income tax deductions for legitimate contributions to civic organizations are discussed in Section 9.2.

## SECTION 7.1 Permissible Fundraising Activities

**Formal civic organizations should generally be permitted to engage in any legitimate fundraising activity, including door-to-door, telephone, direct mail, television, campaigns, lotteries, raffles, and other fundraising events.**

### DISCUSSION

Activities such as raffles, charity balls, and other similar events are occasional and are presented and advertised as fundraising activities. For these reasons they are generally not regarded as economic activities. *See* Section 6.3.

## SECTION 7.2 Fundraising Activities – Limitations, Standards, and Remedies

**A. It may be appropriate to require advance registration of public fundraising campaigns with a public agency responsible for issuing permits and, for in-person solicitations, issuing badges and other identification materials to the fundraisers. However, the government should not be permitted to screen or require approval of specific grants or sources of funds.**

### DISCUSSION

Great care must be taken not to regulate public fundraising<sup>14</sup> in such a bureaucratic or burdensome manner that effective efforts by organizations to obtain public support and to communicate their message to the public are inhibited. There are countervailing pub-

lic interests that favor certain, though limited, regulation of fundraising. For example, rules prohibiting door-to-door canvassing during the middle of the night avoid the harassment of individuals and may promote public safety. Similarly, rules requiring fundraisers to prove to a public agency that they have authority to fundraise from the public for a particular organization may ward off imposters seeking to capitalize on the good name of a particular civic organization. That being said, it is essential that fundraising regulations be narrowly tailored and fully respect the rights of the civic organizations and the individuals involved with them to exercise their rights to freedom of expression, peaceful assembly, and association.<sup>115</sup>

**B. Through either laws regulating fundraising or under rules established by voluntary self-regulatory mechanisms, civic organizations should be required to disclose publicly the way in which funds received from public donations are spent, and, specifically, the extent to which the funds raised are used or expected to be used to defray the direct and indirect costs of fundraising.**

#### **DISCUSSION**

In some countries, there are strict legal rules governing all aspects of fundraising, including limitations on the amount or percentage of funds a civic organization may expend on administrative or overhead expenses or fundraising itself, e.g., 20 percent. Almost without exception, these rules are unsuccessful. In the first place, the legitimate overhead expenses of civic organizations vary widely. A civic organization engaged in running field projects for agricultural development may have very low costs of central administration and overhead, whereas a civic organization formed primarily to engage in research and education may have very large central administration and overhead costs. Rigid, mechanical rules fail to respond to the great diversity among civic organizations.

In many countries, organizations raising money from the general public are not only required to register their fundraising campaigns in advance but are required to file reports about the monies received and how they are spent. Many countries have not yet adopted accounting principles for civic organizations; doing so should be a priority. The next step should be to adopt voluntary standards for public disclosure of such key numbers as the amounts paid to fundraisers and the percentage of revenues spent on overhead and fundraising.<sup>116</sup>

**C. General fraud and other criminal laws should apply to civic organizations and can be invoked if there is any misrepresentation or fraud in connection with the solicitation of funds from others.**

#### **DISCUSSION**

If, after the fact, it is discovered that an individual or organization engaged in deceptive

fundraising (e.g., fundraising for an organization that does not exist or intentionally misleading prospective donors about the manner in which donations will be used), it should be possible to apply general fraud and criminal laws. Depending on the legislation in force, this may mitigate the need to address issues of fraud in the laws on fundraising.

# 8

## Reporting, Supervision, and Enforcement

In any regulations related to reporting, supervision, and enforcement, the need to protect the public from fraud, abuse, and infringement of the rights of others must not result in regulations that unlawfully impinge on the freedoms of expression, association, and peaceful assembly, discussed in Section 2.1.

In the first instance, the legal system should encourage civic organizations to ensure their own accountability and transparency. For example, the laws governing formal civic organizations should require that the governing board exercise fiduciary responsibility and receive regular and detailed reports on finances and operations so that civic organizations can adequately police themselves. *See* Section 8.1. In addition, the civic sector should foster appropriate methods of self-regulation. *See* Chapter 12. Finally, large donors who give money to organizations should impose reporting obligations on their donees as well as requiring evaluation and feedback mechanisms to assess the value of the programs they have funded. *See* Section 8.5.

In the case of MBOs, other than periodic updates of establishment information, reports to the state generally are not necessary or desirable. If a civic organization engages substantially in economic activities, receives substantial benefits from the state, oper-

ates under a license or permit, or engages in substantial public fundraising, however, it is appropriate to require that it provide information on its finances and activities, both to relevant agencies of the state and to the public. The basic tools for achieving accountability and transparency are a variety of reports required to be filed with various agencies, such as the general organ supervising formal civic organizations, tax authorities, and appropriate licensing authorities. These reporting obligations must, of course, be applied in the context of the need to protect the freedoms of expression, association, and peaceful assembly, and the obligations should be commensurate with the benefits the organization obtains from the state. If, for example, the organization receives no state benefits whatsoever, including tax exemption, and does not engage in economic activities or public fundraising, then reporting to authorities of the state should involve no more than periodic updates on information required to be available in the public registry, such as the identity and contact information for the general representative authorized to receive official notices on behalf of the organization.

On the other hand, if a civic organization engages in activities that affect the public safety, health, or welfare (e.g., by setting up a daycare center for small children), it is appropriate to require it to obtain a license to open such a center (*see* Section 6.5), be subject to periodic inspections, and to meet reporting requirements that ensure the health and safety of the children. In addition, it is generally appropriate to require tax filings for all civic organizations that engage in economic activities, subject to the rules applicable to all other taxpayers.

If a civic organization seeks to receive a general classification as a PBO in order to obtain the highest level of tax benefits, if it seeks a state grant to support its operations, or if it engages in a significant amount of public fundraising, then the reporting may be more burdensome. At the same time, only large PBOs with adequate resources should be expected to comply with the full panoply of reporting requirements. Accordingly, it is highly desirable to exempt very small PBOs from some reporting requirements and to allow simplified reporting for others.

Required reports vary in scope, detail, information required, and so forth, depending on the particular reason for which the state agency requires them. It would be much easier for civic organizations if there could be a single and simple form of reporting for all civic organizations and for all of their activities. Unfortunately, this is not possible; still, reports should be as simple and as uniform among agencies as can be achieved.

In a carefully developed system, certain organizations (e.g., many MBOs and small PBOs) will not be required to file detailed reports on their activities and finances. In such a system, it is important that all organizations, including the smallest PBOs and all large MBOS, be required to maintain accurate and complete books and records of their financial and other activities so that the members, the governing board, or the responsi-

ble governmental agency can check to see that the organizations have operated in a legal and responsible fashion. In many countries, policies are being adopted that deal specifically with the accounting rules applicable to civic organizations and that include rules with respect to the manner of keeping books and records of the affected organizations.<sup>117</sup> Moreover, each organization should be required to adopt a policy to retain financial and nonfinancial documents for reasonable periods of time.<sup>118</sup>

Turning to the enforcement side, it is not sufficient for the state to require that the various reports be filed. The reports that are filed must be competently reviewed. Important questions that are raised by them should trigger mail or telephone inquiries, or even on-site inspection and audits in appropriate cases. In addition, because the reports are the basic method used by state agencies to supervise civic organizations, there should be penalties for failing to file reports, for failing to file them on time, for filing false reports, or for failing to maintain records from which reports can be made or checked. *See* Section 8.7. In short, the civic organization laws must be vigilantly and adequately enforced as well as being well conceived and drafted.

Many states require reports from civic organizations, but do not make them public. These reports, however, should serve not only the supervisory role of the state, but also assist citizens themselves in performing a watchdog role. Thus, it is in the interest of the state to insist on public disclosure of basic information about formal civic organizations. *See* Section 8.6. Further, banks, landlords, and other merchants contemplating entering into long-term business relationships with civic organizations should be able to check publicly accessible records to determine the bona fides of such organizations.

There are, however, two caveats regarding the enforcement of reporting obligations. First, not all information supplied to the state should be subject to public scrutiny. It is essential to protect truly confidential or proprietary information from public disclosure. Confidential information might include the names of persons assisted by a civic organization or even the identities of an organization's members and donors.

Second, there is the ever-present danger of over-regulation by the state or the use of reporting and audit requirements to harass civic organizations that are critical of the state or otherwise unpopular. There is no certain protection against state abuse, which exists to some extent in every society. One index of whether reporting burdens on civic organizations are excessive is to compare them with similar burdens on for-profit organizations.<sup>119</sup> Here, as elsewhere, the opportunity to appeal enforcement decisions to an independent judiciary is an important correction for state abuse and a deterrent to future abuses. *See* Section 2.2D.

## SECTION 8.1 Internal Reporting and Supervision

A. Civic organizations should be required to keep financial documentation, reports, and records of their activities. They should also be required to maintain records of meetings of their governing bodies.

B. The highest governing body of a civic organization (e.g., the assembly of members or the governing board) should be required to receive and approve reports on the activities and finances of the organization to ensure that they are consistent with the purposes stated in its governing documents.

C. Some organ of the civic organization (e.g., the governing board or an audit committee created by the governing board) should be given the responsibility, and each member of an MBO the right, to inspect the books and records of the organization.

D. Accounting records of civic organizations should be kept in accordance with generally accepted accounting principles (GAAP).

E. As a matter of good practice, any civic organization with substantial activities or assets should have its financial reports audited by an independent certified or chartered accountant, assuming such services are available at a reasonable cost. This should be a requirement for any sizable PBO.

### DISCUSSION

In most cases, members of the governing board lack the time or the competence to analyze the financial records of a civic organization that has grown to any significant size. Thus, delegation of detailed financial oversight to a responsible finance committee is permissible.<sup>120</sup> Accounts should be rendered in accordance with the requirements of accounting laws or practice in the country in which the organization is operating.<sup>121</sup> In addition, any sizable civic organization should hire the services of an outside chartered accountant to audit and certify the finances of the organization. The civic organization law or the accounting law or standards should make such audits mandatory for sizable PBOs. Further, responsible funders sometimes require independent financial audits of the books of an organization before they will make grants to it. *See* Section 8.5. This Guideline would not apply in countries where such services were not available at a reasonable cost.<sup>122</sup>

## SECTION 8.2 Reporting to and Audit by the Responsible State Agency

**A. Any civic organization receiving more than minimal benefits from the state or engaging in a significant amount of public fundraising should be required at least annually to file appropriate reports on its finances and operations with the state agency that is responsible for general supervision of civic organizations.**

### DISCUSSION

In a carefully developed system, certain organizations (e.g., many MBOs and small PBOs) will not be required to file detailed reports on their activities and finances. It is necessary for the laws or regulations applicable to civic organizations to state which organizations must file reports and with whom. Each country should determine the level of activity that will trigger reporting and audit requirements, in accordance with local circumstances.

It is sometimes posited that there is no need for membership organizations (associations or societies) to file any reports at all—even if they receive tax benefits—because their members adequately monitor the affairs of the organization. However, despite having a governing body made up of its members, individuals in membership organizations frequently do not monitor the affairs of their organization very closely.<sup>123</sup>

**B. Reporting requirements should include a document retention policy that will enable the responsible state agency to adequately supervise the organizations required to file reports.**

Every civic organization should be required to adopt a policy that will require the retention of financial and nonfinancial documents for reasonable periods of time.<sup>124</sup>

**C. All MBOs and small PBOs should be allowed to file simplified reports or none at all.**

### DISCUSSION

As discussed in Section 3.5, it is important that there be a public registry with basic information about every civic organization and that this information be kept up to date. Such a registry allows any individual, for-profit organization, or state agency to make sure that a particular civic organization exists and to learn other basic facts about it, such as its principal purposes.

Beyond this information, the state and the public generally have no legitimate interest in knowing about the activities and operations of an MBO. So long as an organization does not receive significant benefits or funding from the state or the public or engage in activities that substantially affect the public, its affairs should be entitled to as much privacy as those of an individual, whether the organization is large or small.

Even with respect to PBOs, there is no purpose in requiring reports if the organization has only minimal activities and assets (e.g., a start-up PBO with no assets or staff). The reason to exempt PBOs with limited activities and assets is to eliminate burdensome reporting requirements that might stifle them. As long as an organization is small, its ability to have an impact, good or bad, is limited. What constitutes a level of activities and assets too small to require report filing can best be answered in the particular context of each country.

**D. Reporting requirements should make appropriate provision to protect confidential or proprietary information.**

**DISCUSSION**

Countries' laws vary considerably in the extent to which they protect individual privacy. Such protection, however, is important to encourage full participation in the civic sector. The record keeping and reporting rules for civic organizations, like those for all legal entities, should conform to any applicable privacy laws (e.g., nondisclosure of employee medical records).

When an organization engages in public fundraising or otherwise receives substantial state or public support, the disclosure of certain kinds of otherwise private information about the expenditures of the organization may appropriately be required in order to prevent abuse. For example, in order to let the "marketplace" determine whether particular organizations are paying unreasonably high salaries to key officers, it might be appropriate to mandate that the salaries of the top five or ten most highly compensated individuals be disclosed.

**E. The responsible state agency should have the right to examine the books, records, and activities of a civic organization during ordinary business hours, with adequate advance notice.**

**DISCUSSION**

Notwithstanding the general rule stated in this Guideline, there should be protections in place to prevent the responsible state agency from using the pretext of an audit of a civic organization to gather information about one or more individuals. For example, there should be no circumvention of due process protections that are applicable in a criminal investigation or a civil enforcement action, such as the requirement of a search warrant.

**F. The responsible state agency should be able to use random or selective audits and examinations of the books and records of any civic organization subject to reporting requirements in order to ensure that the law is properly observed.**

## DISCUSSION

Audits that are not based on specific suspicion of wrongdoing should be truly random. It is wholly inappropriate, for example, to select organizations for audit based on political criteria. Most audits and examinations, however, should be for cause.

The gravest shortcomings of the state are evident in this particular regard. In many countries, inadequate resources have been allocated to enforcing the legal requirements imposed on civic organizations. Too often when problems arise, such as tax abuse by civic organizations, the temptation is to change the law, to make it stricter, on the theory that abuse will be eliminated. Usually, what is needed is not more or different laws, but rather better enforcement of the existing laws. In such cases, selective and random audits can be more successful than denying benefits to all organizations simply because the state failed to fulfill its supervisory function in an appropriate manner.

## SECTION 8.3 Reporting to and Audit by Tax Authorities

**A. Although reporting should be standardized as much as possible, it is appropriate for separate reports to be filed with the tax authorities. Different kinds of reports should be required for different kinds of taxes (e.g., income or profits taxes and the value-added tax or VAT).**

**B. It is generally inappropriate for the tax authorities to examine any aspects of a civic organization other than those directly related to taxation (including whether the requirements for exemption from taxation have been satisfied) or the use of monies received from the state or the public.**

**C. Civic organizations with small amounts of income should be exempt from filing tax reports or allowed to file simplified ones.**

## DISCUSSION

All civic organizations that have significant amounts of income should be required to file reports with tax authorities. Further, all civic organizations that receive significant tax preferences (e.g., exempt status, tax-benefited contributions) should be required to file reports so that the tax authorities can monitor the tax benefits received by the organization. Reports for VAT will show what transactions have occurred and which of those should be exempt from tax or beneficially rated.

With respect to tax auditors receiving information outside the purposes of their audit that indicates illegal activity, it is customary in any state for there to be interagency

information-sharing agreements. For example, if in conducting a tax audit of a civic organization the tax auditor discovers information that indicates a violation of employment laws, it should be appropriate for the tax authority to notify the ministry of labor of the possible violation. On the other hand, it would generally be improper for the tax authorities to examine aspects of a civic organization other than those directly related to taxation or to allow their authority to be used to pursue nontax investigations. It is never appropriate for the tax authorities to use a tax audit as a pretext to conduct a general appraisal of a civic organization or its activities.

## **SECTION 8.4 Reporting to and Audit by Licensing Authority**

**A. Any civic organization engaged in an activity subject to the licensing or regulatory control of a state organ should be required to file the same reports with that agency as any other similarly situated legal or natural person.**

**B. A licensing organ should have the right to audit and inspect a formal civic organization for compliance with applicable licensing or regulatory requirements just as it does other licensees, but should not generally examine or supervise other aspects of the organization.**

### **DISCUSSION**

As discussed in Section 6.5, civic organizations (like other legal or natural persons) may engage in certain activities for which a special license or permit may be required. For example, a license may be required to operate a medical clinic or a special permit may be required to hold a fundraising concert in a public park. Where such special licenses or permits are required, the licensing organ may require reports about the activity. The extent of the reporting will vary depending on the nature of the activity, its duration, and its impact on the public.

