

Income Tax Issues for NGOs in Anglophone Africa

By

Karla W. Simon
Catholic University of America
School of Law

Introduction. This paper discusses the current state of income¹ tax benefits for NGOs in Anglophone Africa² and compares the laws permitting these benefits to international good practice in this area. It was initially based on research conducted at the International Bureau of Fiscal Documentation in the Netherlands, which has the largest collection of tax legislation in the world, as well as onsite, in various countries. In addition, the paper has been edited to reflect recent changes to the legal framework affecting not-for-profit organizations in South Africa.³ It is possible that this draft does not treat other recent legislative changes in the countries discussed. The authors would appreciate information regarding any such omissions. The countries surveyed are: Botswana, Cameroon, Egypt, Eritrea, Ethiopia, The Gambia, Ghana, Kenya, Lesotho, Liberia, Malawi, Mauritius, Namibia, Nigeria, Seychelles, Sierra Leone, Somalia, South Africa, Sudan, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe.

The paper considers three issues: the range of not-for-profit activities that are exempt from tax, the types of income that are exempt from tax, and the tax benefits granted for donations to charitable and other organizations. It is clear from our research that the approaches to these issues are remarkably similar throughout Anglophone Africa. The similarity is decreasing, however, as more and more countries are looking to increase the tax advantages for NGOs and their donors, modernizing their treatment of these issues and bringing their national legislation closer to the standards of international good practice discussed in ICNL's paper *Tax Preferences for Nongovernmental Organizations*.⁴

Tax preferences for NGOs and their donors are generally thought to be necessary to promote an enabling environment for these organizations. Because NGOs are seen as providing significant public benefits, most countries in the world tend to

¹ A similar study of VAT and excise tax issues is also underway.

² This paper addresses only Anglophone Africa because the systems of taxation in Francophone and Lusophone Africa are in some important ways dissimilar from those in the Anglophone countries. ICNL is studying the legislation in the Francophone and Lusophone countries and will prepare a second paper with a similar discussion of the relevant issues in that context.

³ See the Income Tax Act, as amended by the Taxation Laws Amendment Act (Act 30 of 2000) and the Revenue Laws Amendment Act (Act 59 of 2000).

⁴ See ICNL, *Tax Preferences for Nongovernmental Organizations*, March 2001 version, to be distributed at the conference (hereinafter "Tax Preferences").

provide some form of tax incentives so as to encourage their activities. Tax incentives are generally deemed appropriate for NGOs because:

- 1) they tend to be efficient and cost-effective providers of social services;
- 2) they promote important civic values;
- 3) they support charity and philanthropy;
- 4) they encourage democracy and pluralism; and
- 5) they can contribute to economic development in important ways.⁵

Tax exempt activities. In almost all countries in the region the laws permit organizations that engage in certain types of activities to be exempt from income taxes.⁶ This is generally permitted either in the law itself or in an accompanying schedule,⁷ although Sudan allows exemption only by ministerial order. As the attached chart on “Tax Exempt Activities” suggests, virtually every country in the region exempts educational, charitable,⁸ and religious activities, with quite a few also exempting amateur sports activities. In general the laws of the various countries provide that such activities must be for public benefit or “of a public character,” which may limit the exemption to activities that are performed in the public interest and not for mutual benefit. This is not completely in accord with international practice, which tends to also permit income tax exemption for the income of clubs and societies, at least to the extent that the income comes from membership dues and not from business activities.⁹

In addition to the three or four widely accepted types of activities for which an income tax exemption is available, some countries also specifically permit exemption for other kinds of public benefit activities. These include activities related to health (Egypt); social welfare and civic improvement (Malawi); science (Nigeria); and welfare and culture (Somalia).

In an important development, the Taxation Laws Amendment Act,¹⁰ promulgated on July 19th, 2000, created the new concept of “public benefit organization” in South

⁵ For further discussion of some of these attributes of NGOs, see World Bank, *Handbook on Good Practices for Laws Relating to Nongovernmental Organizations* (Revised Discussion Draft, 2000).

