

**CHARITIES AND KENYA'S TAX SYSTEM: A PROPOSAL FOR TAX  
LAW REFORMS**

**By: Gitau Joseph J. Mwangi**

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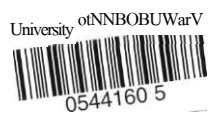
**A thesis in partial fulfillment of the requirement of the degree of Master of Laws (LL.M) at  
School of Law, University of Nairobi**

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**2012**

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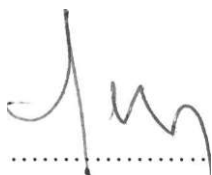
## DECLARATION

I, **Gitau Joseph J. Mwangi** do hereby declare that this thesis is my original work and no portion of this work has been submitted or is being submitted for similar or any other degree in this University or any other University.

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This thesis has been submitted for examination with my knowledge and approval as the university supervisor.

Signed: 

Date: 26 f(

**Supervisor: Professor Albert Mumma**

## **DEDICATION**

I primarily dedicate this work to my mother without whom I would never have started this journey.

To my entire family whose diligence, fortitude and unity are always a source of inspiration.

To my children Priti and Tamara: You are the greatest source of my encouragement.

## **ACKNOWLEDGEMENT**

I do thank my supervisor Professor Albert Mumma for his support and assistance in preparation of this work. You shaped and developed my vague ideas. To you I give all my immeasurable thanks.

I would further like to express my gratitude to M/s Elnorah Juma for providing the necessary secretarial support for this work.

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## **Abstract**

### **Charities and Kenya's Tax System: A proposal for Tax Law Reforms**

Kenya has a particularly rich and diverse range of acts of philanthropy (giving) and charities without appropriate policies and legal framework to nature and supports the charity sector. The contemporary legislative framework fails to provide a definition of 'charity' fails to identify where responsibility lies for determining charitable status, fails also to specify whether the test to be applied to determine such status and registration or regulatory regimes respect of charities is inadequate. There is also multiplicity of agencies and lack of any co-ordination of their respective areas of responsibility in relation to charities

In nutshell, there is unsuitability of the current legal structures/forms for the modern charitable activity and cannot encourage philanthropic activities.

This study will focus to fill an existing gap in the current tax law as it relates to charity sector.

It is generally accepted that socio-economic changes in Kenya and global forces has now made changes to the related legislative framework an inescapable and pressing necessity.

Legislative changes are broadly needed to provide a facilitative and sustainable environment for charities and to put in place registration and regulatory systems.

The range of existing connected legislation, such as the Companies Act, Societies Act, Value Added Tax Act, Income Tax Act, Non-Governmental Organization Co-ordination Act and Customs and Excise Act have impacts upon NGOs and other charities but do not suitably recognize them and encourage charitable purposes.

All will need to be revised and shaped into a more unified and coherent body of law. Any such overhaul of the law relating to charities would also need to address the legal structures that house their activities.

A clearer legislative articulation of the public benefit principle as it applies to contemporary social circumstances in Kenya may well be necessary to underpin and give coherence to the final re-formulation of the law.

The emphasis is on providing recognition for the charitable activities of the organizations in order to facilitate their eligibility for tax exemption and thereby encourage the continuance of such activities.

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43 CLR 364 at 374-375.
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*Re McEnery*, (1941) IR 323

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*Swfie v. Attorney General*, (1912) 1 IR 133

## TABLE OF ACRONYMS

ALL ER	All England Report
BC	Before Christ
CA	Court of Appeal
CEA	Customs and Excise Act
CFSB	Charitable Fundraising Standard Board
EACMA	East Africa Customs Management Act
HL	House of Lords
IR	Internal Revenue
ICNL	International Centre for Not Profit Law
IRC	Inland Revenue Commission
ITA	Income Tax Act
KCDF	Kenya Community Development Foundation
KRA	Kenya Revenue Authority
LN	Legal Notice
LR	Law Reports
NGO	Non-Governmental Organisation
NGOCA	Non-Governmental Organisation Co-ordination Act
NPO	Non-Profit Organisation
PBO	Public Benefit Organisation
QC	Queens Council (UK)
SA	South Africa
UK	United Kingdom
UN	United Nations
USA	United States of America
VAT	Value Added Tax

## CHAPTER ONE

### 1.0.0 CHARITIES: PRINCIPLES, CHALLENGES AND NEED FOR INNOVATIONS

#### 1.1.0 INTRODUCTION AND OVERVIEW

The twenty first century has been a time of huge social innovations.