## **SECTION 8.5 Reporting to Donors**

**Donors to a formal civic organization are entitled to contract for disclosure of information adequate for the donor to assess the suitability of the civic organization for receipt of donations and the use(s) to which donations, or that particular donor's donations, are put.**

## DISCUSSION

The reporting requirements imposed by donors will be contractual obligations enforceable in court. Generally speaking, it is up to each donor to require whatever information it wants from a civic organization. As a matter of best practice, however, donors should impose conditions that will require civic organizations to be accountable to their beneficiaries, to maintain adequate financial records and statements, to avoid conflicts of interest, and to comply with other good management practices. By imposing appropriate contractual conditions, donors can play a significant role in assuring the health and proper operation of the civic sector. It would be desirable for donors, public and private, to meet and agree among themselves what the minimum reporting requirements and performance for grantees should be and to standardize them to the extent possible.

## SECTION 8.6 Disclosure or Availability of Information to the Public

**Any civic organization receiving more than minimal benefits from the state or engaging in a significant amount of public fundraising should be required to publish or make available to the public a report of its general finances and operations. This report may be less detailed than the reports filed with the responsible state agency, the tax authorities, or any licensing or regulatory agency and should permit anonymity for donors and recipients of benefits in addition to protecting other confidential or proprietary information.**

## DISCUSSION

The public has a legitimate interest in knowing about the activities and sources of funds of many civic organizations. Transparency to the public helps the civic sector to retain public trust. The specific rules adopted to implement this principle should not require large or needless expenditures by civic organizations to disseminate their public reports. Some legal systems allow an annual publication in a newspaper or journal generally used for publishing legal notices. Increasingly, publishing regular reports on the organization's homepage on the Internet constitutes a low-cost, highly effective method of making information available to the public.<sup>125</sup>

Under other systems, a copy of the report is filed with the responsible state agency, which places it in a public reading room, while the civic organization is required to provide a copy to any member of the public who requests it, charging no more than a reasonable reproduction charge.<sup>126</sup> Some legal regimes require that the minutes of the annual general meeting be filed with the supervisory organ, which then makes them available for inspection by the public. Any such requirements should be confined to organi-

zations receiving significant benefits from the state or the public. Moreover, such a requirement should not extend to the regular meetings of the governing board or other decision-making bodies, which should be allowed to conduct deliberations in private.

## SECTION 8.7 Special Sanctions

In addition to the general sanctions to which a civic organization is subject equally with other legal persons (e.g., in laws governing contracts and negligence), it is appropriate to have special sanctions (e.g., fines, penalty taxes, or the possibility of replacement of governing board members or involuntary termination) for violations peculiar to civic organizations (e.g., reporting violations, carrying on very substantial business activities, self-dealing, improper public fundraising practices, violations of expenditure limitations contained in tax legislation). Decisions to impose fines, taxes, or other sanctions, however, should be appealable to independent courts. A reasonable time period should be available for such appeals. Where necessary, the civic organization law should specifically reinforce the rights of notice and appeal.

### DISCUSSION

In any modern legal system where the principal method of supervision of civic organizations is performed by the state through the review of an organization's reports, many of the special sanctions for civic organizations relate to these reports. There should be fines for failure to file a report, filing a report late, or filing a false report. The penalties should be graduated, their imposition subject to appeal, and, in some instances, such as when criminal sanctions may apply, enforceable only through court order. If a civic organization fails to file the basic annual report for an extended period of time (e.g., two to three years), the responsible state agency should commence proceedings to terminate the organization with adequate provision for notice and administrative and judicial appeals. This sanction helps remove entities that are no longer functional from the register of civic organizations.

In addition, the fact that the governing board of an organization is given primary responsibility for supervising its activities means that there should be sanctions available to enforce the obligations of the board members. Sections 4.3, 4.4, and 4.5 discuss the duties of board members and their liability for failing to act with loyalty or diligence, or acting out of a conflict of interest, and so forth. In addition to these more modest sanctions, consideration should be given to permitting court-supervised termination of a civic organization if its governing board or assembly of members does not meet for several years. Alternatively, the law could permit court-supervised removal of members of the gov-

erning body if they misuse their offices or fail entirely to exercise any oversight over the organization.<sup>127</sup> Any step as drastic as the proposed termination of an organization or the removal of the governing body should not ordinarily occur without adequate notice and an opportunity to correct, and should not be final until appeal rights have been exhausted.<sup>128</sup> *See* Section 3.7.

Although the general criminal laws (e.g., against embezzlement) should apply to individuals involved with civic organizations just as with other legal persons, it is generally inappropriate to impose criminal penalties (e.g., imprisonment) for violation of the provisions of a law dealing with civic organizations.

As discussed in Section 4.4B, third parties should be allowed to sue a civic organization for harm done by it to them and should be allowed to sue officers and board members if by error or omission they caused or contributed to the harm. As discussed in Section 6.3, a civic organization could lose its status if its principal activities over a period of years were inconsistent with such status.



# 9

## Tax Preferences

Tax preferences are sometimes available to all formal civic organizations, but more frequently to only a smaller class of formal civic organizations.<sup>129</sup> The distinction between mutual benefit organizations (MBOs) and public benefit organizations (PBOs) is of particular importance in the area of taxation. In most legal systems, tax preferences are extended preferentially, or even exclusively, to certain types of PBOs. *See* the Appendix: Glossary of Terms for a discussion of the distinction.

Most tax laws focus on the activities, the purposes, or both of an organization in determining whether tax preferences should be available to the organization or its donors. For example, the tax laws of a particular country historically might have extended preferences only to a small group of organizations, those that are formed for the primary purpose of engaging in activities to support the advancement of education, health, science, culture, or for the relief of poverty. This list is quite limited, however, and over the years in most countries more preferred purposes and activities will have been added to the list, such as the protection of human rights, the interests of minority groups, or the environment. It is also common to find at the end of such a list a catchall category such as “or any other organization formed primarily for the benefit of the public.”<sup>130</sup>

Although it is clearly preferable to make decisions on the basis of principles, in the actual tax laws of any country, lists rather than principles predominate, and lists vary. In addition, the kinds of organizations that qualify for VAT preferences may be different from the kinds of organizations that qualify for income or profits tax preferences.<sup>131</sup> Further, the customs duty preferences may differ from the VAT preferences. This is the natural result of the *ad hoc* and incremental way in which tax and other legal rules develop. It is useful, though, to look at the entire collection of tax rules affecting civic organizations and determine whether a more consistent set of rules founded in principle could be created and applied.

The focus of the sections that follow is on special tax preferences that should or might be extended to formal civic organizations, or at least to PBOs. Virtually without exception, tax preferences are voluntary and are extended only to organizations that want and seek them. A special application must be filed in virtually every tax system in order to establish entitlement to one or more tax preferences.<sup>132</sup> Any organization that prefers to operate without the higher level of oversight and scrutiny that accompanies tax benefits should be allowed to choose not to subject itself to the process. Since tax laws, like other laws, can be used improperly to harass unpopular civic organizations, this option to avoid tax preferences is of fundamental importance.

Aside from the possible imposition of penalty taxes as a sanction for some kinds of special problems that occur in the civic sector (*see* Section 8.7), there should be no special taxes or higher tax rates imposed on civic organizations. The interests of society in having a strong civic sector would be undermined and frustrated by the imposition of special taxes or higher tax rates on civic organizations.

Finally, there is considerable value in stable and predictable tax laws. Although it is common for governments to change their tax laws in connection with their annual budgeting, it would be preferable for both civic organizations and their donors to have well-established tax preferences that remain constant for long periods of time.

## SECTION 9.1 Income or Profits Tax Exemption for Civic Organizations

**Every formal civic organization, whether organized for mutual benefit or for public benefit, and whether a membership or nonmembership organization, should be exempt from income taxation on money or other items of value received from donors or state agencies (by grant or contract) and regular membership dues, if any. A variety of approaches may be taken with respect to exemption of interest, dividends, or**

**capital gains earned on assets or the sale of assets, with full tax exemption on such items generally being made available to PBOs.**

#### **DISCUSSION**

Typical sources of revenue for civic organizations include donations, membership dues, fees under government contracts, and interest, dividends, and capital gains on investments. There is general agreement that the first three of these items should not be taxed, and interest and dividends are frequently not subject to tax.<sup>133</sup> There are two different ways of arriving at this result. One approach assures that civic organizations are not taxed on these ordinary receipts by defining them as not constituting “income” for tax purposes. The other approach recognizes these receipts as income but confers exempt status on civic organizations. In most income tax systems, gifts (donations) and membership dues are not regarded as “income,” while interest, dividends, and capital gains are. The fact that something is regarded as income, however, does not mean that it must be taxed. Hence, it is customary to exempt interest, dividends, and capital gains of PBOs, and many MBOs, from the income or profits tax.

Whichever approach is chosen, there are several questions that remain to be answered. Should those who make donations receive a tax benefit? Should the ordinary trade or business income of a civic organization be tax exempt? How should civic organizations be dealt with under other tax laws? These questions are dealt with in the following sections.

## **SECTION 9.2 Income or Profits Tax Preferences for Donations**

**To encourage philanthropy and good citizenship, individuals and business entities should be entitled to reasonably generous income or profits tax preferences with respect to donations made to PBOs.**

#### **DISCUSSION**

Under the rule recommended in the previous section, no formal civic organization would be taxed on donations it receives. This Guideline recommends that, in addition, the donor should be entitled to a tax credit or deduction against his or her personal or business income or profits tax. Alternatively, provision should be made for tax reclaim schemes (as in the UK)<sup>134</sup> or for tax designation schemes (as in Hungary, Slovakia, Lithuania, and Poland).<sup>135</sup> Such tax preferences are important and useful tools for encouraging NGO-business-government partnerships for social and economic development.<sup>136</sup> If tax preferences for donations are available, each donation receives a double tax benefit, once to the donor

and again to the recipient.<sup>137</sup> As a best practice, this generous tax treatment is justified when the activities of the civic organization in question are for the public benefit and the organization meets the requirements for being a PBO.

The distinction between deductions and credits is of great importance in a tax system with a progressive rate structure. A tax credit reduces the amount of tax owed, whereas a deduction only reduces the amount of income that is subject to tax. Where rates are progressive, deductions tend to favor higher income taxpayers, who are paying a higher rate of tax on income. Tax credits give each taxpayer the same tax benefit for a contribution of the same amount, and hence create greater equity as a matter of tax policy. Most countries with progressive rate structures, however, allow deductions rather than credits. This may be justified by data showing that lower income individuals tend to make donations to civic organizations without regard to their tax impact; and, indeed, other tax rules may preclude them from receiving any tax benefit at all from such a donation.<sup>138</sup> On the other hand, there is substantial empirical data showing that high-income taxpayers are quite sensitive to tax rates and that allowing a deduction rather than a credit tends to attract more and larger gifts from wealthy donors.<sup>139</sup>

Another question that must be dealt with in any scheme of taxation is the limit, if any, to put on the amount of tax benefit that can be achieved. For example, in Russia individuals can claim deductions only up to 1 percent of their income, and business entities are limited to 3 percent. In the United States, by contrast, individuals can claim up to 50 percent and businesses can claim up to 10 percent. In Australia, there is no limit at all. Generally speaking, the deduction limit for individuals should be higher than the limit for corporations, as individuals are often in a position to be more generous than a corporation, which owes its first allegiance to its shareholders. If deductions are limited to donations made to PBOs, i.e., organizations contributing to the public good and often relieving the burdens of the state, generous deduction limits are appropriate.

Another issue that arises with respect to donations is whether there should be a floor—in other words, that donations are given a tax preference only if they exceed a certain amount (e.g., 2 percent of income). Floors have been used in some countries to avoid the necessity of keeping track of small contributions.<sup>140</sup> It is also important to decide whether contributions in any year that exceed the limits imposed may be carried over to future years. In general, permitting carryovers is a good practice. The laws of many countries have not yet dealt with these issues.

## SECTION 9.3 Taxation of Economic Activities

Net profit or surplus earned by a civic organization from the active conduct of income-producing activities may be (a) exempted from income taxation; (b) subjected to income taxation; (c) subjected to income taxation only if the activity constitutes a trade or business that is not related to or is not in furtherance of the not-for-profit purposes of the organization; (d) subjected to income taxation under a mechanical test that allows a modest amount of profits (e.g., 10 percent of overall revenues) from economic activities to escape taxation while imposing taxation on all revenues from economic activities in excess of the limit; or (e) subjected to income taxation under a complex rule that combines some aspects of the preceding rules.

### DISCUSSION

The issues involved in selecting among these possible tax rules involve important, complex, and technical principles.<sup>141</sup>

Alternative (a) is a “*destination of income*” test. Under such a test, all income from economic activities would be exempt from tax as long as all of the profits earned from the income-producing activity were used or set aside to carry out the principal public benefit purposes for which the civic organization was formed.<sup>142</sup>

In a country with a developing market economy, it may be appropriate to strike the balance in favor of a “*destination of income*” test for all profits used or set aside by a civic organization to carry out its purpose-related activities. Countries in which the market economy is still young are generally also countries where civil society is just beginning to flourish. Civic organizations in such countries are often desperate for money simply to survive, and the profits from economic activities may make the difference between their continued existence and termination. In such countries, it is also possible to argue that there is such a strong need to develop economic activities independent of the state that all entities, whether civic organizations or business entities, ought to be encouraged to engage in them.

On the other hand, the problem of unfair competition can become a serious issue, particularly when the scale and number of economic activities by civic organizations begin to pose a threat to private enterprises. Obviously, if a large and wealthy civic organization can engage in a particular activity (e.g., book publishing) without paying taxes, it has an economic advantage over its for-profit competitors.<sup>143</sup> When this issue becomes significant for the fiscal policy of a country, the obvious solution is to tax such profits, at least if they are unrelated to the purposes of the organization.

One possible alternative, used in Poland until the mid-1990s, would permit a civic organization to be exempt from tax on all income, including profit from any economic activities (both purpose-related and regular business activities) as long as the income was spent for tax exempt purposes within the year of receipt or the next suc-

ceeding tax year.<sup>144</sup> Although this seems like a relatively minor modification of a “pure” destination of income test, it creates a need to trace money from the time it is earned until the time it is spent and deters civic organizations from building up financial reserves or endowments.

A rule like (c) in the Guideline, that taxes only “unrelated business income” and exempts the profits from “related” activities makes a great deal of theoretical sense.<sup>145</sup> Often the most effective way for a civic organization to achieve its purpose is to pursue it through economic means. For example, the most effective way to disseminate information about a particular kind of art or culture that a civic organization wants to promote may be to publish and sell a high-quality magazine devoted to that topic. If the “principal” purpose of the organization is to promote the particular kind of art or culture, if it is not primarily seeking to make a profit by operating in a commercial manner, and if no profits are distributed,<sup>146</sup> then publication and sale of the magazine may be viewed simply as the method that has been chosen to pursue the not-for-profit purpose of the organization. Exempting profits from activities related to the organization’s not-for-profit purpose makes good sense in theory.

Unfortunately, it is extremely difficult to distinguish “related” economic activities from “unrelated” economic activities, and hence the related/unrelated rule is very difficult to administer in practice. For example, if a museum sets up a shop on its premises to sell prints of the outstanding works of art in its collection, or perhaps books that picture them or postcards that replicate them, this can easily be argued to be “related” to the museum’s purpose. But what should happen if the museum opens a chain of retail stores that sell books related to art and culture, most of which have no connection with its collection? Is it engaging in an “unrelated” activity, or has it simply broadened its purpose and chosen to pursue the broader purpose using economic means?<sup>147</sup> The fact that a distinction between related and unrelated economic activities is very difficult to apply is demonstrated by the fact that little revenue is raised by a tax that is imposed only on “unrelated” activities.<sup>148</sup>

It should be clear in any tax system that to the extent that economic activities (e.g., publication of a magazine or of books) are simply a chosen means by which most effectively to pursue a given end (e.g., promotion of art or culture), they should not be counted as economic activities that would disqualify the entity for status as a civic organization. This is true even if they constitute the principal activity of the organization. Designing administrable rules for making the related/unrelated distinction that adequately respond to these considerations is not easy.

A “mechanical” test, (d) in the Guideline, for determining the difference between taxable economic activities and nontaxable economic activities creates a simpler system for taxing civic organizations. It might be possible, for example, to tax profits from all economic activities only if they exceed a certain figure or a percentage of all revenue. This

sort of remedy has been chosen by Hungary, where civic organizations are exempt on the net profits from all economic activities—whether related or unrelated—if the annual profit from such activities does not exceed the lesser of 10 million forints or 10 percent of total revenue.<sup>149</sup> Generally, the only consequence of exceeding the minimum in any year should be that taxes must be paid on actual profits in excess of the minimum, but in Hungary taxes are levied on all income from economic activities if the threshold is exceeded, whether the activities are related or not. This is presumably based on the theory that if the organization has a significant amount of economic activity income it is more like a business than a civic organization.

