

**FINANCIAL SUSTAINABILITY OF
NGOs: PROPOSALS FOR 1998-99
FEDERAL BUDGET**

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By

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The involvement of private individuals and the role of trusts and foundations in the distribution of charity and for undertaking works of public interest has been recognised throughout history. Their role has become particularly important in developing countries where, governments in general are faced with a situation of a paucity of resources. There is a general realisation that there is a need for greater cost-effectiveness and transparency in the delivery of services. Studies and experiments throughout the world have established that the involvement of NGOs and CBOs in taking over some of the responsibility of government is more beneficial and ensures sustainability. As such governments throughout the world have encouraged such organisations by giving them special consideration where taxes are concerned. The giving of charity by donees has also been encouraged by allowing the amount donated as a tax write-off.

In 1991, the Government of Pakistan put together the Social Action Programme (SAP). One of the cornerstones of the policy parameters of the programme was the decentralisation of services and the involvement of communities, CBOs and NGOs in delivering services. This has been reiterated more forcefully in the second phase of SAP. As such the Government of Pakistan appears to be encouraging the NGO sector. It is, therefore, an opportune time for revisiting the fiscal framework for the sector. This is necessary to provide a more favourable enabling fiscal environment to promote sustainable development of NGOs, specially to stimulate more local, sustainable funding from private and corporate sources.

Non-Governmental Activities

The role of NGOs has been growing and has evolved in the years since independence. Mainly charitable and philanthropic organisations in the 1950s, NGOs have increasingly stepped into welfare-oriented roles to complement the state system. Over the years NGOs have become more involved in community-based initiatives for social and economic development targeted to improve the quality of life or to help alleviate poverty. Most NGOs/CBOs are supported by community contributions, local donors,

and government funds. In recent years, support from international donors has also become available.

There are three main types of NGOs. The first are the national level capacity-building, research, advocacy and/or funding organisations. The second are the implementing and/or support organisations. These work directly with communities to establish community-based organisations in specific regions, helping them to shift from welfare orientation to participatory development, and supporting their development projects. The third type are the Rural Support Programs (RSPs) that have followed the model of the Aga Khan Rural Support Project in forming village or community organisations. These RSPs do not follow a specific model and are open to working with existing community organisations. In urban areas they are working in the land development, poverty alleviation, education, health and sanitation sectors.

The NGO/CBO is a growing sector in the country. According to reference of the study undertaken there are over 8500 NGOs operating in Pakistan which are registered under the Companies Ordinance, 1984, the Societies Registration Act, 1860 and the Voluntary Social Welfare Agencies (Registration and Control) Ordinance, 1961. Not included in this are those organisations established under the Cooperative Societies Act, 1860, the Trust Act, 1882 and the Muslim Waqf Laws. After religious organisations, professional and commercial associations, employee unions, housing societies, clubs, clinics and hospitals were excluded, 4,545 organisations remained. Of these over 2,000 were engaged in the SAP sectors. The largest number of these are locally based at a mohalla/village level. The distribution of activity is shown in Table 1.

Heads	Education	Health/ Nutrition	Water Supply	Sanitation	Family Planning	Women and Development
NGOS INVOLVED IN:						
TOTAL	<u>33.1</u>	<u>25.8</u>	<u>8.0</u>	<u>15.2</u>	<u>6.3</u>	<u>11.5</u>
of which:						
RURAL	37.4	34.5	40.1	32.9	35.3	23.2
URBAN	62.6	65.5	59.9	67.1	64.7	76.8

NGOs are engaged primarily in resource mobilisation efforts. Table 2 lists their primary activities in order of priority. Project implementation or direct delivery of social services is fifth in the list of priorities and lag behind other activities such as institution building, technical assistance and training. The reason that such a small number of NGOs are directly engaged in the delivery of social services is indicative of the fact that NGO movement in social sector delivery is in its infancy and need to be harnessed.