An exceptional innovation is the charitable sector which constitutes the numerous private nonprofit organizations (NPO) and non-governmental organizations (NGOs) that have emerged in recent decades in virtually every corner of the world to provide citizens with vehicles for the exercise of private initiative in pursuit of public benefits.<sup>1</sup>

The limitations of the state, coupled with growing citizens' activism have unleashed a significant growth of the charity sector.<sup>2</sup> The days in history when governmental responses were regarded as the only legitimate response to social and economic distress are long gone.<sup>3</sup>

We do have coordinated responses from the charitable sector and we need to ignite a new spirit of involvement by the Kenyan community.

Law is an active political tool.<sup>4</sup> This study is an appeal for political intervention through Change of the law to find new ways of having fruitful cooperation between public authorities or the state community and the charity sector.

#### 1.2.0 STATEMENT OF THE PROBLEM

This study will focus to fill an existing gap in the current tax law as it relates to the charity sector. The Kenyan's tax laws can be said to be in foundation stages in recognizing the roles of charities and appreciating them in terms of support that recognizes our different ways of

1 See "Civil Society in the United States," <http://soliir.rtd.utk.edu/-cesi/causa/csintrod>. Last accessed on 12 August 2012

2 See Lester M.Salamon and Helmut K. Anheier. *The Nonprofit Sector: A New Global Force*, Baltimore, The John Hopkins University Press, 1995, Page 3,

3 Lawrence Antingdui, *Defining the Nonprofit sector: Ghana*, Working Papers for the John Hopkins Comparative Nonprofits sector Project 1995, <<http://www.adm-cf.com>> (Last accessed April 7, 2012).

4 Ibid note 1 p 7

giving. There is only a resemblance of the traditional means of support provided to the charity sector which are statutory provided. In the year 2006<sup>5</sup>, the Minister for Finance spelt further measures towards supporting charity by allowing certain deduction for institutions that support charity. These changes were introduced through Finance Act 2006 but have elicited remote enthusiasm in charity sector, if any.

The budget process and its implementation have little to support philanthropy. The current system is mostly promulgated by the executive<sup>6</sup> and geared to raising revenue without corresponding efforts towards rewarding those who directly or indirectly assist the government in its endeavors of social development and reduction of poverty.

The basic law applicable to the charitable sector and NPOs is at remarkably immature state of development. Misperceptions continue to surround even the most basic fundamental issues, including the purposes for which these institutions are formed.

This thesis is premised on such acute shortcomings affecting the charities' tax law legal framework in Kenya. In chapter three of this study, we are going to highlight the current tax definition of charities in Kenya, make a criticism and propose a definition suitable for the current circumstances.

Now, and during the coming years, charity sector will definitely be hit by the funding constraints especially in areas of service provision.<sup>7</sup> A contributory factor is the decrease in foreign funding directly to the sector. This makes it more critical for the sector to be given an enabling environment particularly one that promotes and encourages donations from the local markets. A more comprehensive package of tax benefits and exemptions for a broader cross section of organizations, and more attractive incentives for the donors, would be a

<sup>5</sup> *Finance Act 2006*, The *Finance Act* amending the 1st schedule to the *Income Tax Act 2006* provides that contributions made to a tax exempt entity shall be exempt from tax.

<sup>6</sup> Although the parliament has a primary duty of enacting law, the law is mostly drafted by the executive and receive little or no amendment in the parliament.

<sup>7</sup>The Baring Foundation, Civil Exchange and DHA, January 2012, *Protecting Independence: the voluntary sector in 2012*, Page 17, <[www.hnrnlifoointintion.orii.uk](http://www.hnrnlifoointintion.orii.uk)> (last accessed on 14th April 2012)

positive step towards creating the enabling environment. This is the ultimate goal in undertaking this study. In chapter three of this thesis, will are going to propose a number of tax reliefs which can offered to charities to enable them thrive while at the same time offer proposals to encourage donors to donate in their own ways.

Lack of reporting requirement and regulation mechanism has made it that there are no means by which the government can measure the cost of income tax exemption nor monitor the nature or activities of those benefiting from it.