The “principal purpose” test is also a mechanical test in a certain sense. It takes a mechanical approach to determining eligibility for classification as a civic organization as opposed to treatment as a business entity. Thus, if more than 50 percent of the expenditures of a civic organization constitute non-purpose-related activities for a significant period of time (e.g., three years), the organization should be required to be reclassified as a business entity. From a tax standpoint, as long as any “related” economic activities are permitted for a civic organization, tax can properly be imposed on all unrelated economic activities. These may not be more than 50 percent or more of all activities (measured by revenue, not by time) and no profits may be distributed. With rules like these in place, civic organizations cannot be regarded as “tax dodges.”

Some countries require that business activities of civic organizations (or only of PBOs) be conducted in a subsidiary rather than directly by the organization itself.<sup>150</sup> There are advantages to this system, in that it can provide greater transparency with respect to the activities. On the other hand, it is administratively burdensome, and it costs more to set up a subsidiary to conduct business activities. The same transparency objective can be met by requiring that a civic organization maintain separate books and records for all of its economic activities. Further, if the subsidiary approach is used, there should be a rule permitting *de minimis* business activities to be conducted without the formation of a subsidiary.

## SECTION 9.4 VAT and Customs Duties

### A. PBOs should be given preferential treatment under a value-added tax (VAT).

#### DISCUSSION

Many activities of civic organizations are given preferential treatment under a VAT, although the precise activities vary from country to country.<sup>151</sup>

Design of VAT preferences is important. If a civic organization is excluded from a VAT system by not being defined as a “taxable person” or by being exempt, it pays VAT

on goods and services it buys from others, for the tax is built into the price it must pay (input VAT). However, since it is not in the VAT system, it cannot apply for a rebate of the input VAT when it sells its goods or services, and is treated like a final consumer.<sup>152</sup> Although exclusion from the VAT system is thus not desirable from a tax point of view, civic organizations may rationally prefer it in order to be relieved of compliance burdens.

A better situation for a civic organization that is willing to deal with the compliance burdens would be to elect to be included in the VAT system<sup>153</sup> and to be zero-rated with respect to the goods and services it provides, provided that they are related to its public purposes. This would mean that, although the organization would pay input VAT on the goods and services it bought, it would not have to collect output VAT because it would be zero-rated on its outputs.<sup>154</sup> It could then receive a rebate of or offset for the input VAT paid.<sup>155</sup> This would constitute a rather significant tax subsidy, and the approach is therefore not adopted in many countries.<sup>156</sup> The more general approach, and the only approach allowed in the European Union and countries seeking accession to it, is to reduce the potential revenue loss by allowing certain goods and services produced by public benefit organizations a favorable VAT rate, but not a zero rate. For example, if the general rate of the VAT is 20 percent, the special rate for listed goods and services might be 5–10 percent.<sup>157</sup>

**B. PBOs should be given preferential treatment under, or exemption from, customs duties and import VAT on imported goods or services that are used to further their public benefit purposes.**

**DISCUSSION**

Customs duties and import VAT are among the most contentious and difficult issues faced by civic organizations in practice, particularly those in developing and transition countries. Even if the law of a particular country provides for exemption for PBOs from both customs duties and VAT on imports, customs officials often disregard the law, and PBOs must spend a disproportionate amount of time dealing with senior officers to actually receive the benefit of the exemption.<sup>158</sup> At the same time, laws allowing customs and import VAT exemptions for PBOs tempt charlatans and crooks into the civic sector with the prime motive of using a fake civic organization<sup>159</sup> to receive exemptions on the import of certain goods.

If customs duties and import VAT are imposed on legitimate civic organizations, however, they can dramatically increase the costs of operations. This difficulty arises for both foreign and domestic civic organizations. It can be particularly severe for humanitarian relief organizations that typically must import all of their goods and services in order to meet emergency relief needs. It is a problem, though, for even the smallest organization, which might want to import a fax machine or a computer to make its work more productive.<sup>160</sup>

Some countries therefore provide customs duty and import VAT exemptions to PBOs.<sup>161</sup> Sometimes these exemptions are limited to civic organizations funded by foreign governments or multinational organizations, which generally insist on such exemptions for themselves and for their grantees. But if such exemptions are available, there must also be a fair but thorough process for assuring that only genuine PBOs qualify for the exemption. Countries have generally provided for a certification, licensing, or similar process to ensure that an organization's exemption will be honored at the border.<sup>162</sup>

To protect against the improper use of the exemption, it is also appropriate to provide that imports will be exempt only if they are going to be used by the PBO in its operations. To avoid abuses, if an item is sold by a PBO (e.g., a computer, a truck, or an automobile) within a short period (e.g., two to three years) after its import, it should be subject to customs duties and import VAT at the time of sale.

## SECTION 9.5 Other Taxes

### **A. Exemption from or preferential treatment under other tax laws should be considered for civic organizations.**

#### **DISCUSSION**

Many countries provide civic organizations with exemptions or preferential treatment for taxes such as real or personal property tax, sales tax, and estate or inheritance taxes. For example, in the United Kingdom, "charities" are entitled to an 80 percent reduction of the local property tax. Local authorities have the discretion to grant a further 20 percent relief.<sup>163</sup> "Noncharitable" civic organizations can receive partial or total exemption from property taxes, at the discretion of local authorities.<sup>164</sup> "Charities" in the United Kingdom are also exempt from paying *ad valorem* stamp duty on the transfer of assets, including shares,<sup>165</sup> and inheritance tax on legacies and bequests, and capital gains tax.<sup>166</sup> Similar exemptions for PBOs from local taxes apply in many countries in Central and Eastern Europe.

### **B. Civic organizations generally should not be exempted or given preferential treatment under generally applicable social security taxes (including levies for health and retirement funds).**

#### **DISCUSSION**

Arguments have been advanced that civic organization workers are paid less than workers in the for-profit sector, and that they should therefore be exempt from social security taxes or pay them at a reduced rate.<sup>167</sup> However, to exempt civic organization employees

from social security taxes while including them in the benefits of such systems (e.g., pension and health benefits) would create an appearance of unfairness and may cause resentment among workers in the for-profit sector. On the other hand, employees of civic organizations should not suffer the double disability of working for a lower wage and being excluded from basic employee benefit programs provided for other employees in the society.

It may nevertheless be appropriate to exempt from social security taxes expatriate staff members of civic organizations who temporarily reside in the country. For example, civic organizations funded by foreign governments often receive preferential treatment under treaty or special bilateral agreement.<sup>168</sup> As discussed in Section 10.1, some countries also provide this benefit to workers of other foreign organizations as a way to attract foreign assistance.

# 10

## Foreign Civic Organizations and Foreign Sources of Funds

### SECTION 10.1 Establishment and Supervision of Foreign Civic Organizations

A. A formal civic organization that is organized and operated under the laws of one country but that has, or intends to have, operations, programs, or assets in another country should generally be allowed to establish a branch office in that other country, and such branch office should enjoy all of the rights and be subject to all of the requirements of civic organizations in that other country.

B. A foreign civic organization should also be permitted, if it wants a separate legal entity, to create a subsidiary or affiliated organization under the generally applicable civic organization laws.

## DISCUSSION

The law should provide a level playing field for foreign and domestic organizations, permitting the former to participate actively in another country's civic activities. If it is going to have more than *de minimis* or transient activities in the country, it is appropriate to require a foreign organization to be established in some form as a condition of operating in another country. It is also appropriate to require the foreign organization to meet the same legal requirements—reports, taxes, etc.—that apply to domestic organizations.<sup>169</sup>

The foreign organization ordinarily should be allowed to establish a branch or representative office in a country.<sup>170</sup> Such an office is not a separate legal entity, but it does legitimize the activities of the foreign organization in the country without its having to create a separate legal entity. If the foreign entity operates through a branch, all of the assets of the entire organization stand behind any contract or obligation it may incur in the country of branch operations. If the foreign organization wants to insulate its assets or operations from the claims that may arise in the foreign country, it should be allowed to form an affiliate or a subsidiary—a separate legal entity formed for the purpose of carrying on activities and operations in the foreign country.

A fundamental requirement of establishment as a branch is to allow the organization to be sued in the country in which it is working and otherwise to be held accountable in that country for its activities there. For example, a branch would be required to designate a general representative and a principal office, where it would maintain books and records for possible inspection regarding its activities in that country. All civic organizations, but especially those that are foreign-based or foreign-controlled, should be required to have a general representative who is a citizen and resident of the country and upon whom legal notices can be served.

Certain technical problems can arise if branch establishment is allowed. If the establishment criteria of the country of origin are significantly different from the establishment criteria of the country in which the branch wants to operate, the responsible state agency may have to decide whether the differences are too great to allow the branch to be recognized as the equivalent of an association, foundation, company limited by guarantee, or other appropriate civic organization in the country where it will operate.

Two separate pressures come to bear on this principle of a level playing field. Very often foreign organizations want privileges not available to domestic organizations. For example, they may want to be exempt from the tax or labor laws of the country in which they want to work. Privileges of this sort are sometimes provided to them by treaty or special bilateral agreement. These privileges are often extended in order to attract foreign organizations that want to bring substantial sums of money or other benefits to the country. Decisions to extend special privileges to foreign organizations are sometimes made on a case-by-case basis and at the discretion of the state. Some private funders also

seek these special exemptions and privileges and refuse to operate in countries that do not extend them.

The pressure from the other direction stems from the fear of subversion and terrorism. Some countries fear that foreign civic organizations will be used to subvert the state, fund or train terrorists, or otherwise harm society. This fear is generally not well founded. The foreign organization, branch, affiliate, or subsidiary will be subject to the host country's domestic laws, just as a domestic organization is, and those laws should prevent and punish illegal activity of any kind.

## SECTION 10.2 Foreign Funding

**A formal civic organization that is properly established in one country generally should be allowed to receive cash or in-kind donations, transfers, or loans from sources outside the country so long as all generally applicable foreign exchange and customs laws are satisfied. Such laws should not impose confiscatory taxes or unfair rates of exchange.**

### DISCUSSION

Generally, the legal rules for foreign and domestic funding should be the same. Foreign funding represents a significant source of income for many civic organizations.<sup>171</sup> Foreign funders, like domestic funders, should be entitled to support any lawful civic organization activities. Requiring advance approval for every foreign grant, as is done by countries in some parts of the world, is a wasteful, dilatory, and excessively bureaucratic approach to an illusory problem.<sup>172</sup>

Problems with respect to foreign grants can arise because of banking or foreign exchange rules. In a country that does not have a fully convertible currency, states may extract a significant share of the value of a foreign grant by requiring that it be exchanged for local currency at an unrealistic rate of exchange or that a substantial tax or fee be paid to a state bank for processing the transfer. Such confiscatory practices both discourage foreign funding and provide an incentive for surreptitious cash transfers.<sup>173</sup>

Foreign funders are increasingly interested in providing funding to civic organizations in the form of loans or guarantees or other types of financial instruments. These forms of support are particularly useful in the economic development context, where donors seek to support lending by civic organizations to micro-enterprises and small businesses. *See* Section 6.4.



# 11

## Other Government Relations

### SECTION 11.1 QUANGOs and GONGOs

**A. There are many appropriate roles in society for quasi-nongovernmental organizations (QUANGOs) or government-organized or -controlled civic organizations (GONGOs) (e.g., museums, research institutes, special lending or credit programs). There is a serious possibility, however, that such entities might be given unfair competitive advantage or be used inappropriately to benefit state officials, directly or indirectly, either politically or monetarily, and oversight should ensure that these problems do not occur.**

#### **DISCUSSION**

In some countries, the civic organization law permits state bodies to found civic organizations.<sup>174</sup> These organizations typically have the same obligations and benefits as other civic organizations. In the civil law context, these organizations are “private law” entities. There is no consensus on what constitutes a QUANGO or a GONGO. Some feel that any organization formed by the state falls into this category even if it is a private law entity,

others think that any organization funded principally by the state qualifies; still others place the emphasis on state control of the organization, such as by controlling the appointment of the governing board. Regardless of which definition is used, these organizations are a fact of life in most countries.

In some countries, state bodies are also permitted to found an entity or institution through special provisions or a separate legislative act. In the civil law context, these organizations often fall into the category of “public law” entities, and examples might include the national museum or the national theater. These organizations are beyond the scope of the Guidelines, although many of the principles stated herein have validity for these sorts of organizations.

Among independent civic organizations in some countries, there is much hostility to QUANGOs and GONGOs—even if organized as private law entities—due to their historical role as tools of state policy. Stories abound about the use of them to evade legal requirements, to enrich government offices, to draw support away from nongovernmental civic initiatives, or to create the false appearance of a burgeoning civil society. Some feel that abuses are so pervasive that QUANGOs and GONGOs should not be permitted to exist.

The experiences in other countries have been more positive, suggesting that there is no need for an outright ban on QUANGOs and GONGOs, which are in fact often very useful entities. For example, the state may find that the public (through contributions) is more than willing to bear part of the cost of operating a museum or an opera house if it is transferred to a civic organization, where it has a governance structure separate from that of the state. It may be that the state continues to provide substantial funds or even controls the board, but members of the public may also be chosen for the board, and may be willing to make substantial contributions to the organization (particularly if tax deductions are available).<sup>175</sup>

There are other examples: It may be easier to operate a research institute staffed largely by researchers from various universities or from abroad if it remains outside the regular civil service system. Or, to establish a small business micro-enterprise fund, the state might set up a separate structure with an endowment in order to avoid annual budget uncertainties.

In all these situations, there is the danger of conflicts of interest, self-dealing, or other improper personal enrichment. For example, a minister of finance might appoint her son to run a micro-enterprise fund endowed by her ministry. A minister of culture might arrange to receive two salaries, one from the ministry and the other from a GONGO funded by the ministry. In order to prevent and punish such corruption and impropriety, it is important to establish clear rules with respect to these matters and to enforce them vigilantly.<sup>176</sup>

While QUANGOs and GONGOs may be appropriate vehicles for some activities, they may nonetheless constitute a threat to independent civic organizations if they absorb more than a modest share of state resources. In countries where resources traditionally have been concentrated in the hands of the state or in state-subsidized organizations, any resources the state makes available should be on a nondiscriminatory basis through fair and open competition among all qualified civic organizations.

**B. Certain special purpose QUANGOS or GONGOs can perform activities delegated to them by the state. These are generally self-regulatory, membership bodies with specific and limited functions.**

#### DISCUSSION

A special type of QUANGO or GONGO is a professional association to which state licensing powers have been delegated. In many countries, professionals, such as lawyers or engineers, are required to be members of such organizations, and the organization is given the responsibility to set professional standards and determine whether an individual should be permitted to practice the profession in that country. The association may also be given the authority to discipline or expel members for a breach of the rules and standards it has laid down. In general, this form of QUANGO or GONGO is considered legitimate even though membership is mandatory,<sup>177</sup> and such organizations, despite their special status, may be subject to many of the rules applicable to civic organizations and discussed in the Guidelines.

Another special type of organization has been set up in the Philippines, called the Philippine Council for NGO Certification (PCNC), which has reached an agreement with the Department of Finance under which it has been given the authority to certify and decertify civic organizations as being eligible to receive tax deductible donations.<sup>178</sup> Formed from six civic organization networks, the PCNC is an interesting experiment in self-regulation of the civic sector. *See* Section 12.2.

## SECTION 11.2 State Grants and Contracts

**Civic organizations should be entitled to participate in open, fair, and nondiscriminatory procurement processes carried out by state bodies for the acquisition of goods and services (whether through grants, contracts, or purchase orders).**

#### DISCUSSION

Procurement is not a problem peculiar to civic organizations. Good procurement laws are fundamental to the fair, effective, and noncorrupt operation of the state.<sup>179</sup> Generally speak-

ing, all formal civic organizations should be eligible to bid on state contracts on an equal footing with for-profit entities.

In some situations, it may be appropriate to limit eligible bidders to civic organizations or to the subclass of PBOs. Thus, it might be politically offensive for a commercial organization to be seen to make profits by caring for orphans, the elderly, or the disabled under a grant or contract from the state. In addition, in circumstances where it is difficult to define in advance what has to be done to achieve the particular outcome desired by the state (e.g., finding a cure for a prevalent illness), it again may be appropriate for the state to limit bidders to PBOs and use a grant mechanism rather than a contract.