TABLE 2 PRIMARY ACTIVITIES (%)						
Heads	Education	Health/ Nutrition	Water Supply	Sanitation	Family Planning	Women and Development
NGO'S INVOLVED IN:						
Total of which:	<u>33.2</u>	<u>25.7</u>	<u>8.0</u>	<u>15.1</u>	<u>6.4</u>	<u>11.5</u>
Project Implementation	20.7	24.5	21.7	24.3	30.1	27.6
Research	16.4	17.1	20.2	23.1	25.0	19.6
Resource Mobilisation	42.4	45.2	50.4	52.1	49.1	45.5
Data Gathering	16.7	17.6	28.7	28.0	27.8	25.6
Institution Building	46.4	43.2	38.2	40.9	50.9	39.5
Technical	40.2	42.6	52.9	53.0	60.6	46.8
Training	54.1	41.8	40.1	43.1	48.1	53.0

Most NGOs have multiple sources of finance (See Table 3). 41 percent subsist on their own membership fees, 31 percent on donations, 15 percent on income from services. Only 8 percent of NGOs reported receiving aid from donors (both government and international agencies). As such, donations and self-generated funds constitutes the principal sources of funding for NGO/CBO activity in Pakistan.

TABLE 3 FINANCIAL SOURCES OF NGOs (%)						
Heads	Education	Health/ Nutrition	Water Supply	Sanitation	Family Planning	Women and Development
NGOs WITH INCOME SOURCE BASED ON:						
Membership Fee	85.8	85.3	91.2	86.5	86.0	82.6
Fund raising and donations	62.7	68.0	58.4	61.1	31.0	61.6
Aid-donor & Government Agencies	13.3	16.8	15.3	17.2	24.0	15.3
Income from services	31.5	30.6	15.3	23.3	34.9	40.5
Others	10.3	13.1	13.9	8.8	17.1	12.0
TOTAL	33.9	26.6	6.7	14.5	6.3	11.9

Because of limited financial resources, expenditures of NGOs remain limited. For Most NGOs' total annual expenditure does not exceed Rs 50,000 (See Table 4). Also, about 63 per cent of NGO's spend upto 25 per cent of their total expenditure on capital expenses, including acquisitions.

TABLE 4					
	% OF NGOs WITH ANNUAL EXPENDITURE OF RS:				Total NGOs
	<= 50,000	5,00-100,000	100,001-500,000	>= 500,001	
TOTAL NGOs	65.4	13.7	16.6	4.2	100.0

To promote financial sustainability of NGO and not-for-profit organisations it is important that fiscal environment in which they operate is improved. To prepare a working paper of the provision of tax relief for the sector a working group was constituted by SPDC which included the following:

- ? Dr. Aisha Ghaus-Pasha, *Chief Executive Officer*
SOCIAL POLICY AND DEVELOPMENT CENTRE (CONVENOR)
- ? Mrs. Sadiqa Salahuddin, *Director*
NGO RESOURCE CENTRE, THE AGA KHAN FOUNDATION
- ? Mr. Leon Irish, *President*
INTERNATIONAL CENTRE FOR NOT-FOR-PROFIT LAW
- ? Mr. Shahid Kardar, *Director*

SYSTEMS (PVT) LTD.

- ? Dr. Mutawakkil Kazi, *Member II*
PLANNING COMMISSION, GOVERNMENT PAKISTAN
- ? Mr. Nasim Hyder, *Director*
SIDAT HYDER MORSHED ASSOCIATES (PVT) LTD.
- ? Mr. Joe Bolger, *Programme Co-ordinator, Pakistan-Canada*
SOCIAL INSTITUTION DEVELOPMENT PROGRAMME, THE AGA KHAN FOUNDATION
- ? Mr. Zafar H. Ismail, *Principal Specialist/Company Secretary*
SOCIAL POLICY AND DEVELOPMENT CENTRE

The working group reviewed international and local available literature on the subject, including "A Study on Fiscal Framework only for NGO Sector in Pakistan" commissioned by The Aga Khan Foundation prepared by Siadat Hyder Morshed (Pvt) Ltd. The scope of the proposals was limited to income taxation. Proposals[?] of the working group that can potentially be included in the 1998-99 budget are presented below:

PROPOSED CHANGES IN FISCAL LAWS AFFECTING NGOS

The following changes to the Income Tax Ordinance of 1979 are proposed:

1 *Need for clearer definition of terms*

In Section 2 sub-section (14) defines the term "charitable purpose" as

"Charitable purpose includes relief of the poor, education, medical relief and the advancement of any other object of general public utility"

The definition of "charitable purpose" needs to be clear and more specific in view of the wider and more pronounced role of non-governmental organizations. A clear and specific definition creates confidence and transparency, and restricts the possibility of incorrect interpretation. The above definition may,

[?]Comments on the proposals were then sought from Dr. Suleiman Sheikh, CEO, Strengthening Participatory Organisation, Mohammad Tehseen, Executive Director, South Asia Partnership.

therefore, be replaced by the following:

“charitable purpose” includes

- (a) *relief of poverty,*
- (b) *provision of humanitarian or disaster relief,*
- (c) *advancement of religion,*
- (d) *provision of education, training, or development of human resources by targeting the poor,*
- (e) *provision of health, nutrition, or family planning services,*
- (f) *advancement of culture or the arts,*
- (g) *non-commercial research, including scientific, technological, or social research, but not related to armaments or warfare,*
- (h) *promotion of historical or cultural preservation,*

- (i) *promotion of social or economic development primarily for the benefit of economically or socially disadvantaged individuals or groups, including micro-credit programmes,*
- (j) *protection of human rights,*
- (k) *protection or enhancement of the environment,*
- (l) *elimination or reduction of discrimination, or*
- (m) *any other object of general public utility.*

The term "*public benefit non-governmental organisation*" has not been defined in Section 2. It is, therefore, proposed that a new sub-section be added after sub-section (36) as follows:

(36A) *A "public benefit NGO" is any society registered under the Societies Registration Act, 1860, cooperative society registered under the Co-operative Societies Act, 1860, company registered under Section 42 of the Companies Ordinance, 1984, voluntary social welfare agency registered under the Voluntary Social Welfare Agencies (Registration and Control Ordinance, 1961), public and charitable trust registered under the Trust Act, 1882, or a waqf registered under the Mussalman Wakf Validating Act, 1913 and*

- (i) *which is established in Pakistan primarily for the purpose of engaging in one or more charitable purposes, and*
- (ii) *from which no net earnings, profits, or assets can be distributed during the life of the organisation or upon its termination to any member, founder, director, officer, or employee, or to any spouse or blood relative of such a person, and*
- (iii) *that provisions similar to those of Sections 230, 233, 234, 236, 241 and 242 of the Companies Ordinance, 1984 shall apply equally to all public benefit NGOs registered under any of the foregoing Acts/Ordinances hereinbefore mentioned with respect to the maintenance and submission of accounts, and*
- (iv) *that the provisions similar to those of Sections 252, 253, 254, 255, 256 and 257 of the Companies Ordinance, 1984 shall apply equally to all public benefit NGOs registered under any of the foregoing Acts/Ordinances hereinbefore mentioned with respect to the audit of the accounts of the public interest NGO.*

This would also require a consequential amendment in sub-clause (3) of Clause 62 of Part I of the Second Schedule which reads:

(3) A trust or welfare institution approved by the Central Board of Revenue for purposes of this sub-clause.

As the stricter definition of public interest NGO would ensure greater transparency in the operations of such organisations, the terms "trust or welfare institution" should be replaced by "public interest NGO".

2 Proposal to Broaden the Sources of Investment Income that are Exempt.

The existing Clause 93 of Part I of the Second Schedule reads;

(93) Any income which is derived from investments in securities of the Federal Government and house property held under trust or other legal obligations wholly, or in part only, for religious or charitable purposes and is actually applied or finally set apart for application thereto:

Provided that nothing in this clause shall apply to so much of the income as is not expended within Pakistan:

Provided further that if any sum of the amount so set apart is expended outside Pakistan, it shall be included in the total income of the income year in which it is so expended or of the year in which it was set apart, whichever is the greater, and the provisions of sub-section (3) of Section 65 shall not apply to any assessment made or to be made in pursuance of this proviso.