Accordingly, part of this thesis focuses on reporting requirements. It outlines the reasons for an enhanced reporting mechanism and proposes a new legal order for regulations to be implemented. We lack a unified system of registering and/or establishing the charitable institutions in Kenya. Chapter five of the study gives recommendations on regulatory mechanism necessary to ensure accountability and bolster confidence in the sector.

The resulting network of the institutions is complex and diverse. However, the values that the public attaches to their objectives differ fundamentally, some are highly rated in terms of their contributions to the society, while others are shunned. There are two points worthy of particular attention due to such phenomenon; First, efforts to introduce statutory and doctrinal uniformity in charities laws which depend on the public perception of the charitable sector and secondly, making sure that laws' underlying formal structure impact on the public concerns and its dependability.

Certainly, the foremost reason for increasing conflicts and misunderstanding over the roles, rights and responsibilities of the charities sector is confusions about their nature and the language we have used to describe them.

It is the aim of this study to create a universal reference of charities as common 'vehicle" for implementing public policies and programs. This would be done by crafting a definition for purposes of taxation. To define a charity for purposes of taxation requires a review not only

of the profound changes in what the charities do but also of the language, assumptions and concepts we use in understanding the sector.

Finally, the aim in undertaking this study is to stimulate debate, innovation and research. Currently there is a dearth of primary data on philanthropy in Kenya which reflect a wider bias against non-profit sector research. It is intended that this study will generate curiosity towards this area of study.

### **1.2.1 RESEARCH QUESTIONS**

In Kenya, as in other jurisdictions, the charity sector and the charitable activity have greatly changed and face new challenges.<sup>8</sup> However, unlike the other jurisdictions, charity law in Kenya remained unchanged.

This give rise to two research questions. Firstly, does the legal framework, within which many thousands of charities now operate, remain appropriate to support and promote their activities?

Secondly, does it continue to provide an effective means for regulating their activities?

In addition to examining the appropriateness and effectiveness of the charity law in Kenya, the thesis also consider its adequacy in the light of the particular stresses, which have characterised the sector. A distinct research focus is needed to highlight how the charity law framework in Kenya responds not just to the pressures which affects it from the common law world jurisdictions but also to those internal pressures from its environs of its operation. This gives rise to a third research question: does the existing charity law framework offer a sufficient means of responding to the characteristic and indigenou social problems in Kenya?

8 Douglas, James. "Political Theories of Non-profits Organizations." In *The Nonprofit Sector*, edited by Walter W. Powell. New Haven and London: Yale University Press, 1987.



### **1.3.0 JUSTIFICATION FOR THE STUDY.**

No one wants to see the voluntary sector squeezed out despite the lack of concerns in the shortcomings of the current regulatory framework. This is largely because the voluntary sector is seen both as a safeguard of certain fundamental political values and an engine of innovation and social advance. A strong voluntary sector is fundamental to supplement the existence of a comprehensive network of statutory services.<sup>9</sup>

A range of powerful global and local forces are requiring a greater role for philanthropy, both in Kenya and internationally.<sup>10</sup> These forces are setting greater expectations on the role of corporate partnership and corporate philanthropy, and encouragement by the government on social partnership in development circles.

As a result, these factors have enormously stretched the need to evaluate the taxation laws on the way they regulate the charitable sector. In determining whether the current law can address these forces, two problems are met: Whether the current law can appropriately encourage giving, and suitability of archaic definition of charitable giving in a new era and which indeed is operating in a different territory than where it was conceived.

<sup>9</sup> Lord Beveridge, for example. *Voluntary Action*, 1948. London, Allen and Unwin, who has a good claim to rank as one of the main architects of the welfare state was a consistent exponent of the need for private charitable organizations and the role they play in advancing some democratic theories which cannot be advanced in other public institutional setups. "There are many people, he wrote "able and willing to serve the public who are neither suited nor ready to submit to democratic election themselves or to become paid officers on an elected authority, to reject their help is to delay social advance and prevent experiment .innovation and self-criticism." Page 3.

<sup>10</sup> These forces include, The worldwide renewal of interest in the idea of civil society, Reduction in public sector spending and government activity, Privatization of community and public services, Changed approaches to resourcing of educational, scientific and cultural institutions. New patterns of wealth distributions and intergenerational wealth transfers and Growing use by the government and international donors of grant making mechanism for its funding process. See H Picarda, 1999, *The Law and Practice relation To Charities*, Butterworths, 3rd Ed., p 6.