In countries where providing general state support to civic organizations is considered appropriate (including general institutional support), some governments have set up funds that provide direct subsidies to civic organizations. One example is the newly enacted National CSO Fund in Hungary.<sup>180</sup>

## SECTION 11.3 Transfer of State Assets and Activities to Civic Organizations

**Under the principle of “subsidiarity,” governments delegate social and economic development responsibilities to the lowest competent level, which in many instances will be one or more civic organizations. When this occurs, the government should transfer appropriate funding and/or assets to the civic organizations to enable them to carry out such functions.**

### DISCUSSION

In many countries in Europe, the principle of subsidiarity<sup>181</sup> is being implemented by transferring social and economic development tasks and educational and cultural assets to civic organizations.<sup>182</sup> Although there is sometimes a good deal of controversy about this issue, it is a trend that seems to be increasing. In some countries in Central and Eastern Europe and the former Soviet Union, as well as in China, it has been thought necessary to create a new and special legal entity to receive assets that formerly belonged to the state. In Western Europe, on the other hand, regular civil law foundations have been used. It is generally better to avoid a proliferation of types of legal entities in the civic sector, if at all possible.

# 12

## Methods of Voluntary Regulation

### SECTION 12.1 Methods and Subjects of Voluntary Regulation

**Although basic, minimum standards of conduct and requirements for all formal civic organizations should be enacted as published laws, civic organizations should be permitted and encouraged to set higher standards of conduct and performance through voluntary self-regulation.**

#### **DISCUSSION**

In addition to the minimum internal governance structures and standards discussed in Sections 4.1 and 8.1, civic organizations should be encouraged to adopt appropriate internal standards for programs, organizational integrity, management practices, human resource policies, finances, communications, and fundraising.

Each civic organization should be permitted and encouraged to adopt an internal code of conduct. Although a code of conduct needs to be tailored to the peculiar circumstances of each organization, it is common for such codes to cover matters such as conflicts of interest, travel expense policies, standards for selection of board members, prohibitions on private inurement or self-dealing, and so forth. For example, a code of conduct should state that no officer or board member can participate in the discussion or decision of a matter directly affecting that individual (e.g., re-election to the board, remuneration, approval of a transaction involving that individual or a close family member).

A code might also require each officer or board member to disclose each institutional affiliation he or she has that might possibly involve a conflict of interest (e.g., sitting on the board of another civic organization with overlapping goals and missions). Or it might preclude any officer or director from receiving any compensation from the organization other than the reimbursement of reasonable expenses, without disclosure to and approval by the board (e.g., for legal or accounting services rendered to the organization). A code might require employees, officers, and directors to refuse all significant gifts connected with their positions, or to turn significant gifts over to the organization. A code might require that employees, officers, and directors use the least expensive appropriate form of transportation and stay only in moderately priced hotels.

Such a code can have great value in assuring that all individuals involved with the civic organization are sensitive to potential improprieties and excesses. Discussing, drafting, and adopting such a code will help the organization to define its values. New officers, directors, and employees should be given copies of the code when they join. Many organizations require annual certifications by employees, directors, and board members that they have reviewed the conflict of interest provisions and are in compliance.<sup>183</sup> Finally, the adoption and internal enforcement of a clear, strong code of conduct is a powerful statement to donors, beneficiaries, and other interested parties that the civic organization has high standards and takes meaningful steps to enforce them.

## SECTION 12.2 Umbrella Organizations

**A. The laws should permit, and society should encourage, the formation of umbrella organizations to adopt, promulgate, and enforce principles and standards of conduct and management.**

### DISCUSSION

As mentioned in Section 3.1J, other legal entities should be permitted to establish civic organizations. Thus, a group of civic organizations should be able to form an umbrella

organization to articulate, promulgate, and enforce standards such as those discussed in Section 12.1. For example, organizations operating in a particular field (e.g., social services for the elderly or environmental protection) might form an association of civic organizations that democratically adopts special standards for governance, disclosure, fundraising, and so forth, and requires member organizations to certify compliance. The umbrella group could be given power by its members to audit members or investigate complaints to assure compliance, and to expel members that fail to correct operations that are not in compliance. By publicizing its membership, expulsions, and standards, the umbrella organization could give added confidence to the public about the integrity and operations of member organizations. Membership in such an organization, or lack of it, might become an important criterion in selecting an organization to receive a contract or grant. Such an umbrella organization can be a less intrusive and more appropriate alternative to similar oversight by a state body.<sup>184</sup>

**B. The law should not require membership in any specific umbrella organization.**

**C. “Watchdog” organizations should be permitted to monitor and evaluate organizations in the civic sector.**

#### **DISCUSSION**

In some countries, special civic organizations have been formed or funded to monitor all civic organizations in the sector or in parts of the sector. These programs are not voluntary in the manner that membership in an umbrella organization is voluntary. Rather, these organizations are self-appointed “watchdogs” that apply criteria and values they deem appropriate. These standards are usually developed carefully after extensive consultation with civic leaders and experts. The evaluations prepared by these watchdog organizations can have a substantial impact in creating public awareness of the importance of standards for civic organizations and in publicizing the fact that certain civic organizations live up to those standards and others do not. Although not voluntary in the usual sense, these watchdog organizations provide yet another example of the sector seeking to regulate itself, rather than being regulated by the state.<sup>185</sup>



# Appendix

## Glossary of Terms

### 1. Affiliate

A separate legal entity that is linked to another through the common ownership by a third legal person, or one that shares a common name, directors, and/or adherence to a common set of standards with one or more other organizations.

### 2. Assembly of Members

The entire membership of a membership organization, which is convened from time to time to set policy for the organization, review its finances, etc.

### DISCUSSION

Many membership organizations do not have a governing board. The managers and officers running the organization report directly to and are supervised and controlled by the assembly of members, which meets periodically. At the same time, many membership organizations, especially larger ones, have a governing board elected by the assembly of members. This board sets policy and supervises the management of the organization, subject to policies and guidelines established by the assembly of members. Typically the assembly of members is an annual event, called the “annual general meeting” or “AGM.”

### **3. Audit Commission**

A small group of members of the governing board (e.g., one to three) that is given the responsibility of overseeing and investigating the activities and finances of an organization and who report at least annually to the governing board on whether the organization is in compliance with laws, its governing documents, resolutions, etc.

#### **DISCUSSION**

In some countries, the audit commission is called a “supervisory board.”

### **4. Branch**

A separate office of an organization, often in a foreign country, which does not constitute a separate legal entity.

### **5. Civic Organization**

“Civic organization,” as used in these Guidelines, refers to an association, society, foundation, charitable trust, not-for-profit organization, or other entity that is not regarded under the particular legal system as part of the state sector and that is not operated for profit (i.e., if any profits are earned, they are not and cannot be distributed as such). It does not include trade unions, political parties, cooperatives, or religious organizations devoted primarily to religious worship.

#### **DISCUSSION**

“Civic organization” is not a legal term. “NGO” or “nongovernmental organization,” the term used almost universally by the World Bank, the United Nations, and other national or multinational bodies when referring to nongovernmental, not-for-profit entities is widely, but not universally accepted. Other accepted terminology includes “CSO” (civil society organization), “NPO” (not-for-profit or non-profit organization), “PVO” (private voluntary organization).

In order to avoid misleading references, to unify terminology, and to emphasize their contribution to the creation of an open society, the term used in the Guidelines is “civic organization.” The Guidelines deal principally with civic organizations that have been established as formal legal persons, referred to as “normal” civic organizations.

As discussed here, civic organizations do not include religious organizations devoted primarily to religious worship, which are frequently, but not always, regulated under separate laws. Other religious organizations, such as schools and clubs, are properly considered civic organizations for the purpose of the Guidelines. Also excluded are trade unions, political parties, and cooperatives for the same reason.

In the civil law, the association is the basic form of membership organization, and the foundation is the principal form of nonmembership organization. Entities in common law systems include societies, associations, and not-for-profit companies, as well as charitable trusts.

### **6. Creation**

The formal acts required by law to start a civic organization, such as the holding of a founding meeting, the adoption of a formal set of governing documents, notarization of certain documents, etc.

## **7. Decision, Decree, or Order**

A binding rule issued by an executive organ, such as the council of ministers or a minister of a cabinet department, and published by the state.

## **8. Dissolution**

Ending the formal status of a civic organization as a legal person, either by voluntary act of the highest body of the civic organization or involuntarily by action of the state.

## **9. Donor**

A legal or natural person that makes a gratuitous transfer of money or property to a civic organization.

## **10. Endowment**

A sum of money owned and invested by a civic organization to enable it to carry out its purposes over time.

### **DISCUSSION**

Income from an endowment (e.g., dividends and interest) may be spent on the operations or programs of the civic organization, but the corpus of the endowment is usually maintained perpetually for the long-term support of the organization. Endowments are typical of grantmaking foundations. Civic organizations may instead have a financial reserve equal to the average expenses for 3-12 months, which is a best practice, if feasible.

## **11. Establishment**

The formal legal process by which a civic organization becomes a legal person.

### **DISCUSSION**

The term “establishment” is used here to refer to the process by which documents are filed according to prescribed procedures with a designated office or agency of the state or a court (in the Guidelines referred to as the “responsible state agency”). When the filing is accepted, the civic organization comes into existence as a legal person. “Registration” is a term used for this process in many civil law countries, while “incorporation” is a term used in common law countries.

## **12. Governing Board**

A body of elected or appointed individuals that has final authority over management, sets policies for a civic organization, and exercises regular oversight and supervision of its finances, operations, and activities.

### **DISCUSSION**

For the sake of simplicity, the term “governing board” is used in these Guidelines, instead of other possible terms (e.g., “board of directors,” “trustees,” “nonexecutive directors,” etc.), which tend to be used in common law systems. In some civil law countries, the governing body is called the “supervisory board,” and those who are responsible for managing the organization are referred to as a “management board.”

### 13. Governing Documents

The legally operative documents that define the rights, duties, and powers of an organization, set out its governance structure, and otherwise define the legal parameters within which it operates.

#### DISCUSSION

The use of the term “governing documents” in the Guidelines is intended to be neutral and to encompass all legally relevant terminology. Civil law systems typically use the terms “founding document,” “establishing act,” or “statute.” Common law systems typically refer to “articles of association,” “certificate of incorporation,” or “charter.”

### 14. Law

A general and binding legal rule enacted by the parliament or other competent legislative body and published by the state.<sup>186</sup>

### 15. Legal Person

A legal person (sometimes called a “juridical” or “juristic” person) is a corporate entity that is capable of enjoying and being subject to legal rights and responsibilities.

### 16. Liquidation

The process of disposing of the assets and satisfying the liabilities of a civic organization that has been dissolved.

### 17. Management or Management Board

A small group of individuals selected by the governing board who are responsible for the conduct of the day-to-day activities of a civic organization.

#### DISCUSSION

Members of the management are generally not permitted to be members of the governing board, except that the chief executive officer is frequently a member of the governing board *ex officio*.

### 18. Membership and Nonmembership Organizations

A membership organization is one in which the highest governing body consists of the members of the organization. A membership organization usually has a governing board or similar body the members of which are elected by, and are accountable to, the membership.

A nonmembership organization is one in which the highest governing body is a governing board or similar body.

#### DISCUSSION

There is a fundamental structural difference between a membership and a nonmembership organization. The governing board of a membership organization is generally subject to additional supervision or review, usually by the membership. A membership organization is arguably entitled to a lower level of scrutiny or supervision by the state because of that internal supervision. In reality, however, members often do not exercise adequate scrutiny over the affairs of an association.<sup>187</sup> Therefore,

the public does have an interest in the governance and operations of membership organizations formed for a public purpose.

Laws governing membership organizations stipulate the minimum number of individuals or organizations (e.g., three) that must come together to form a membership organization. Although most modern laws governing membership organizations allow such organizations to be formed by legal persons (e.g., other organizations), many existing laws do not. Under these latter laws, it is either difficult or impossible to establish a formal umbrella organization that can provide services to and speak on behalf of like-minded organizations.

Laws governing nonmembership organizations typically allow one or more individuals or organizations to form such an organization. Such laws also often allow nonmembership organizations to be created by will or other testamentary act. Virtually all endowed and grantmaking organizations are established as nonmembership organizations, many of which came into existence by testamentary act. Vacancies on the governing board may typically be filled by the remaining directors or through nomination by others (e.g., the founders or the governing board of an affiliated organization).

The question of whether the highest governing body of an organization should be the assembly of members or a self-perpetuating governing board is separate from the question of whether the principal purpose of the organization is to serve the mutual benefit of a defined group of individuals or a public purpose.

## **19. Mutual Benefit and Public Benefit**

**A mutual benefit organization (MBO) is an entity organized and operated primarily for the mutual benefit of a defined group of individuals. A public benefit organization (PBO) is an entity organized and operated primarily or exclusively for the benefit of the public or some segment thereof.**

### **DISCUSSION**

Many states seek to confer special benefits on “public benefit organizations,” a subset of civic organizations. Essentially, PBOs are organizations whose principal purposes and activities directly affect the public or a significant portion of it. Although it is generally beneficial to society that there are singing groups and sailing clubs, such organizations that principally engage in activities to benefit their members are ordinarily MBOs, not PBOs. In other words, the fact that mutual benefit organizations may be good for society does not make those organizations entities that serve the public good or affect the public interest in the sense meant here. The fact that the members of a PBO share a common interest in its activities does not make it an MBO. For example, an organization formed by doctors to provide medical care to people in Cambodia is a PBO even if the doctors all share a passionate interest in what the organization does.

A civic organization should not be classified as a PBO unless its activities are primarily or exclusively for public benefit. An MBO may, of course, conduct certain public benefit activities (e.g., the sailing club may conduct a safe sailing clinic), but that also does not make them PBOs.

While it is difficult to say exactly what constitutes “public benefit,” conceptually the term embraces activities serving the interest of the public as a whole or activities serving a targeted class of beneficiaries, where the class is disadvantaged relative to the population as a whole, or there is a

significant value to the community in providing special benefits to the targeted class.<sup>188</sup> Thus, a civic organization set up to care for disabled Romani children in Bucharest is a PBO even though the number of beneficiaries may be very small. The same is true of an organization helping to assist the nomadic peoples of Morocco or Mali or the indigenous inhabitants of the rainforest in Brazil.<sup>189</sup>

As a practical and legal matter, what constitutes “public benefit” is usually specified in legislation. Thus, the advancement of education, religion, art, science, the relief of poverty, and protection of human rights and the environment might be listed as public benefit purposes.<sup>190</sup> The fact that some other purpose, (e.g., historic preservation), may conceptually constitute a public benefit purpose does not make a civic organization dedicated to that purpose a “PBO” unless “historic preservation” is listed in the relevant law.

In addition to examining an organization’s purposes when determining its status as a PBO or an MBO, it is useful to inquire about its funding practices. An MBO can receive public support from donations and contributions by members of the public (e.g., a singing group that raises funds from the local community for a trip to appear at a song festival in another city or country), but the normal support for such an organization would come from membership dues and other revenues. A PBO, on the other hand, frequently derives a principal source of its support from private or government grants or public contributions.

## **20. Responsible State Agency**

**The state agency (ministry, court or agency of local government) with responsibility for the establishment and oversight of the activities and finances of formal civic organizations. May also be used to refer to an agency that grants PBO status and oversees PBO activities and finances.**

## **21. Rule, Regulation, or Instruction**

**Guidance issued by a government organ and published by the state, which may be accorded binding status by the legislature or the judiciary.**

## **DISCUSSION**

State officials are typically required to follow pertinent rules, regulations, or instructions, which may be binding with respect to the person to whom they are issued. However, rules, regulations, and instructions typically interpret and apply laws, decrees, decisions, and orders; in some legal systems, they may have the full force of law, in others not. In the adjudication of a litigated case, courts often defer to the interpretation of an organ that has issued a rule, regulation, or instruction. But courts will often disregard the interpretation if they regard it as outside the scope or meaning of the law in question. On some occasions legislatures will delegate to government organs the authority to create new and binding legal rules through the promulgation of regulations or instructions.

## **22. Sponsor**

**A legal or natural person that makes a transfer of money or property to a civic organization with the expectation that publicity of some form or other will be given to the gift.**

### **23. Subsidiary**

A legal entity partially or wholly owned or controlled by a separate legal entity.

### **24. Tax preference**

Advantageous treatment under one or more tax laws.

### **DISCUSSION**

Having exempt status under an income tax law is a tax preference. If donors to civic organizations receive deductions in computing their tax liabilities or credits against the taxes they would otherwise owe, these are also tax preferences. A civic organization that is exempt from taxes on real property or is zero-rated for purposes of the value-added tax (VAT) receives a tax preference.

### **25. Termination**

Sometimes used to refer to the act of ending the existence of an organization, but more frequently used when an organization's status as a PBO is ended, voluntarily or involuntarily.