⁶ Ethiopia and Eritrea have no specific rules for exemption. It can, however, be inferred from the fact that the income and profits tax is imposed only on trade and business activities that at least some organizations are exempt.

⁷ Some countries rely heavily on a schedular system, while others do not. Using schedules seems to be less attractive to the drafters of more recent legislation, such as that enacted in Uganda in 1997.

⁸ Some countries use slightly different terms, such as “benevolent,” “relief of poverty and distress,” etc. It is clear, however, that these terms are intended to encompass organizations that are within the normal definition of “charity” in the English-speaking world.

⁹ See Tax Preferences, *supra* note 4, at 3.

¹⁰ Act 30 of 2000.

Africa.¹¹ The sole purpose of such an organization is to carry on one or more public benefit activities in a non-profit manner. Definition of the term “public benefit activity” was, in large part, delegated to the Minister of Finance. Section 30(2)(a) of the Income Tax Act¹² states “The Minister shall, by notice in the *Gazette*, determine any activity which is of a philanthropic and benevolent nature, having regard to the needs, interests and well-being of the general public for the purposes of this section.” The Minister has proposed two lists of public benefit activities pursuant to this obligation: the first for the purposes of income tax exemption, and the second for purposes of donor deductibility.

The list of public benefit activities for purposes of tax exemption builds upon the activities set forth in the previous legislation, which restricted the tax exemption to religious, charitable, and educational activities, to more broadly extend tax exemption to a list of eight major categories of activities. These include activities that are focused on culture and the arts and environmental concerns, as well as scientific research, among others.¹³ The Minister will publish the proposed list in the Government Gazette after considering public comments on the matter.¹⁴

The publication of an expanded list of public benefit activities for the purposes of tax exemption in South Africa is in accord with the wider range of exempt activities permitted in other countries. For example, Germany permits a large number of activities to be exempt from tax under section 52 of the Fiscal Law (“Abgabenordnung”); the U.S. has twenty-three categories of tax exempt organizations;¹⁵ Sweden also has a long list,¹⁶ as does Hungary, but the latter strangely enough does not include education in the list of exempt activities.¹⁷ The general trend in Anglophone Africa to date seems to be more

¹¹ See §30 of the Income Tax Act, created under §35(1) of the Taxation Laws Amendment Act.

¹² Established pursuant to §35(1) of the Taxation Laws Amendment Act.

¹³ For a full listing of the proposed categories, see the attached chart on “Tax Exempt Activities,” which is taken from the web site of the South African Revenue Service (www.sars.gov.za). It is important to note that although the Ministers proposed list is an improvement, it does not go as far as the list proposed by the Katz Commission. See *Ninth Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa – Fiscal Issues Affecting Non-Profit Organizations*, 1999 (the Katz Commission report).

¹⁴ For a discussion of possible changes in the proposed list, see Non Profit Partnership and Legal Resources Centre, *Joint Submission to the South African Revenue Service on the Draft Schedules of Public Benefit Activities: Income Tax Exemption and Deductibility of Donations*, February 2001 (Joint Submission), to be published in the *International Journal of Not-for-Profit Law*, Vol. 3, Issue 3 (March 2001).

¹⁵ Internal Revenue Code section 501.

¹⁶ See report on Sweden, in Salamon (ed.), *International Guide to Nonprofit Law* (John Wiley and Sons, 1997).

¹⁷ See report on Hungary in ICNL, EFC, and UBFA, *Select Legislative Texts and Commentaries* (ICNL, 1995, second edition appearing as *International Reporter on Not-for-Profit Law*, 1999). The rationale for this seems to be that education is seen as a function of the state, but that seems a bit too restrictive now because there are many private schools in Hungary.

conservative than the approach being taken in South Africa. But having a longer listing of exempt activities, which includes such things as science, culture, job and skills training, international understanding, and the environment, would seem to be appropriate. This is especially true in light of a more modern trend recognizing the public benefit of such activities – while they may not have been recognized when the concept of charity first entered English law in 1601, they are certainly seen today as being of benefit to the general public.