This is extremely restrictive, exempting only investment income from securities of the Federal Government or house property. By limiting the class of exempt investments to these two categories, the tax law effectively limits the actual investments made by charitable organizations.

Broadening the classes of investment income that are exempt will permit charitable organizations to earn higher rates of return. This will make more resources available for their work. This in turn relieves the

burdens of government, without diminishing the revenues of the Government.

Clause 93 of Part I of the Second Schedule may, therefore, be amended by inserting, after the words "Federal Government", the following;

, deposit with banks and financial institutions,

3 Proposal to Clarify that Donations and Subscriptions are Exempt.

The application of existing law as practiced exempts donations and subscriptions under Clause 94 of Part I of the Second Schedule. However the existing law reads as follows:

(94) Any income of a religious or charitable institution derived from voluntary contributions applicable solely to religious or charitable purposes of the institution:

Provided that nothing contained in clause (93) or this clause shall apply to the income of a private religious trust which does not ensure for the benefit of the public.

Therefore, to make the law consistent with actual practice a technical correction is required. This can be achieved by inserting, after the words "voluntary contributions," the following:

,donations, or subscriptions

4 Proposal to Exempt Income from Contractual Payments

There is general agreement that all levels of government are faced with a paucity of resources and that there is now a need to use alternate mechanisms for limiting the role of the state in the provision of services. In 1991, the Government of Pakistan put together the Social Action Programme (SAP). One of the cornerstones of the policy parameters of the programme was the decentralisation of services and the involvement of communities, CBOs and NGOs in delivering services. This has been reiterated more forcefully in the second phase of SAP. This is also the mainstay of delivery envisaged for the Ninth Five Year Plan. While the Government of Pakistan would appear to be encouraging the NGO sector, on the

one hand, it had, on the other hand, introduced a series of changes in tax exemption of incomes by the NGOs and the manner in which requests for such exemptions are being handled by the Central Board of Revenue.

In the second phase of SAP, one major component requires that NGOs be contracted by the Federal and Provincial Governments to assist in mobilising communities, actually implementing delivery programmes and in supporting the move towards greater efficiency through research, monitoring and evaluation. In addition the recently created Pakistan Poverty Alleviation Fund Company established by the Government of Pakistan proposes to use the services of NGOs/CBOs in implementing its programme. However, income from such payments are subject to tax. This is proving to be an impediment to the growth of the NGO sector.

Exempting such income that is derived from carrying out the charitable purposes of a public interest NGO (which by definition would target the disadvantaged segments of society) would assure an important source of financial support for charities, thereby strengthening them. Examples of revenue that might be exempt if this amendment were adopted are fees earned by a charitable hospital or tuition charged by an educational institution set up for the disadvantaged.

Income from contracts, or other payments from private charitable institutions, other public interest NGOs, or bilateral, multilateral, governmental or para-statal agencies should, therefore, be exempted from tax. At the current time virtually no revenue is collected from charitable purpose institutions with respect to income derived from carrying out their charitable purposes. Accordingly, enactment of the proposed amendment will clarify current law without diminishing tax revenues.

Therefore, there is a need to introduce this concept *de novo* by adding a new Clause (94A) after Clause (94) of Part I of the Second Schedule as follows:

(94A) Any income derived by a public interest NGO representing contractual payments from private charitable institutions, other public interest NGOs, bilateral, multilateral, governmental or para-statal agencies to carry out activities of social development in Pakistan.

5 Calculation for Charitable Deductions

Currently the allowance for charitable contributions is calculated based on the average rate of tax paid by taxpayer rather than the highest applicable marginal rate. The existing method of calculation is governed by Clause (e) of Para A of Part I of the First Schedule, namely:

- (e) *Notwithstanding anything contained in this Ordinance, the rebate for any allowance under Section 47 shall be computed at the average of tax and allowed accordingly.*

The current method of calculating the allowance for charitable contributions is neither fair nor reasonable, and it improperly understates the value of the allowance. Individuals make contributions out of their disposable income, not out of their income that is necessary to provide food, shelter, education, and so forth, for their families. In other words, charitable contributions come out of the last rupee that a taxpayer earns, not out of the first. It is, accordingly, appropriate to calculate the value of the charitable contribution according to the highest tax rates(s) applicable to an individual taxpayer, rather than the average rate. (The current method of calculating allowances for charitable contributions does not currently affect companies, which pay a single rate of tax-thirty per cent - on all of their taxable income.)