There is a further need for regulation; the existence of so many points of contact between charitable sector and a government multiplies sources of potential friction and confusion in the relationship between the two sectors.

The embracing of the reform recommended here will not abate these problems, and probably will intensify. There is hence a need to mollify the conflict through clear set guidelines and set up a forum and mechanism of potential conflicts resolution.

#### 1.4.0 THEORETICAL FRAMEWORK

Charitable reliefs have attracted significant attention from academics who have attempted to justify its continued use.<sup>11</sup> These justifications fall primarily along two different features of thought. The first and predominant feature argues that charity merits charitable relief because it encourages more and/or better spending on public goods. This justification reflects the current accepted view with regard to charitable relief and has been embraced by an array of distinguished scholars writing in the field today, including Evelyn Brody, John Colombo, and

12

Mark Gergen.

This approach relies on two theoretical pillars. The first is that some public goods require more spending than what is provided to them by the tax-spending process. One may think of this justification as the claim that, without more funding, these goods will not be supplied at a socially optimal level. The second is that charitable relief results in a transfer of funds that efficiently promotes public good. Advocates of this theory rely on the presumption that spending by NPOs is in many cases more efficient than government spending.

The second strand was developed by Saul Levmore, who argued that charitable relief is desirable because it allows taxpayers to vote with their cash and to express their preferences

11 David E. Pozen, *Remapping the Charitable Deduction*, 39 CoNN. L. REV. 531, 533 (2006).

12 See, e.g., Evelyn Brody, *Charities in Tax Reform: Threats to Subsidies Overt and Covert*, 66 TENN. L. REV. 687 (1999); Colombo, *supra* note 3; Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393 (1988); David M. Schizer, *Subsidizing Charitable Contributions: Incentives, Information and the Private Pursuit of Public Goals*, (Columbia Law Sch. Ctr. for Law & Econ. Studies, Working Paper No. 327, 2008), available at <<http://papers.ssm.com/sol3/papers.>>; Simon et al., *supra* note 3, at 274-75.

over the proper allocation of public goods in society.<sup>13</sup> Viewed in this light, charitable relief can be justified as an efficient "government-free" public spending mechanism that allows taxpayers to speak while avoiding the bureaucratic shortcoming of government spending.<sup>14</sup>

The existing justifications for charitable relief fail to address its democratic shortcoming and resulting negatives effects of the application of the law. Moreover, they fail to recognize that legislators cannot structure a proper relief scheme without first directly addressing the administrative constraints that a legitimate scheme should adhere to. This results in vagueness about the proper scope of charitable privileges which obviously helps taxpayers, who know how to best utilize tax law ambiguities to avoid taxes. It also introduces the aspects of misapplication<sup>15</sup> and corrupt use of the charity law to promote criminal activities such terrorism.<sup>16</sup>

More than revenue is at stake. First, theoretical cloudiness surrounding justifications for charitable relief allows policymakers to design charitable laws in ways that arguably that do not resonate with the society's values. Second, it indicates a conceptual ambiguity about the role of charity law in developing and promoting charitable activities.

My argument develops in the following manner: First, I argue that the current tenet, which justifies charity law as a tool to promote social inclusion is defensible. I further show that given such a focal point, it is still true that charitable relief promotes more or better spending on charitable objectives. The unavoidable conclusion of my analysis is that the Kenya's tax laws on charity are materially flawed and in need of a major reform.

<sup>13</sup> See Saul Levmore, *Taxes as Ballots*, 65 U. Cm. L. REV. 387, 387-89 (1998).

<sup>14</sup> Nancy C. Staudt, *Taxation Without Representation*, 55 TAX L. REV. 555,572-73 (2002) (providing a good summary of this approach).

<sup>15</sup> Terrance S. Carter and Benjamin S. Hutchinson, "COMBATING THE ABUSE OF NON-PROFIT ORGANIZATIONS" Summary and Commentary of a Document Issued by the Financial Action Task Force on Money Laundering on October 11, 2002 .

<sup>16</sup> See generally Terrance S. Carter and Sean S. Carter, U.S. Report on the Impact of Terrorism Laws on Charities and How the Work of Charities Can Counter Terror , 2009

Tax law, however, develops frequently through incremental changes rather than through fundamental reforms.<sup>17</sup> Therefore, to substantiate the analysis's contribution, I extend its conclusions to try and generate a policy framework to better understand and resolve real-world problems with reference to reviewing the existing law and legislate on some aspect of charity law.