# Endnotes

1. Among the reasons individuals or legal persons might want to establish a separate legal entity are: (1) to give the new organization the capacity to act in its own name (e.g., open its own bank account, rent its own space, hire its own employees), (2) to limit the liability of individuals involved with the organization to their individual acts or omissions that are in negligent or willful violation of their duties to the organization, (3) to provide for the perpetual existence of the organization, (4) to establish clear and legally enforceable rules for the internal governance of the organization, including election of officers and members of the governing board, (5) to become eligible for tax or other state benefits that are extended only to legally established entities, and (6) to be eligible to receive grants from private funders, many of which make grants only to legal entities.
2. Trade unions, political parties, and religious organizations devoted primarily to religious worship are important kinds of civic organizations, but they are typically regulated by laws that do not apply to other types of civic organizations. Nevertheless, many of the suggested rules in the Guidelines are also relevant to these forms of civic organizations.
3. Publications about many of the laws and commentary on them, as well as many of the laws themselves, are available from ICNL at <http://www.icnl.org>. For updates on legal developments about civic organization laws, consult the ICNL website, and the International Journal of Civil Society Law at: <http://law.cua.edu/students/orgs/ijcsl>. See also Alliance Magazine at <http://www.allavida.org/alliance> and the SEAL Bulletin at <http://www.efc.be/publications/sealabstract.html>.
4. See Appendix: Glossary of Terms.
5. In this sense all civic organizations benefit the public. The fact that it is desirable to let people come together to pursue their mutual interests, however, does not mean that all such organizations are PBOs.
6. For example, the Constitution of Namibia provides that all persons have the right to “freedom of association, which shall include freedom to form and join associations or unions, including trade unions and political parties.” Namib. Const. ch. 3, art. XXI, § 1. The Constitution of Georgia states that “Every individual has the right to create and join any association, including trade unions.” Georg. Const. ch. 2, art. XXVI. The constitutions of most countries of the world can be found at: <http://oncampus.richmond.edu/~jjones//confinder/const.htm>.
7. See, e.g., Civil Code of Switzerland, Schweizerisches Zivilgesetzbuch [ZGB], book I, tit. II, ch. 1, art. 52(2) (“Those associations and foundations that fall under Public Law, societies that have no industrial object and religious and family foundations are exempt from the necessity of registration.”) The obligation continues to exist, however, for any society that carries on a commercial project “for the better attainment of its object.” *Id.* at ch. 2, art. 61(2). See also Republic of Albania Assembly Law on Nonprofit Organizations, Law No. 8788, ch. 1, art.

- 3 (May 7, 2001) (“Everyone has the right to collective organization without needing to register this as a non-profit organization.”)
8. Entities with legal personality formed pursuant to a domestic civic organization law are “formal” civic organizations; other organizations, those without legal personality, are “informal” civic organizations. The Guidelines focus on the laws regulating formal civic organizations. Informal associations are protected by laws permitting individuals to exercise their fundamental rights of expression, association, and peaceful assembly.
9. See detailed discussion *infra* Section 2.1.
10. See Ashutosh Varshney, *Ethnic Conflict and Civic Life: Hindus and Muslims in India* 3-4 (2002). (“Studies of intercommunal violence in India demonstrate that civic organization engagement can promote peace, prevent communal violence and constrain the polarizing strategies of political elites.”)
11. See generally the discussion *infra* Section 11.3. See Karla Simon, *Privatization of Social and Cultural Services in Central and Eastern Europe: Comparative Experiences*, 13 B.U. Int’l L. J. 383 (1995).
12. Economists define a “public good” as one which does not cost more to create for the many than for the few and from the benefit of which the many cannot be excluded once it is built. The classic example is a lighthouse.
13. “Subsidiarity” is the doctrine according to which social or political functions should be performed by the lowest-level competent institution, the one that is furthest from the sovereign authority and closest to the people. The lowest level competent institution may be a civic organization. See Andrea Maltoni, *The Principle of Subsidiarity in Italy: Its Meaning as a “Horizontal” Principle and Its Recent Constitutional Recognition*, 4 Int’l J. Not-For-Profit L. 4 (July 2002), available at: [http://www.icnl.org/journal/vol4iss4/ar\\_maltoni.htm](http://www.icnl.org/journal/vol4iss4/ar_maltoni.htm).
14. See Robert Putnam, *Making Democracy Work: Civic Traditions in Modern Italy*, 154-157 (1993). (“[C]ivics helps to explain economics, rather than the reverse. . . . [C]ivics traditions turn out to be a uniformly powerful predictor of . . . socioeconomic development. . . . [C]ivics is actually a much better predictor of socioeconomic development than is development itself. . . .”)
15. Universal Declaration of Human Rights, U.N.G.A. Res. 217, arts. 19-20 (December 10, 1948).
16. The two other instruments mentioned in the text that have binding force on States Party, the African Charter and the American Convention, protect freedoms of expression, peaceful assembly, and association. African Charter on Human and Peoples’ Rights, 21 I.L.M. 59, arts. 9-11 (June 27, 1981) (entered into force October 21, 1986); American Convention on Human Rights, 9 I.L.M. 673, art. 13, 15-16 (November 22, 1969) (entered into force July 18, 1978). But in neither regional system has there been any development of the meaning of the right of association, as has occurred under the European Convention. The only case in the Inter-American Court of Human Rights dealing in any fashion with freedom of association concerns mandatory membership in an association of journalists, and the Advisory Opinion rendered in the case focuses primarily on the freedom of expression. See *Compulsory Membership in an Association Prescribed by Law for the Practice of Journalism* (arts. 13 and 19 of the American Convention), Adv. Op. OC-5/85, Inter-Am. Ct. H.R. 73 Ser. A/No. 5 (November 13, 1985 [hereinafter: Advisory Opinion]). Moreover, the African Charter provisions are much weaker on their face than those in the other instruments. For example, article 10 guarantees the right to freedom of association to an individual “provided that he abides by the law.”
- The Arab Charter on Human Rights also protects freedom of association, but not freedom of expression. It has not yet entered into force. Arab Charter on Human Rights (September 15, 1994), available at: <http://www1.umn.edu/humanrts/instreet/arabhrcharter.html##1>.
17. International Covenant on Civil and Political Rights, 999 U.N.T.S. 171 (December 16, 1966) (entered into force March 23, 1976 [hereinafter ICCPR]). As of July 7, 2003, 149 countries were Party to the ICCPR. An additional 8 have signed but not ratified. See <http://www.unhcr.ch/pdf/report.pdf>.
18. One of the important corollaries of the freedom of association is the freedom of nonassociation. Generally speaking, no one can be compelled to join or remain a member of an association. See Wino van Veen, *Negative Freedom of Association: Article 11 of the European Convention for the Protection of Human Rights and Fundamental Freedoms*, 3 Int’l J. Not-For-Profit L. 1 (October 2000), available at: [http://www.icnl.org/journal/vol3iss1/ar\\_wv1.htm](http://www.icnl.org/journal/vol3iss1/ar_wv1.htm); Emeka Iheme, *Freedom of Association in a Nigerian Community - Old Usages, New Rules*, 4 Int’l J. Not-For-Profit L. 2-3 (May 2002), available at: <http://www.icnl.org/journal/vol4iss23/ihemeprint.htm>.
19. ICCPR, *supra* note 17, art. 2.
20. Optional Protocol to the International Covenant on Civil and Political Rights, 999 U.N.T.S. 171 (December

16, 1966, entered into force March 23, 1976). As of July 7, 2003, 104 countries had ratified the Optional Protocol, and 5 countries had signed but not ratified it. See <http://www.unhchr.ch/pdf/report.pdf>.

21. Individuals who make a claim, and who have exhausted all available domestic remedies, are entitled to submit a written communication to the Committee. Communications that the Committee determines are admissible under the ICCPR are brought to the attention of the State Party alleged to be in violation. Within six months, that State must submit to the Committee written explanations or statements clarifying the matter and indicating the remedy, if any, that it has applied. *Id.* at arts. 2&4.

22. 213 U.N.T.S. 222 (November 4, 1950, entered into force September 3, 1953).

23. See <http://conventions.coe.int/treaty/EN/cadreprincipal.htm>. The European system has been called "the most effective human rights enforcement regime in the world." See Michael Ignatieff, *The Rights Stuff*, New York Review of Books 18-19 (June 13, 2002).

24. *Sidiropoulos and Others v. Greece*, 4 Eur. Ct. H.R. 500 (1998). The text of *Sidiropoulos, UCP, Özdep* and other decisions of the European Court of Human Rights discussed in the text can be found on the website of the Court: <http://www.echr.coe.int/eng/>.

25. *Id.* at ¶ 40.

26. *United Communist Party of Turkey and Others v. Turkey*, 4 Eur. Ct. H.R. 1 (1998).

27. *Freedom and Democracy Party (ÖZDEP) v. Turkey*, 31 Eur. Ct. H.R. 27 (1999).

28. *Id.* at ¶ 14.

29. See *United Communist Party*, *supra* note 26 at ¶ 33.

30. The constitutions of many countries guarantee the freedoms of expression, association, and peaceful assembly. Many constitutions also require that their provisions be interpreted in conformity with international human rights treaties or incorporate these treaties into domestic law. The legal systems of many countries also provide for the supremacy of international obligations in the event of a conflict with domestic law. Thus, although the domestic constitution or laws of a particular state may limit the exercise of the freedom of association to a "legitimate purpose" or some similar discretionary standard, these restrictive laws cannot be more restrictive than the limitations on the freedom of association allowed by the international instruments to which the state is a party.

31. See European Convention, *supra* note 22, art. 11 (2); ICCPR, *supra* note 17, art. 22 (2); American Convention, *supra* note 16, art. 16 (2).

32. See *Sidiropoulos*, *supra* note 24 ¶ 40; *United Communist Party*, *supra* note 26 ¶ 46.

33. *Refah Partisi (the Welfare Party) and Others v. Turkey*, Hudoc Reference REF00004090 (February 13, 2003).

34. See, e.g., Petra Bard, Report on the Conference on the Turkish Welfare Party Case, 1 Int'l J. Civil Society Law 207 (July 2003), available at: <http://www.law.cua.edu/students/orgs/ijcsl>.

35. Declaration on the Right and Responsibility of Individuals, Groups and Organs of Society to Promote and Protect Universally Recognized Human Rights and Fundamental Freedoms, G.A. Res. 217A(III), U.N. GAOR, 53rd Sess., Supp. no. 3, at 3, U.N. Doc. A/53/144 (1999).

36. *Id.* at art. 1. Although such General Assembly resolutions do not have binding force, they "sometimes provide important evidence of [international] law." Restatement (Third) of Foreign Relations Law § 103, n. 2 (1986).

37. See ICCPR, *supra* note 17, arts. 2 & 3.

38. *Id.* at art. 22(2).

39. Article 14 of the European Convention, *supra* note 22, and article 2(1) of the ICCPR, *supra* note 17, prohibit discrimination on any invidious ground, including "political or other opinion."

40. The United Nations Human Rights Committee has confirmed that aliens have the same rights to expression and association as citizens within the territory of a Party. See United Nations Human Rights Committee, General Comment 15, The Position of Aliens under the Covenant (27th Sess. 1986), U.N. Doc. HRI\GEN\1\Rev.1 at 18 (1994).

41. The connection between formal civic organizations and other kinds of legal persons can be made clear by the structure of a law. In the Philippines, a section on “Non-Stock Corporations” was simply added to the existing Corporation Code. Corporation Code of Philippines, tit. XI, ch. 1 (1996). In many common law jurisdictions, the rules applicable to all corporations are found in the Corporate Law, with “Companies Limited by Guarantee” governed by special sections with separate provisions. *See, e.g.*, Companies Act of the Republic of South Africa, no. 61, ch. 3, § 21 (1)(e) (1973); India Companies Act of 1956, pt. II, § 25.
42. *See, e.g.*, Madagascar Law No. 27/96, ch. 4, art. 18 (1996). (“Any NGO employee, representative or paid agent performing a remunerated work in Madagascar shall pay income taxes, unless there is a special fiscal covenant.”)
43. It is possible that special accounting rules will exist for formal civic organizations (to account properly for grants, for example). For further discussion, *see infra* note 121.
44. For example, Israeli law provides: “Should the Registrar refuse to establish an Amuta [civic organization] the founders may appeal before the District Court within thirty days of receiving notice of the refusal.” The same article provides that an amuta can appeal a demand by the registrar that the amuta change its name. State of Israel, Law of Amutot 5740-1980, ch. A, art. 6.
45. The opposite is true in, e.g., Switzerland. C. Civ., tit. II, ch. 2, art. 60(1). (“Associations which have a political, religious, scientific, artistic, charitable, social, or any other than an industrial object, acquire the status of a person as soon as they show by their constitution their intention to have a corporate existence.”) Mongolia is similar: “An NGO shall be considered established after the founders have issued a decision to establish the NGO and have approved the NGO’s by-laws.” Such an organization cannot exercise its rights as a legal entity, however, until it has completed the establishment process. The Law of the State of Mongolia on Non-Governmental Organizations, ch. 1, art. 6 (January 31, 1997 [hereinafter: Mongolian NGO Law]). Under these laws a civic organization is established when a group of individuals completes required acts, such as the adoption of a constitution, without any involvement of the state.
46. *See, e.g.*, the Law of the Kyrgyz Republic on Non-Commercial Organizations, ch. 2, art. 18 (October 1, 1999). (“Founders of a public association shall convene a constituent meeting and adopt a decision on establishing a public association, approving its Charter, and forming governing and audit bodies.”)
47. *See, e.g.*, Kenya Societies Act, part IV, § 17 (1998).
48. The system in Mongolia may serve as an example. After a completed application is filed, the establishing authority has 30 days within which to establish the civic organization or to refuse establishment. Refusal must be on one of two grounds: The purpose of the organization violates the Mongolian law or another organization with the same name is already established. If neither of these conditions is met, the authority must establish the organization. Mongolian NGO Law, art. 16(2).
49. However, in some countries, certain organizational forms must by definition serve the public interest. For example, in almost all countries of Western Europe, the foundation form may only be used for public benefit purposes. *See* European Foundation Centre, Working with Foundations in Europe: Why and How? 1 (2001), available at: <http://www.efc.be>. The same is true of foundations in Poland, *see* art. 1 of the Law on Foundations (1984), and Vietnam, *see* Civil Code of Vietnam, ch. 3, art. 115 (1995).
50. The laws of some countries contain provisions that certain government agents will publish forms for the use of both civic organizations and the government. *See, e.g.*, Co-operative Societies Act of Tanzania, No. 6, pt. X, § 57 (July 4, 1995). The forms discussed in § 57 were published by the minister of state on October 9, 1995. Another example is the Kenya Non-Governmental Organizations Co-Ordination Regulations (no. 19 of 1990), pt. III, § 9 and the regulations published by the minister of state in 1992.
51. The law of the Republic of Yemen provides that applications should be submitted to the Ministry of Pensions and Social Affairs, either the centralized ministry or a branch office. Article 9 of the law gives the ministry one month to process an application. “[I]f this period terminates and the processing has not been completed, then the application shall be deemed to have been accepted by force of law and the Ministry or its relevant office . . . should undertake that registration in the register set up for this and . . . publicize this in any official newspaper.” The Law of Associations and Foundations of the Republic of Yemen, ch. 2, sec. ii, art. 9 (2001).
52. *Id.* at art. 10 (“In the event that the application is refused pursuant to this Law [the Ministry] should notify the founders of the decision to reject the application in writing, giving the reason thereof, and should post this in its bulletin board of the Ministry or the relevant office within ten days of the date of decision.”) Article 11 creates a 60-day appeal period from the day that the applicants are notified of the rejection.