Tax exempt income by type. The tax laws of Anglophone Africa generally exempt the income of tax exempt organizations that comes from gifts, grants, and donations, as well as membership dues (in most cases). However, the rules for income from investments (dividends, interest, and rent) vary. In addition, the rules that apply to income from business activities also differ from country to country.

Investment income is, under the usual rule¹⁸ in these countries, not subject to tax. But some laws are either silent on the issue (Nigeria) or tend to follow the rule in Francophone Africa,¹⁹ which taxes income from movable property without exemption for NGOs (Egypt). One interesting limitation is found in Liberia, which only exempts interest if it is earned on property used for exempt purposes, but the general trend is to exempt all income from investment. This is in accord with international good practice.

Business income is generally subject to tax in these countries. Although some countries solve the problem by simply denying tax exempt organizations the privilege of engaging in trade or business activities,²⁰ most allow them to engage in business but tax the income derived therefrom. The countries that do tax income from business activities make a distinction between related and unrelated activities. Thus, an NGO that operates a school would be permitted to charge tuition in the normal course of events, but it could not engage in any trading activities, such as selling groceries or computers, without being subject to tax on the income generated by the latter activities. Other countries use what is known as the “destination of income test,” under which the income from business activities is not taxed if it is dedicated to the exempt activities of the organization. Countries following this rule include Liberia and Mauritius. From the study of international good practice, it is clear that either rule meets international standards.²¹ The more lenient destination of income test may be appropriate for developing countries with a weak NGO sector,²² but it does not generally apply in this region.²³

¹⁸ The exceptions to this are Ethiopia, Eritrea, and Sudan, which have no clear rules about exemption.

¹⁹ This is, however, not the rule in France. In a set of very complex special rules, most NGOs are exempt from tax on most sources of investment income.

²⁰ Namibia tends not to permit NGOs to engage in business activities. This is like the rule in the UK, which does not permit charities themselves to engage in business, but does permit business activities to be conducted indirectly, through a subsidiary. See Philip Kirkpatrick, *Country Report for the Laws of England and Wales Affecting NGOs*, 15 (ICNL, 1996).

²¹ See Tax Preferences, *supra* note 4, at 5.

²² See Tax Preferences, *supra* note 4, at 6.

The recently adopted legislation in South Africa employs four separate tests for determining the permissibility of trading activities.²⁴ In addition to the “relatedness test,” described above, South African public benefit organizations may engage in trading activities where the income generated from the given activity does not exceed the greater of 15% of gross receipts or 25,000 Rand. South African public benefit organizations may also engage in trading activities of an occasional nature, which are undertaken substantially with assistance on a voluntary basis without compensation. Lastly, even where an activity does not satisfy one of the tests set forth above, the Minister of Finance -- weighing certain factors -- has the discretion to allow an organization to engage in trading activities.²⁵

Tax benefits for donations. Although there are several ways in which the tax law may provide benefits for donors to NGOs,²⁶ the pattern in Anglophone Africa is to permit a deduction for such gifts. This is a widely but not universally accepted practice in the region. The accompanying chart indicates that of the 24 countries surveyed, 13 permit tax deductions for gifts to charity and other public benefit organizations. But more tellingly, the more recent legislation generally tends to permit deductions, while the older legislation tends not to.

There are essentially three issues that need to be considered with respect to tax benefits for donations:

- Is a deduction allowed?
- What are the percentage limitations if a deduction is allowed (and are they different for individuals and businesses)?
- What types of organizations or activities qualify as charitable donees?

With respect to the question of whether a *deduction is permitted* at all, the approach taken in the older legislation is that deductions are allowed to corporations only for business expenditures, which clearly would not include a gift to charity. This approach is exemplified by the law in Zimbabwe. But legislation adopted since the mid to late 1960's tends to allow at least a modest deduction for charitable gifts, either those made by individuals, by corporations or by both. In nine of the thirteen countries where deductions are permitted, the laws allowing them have been adopted since that time.