## **1.5.0 RESEARCH METHODOLOGY, OBJECTIVES AND HYPOTHESIS**

### **1.5.1 RESEARCH METHODOLOGY**

The nature of the study necessitated that most of the research work be library based. Text books and journal especially those that discuss the taxation of charities were useful in accomplishing the study. We extracted information, views and findings from various collections of law reports, law books, articles published in respected law journals, periodicals and commission reports.

### **1.5.2 OBJECTIVES OF THE STUDY**

Much of what can be discussed under this head is encapsulated under the title "Justification of the study" ante.

Broadly the thesis presents an appraisal of provision of tax law as it relates to charities, reevaluation of our culture of giving and philanthropy, conceptual appreciation on how our tax system affects our giving culture and making a call to revive the tax laws of charity from its current level of dormancy.

More specifically and to accomplish the aims under the heading "justification", we hope to achieve the following objectives:

- a) To identify the problems, shortcomings and inadequacies in the current law regime for taxation of charitable organizations in Kenya and press forward that a new legal order is necessary

17 Brys. B. (2011). "Making Fundamental Tax Reform Happen". *OECD Taxation Working Papers*, No. 3, OECD Publishing. Page 3  
<hitj>://clx.(loi.)i B> Accessed on 4th April 2012.

- b) To contribute to the debate on the role of the charitable sector in present day set up and how the government can effectively recognize that role by a favoured tax regime.
- d) Give recommendations on registration and reporting mechanism for all those institutions that would benefit in the proposed tax regime.
- e) To propose and define contours on further research on charity sector.

### **1.5.3 HYPOTHESES**

The thesis proceeds on various hypotheses, some of which will have been detected under the headings, "Statement of the Problem and Justification for the study", *ante*

One hypothesis is that, there are conceptual, structural and institutional inhibitions that continue to deter the culture of philanthropic giving and development of the charity sector in Kenya. The second hypothesis is that the current charity law including the existing common law is in fundamental respects is misconceived and badly flawed.

Thirdly, we hypothesize that modification of the current law of charity would lead a vibrant charity sector and the public concerns depends on the underlying formal structures of law and jurisprudence.

Finally, it is our proposition that any review of the current law should take a global perspective into definition, operational and regulatory regime which would entail looking at the operation of the institutions at all levels.

### **1.6.0 LITERATURE REVIEW**

There is scarcity of legal literature related to appraisal of charity legal sector and the importance of the same in national life in Kenya. This basically was our motivation in undertaking this study.

Due to well developed charity sector, a fair amount of literature exists in western countries especially on provision of the statutes and their interpretation. Analytical look at the available literature would help in establishing a suitable legal regime in Kenya.

Nina J.Crimm, in an article titled, *An explanation, of the federal Income Tax exemption for charitable Organizations: a theory of risk compensation*<sup>18</sup> makes an attempt to explain the rationale for income tax exemption through theories based on economic, social and public policies reasoning.

She notes that the major importance of charity sector or other non-profit institutions is promotion of the pluralism in the society. She discusses the need of the courts to maintain the spirit of pluralism in the society through the various interpretations of charity laws especially when called upon to determine whether certain objectives are charitable or not.

Nina further discusses in details how the nonprofit sector generally provides a means by which collaborative actions of persons can be freely be expressed through social and goals linked to the act of giving .

Another theory which is well highlighted in the paper is the combination of the "market" and "subsidiary" theories as fundamental reasons in giving charitable sector tax privileges. She notes that the preferential tax status given to charities is because they relieve the government some burdens by providing goods and services that otherwise the government would be responsible.

However, the theories put forward by Nina in this article are viewed by academicians as alternatives to other theories such as:

- a) The income measurement theory-which suggests that there is no practical or traditional accounting method to, measures the net income of a charitable organization.<sup>19</sup>
- b) Capital Formation theory which explains the appropriateness of the exemptions because it compensate nonprofit sector organizations for inadequate access to capital from traditional equity investment sources.<sup>20</sup>

18 50 Fla. Law Review 1998, 419, 430-391.

19 Boris, Bittker & George K. Rahdert, The Exemption of Non -Profit Sector Organization from federal income Tax, 83 Yale Law Journal,299, 330,1976.