53. In the United States, which has more successful foundations than any other country, there is generally no requirement for a minimum amount of capital to establish a foundation. David Freeman, *The Handbook on Private Foundations*, 1-9 (1991). This is also true in countries seeking to develop a more vibrant foundation community. For example, neither Albania nor Slovenia requires a minimum for foundations. The United States does, however, require that a minimum percentage (5 percent) of a foundation endowment be spent every year on programs and operations. *See* 26 U.S.C. §4942 (2000). Without such a rule, a foundation could become a vehicle for investing money indefinitely without paying taxes and without fulfilling its charitable purposes.
54. In Mongolia, a public benefit organization is defined as an organization that “operates for the public benefit in the fields of culture, art, education, science, health, sport, nature and environment, community development, human rights, protection of the interests of specific subsets of the population, charity *and other such fields*.” Mongolian NGO Law, *supra* note 48, art. 4(2) (emphasis added).
55. In Kyrgyzstan, nonmember foundations and legal entities can be established by individuals or legal persons. *See* Law of the Kyrgyz Republic on Non-Commercial Organizations, ch. 3-4, arts. 23 & 31 (1999). The Republic of Montenegro Law on Non-Governmental Organizations states: “A non-governmental organization is a not-for-profit membership organization which can be established by domestic and foreign natural or legal persons. . . .” pt. I, art. 2 (July 29, 1999).
56. *See supra* note 40 and accompanying text. The European Parliament issued a resolution requesting that “all discriminatory measures based on nationality that affect the right to belong to, form or administer an association be rapidly abolished throughout the Community, in respect of citizens of Member States.” Eur. Parl. Doc. A2 196/86 (March 13, 1987). The European Court of Justice ruled against Belgium’s nationality restrictions for participation in civic organizations. *Case C-172/98, Kingdom of Belgium v. Commission* (June 29, 1999) available at: <http://www.curia.eu.int>. On June 30, 2000, the existing legislation was amended to remove the requirements. *See* Bart Servaes, *Belgian NonProfit Associations and Belgian International Associations Lose Belgian Nationality and Residency Requirements For Their Members and Directors*, 3 *Int’l. J. Not-For-Profit L.* 2 (December 2000), available at: [http://www.icnl.org/journal/vol3iss2/cr\\_weurope.htm#belgium](http://www.icnl.org/journal/vol3iss2/cr_weurope.htm#belgium).
57. Croatian law provides that minors can be “nonactive” or “nominal” members of associations. *See* Law Relating to Associations of the Republic of Croatia, I, art. 3 (July 7, 1997). Other countries, like Estonia, have eliminated references to the age of founders and members, addressing this through the Civil Code and other provisions dealing with the authority of minors to act directly or through their legal representatives (e.g., parents or guardians). C. Civ. of the Republic of Estonia, ch. 2, §11(1) (June 28, 1994). Query whether restrictions on membership of minors violate the Convention on the Rights of the Child, art. 15, which guarantees the freedom of association to children. *See* Convention on the Rights of the Child, 28 I.L.M. 1448 (Nov. 29, 1989) (entered into force September 2, 1990).
58. The law in Trinidad and Tobago provides that a person who enters into a contract in the name of an as-yet-unestablished company is personally bound by the contract unless, after establishment, the company signifies its intention to be bound by the contract. If the company does not do so, the individual can seek to share liability with the company. The Law of the Republic of Trinidad and Tobago, Companies Act No. 35 of 1995, pt. III, div. 1, § 20. Estonian law provides that people acting on behalf of an association in the process of establishment are liable for the actions on behalf of the organization. When the organization is established, the obligations automatically transfer to the organization “if the persons who entered into the transaction had the right to enter into the transaction in the name of the association.” If the person did not have that right, then the obligations only transfer from the individual to the organization if all the members agree. The law does not specify what constitutes “having the right” to enter into a transaction on behalf of an organization. The Non-Profit Association Acts of the Republic of Estonia, ch. 1, § 11(2-3) (June 6, 1996, amended June 5, 2002).
59. Such testamentary acts should conform to the local legal requirements for making wills effective as well as the requirements for establishing civic organizations.
60. In California, the decision of whether an organization is formed as an MBO or a PBO is made by self-selection, at the time of establishment. California Corporations Code, Tit. I, Pt. II, ch. 2 (1), § 5310. Note that an association of PBOs may itself be a MBO, such as when it provides member benefits or advocates policies of immediate benefit to members.
61. *See* Advisory Opinion, *supra* note 16. This case concerned a legal requirement in Costa Rica that journalists be members of an association that had restrictive educational qualifications. While determining that such a legal requirement is incompatible with the freedom of expression guaranteed by article 13 of the American Convention, the Court noted that mandatory membership in licensing bodies for law and medicine could be considered differently. *Id.* at ¶ 73. *See also* *Case Of Chassagnou and Others v. France* ¶ 117 (E.C.H.R. April 29, 1999) (compulsory membership in a hunting association held to be a violation of article 11); *Le Compte, Van*

*Leuven and De Meyere v. Belgium*, App. no. 6878/75 & 7238/75 (E.C.H.R. June 23, 1981) ¶ 65 (Licensing association for medical practitioners carrying out government functions was not an “association” within the meaning of article 11 of the European Convention. Since petitioners were not prevented from joining voluntary private associations formed to protect the professional interests of medical practitioners, there was no violation in requiring membership in the licensing association.)

62. In Japan, special types of legal persons (e.g., “Public Interest Legal Persons” such as associations and foundations, social welfare corporations, educational corporations, religious corporations, and medical corporations) are all permitted to be established under different laws and by different ministries. The creation of the new “special nonprofit activities legal person” created in 1998 simply added another category and another responsible state agency (the Economic Planning Agency) to this already complex system. Thus, choice of form is a very important issue in Japan. See Robert Pekkanen & Karla Simon, “The Legal Framework for Voluntary and Non-Profit Sector in Japan,” in *The Voluntary and Non-Profit Sector in Japan* (Stephen Osborne, ed.) (2003).

63. Greece is one example. See the Greek Civil Code, C. Civ., ch. 4, § 79, § 81. Albania is another. See Law on the Registration of Non-profit Organizations, no. 8789, ch. 2, art. 5 (May 7, 2001).

64. Some countries use the ministry of justice. See e.g., Law of Mongolia on Non-Governmental Organizations, ch. 3, art. 15 (January 31, 1997); Decree of the Minister of Justice of the Russian Federation: Rules Governing Application by Social Organizations for Government Registration to the Ministry of Justice of the Russian Federation (no. 19-01-122-97, October 6, 1997). In South Africa, Egypt, and Pakistan, the ministry of social welfare or its equivalent is the place where civic organizations are established. See Nonprofit Organisations Act of the Republic of South Africa, ch. 3, § 11 (1997); Law on Private Associations and Establishments Law No. 84 of 2002 of Egypt, ch. 1, art. 3; Registration as a Non-Profit Company under Section 42 of the Companies Ordinance Act 1984 of Pakistan, § 4.3.1.

65. The Regulations on the Registration of Social Organizations of the Peoples’ Republic of China state that the registration may occur at the national level or at local branches of the Ministry of Civil Affairs. See Hong Qi, *The Current Legal Framework for Voluntary and Not-for-Profit Activity in China: A 2003 Update*, 1 Int’l J. Civil Society Law 93, 97 (July 2003), available at: <http://www.law.cua.edu/students/orgs/ijcsl>.

66. The Charity Commission in Moldova has nine members, with at least three members who represent the public sector and who are not employed by the state. Commission members have a five-year term, which permits a degree of professionalization that comes with time. Law of the Republic of Moldova on Public Associations, No. 837-XIII, ch. 5, art. 34-37 (May 17, 1996).

67. See Charity Scotland: The Report of Scottish Charity Law Review Commission, ch. 3 (May 2001), available at: <http://www.scotland.gov.uk/justice/charitylaw/csmr/csmr-00.htm>; Commonwealth of Australia: Definition of Charities and Related Organisations, ch. 32 (2000), available at: <http://www.cdi.gov.au/html/report.htm>. Similar to these commissions is the “NGO Council” established in Kenya. See generally Edward Yaansah, *An Experiment in NGO Self-Regulation in Kenya*, 1 Int’l J. Not-For-Profit L.1 (September 1998), available at: <http://www.icnl.org/journal/voli1ss1/frames.html>.

68. Moreover, legislation should guarantee that civic organizations can alter governing documents without re-establishment in those situations in which laws are passed creating new technical requirements for establishment, such as supplying the addresses of board members. In some countries, such as Belarus, technical changes to the law have served as an excuse to require reregistration of all civic organizations in a barely disguised effort to assert political control over them. See United States Department of State, Country Reports on Human Rights Practices 2001: Belarus, available at: <http://www.state.gov/g/drl/rls/hrrpt/2001/eur/8226.htm>.

69. This is exactly what happened with the March of Dimes in the United States. See generally <http://www.marchofdimes.com>.

70. E.g., the common law doctrine of cy pres. For a discussion of this in one common law country, see Kerry O’Halloran, *Charity Law*, ch. 16 (2000). In England and Wales the Charity Commission has cy pres approval authority.

71. Internal dissent can produce other sorts of deadlocks appropriate for judicial intervention. The Greek Civil Code provides that, in the absence of another provision in the articles of association, the governing body of an association must call a meeting when one-fifth of the members so request. “If such request is not complied with, the President of the Court of First Instance may authorize the applicants to convene the meeting and may also regulate matters pertaining to the chairmanship of such meeting.” C. Civ., ch. 4, § 96.

72. South Africa has placed its registry on the Internet, at <http://www.socdev.gov.za/NPO>. The online registry lists each civic organization's name and address, the registration number, the date registered, and any date that the organization was deregistered, wound up, or dissolved. The online registry fulfills the legal obligation of the director of nonprofit organizations to publish annually the registry and the names of all organizations removed from the registry in the previous year "in the Gazette and at least one other widely circulated means of communication." See Nonprofit Organizations Act, no. 71, vol. 340, no. 18487, ch. 2, § 24(7) (December 3, 1997). The Czech Republic and a number of other countries in Central and Eastern Europe have also placed their registries on the Internet. For the Czech Republic, see [http://www.justice.cz/cgi-bin/sqw1250.cgi/or/L\\_hled.sqw](http://www.justice.cz/cgi-bin/sqw1250.cgi/or/L_hled.sqw).
73. Macedonian law provides for such a system. "[C]itizen associations and foundations are entered into the Register that is maintained by the primary court on whose territory they have their seat." The Law on Citizen Associations and Foundations of the Republic of Macedonia, IV, art. 43 (June 25, 1998). Moreover, the Primary Court Skopje maintains a master register for the country. *Id.* at art. 51.
74. The law in Palestine provides: "Two or more Associations or Organizations may merge or unite together, without prejudice to the rights of other parties towards each of these Associations or Organizations before the merger." The Law of Charitable Associations and Community Organizations, ch. 6, art. 26 (1) (2000).
75. See Revised Model Nonprofit Corporation Act, ch. 14, § 1 4.03 (American Bar Association, 1988).
76. For example, the law of the Republic of Yemen requires that the government, prior to suing for dissolution, issue "the association or foundation three notices within six months to remedy the violation." The Law on Associations and Foundations of the Republic of Yemen, Law No. (1) for the Year 2001, ch. 4, § 1, art. 44 (2).
77. Although the principles described in the text should apply without exception to civic organizations that have received state funds, public donations, or significant tax benefits, when none of these circumstances applies, distribution to members may be permissible.
78. See, e.g., Law of the Republic of Indonesia, No. 16 of 2001, Concerning Foundations, ch. 2, art. 17 (2001).
79. Members, officers, and members of the governing board, who need to be aware of these legal limitations, have a fiduciary duty to review the governing documents but not to become experts in the law.
80. The minimum number of directors necessary for establishment should be kept very small in order not to make it difficult to form a new civic organization, but it might be appropriate to provide that any civic organization that reaches a certain size must have a larger board.
81. In an unusual decision, the Constitutional Court of Croatia ruled that freedom of association also encompasses the freedom of founders to regulate the association's internal governance. The Court held invalid § 11.3 of the Croatia Law of Associations, which prescribed a number of issues to be addressed in an organization's bylaws, saying that these issues should be left to the discretion of founders or addressed in other acts. Decisions of the Constitutional Court of Croatia on February 3, 2000, Official Gazette No. 20 (February 16, 2000). See Dragan Golubovic, *Croatian Constitutional Court Strikes Down a Number of Provisions in the Law on Associations*, 2 Int'l J. Not-for-Profit L. 3 (March 2000), available at: [http://www.icnl.org/journal/vol2iss3/cn\\_croatia1.htm](http://www.icnl.org/journal/vol2iss3/cn_croatia1.htm).
82. This is known, even in the not-for-profit sector, as the "business judgment rule." This rule protects directors from liability for decisions made reasonably and in good faith in the course of conducting operations, even if those decisions turned out to be disadvantageous to the organization. Australian law provides that the director or officer will be found to have met his duty so long as he (1) makes the judgment in good faith for a proper purpose, (2) does not have a material personal interest in the subject matter of the judgment, (3) informs himself about the subject matter of the judgment to the extent he reasonably believes to be appropriate, and (4) rationally believes that the judgment is in the best interests of the corporation. The law further provides that this fourth "rational belief" element will be found to be satisfied "unless the belief is one that no reasonable person in [his] position would hold." Commonwealth of Australia, Corporate Law Economic Reform Program Act of 1999, sch. 1, ch. 2D, § 180(2).
83. For a general discussion of the legal rules applicable to governing board members, see Thomas Silk, *Corporate Scandals and Governance of NGOs in America*, 1 Int'l J. of Civ. Soc. L. 19 (July 2003), available at: <http://law.cua.edu/students/orgs/ijcsl>.

84. An extreme example of trustees gone awry—one in which the state attorney general intervened and asked a probate court to appoint new trustees—is found in the case of *Kona Enters v. Estate of Bishop*, 51 F. Supp. 2d 1048 (D. Haw. 1998), aff'd, 179 F. 3d 767 (9th Cir. 1999). See also Randall Roth, *Overview of the Bishop Estate Controversy*, 1 Int'l J. of Not-For-Profit L. 2 (December 1998), available at: <http://www.icnl.org/journal/vol1iss2/index.html>.

85. For example, Albanian law states “a conflict of interest between a non-profit organization and a member of the decision-making or executive organ or its employees is not permitted.” Law on Non-Profit Organizations of the Republic of Albania, Law No. 8788, ch. 5, art. 26 (May 7, 2001). The organization is allowed to go to court to seek indemnification for damages arising out of the conflict. *Id.* at art. 27.

86. See *Stern v. Lucy Webb Hayes National Training School for Deaconesses and Missionaries*, 381 F. Supp. 1003 (D. D.C. 1974) for an example of flagrant violations of this principle. This case is a leading case on the general issue of the duties and liabilities of charitable fiduciaries in the United States.

87. Paid employees have an interest in their compensation, while directors of an organization have a duty to act in the interest of the organization. Because of the potential for conflict, it may be appropriate to forbid employees paid by an organization from serving on the board of the organization. Alternatively, employees who do serve on the board (such as the chief executive officer) may be required to be nonvoting members of the board and to recuse themselves from decision-making with regard to their own compensation.

88. For example, compensation is often paid to board members of a large grantmaking foundation who have to attend monthly meetings and do extensive preparation and review.

89. Without trying to set salaries, the U.S. Congress has enacted a law imposing financial penalties for “excess benefit” transactions, including the payment of unusually high salaries to employees of civic organizations. See 26 U.S.C. § 4958 (2000).

90. In the United States, the Internal Revenue Code provides for special taxes when a transaction between an individual characterized as “disqualified” and a not-for-profit organization produces a windfall for the individual. *Id.* These windfalls are known as “excess benefit transactions,” and the tax liability extends to the individual and to any managers of the organization who were knowingly involved in the transaction.

91. For example, the U.S. Internal Revenue Code, 26 U.S.C. § 4941 (2000), prohibits any “private foundation” from engaging in any of an enumerated list of acts of “self-dealing” between the organization and a “disqualified person,” which includes officers, board members, substantial donors, etc.

For purposes of this section, the term “self-dealing” means any direct or indirect

- sale or exchange, or leasing, of property between a private foundation and a disqualified person;
- lending of money or other extension of credit between a private foundation and a disqualified person;
- furnishing of goods, services, or facilities between a private foundation and a disqualified person;
- payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person;
- transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation; and
- agreement by a private foundation to make any payment of money or other property to a government official (as defined in section 4946(c)), other than an agreement to employ such individual for any period after the termination of his government service if such individual is terminating his government service within a 90-day period.

The provisions are enforced by a two-tier excise tax.

In another example, Article 20(6)(c) of the Polish Law on “Public Benefit Activity and Volunteerism” of 2003 places a flat limit on the remuneration that may be received by an employee or officer of a “public benefit organization” of two times the average national salary. Many Polish civic organizations will choose not to seek public benefit status because of this unrealistically low limit.

92. Under Japanese law, the articles of association of the civic organization must specify the means for dissolving it. Any remaining assets are to be assigned to another civic organization specified in the articles of incorporation. If there is no such provision in the articles, the liquidator may, upon approval from the relevant government agency overseeing the organization, transfer them to another civic organization or the national

government. Law to Promote Specified Nonprofit Activities, ch. 2, art. 32 (March 25, 1998) [hereinafter: Japanese NPO Law], available at: [http://www.jcie.or.jp/civilnet/civil\\_soc\\_monitor/npo\\_law.html#chap2](http://www.jcie.or.jp/civilnet/civil_soc_monitor/npo_law.html#chap2).

Nigerian law states: "If in the event of a winding-up or dissolution of the corporate body there remains after the satisfaction of all its debts and liabilities, any property whatsoever, the same shall not be paid to or distributed among the members of the association, but shall be given or transferred to some other institutions having objects similar to the objects of the body, such institutions to be determined by the members of the association at or before the time of dissolution." Companies and Allied Matters Act of the Federal Republic of Nigeria, pt. XVIII, ch. 59, pt. C, § 691(4) (1990).