Changing the method of calculating the allowance for charitable contributions would increase the incentive for charitable giving especially be those who can most afford to do so. By increasing the value of the allowance, the proposed change would increase the monies flowing into public interest NGOs that do work that otherwise would be the responsibility of the State.

It is, therefore, proposed that Clause (e) of Para A of Part I of the First Schedule either be deleted or the words "*average of tax*" be deleted and replaced by "*marginal rate of tax*".

6 Removing the Limit on Donations to a Single Donee

At present sub-section (3) of Section 47 reads :

- (3) *The sum eligible for allowance under sub-section (1), in respect of any institution or fund referred to in clause (d) of section (1) shall not exceed twenty-five hundred thousand rupees.*

And sub-section (3A) of Section 47 reads :

(3A) The aggregate of allowances under sub-section (1), in respect of donations, subject to the limit specified in sub-section (3), shall not exceed -

- (i) in the case of a company, ten percent of the total income; and*
- (ii) in any other case twenty five percent of the total income.*

The twenty-five hundred thousand rupee limit on the amount of deductible donations that can be made by one individual or company to a single public interest NGO is arbitrary, outmoded, and artificially restricts charitable contributions. The restricts the fundamental right of the individual or an organisation in determining how (s)he/it spends its money. It could well be argued that this may be against the fundamental rights conferred by Articles 18 and 23 of the Constitution.

There is a need to amend the law to remove this maximum limit. It is, therefore, proposed that

- (a) sub-section (3) of Section 47 be deleted, and*
- (b) in sub-section (3A) of Section 47 the words and commas: “, subject to the limit specified in sub-section (3),” be deleted.*

7 Provision to Carry Forward Excess Donations

The current law limits the total donation which may be claimed as an allowance to ten percent of income of companies and twenty five percent in other cases.

Sub-section (3A) of Section 47 reads :

(3A) The aggregate of allowances under sub-section (1), in respect of donations, subject to the limit specified in sub-section (3), shall not exceed -

- (i) in the case of a company, ten percent of the total income; and*
- (ii) in any other case twenty five percent of the total income.*

The stated policy of government is to encourage the establishment of public interest NGOs. This limit is seen as an impediment to donations by the private sector or individual. There may be instances where a donee may wish to commit an annual amount for a specific charitable purpose, but is unable to claim the allowance because he has incurred a loss or been unable to earn an income. However, owing to the commitment given, he is obliged to make this payment. While there appears to be a justification for limiting the aggregate of allowances to a proportion of the income, there is nevertheless a justification to permit the giving of donations even where an assessee may have incurred a loss in any particular year or have derived no income. The law should allow for such circumstances.

It is proposed, therefore that a proviso be added after sub-clause (3) of Clause 62 of Part I of the Second Schedule as follows:

Provided that in the event of there being no income in a year, the donation paid in the year shall be allowed to be carried forward for allowance in the following assessment year.

Provided further that such carry forward would be limited to four assessment years immediately succeeding the assessment year in which the donation was first paid.

AMENDMENTS ACCEPTED IN TAX LAWS

As a result of the above recommendations submitted to the Government, the Finance Act 1998 contained changes with respect to the kind and level of donations for charitable purposes. Changes to Section 47 of the Income Tax Ordinance, 1979 have been included. The first notification was with respect to donation of articles or goods. The value and type of such articles or goods, will, however be determined by the Central Board of Revenue.

The cap on donations set at Rs 2.5 million has been removed entirely. The final amendment has increased the share of income that may be donated in any one year. The limit of 10 percent in the case of companies has been increased to 15 percent. In the case of all other assesseees 30 percent of income can now be donated for charitable purposes.

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