- c) The altruism theory that suggests the legitimacy of exemption is based on supporting nonprofits organizations intrinsically good intangibles of fostering voluntarism and pluralisms: the initiative of thoughts, actions and experimentations.<sup>21</sup>
- d) A donatives theory which posits that those charitable organizations funded substantially by philanthropic donations deserves an exemption because they are also supported by the public.<sup>22</sup>
- e) The risk compensation theory which implores that nonprofit organization must be compensated for the risk of providing public goods for which there is limited financial returns.

This study shall show how these theories complement each other in supporting and furthering the noble idea of exempting the charities from tax. We shall consider and evaluate new aspects of giving such as donor been allowed to deduct donations from taxable income. We shall consider these new tax aspects and postulate their need in encouraging giving as a critical factor in maintaining the charitable sector vibrancy. Our arguments shall deviate from these traditional theories and focus on the expanded aspects of giving and the need for the taxation regime to not only recognize charities but also givers.

Nina J. Crimm has written extensively on taxation and philanthropy. In another article; *Core Society's Values Deserve Federal Aid: Schools, Tax Credits and Establishment Clause*,<sup>23</sup> she argues for establishment of the schools as one of the core values to be embraced by the society and that the ideas should be supported by the government through tax exemptions. She makes a strong case for institutions established for "advancement of education" to be treated as charitable. She argues that education should not be restricted to the narrow sense

20 Henry Hans Mann. The Rationale for Exempting Non -Profit Organization from Corporate Income Taxation, 91 Yale Law Journal.54(58-62) 1981,

21 Rob Atkinson .Altruism in Non-Profit Organizations, 31 BC law Review 510, 68, 628-638,1990

22 Mark A. Hall,& John D Colombo, The donatives theory of the charitable Tax exemptions,52 Ohio Street Law Journal, 1379 , 1991

23 34 Georgia Law Review, Volume 1 1999.

of schools and universities and should include increasing and promoting the appreciation of arts and culture. In our study we are going to have a similar approach in justifying new 'heads' of charitable purposes to be included in our definition of what is charitable.

Whiteman G.Peter, in his book, *Whiteman on Income Tax*,<sup>24</sup> has dedicated chapter 26 of the book on laws of charity. It is a book written on England legal system and examines in detail the provisions of the taxes statutes in historical perspective bringing in the role Statute of Elizabeth, Mortmain Act and charities Uses Act of 1988 and Charities Act of 1960.

The book discusses in details the nature and extent of the terms of "relief of poverty, advancement of religion, Advancement of education and other purposes beneficial to the community" as outlined by lord Macnaghten in the distinguished case of *Commissioner of Income Tax V Pemsel*.<sup>25</sup>

Our legal system in general is greatly shaped and influenced by English legal system .In our study we are going to bring out various factors that have influenced the current definition of charities in Kenya and trace their historical perspectives and importance to England Legal System.

This study consider the traditional "heads" of charities enumerated by Lord Macnaghten and helps in making a case for adoption of the same in our charity laws.

The historical perspectives of the law charity as contained in England legal system would make part of this study. The thoroughness with which Whiteman has considered the four heads of charity would be of great help in making a case for new "heads" of charitable purposes to suit new roles of charities.

<sup>24</sup> Sweet & Maxwell 3rd Edition. London 1998

<sup>25</sup> (1891) Appeal Cases , 531 ,(1891) All ER Rep 28



Karen Wright in an article for Civil Society Working Papers; *Generosity Versus Altruism : Philanthropy and charity in the US and UK\** , starts by pointing that the international differences in giving levels are becoming increasingly well documented by a variety of sources. She continues to argue that less well explicated in both research and practice are the social understanding of the role and meaning of charity. This paper contributes a comparative analysis of giving ethos and behaviours in two countries; the United States and United Kingdom, in particular the relationship of giving to civic life. It identifies differences in giving ethos and behaviour in the two countries, and postulates two models-generosity and altruism- for explaining the differences."<sup>7</sup>

This work has encouraged us in undertaking this study in two ways: Firstly, it recognizes that different countries/societies have different attitudes and cultures in philanthropy, and secondly, it proposes a taxation regime and other government incentives that would correlate well with the giving ethos of the country. It is our intendments to make legislative recommendations that would suit our own circumstances.

### **1.7.0 CHAPTERS BREAKDOWN**

**Chapter one** will seek to lay a foundation on the concept of philanthropy and set in motion the objectives upon which the study is premised. We shall justify the study and in our theoretical segment we shall lay background to the culture of giving and seek to establish that the current favoured position of givers and giving lay it norms since time immemorial.