93. Different terms are used in various countries to describe the concept of public benefit. For example, German law refers to "organizations of public utility" (Gemeinnuetzigkeit). Similarly, in France, some organizations are referred to as being "of public utility" (d'utilité publique).

In some civil law countries, it has become fairly widespread to talk about "charitable" activities, even though charity is a common law concept generally associated with the Anglo-American legal system. The concept of charity in the common law, however, includes limitations on some public policy activities of civic organizations, which are largely inconsistent with civil law traditions. This loose use of the term "charitable" is frequently a substitute for the broader term "public benefit," which is used more commonly in both common law and civil law systems and is used in the Guidelines to distinguish between those activities that primarily affect the public in terms of health, education, culture, welfare, and so forth, and those that do not.

94. In this context, it is useful to distinguish between "purposes" and "activities." The latter embraces any actions intended to bring about a particular objective or goal. An organization should be classified as a PBO only if its purposes—its objectives or goals—fit the relevant definition of "public benefit" and its activities primarily or exclusively are in pursuit of those purposes.

95. See *United Communist Party*, *supra* note 26 and accompanying text.

96. In some common law countries, a public benefit organization is not permitted to have lobbying as its purpose or objective, but may engage in lobbying as an activity that advances its otherwise permissible purposes. Further, even where lobbying is not permitted, public benefit organizations may be permitted to engage in "defensive lobbying"—lobbying necessary to preserve the status and benefits of the organization.

97. In the United States, an organization cannot qualify for tax exemption and tax deductibility for charitable contributions if it is found to "participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office." 26 U.S.C. § 501 (c) (3) (2000). On the other hand, a "social welfare organization" may be exempt from tax (but its donors not eligible for tax deductibility) under 26 U.S.C. § 501 (c) (4) even if it engages in a substantial amount of lobbying. See 26 C.F.R. § 1.501 (c) (4)-1(ii) (2003). U.S. law permits a § 501 (c) (3) charity to control a § 501 (c) (4) social welfare organization, provided the organizations maintain separate books and records, observe the corporate formalities associated with their status as separate legal entities, and maintain sufficient internal controls to keep their financial resources separate. For a discussion of the freedom of expression issues implicated by the U.S. regulatory scheme, see *Regan v. Taxation with Representation of Washington, Inc.*, 461 U.S. 540, 553 (1983) (Blackmun, concurring).

98. On the other hand, some civil law countries have restrictions as to the amount of lobbying a PBO can engage in and still receive tax and other benefits. As to France, see *Caroline Newman, Amendments to the Tax Code Affect Taxation of NGOs*, 5 Int'l J. Not-for Profit L., available at: [http://www.icnl.org/Journal/vol5iss1/cr\\_weurope.htm#france](http://www.icnl.org/Journal/vol5iss1/cr_weurope.htm#france).

99. The United States has detailed requirements that a public benefit law firm must satisfy. See Rev. Proc. 92-59, 1992-2 C.B. 411.

100. For example, Japan's NPO law provides that a "specified nonprofit corporation" may not engage in "recommending, supporting, or opposing a candidate (including a prospective candidate) for a public office . . . a person holding a public office, or a political party." Japanese NPO Law, *supra* note 92, ch. 1, art. 2(ii) (b) & (c).

101. Some countries have clear restrictions on public policy activities that are like those of political parties. Article 9 of Lithuania's Law on Charity and Sponsorship Funds prohibits funds "from participating in political activities, sponsoring political parties and political organizations." Law on Charity and Sponsorship Funds of the Republic of Lithuania, art. 9 (March 14, 1996). Macedonian law provides that associations and foundations "may not perform political activities or use their property and assets for implementation of the goals of political parties." It goes on to attempt to define a "political activity" as "direct participation in an electoral campaign, or fund raising for an electoral campaign and financing political parties." Law on Citizen Associations and Foundations of the Republic of Macedonia, Law No. 31/98, ch. 1, art. 3 (June 25, 1998). In Poland, associations

may participate in the political process, including supporting candidates and lobbying the legislature. Law on Associations of the Republic of Poland, ch. 1, art. 1(3) (April 7, 1989). (“Associations have the right to voice their opinions on public issues.”)

102. A vaguer standard is established in Japan: “A specified nonprofit corporation may engage in operations for the purpose of generating revenue. . . to be used in the specified nonprofit activities thereof, to the extent that said revenue-generating operations do not interfere with operations relating to specified nonprofit activities.” Japanese NPO Law, *supra* note 92, ch. 2, art. 5(1). No test is provided for determining when income-generating activities “interfere” with not-for-profit activities. Vague standards can provide great flexibility, but their application is also more difficult to make or predict.

103. An alternative is to focus on whether an organization competes with organizations in the for-profit sector in a “commercial manner.” *See, e.g.*, laws in France and South Africa, which use competition with the private sector as a test, *infra* note 143.

104. *See Better Business Bureau v. United States*, 326 U.S. 279 (1945).

105. Similarly, the fact that an MBO uses economic activities to pursue its mutual benefit purposes should not disqualify it as a civic organization even if those activities predominate. For example, a professional organization may charge fees for professional development programs that it conducts. This is an economic activity pursued for a mutual benefit purpose. If profits were distributed, however, that should disqualify it as a civic organization.

106. The common law charitable trust and the civil law public benefit foundation are nonmembership organizations that may provide financial support for public benefit activities, often conducted by others, through income earned on the assets held, usually as a perpetual endowment. They would be unable to function without dissipating their assets if they were not permitted to invest and earn income on their assets.

107. For example, if the Fondation de France gives money to a civic organization to teach computer skills to children in a developing country, that is not an economic activity, but if it gives money to the organization to redesign the Fondation’s own computer system, that is an economic activity.

108. In England and Wales, a charity may engage in a trade or business but only indirectly, through a subsidiary. For further information on how a charity should establish a subsidiary to carry out business activities, *see* Charity Commission 35 on Trading by Charities, available at: <http://www.charity-commission.gov.uk/publications/cc35.asp>.

In Poland, a foundation may engage in a trade or business directly. The Law on Foundations of the Republic of Poland, art. 5(5) available at: [http://www.icnl.org/library/cee/laws/polfoundations1984\(eng\).htm](http://www.icnl.org/library/cee/laws/polfoundations1984(eng).htm). In both countries, no tax is paid on net profits that are used for the charitable purposes of the organization. In France, by contrast, a foundation cannot engage directly or indirectly in a trade or business activity, so the tax issue never arises. In England and Wales, all profits earned by a “trading” subsidiary can be transferred tax free to the parent charity. Income and Corporations Taxes Act 1988 of the United Kingdom, pt. VIII, §340(2)(3) (1988) [hereinafter: U.K. Tax Act].

109. Microcredit is not a for-profit (or profitable) business. Lending capital comes principally from donor agencies, and operating income does not generally meet expenses.

110. Thus, microcredit institutions should not be subject to the same kind of licensing rules as for-profit financial institutions. *See generally* the Virtual Library on Microcredit at: <http://www.gdrc.org/icm>.

111. *See, e.g.*, Income Tax Act of the Republic of South Africa, ch. 2, pt. I, § 30(1)(c)(ii) (1962), available at: [http://www.sars.gov.za/it/pbo/section\\_30.pdf](http://www.sars.gov.za/it/pbo/section_30.pdf).

112. Although it is probably unnecessary to have special provisions in this regard in the civic organization laws, some countries have felt it necessary to do so. Under Albanian law, for example, “[w]hen the exercise of an activity is subject to the need to obtain a license or permission, the non-profit organization submits a request to the competent organ, which, after determining that it fulfills all the criteria and the relevant legal procedures, gives it the respective license or permission.” Law No. 8788 on Non-Profit Organizations of the Republic of Albania, ch. 7, art. 34 (May 7, 2001).

113. Romanian law encourages sponsorship of nonprofit activities through the grant of special tax benefits. The beneficiary can only inform the public about the sponsorship by using the sponsor’s name, trademark, or public image. Neither the beneficiary nor the sponsor can engage in commercial publicity during the sponsorship. The Sponsorship and Donations Law of the Republic of Romania, art. 10 (1) & 10 (3) (1994, modified 1998).

114. The term “public fundraising” generally refers to solicitations for donations of cash and goods to civic organizations from the general public. The methods may include selling raffle tickets, telemarketing, going door-to-door, soliciting donations from passersby, mailings, television and radio appeals, and similar events. Soliciting from known individuals or businesses is not public fundraising.
115. The limits on fundraising regulation in the United States are largely a product of jurisprudence under the First Amendment to the Constitution, which protects freedom of speech. *See* Errol Copilevitz, *The Historical Role of the First Amendment in Charitable Appeals*, 27 *Stetson L. Rev.* 457 (1997). *See generally* *Developments in the Law – Non Profit Corporations*, 105 *Harv. L. Rev.* 1578 (1992).
116. For a description of an effective, self-regulatory disclosure system, *see* Wino van Veen, *Self-regulation and Monitoring of Fundraising Organizations in the Netherlands: The Central Bureau of Fundraising (CBF)* (1996) (unpublished manuscript on file with the authors).
117. *See infra* note 121.
118. *See, e.g., infra* note 124; art. 43 of the Yemen Law on Associations and Foundations (2001).
119. This test is not dispositive, however, for countries in transition frequently impose excessively burdensome reporting requirements on both types of organization.
120. A “finance committee” of the governing board, established to assist and advise the board (by, e.g., reviewing the report of any outside auditor hired by the organization), should not be confused with an “audit committee,” which is responsible for overseeing and investigating the activities and finances of an organization and which reports at least annually to the governing board on whether the organization is in compliance with the law, its governing documents, resolutions, etc.
121. Recently adopted accounting rules for civic organizations include Swiss GAAP FER 21 - Rechnungslegung für gemeinnützige, soziale Non-profit-Organisationen, available at: [http://www.fer.ch/pdf/FER21\\_Dez\\_2002\\_final\\_1.pdf](http://www.fer.ch/pdf/FER21_Dez_2002_final_1.pdf); The Institute of Chartered Accountants of India, *Technical Guide on Accounting and Auditing in Not-for-Profit Organizations*, which focuses on applying the existing accounting and auditing standards to not-for-profit organizations and also provides illustrative formats for financial statements and audit reports of not-for-profit organizations. *See* <http://www.icai.org/common/index.html>.
122. The United Nations Mission in Kosovo (UNMIK) decided not to require audited financial statements by civic organizations immediately after the transition precisely because of concerns over the availability of qualified, independent accountants. *See* UNMIK Administrative Direction No. 2002/9, §1 (March 29, 2002). This is not, however, a common situation, given the range of accounting skills taught in modern universities around the world.
123. In England, an independent inquiry on governance conducted for the National Federation of Housing Associations concluded that “the accountability impact of membership structures is largely illusory. . . .” *See* Lawrence Holden, *Charities and Governance: A Study in Evolution*, 4 *Charity Law & Practice Rev.* 27, 39 (1996). *See also* One World Trust, *Power Without Accountability*, available at: <http://www.oneworldtrust.org/Files/Pubs/GAP%20report/GAP2003.pdf>. (“A clear conclusion emerging from this study is that only a minority of members actually exert real control over many of the organizations examined.”)
124. The following is an example of a document retention policy:
- (1) Indefinite retention:
    - The original governing documents of the organization and any amendments thereto, the original application file and any subsequent applications;
    - Minutes of meetings of the General Assembly, the governing bodies, and any committee of the governing bodies, including resolutions and attachments; and
    - Rules, regulations, procedures, or bylaws adopted by the General Assembly, the governing bodies, or any committee thereof.
  - (2) Retention for six (6) years: All financial reports and tax records, and all papers and records relating to any litigation, investigation, or tax dispute.
  - (3) Retention for three (3) years: All other documents and records.

125. GuideStar, the national database of U.S. charitable organizations, gathers and distributes data on more than 850,000 tax-exempt nonprofits, and frequently links to organization homepages for the accounting reports and tax forms they file. See <http://www.guidestar.org>.

126. In Kenya the public has complete access to reports and files of civic organizations maintained by the Non-Governmental Organizations Coordinating Board and for a fee can make copies of them. Non-Governmental Organizations Coordination Regulations, pt. V, § 31 (1992).

127. In England and Wales, such remedies are available to the Charity Commission itself, which is a quasi-judicial body. Charities Act, Part IV, § 33 (1) (1993). In other countries the remedies are available only upon application to a court by the state attorney or public prosecutor. *Revised Model Nonprofit Corporations Act*, ch. 8, § 8, *supra* note 75.

128. South African law generally conforms to good practice. If the director of nonprofit organizations concludes that an organization has failed to comply with a material provision of its constitution, with a condition of a benefit bestowed on it as a formal civic organization, or with its accounting, reporting, and notice obligations, then the director must notify the organization of the noncompliance. The notification must be in writing, must explain the noncompliance and the steps required for compliance, and must inform the organization of the time it has to come into compliance (generally one month, which may be extended for good cause). Failure to meet the requirements will result in cancellation of establishment, which can be appealed to an arbitration tribunal. Nonprofit Organisations Act of the Republic of South Africa, ch. 3, § 20-22 (1997).

129. A civic organization that receives some tax benefits need not be offered all available tax benefits in the jurisdiction. It may be that some tax benefits are offered to a subset of PBOs, and further tax benefits are extended to a smaller subset. In the United States, a distinction is made between “charitable” organizations, to which tax deductible contributions can be made, and “social welfare” organizations, for which tax deduction is not available. 26 U.S.C. § 501 (c) (3) & § 501 (c) (4) (2000). Both types of organizations, however, are generally exempt from income taxes.

130. The catchall need not come at the end, of course. The Law on Public Benefit Organizations of the Republic of Hungary equates public benefit activities with “activities included in the founding document of the organization, directed towards the satisfaction of the common interests of the society and the individual . . .” and a long list of examples follows. Act CLVI of 1997, ch. 5, § 26(c).

131. While this section mainly deals with income or profits tax exemptions, similar principles apply to relief from VAT. Because VAT is a tax on sales of goods and services, relief from it is often based upon the kind of goods or services being sold (e.g., medical relief supplies) in addition to or instead of the kind of organization involved.

132. In South Africa, an organization that wishes to be tax exempt must submit “to the Commissioner a copy of the constitution, will, or other written instrument under which it has been established” in order to demonstrate its qualification for exemption. By choosing not to file the required papers, organizations that wish to can avoid tax exemption and the extra scrutiny that accompanies it. Income Tax Act, *supra* note 111, § 30 (3) (b). Requiring an application means, however, that there may be a period of time between an organization’s establishment and the grant of tax exempt status when it is technically a taxpayer. It is a good practice to make tax exemption retroactive to the date of establishment if the application for it has been made in a timely fashion.

133. Mongolia exempts MBOs from taxation on membership fees and members’ contributions. It exempts PBOs from taxation on membership fees, all contributions and inherited funds, and income from mission-related economic activities. See Mongolian NGO Law, *supra* note 45.

134. See Paul Bater, *Evaluating Incentives for Donations to Public Benefit Organizations*, 2 Int. J. Not-for-Profit L. 3 (Dec. 2000), available at: [http://www.icnl.org/journal/vol3iss2/ar\\_bater.htm](http://www.icnl.org/journal/vol3iss2/ar_bater.htm).

135. See *infra* note 138.

136. For a longer discussion of the design of tax preferences for donations, see *supra* note 134.

137. There is some risk of abuse if deductions or credits are made available for gifts-in-kind as well as in cash. The risk of fraud increases when the donated object is difficult to value, e.g., a work of art. The risk is that someone will buy an object at a low cost, find an appraiser that will assign a high value to it, and donate it to charity for a large deduction.

When a donor contributes property (e.g., shares of stock or works of art) that have appreciated greatly since he acquired them, the question arises whether the donor, who is receiving a deduction based on the fair

market value of the asset at the time of donation, should pay income tax on the appreciation. Although the imposition of tax on the appreciation is justified as a matter of tax policy, in the United States no tax is imposed on such donations in order to encourage the donation of appreciated assets to charities.