²³ Interestingly, the destination of income test is also used in developed countries with strong NGO sectors. The United States followed that rule until 1950, and the UK essentially has such a system today because it permits 100% of the profits of a trading subsidiary to be covenanted to a charity and thus escape tax.

²⁴ See Income Tax Act §30(3)(b)(iv).

²⁵ See Income Tax Act § 30(3)(b)(iv)(old).

²⁶ See Tax Preferences, *supra* note 4, at 9 ff.

With respect to *percentage limitations*, the most recently adopted tax legislation relating to NGOs was adopted in South Africa, and that permits a deduction of up to the greater of 5% of income or 1000 Rand for charitable gifts for both businesses and individuals.²⁷ This change is an improvement over the former restrictive rule, which allowed for the deductibility of donations only up to 2% of income. The percentage limitations of other recent legislation are even more generous (Zambia – 15% for both business and individual donations; Botswana – 20% for individual donations).

With respect to *activities* of organizations that are qualified to receive deductible donations, it is less clear that the modern trend favors a fairly large class of permissible donees. The general rule in the region is to have only a limited group of activities, such as educational, religious, and charitable activities, qualify. In fact, in Namibia at present, deductible gifts may only be made to educational organizations. In South Africa, where deductible donations have also historically been limited to educational institutions, the Finance Minister has proposed an expanded list of public benefit activities for purposes of deductibility of donations. However, it is of note that seven of the ten proposed activities are directly related to education or training.²⁸ Unfortunately, this list does not go as far as the Katz Commission proposal in increasing the range of organizations that qualify to receive deductible donations.²⁹ The Minister will publish a final list in the Government Gazette after having taken into account public comments on the subject.³⁰

Developing a broader range of public benefit activities to which donors may make tax deductible gifts is consistent with a general desire to encourage more private participation in both social welfare activities and in social and economic development. In general, deductions stimulate charitable giving, and some studies in the United States indicate that the gain to the supported institutions at least equals and in some cases exceeds the revenue loss to the fisc.³¹ Nonetheless, it is important that sufficient resources be devoted to ensuring that the allowance of deductions for charitable contributions does not become subject to fraud and abuse. Therefore, rules must be developed that will assist the revenue authorities to ensure that a gift is actually being made to charity when a deduction is permitted.³²

²⁷ See Income Tax Act §18A(1). Uganda, which also recently adopted tax legislation relating to NGOs, also permits a deduction of up to 5% of income for charitable gifts for both businesses and individuals.

²⁸ The care and welfare of abused and orphaned children; the care of destitute aged persons, and the prevention of HIV and the provision of care to those whose lives have been impoverished by HIV are also included in the proposed expanded list of activities. See Minister of Finance, *Draft Public Benefit Activity List: Deductibility of Donations* (Attached as Annex B).

²⁹ See Katz Commission, *supra* note 13, at 5.14.6.

³⁰ See Joint Submission, *supra* note 14.

³¹ See Auten, Cilke & Randolph, *The Effects of Tax Reform on Charitable Contributions*, XLV *National Tax Journal* 266 (1992).

³² One possibility would be to require that the recipient organization give the donor a receipt stating that it qualifies as a proper recipient under the law, that the gift will be used for public benefit purposes, and stating the amount of a cash gift or the fair market value of a property gift.

Conclusion. At present the tax laws in Anglophone Africa provide some tax benefits for NGOs and their donors. In some countries in the region these benefits are still too limited to create an enabling fiscal environment that will strengthen the ability of the NGO sector to provide needed social services. This is true because the range of tax exempt activities is too narrow and because there are no tax benefits for donations. Our research indicates, however, that more and more countries are recognizing that the failure to provide adequate tax benefits will stifle development. Thus, the trend in the region is to create more tax incentives than were traditionally available, and this trend is entirely consistent with international good practice.