138. In some countries, salaried individuals do not file tax returns because the taxes subtracted from their wages are final. In such situations it is difficult to claim a refund if a charitable contribution is made. In some countries with this system, however, an employee is permitted to inform the employer of the charitable contribution, and the employer adjusts tax withholding accordingly. Under a tax designation scheme adopted in Hungary, however, an individual may direct that 1 percent of the taxes he or she pays go to an “eminent” PBO of his or her choice. Act No. CXXVI on the Public Application of a Certain Portion of Personal Income Tax upon Taxpayer’s Order, § 3(1) (1996). Lithuania, Slovakia, and Poland have adopted similar laws. See V. Ilgius, *New Tax Designation Rule Enacted*, 4 Int’l J. Not-for-Profit L. 4 (July 2002) (Lithuania), available at: [http://www.icnl.org/journal/vol4iss4/cr\\_cee.htm#Lithuania](http://www.icnl.org/journal/vol4iss4/cr_cee.htm#Lithuania); J. Kadlecova, *Impact of the April Amendment of the Act on Income Tax on NGOs*, 4 Int’l J. Not-for-Profit L. 4 (July 2002) (Slovakia), available at: [http://www.icnl.org/journal/vol4iss4/cr\\_cee.htm#Slovakia](http://www.icnl.org/journal/vol4iss4/cr_cee.htm#Slovakia); Law on Public Benefit Activity and Volunteerism, art. 27 (2003) (Poland) (goes into effect Jan. 1, 2004), discussed in Igor Golinski, *Polish Parliament Adopts New Law on Public Benefit Activities and Volunteerism*, 1 Int’l J. Civ. Soc. L. 124 (July 2003), available at: <http://www.law.cua.edu/students/orgs/ijcsl>. Such tax designation schemes do not give a deduction or credit and do not require the individual to file a tax return, which means that all taxpayers are able to participate in supporting civic organizations.

139. See, e.g., Charles Clotfelter, *Tax Incentives and Charitable Giving: Evidence from a Panel of Taxpayers*, 13 J. of Pub. Econ. 319 (1980); Richard Steinberg, *Taxes and Giving*, 1 *Voluntas* 61 (1990); Kevin Barrett, Anya McGuirk & Richard Steinberg, *Further Evidence on the Dynamic Impact of Taxes on Charitable Giving*, 50 Nat’l Tax J. 321 (1997).

140. See, e.g., Basic World Tax Code, title I, ch. 1, § 38(b) (1996), available at: <http://www.taxanalysts.com/www/website.nsf/Web/BasicWorldTaxCode?OpenDocument>.

141. For a useful analysis of the issues related to taxation of profits from economic activities, see Industry Commission, *Charitable Organizations in Australia* 311-312 & App. J (1995).

142. Income used to maintain or expand the economic activities, however, would be taxed.

143. Some countries also look to the “commerciality” of the economic activities—whether the income is derived from an activity that is conducted in competition with the business sector and in a commercial manner. For example, France has developed a set of complex tests that provide for such a rule. See Caroline Newman, *Recent Ministerial Instructions Regarding the Tax Treatment of NPOs*, 2 Int’l J. Not-For-Profit L. 2 (March 2000), available at: [http://www.icnl.org/journal/vol2iss2/cr\\_france1.htm](http://www.icnl.org/journal/vol2iss2/cr_france1.htm). South African law also looks to the commerciality issue in some cases. See Income Tax Act, *supra* note 111, § 30 (3) (b) (iv) (bb) (B).

144. Poland has now gone to a pure destination of income test. See Corporate Income Tax Act, art. 17 (1), (4), (5). Germany has a rule similar to the former rule in Poland. See *Country Report - Germany*, 2 Int’l J. Not-For-Profit L. 4 (June 2001), available at: [http://www.icnl.org/journal/vol2iss4/cr\\_wueurope.htm#GERMANY](http://www.icnl.org/journal/vol2iss4/cr_wueurope.htm#GERMANY).

145. This is the rule used in the United States. See 26 U.S.C. §§ 511-514 (2000). Both the law itself and the regulations issued thereunder, however, are exceedingly detailed and complex.

146. One of the criteria used in France for distinguishing between taxable and nontaxable income from economic activities is whether the managers are owners of the organization. See Newman, *supra* note 143.

147. See Rev. Rul. 73-105 (1973), available at: <http://www.taxlinks.com>, and IRS Publication 598, *Tax on Unrelated Business Income of Exempt Organizations*, available at: <http://www.irs.gov/pub/irs-pdf/p598.pdf>.

148. See James Hines, *Nonprofit Business Activity and the Unrelated Business Income Tax* in 13 *Tax Policy and the Economy* 57-84 (1999); Henry Hansmann, *Unfair Competition and the Unrelated Business Income Tax*, 75 Va. L. Rev. 605 (1989).

149. Hungary Law Act LXXXI on Corporate Tax, ch. 2, §20 (1) (a) (1996).

150. See, e.g., U.K. Tax Act, *supra* note 108.

151. See Sixth Council Directive of the European Community 77/388/EEC of 17 May 1977 on the Harmonization of the Laws of the Member States Relating to Turnover Taxes: A Common System of Value Added Tax and Uniform Basis of Assessment, available at: [http://europa.eu.int/smartapi/cgi/sga\\_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31977L0388&model=guichett](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31977L0388&model=guichett).

152. For further discussion of this problem, see Ole Gjems-Onstad, *The Taxation of NonProfit Organizations: International Fiscal Association Congress 1999*, 1 Int'l. J. Not-For-Profit L. 4 (June 1999), available at: <http://www.icnl.org/journal/vol1iss4/index.html>.
153. Some civic organizations would necessarily be included in the system because their economic activities are substantial. Most countries have a threshold amount of turnover that must be met before a legal entity is included in the VAT system, but most countries allow entities that have outputs below the threshold to opt into the VAT system if they wish to. See David Williams, *Value-Added Tax*, in International Monetary Fund, *Tax Law Design and Drafting* 164 (Victor Thuronyi, ed.) 1996.
154. If the organization were engaged in unrelated income-producing activities, it would need to treat that aspect of its activities separately from the zero-rated activities.
155. Although it might seem equally good to zero-rate civic organizations on *inputs*, doing so would cause organizations selling to civic organizations to charge higher prices, so that they could cover their input VAT costs.
156. In most Western European countries, there are certain VAT preferences, although these vary considerably from country to country. See Derek Allen, *VAT in the European Community* (1994). But see *supra* note 151, with regard to VAT harmonization.
157. Tax authorities generally oppose VAT preferences for civic organizations (or anyone else) because they have a distorting effect and make the system more complicated. For a fuller discussion of VAT issues, see International Monetary Fund, *The Modern VAT* (2002); see also Williams, *supra* note 153 at 176.
158. According to the IMF, in Rwanda, for example, the only tax benefits for civic organizations are exemption from customs duties and exemption for expatriate NGO employees from the entrance fee, and these are granted on a random basis, only under agreements with the individual organizations. Memorandum from IMF, July 2003 (on file with the authors). Kenya and Uganda, on the other hand, grant a range of customs duty exemptions to civic organizations in addition to other tax preferences. Customs and Excise Tax Act Cap. 472 of the Republic of Kenya, pt. A, § 12 (2000); Income Tax Act 1997 of the Republic of Uganda, act. 11.
159. Called "suitcase NGOs" in some countries.
160. Often the problem is not the absence of an exemption for civic organizations, but the red tape involved in claiming it. Complex procedures imposed in many countries create numerous bureaucratic obstacles, conditionality provisions, and rent-seeking.
161. Many do not, of course, because they rely on customs duties and VAT as a principal source of revenue.
162. Exemption at the border, however, offers serious possibilities for corruption. See Williams, *supra* note 153 at 176.
163. Local Government Finance Act 1988, § 47.
164. *Id.*
165. Finance Act 1982, § 129.
166. Inheritance Act 1984, § 23.
167. In Australia, civic organizations involved in social welfare work pay reduced sales taxes and, if their payroll is over A \$10,000 a month, a reduced fringe benefits tax as well, depending on which State they are in. See section 57, Fringe Benefits Assessment Tax of 1986.
168. See e.g., Agreement Between the Government of the United States of America and the Government of the Republic of Hungary Concerning Economic, Technical and Related Assistance, art. 3 (December 22, 1995). (Agreement on file with the authors).
169. For example, the Law on Non-Profit Organizations of Albania states: "Foreign non-profit organizations have the right to exercise temporary or permanent activities in the Republic of Albania, respecting Albanian legislation and good customs and under the same conditions with those of local non-profit organizations. For the exercise of their activity in the Republic of Albania, foreign non-profit organizations may establish and register the non-profit organizations, or their branches, according to Albanian law." Law No. 8788, ch. 6, art. 29 (May 7, 2001).
170. Under the European Convention on the Recognition of the Legal Personality of International Non-Governmental Organizations, member states of the Council of Europe that have ratified the convention must

accord special recognition to branches of the qualifying organizations. However, the scope of the convention is quite limited. See Ole Gejms-Onstad, *The Proposed European Association: A Symbol in Need of Friends?* 6 *Voluntas* 1, 7-8 (April 1995). More recent European efforts to facilitate cross-border operation of civic organizations include debate on a draft statute to create the legal form of a "European association." See Statute for a European association, available at: <http://europa.eu.int/scadplus/leg/en/lvb/l26017.htm>. As to foundations in the European Union, see developments discussed in Hanna Surmatz, *European Efforts to Facilitate the Operations of Public Benefit Foundations*, 1 *Int'l J. Civil Society Law* 210 (July 2003), available at: <http://www.law.cua.edu/students/orgs/ijcsl>.

171. According to the U.S. Agency for International Development, civic organizations in most South Eastern European countries and Eurasian countries still remain almost entirely dependent upon support from international donors. Civic organizations in Latvia receive over 80 percent of their funding from foreign sources. United States Agency for International Development, 2001 NGO Sustainability Index for Central and Eastern Europe (2001), available at: [http://www.usaid.gov/regions/europe\\_eurasia/dem\\_gov/ngoindex/2001/](http://www.usaid.gov/regions/europe_eurasia/dem_gov/ngoindex/2001/).

172. "[L]egitimate NGOs should be able to receive foreign funds and donated goods without onerous bureaucratic delays. There should be no arbitrariness, bias or 'rent-seeking' in the awarding of these privileges." John Clark, *The State, Popular Participation, and the Voluntary Sector*, 23 *World Development* 593, 595 (1995).

173. Some foreign-funded civic organizations are established overseas in order to avoid problems like these.

174. The Czech Republic Law on Public Benefit Corporations states: "The Founders of the Public Benefit Corporation may include natural persons, the Czech Republic or legal bodies." Ch. 2, art. 3 (September 28, 1995). See also the Law on the Foundation of and Participation in Legal Persons in Private Law by the State Act of the Republic of Estonia, ch. 2, § 5 (6) (July 19, 1996, as amended October 7, 1998), which authorizes and regulates state participation in private law entities, including civic organizations.

175. One example is the Smithsonian Institution in the United States, created by an act of Congress and funded initially by a private bequest. Its board comprises government officials and private individuals, and it raises money from a variety of public and private sources. See <http://www.si.edu>.

176. The Yemen Law on Associations and Foundations has a provision presumably intended to prevent such corruption. Article 35 provides: "A member of the Board of Directors of an association or foundation may not also be employed with the Ministry [of Pensions and Social Affairs] or other public entities that are responsible for overseeing, guiding or controlling the association or foundation, or otherwise providing it with funds, unless approval thereof is issued for reasons that are necessitated by public interest." This prohibition only applies to those "who are actually exercising a management function" in the public entity. Law No. 1 for the Year 2001 Concerning Associations and Foundations, ch. 3, § ii, art. 35.

177. See Advisory Opinion, *supra* note 16.

178. See Fely Soledad, *The Philippines Council for NGO Certification*, presented at the Legal Framework for Civil Society in East and Southeast Asia conference held at the Catholic University of America School of Law, April 22, 2002 (paper on file with the authors). Further information on the PCNC can be obtained from the organization's website at <http://www.pcnc.com.ph/>. Another model for using a civic organization to certify others for tax deductibility is being developed in Pakistan. See <http://www.pcp.org.pk/certification.htm>.

179. Section 217(1) of the South African Constitution (1996) sets out this principle: "When an organ of state in the national, provincial or local sphere of government, or any other institution identified in national legislation, contracts for goods or services, it must do so in accordance with a system which is fair, equitable, transparent, competitive, and cost-effective." Const. of the Republic of S. Africa, ch. 13, § 217(1) (1996).

180. See *Hungary Adopts New Law on the National Fund for Support of Civil Society Organizations*, 1 *Int'l J. of Civ. Soc. L.* (July 2003), available at: <http://law.cua.edu/students/orgs/ijcsl>.

181. See *supra* note 13.

182. See Karla Simon, *Privatization of Social and Cultural Services in Central and Eastern Europe: Comparative Experiences*, 13 *B.U. Int'l L. J.* 383 (1995).

183. The Maryland Association of Nonprofit Organizations has issued a model code of ethical behavior entitled "Standards for Excellence: An Ethics and Accountability Code for the Not-for-Profit Sector." The code combines both sweeping policy recommendations under the heading of eight guiding principles, as well as practical recommendations under the heading of fifty-five standards. One such standard concerns conflict of interest statements: "Nonprofits should provide board members, staff and volunteers with a conflict of interest statement which summarizes the key elements of the organization's conflict of interest policy. The conflict of

interest statement should provide space for the board member, employee or volunteer to disclose any known financial interest which the individual, or a member of the individual's immediate family, has in any business entity which transacts business with the organization. The statement should be provided to and signed by board members, staff, and volunteers, both at the time of the individual's initial affiliation with the organization and at least annually thereafter."

The Standards for Excellence are available at: [http://www.mdnonprofit.org/ethics\\_initiative.htm](http://www.mdnonprofit.org/ethics_initiative.htm).

184. For examples of codes of conduct, *see, e.g.*, Minnesota Council of Nonprofits, Principles and Practices for Nonprofit Excellence, available at: [http://www.mncn.org/info\\_principles.htm](http://www.mncn.org/info_principles.htm); Caucus of Development NGO Networks, The CODE-NGO Revised Covenant on Philippine Development, Part IV, available at: <http://www.codengo.org/main.php3?action=displayarticle&articleid=64>. InterAction, Private Voluntary Organization Standards, available at: <http://www.interaction.org/pvostandards/index.html>. *See generally* Codes of Conduct for Partnership In Governance: Texts and Commentaries (Tatsuro Kunugi & Martha Scwheitz, eds.) 1999 (on file with ICNL).

185. For an example of a watchdog agency and the standards it applies, *see* the Better Business Bureau's Standards for Charitable Solicitation at <http://www.give.org/standards/>.

186. In addition to enacted legislation, in some countries, the activities of civic organizations are also governed by "customary law." However, in some instances customary law may conflict with a state's constitution and its commitments under international treaties. Such was the case in Nigeria, with respect to mandatory membership in an age-group association. The Supreme Court of Nigeria held that the customary law must give way when the Constitution's guarantee of freedom of association would allow a person to opt out of such an association. *See Agbai v. Okogbue*, discussed in *Iheme, supra* note 18.

187. Holden, *supra* note 123.

188. Under traditional charity law, no self-help group is a charity because the benefits go only to members and not to the public, which means it cannot satisfy the public benefit requirement. If the members of a self-help group constitute a disadvantaged or needy group, however, there is a strong argument that it should be given PBO status. *See, e.g.*, Exposure Draft, Charities Bill 2003 available at: [www.taxboard.gov.au](http://www.taxboard.gov.au). (Australian proposal to amend definition of "charity" to include "open and non-discriminatory self-help groups that have open and non-discriminatory membership").

189. One perplexing problem is whether civic organizations that provide benefits primarily or exclusively to the wealthy elite deserve treatment as PBOs. For example, is an opera company whose patrons are the wealthy or a museum that caters to the artistic tastes of the elite an organization serving the public interest? Passionate views have been expressed on both sides of this issue.

190. *See* Model Provisions for Laws Affecting Public Benefit Organizations: Law on Public Benefits Organizations, developed in 2000 by a group of experts in Central and Eastern Europe convened by ICNL, available at: [http://www.icnl.org/programs/cee/pubs/modelpbo/#\\_ftn1](http://www.icnl.org/programs/cee/pubs/modelpbo/#_ftn1). *See also* European Foundation Centre, Model Law for Public Benefit Foundations in Europe, available at: [http://www.efc.be/ftp/public/EU/LegalTF/model\\_law.pdf](http://www.efc.be/ftp/public/EU/LegalTF/model_law.pdf).



*Guidelines for Laws Affecting Civic Organizations*, revised and enlarged since the first edition in 1997, provides guidance for creating or amending domestic laws that protect and regulate civic organizations. It establishes the framework for such laws in internationally recognized rights to freedom of expression, association, and peaceful assembly. The book is an essential resource for the expanding global civic sector, which includes everything from advocacy groups for the environment to associations of opera aficionados, from women's rights groups to gardening clubs. Aimed at anyone involved with civic groups, the book includes chapters on the legal existence of civic organizations, fundraising, tax preferences, foreign organizations, and methods of voluntary regulation, as well as examples of domestic laws from around the world.