This chapter would be instrumental in establishing a basis for the whole study.

26 Karen Wright .Generosity Versus Altruism: Philanthropy and Charity in the US and UK , Civil Society Working Paper 17 .The Centre For civil Society, London School of Economics , London,2001

27 One major conclusion in the paper is that obvious disparities between the two countries exist when overall levels of giving are considered. This conclusion however neglects the complicity of the differences in political structures, social attitudes and the role of charity giving laws in the two countries, as the factors contributing to the discrepancies.

**Chapter Two** comprehensively map the charity sector by clarifying the strategies towards the sector and setting out the principles which should underpin reformed legal and regulatory framework. It is the theory chapter that clarifies the need for sector and the need for reforms in the sector.

**Chapter Three** will deal with definition of charitable purposes which are central to operations of any charity tax law for proper definition of the organizations that qualify to enjoy the privileges of Charities. This chapter defines what would be a charity in Kenya in the context of the circumstances. It derives what we may call "a taxing definition."

**Chapter four** summarises the current 'benefits and exemption' regime, in law and in practice, applicable to charities and the wider not for-profit sector in Kenya. This chapter furthers lays down proposals to support charities through the tax system. It constitute arrange of legal reforms which would enable charities to thrive on a favoured tax regime. Most important it recommends fiscal benefits to be accrued by the "Givers". It is a chapter on encouraging giving and recognizing the noble work of the charities through the tax laws-It is entirely on tax concessions in support of charity giving.

**Chapter Five** aims at giving our charity sector a modernized system of purpose and new accountability framework based on the principles of increasing public trust and confidence in charities, ensuring compliance with law, enabling the charities to maximize their social and economic potential and enhancing accountability to donors and beneficiaries.

**Chapter Six** gives the conclusions derived from the study and set out the proposals recommended in a summarized form. It constitute arrange of legal reforms which would enable charities to thrive on a favoured tax regime. It is a chapter on encouraging giving and recognizing the noble work of the charities through the tax laws-It will capture entirely the concessions in support of charity giving.

## CHAPTER TWO

### 2.0.0 WHAT IS THE NECESSITY OF CHARITY LAW?

#### 2.1.0 INTRODUCTION

Charity law - the legal rules, doctrines, principles and practices that apply to 'charity' as such - remains widely discussed but with great difference of opinion despite its great age.<sup>1</sup> There is vast and rich literature on the theory of civil society from a variety of disciplinary perspectives. Scholars who made their contribution to regulations that is made up of charity law have typically taken either historical or doctrinal approaches to the subject," or recommended the abandonment of charity law for a broader regulatory framework built upon foundations that the legal conception of charity cannot provide." However, theoretical approaches to charity law should seek to explain and justify it on terms specific to it.<sup>4</sup>

The charity sector is being subjected to scrutiny and change, perhaps as never before/ It is especially important that we have a clear sense of the theoretical dimensions of charity law. What does charity law tell us about functions and roles of the charity sector? What are the challenges of the sector? How can the charity law be used

<sup>1</sup> The best account of the history of charity law, but only up to the nineteenth century, remains Gareth Jones, *History of the Law of Charity 1532-1827* (Cambridge University Press, Cambridge, 1969).

<sup>2</sup> See, eg, *ibid*; Peter Luxton, *The Law of Charities* (Oxford University Press, Oxford, 2001); Jean Warburton, Debra Morris and NF Riddle, *Tudor on Charities* (9th ed, Sweet and Maxwell, London,

2003); Hubert Picarda QC, *The Law and Practice Relating to Charities* (paperback ed, Bloomsbury, London, 2010); Gino Dal Pont, *Law of Charity* (2nd ed, LexisNexis Butterworths, Chatswood NSW, 2010).

<sup>3</sup> See, eg, Jonathan Garton, *The Regulation of Organised Civil Society* (Hart Publishing, Oxford, 2009). But note also Matthew Tumour, *Beyond Charity: Outlines of a Jurisprudence for Civil Society* (PhD Thesis, QUT, 2009), which recommends a regulatory framework for civil society .

<sup>4</sup> Two examples are Francis Gladstone, *Charity, Law and Social Justice* (Bedford Square Press, NCVO, London, 1982) and Michael Chesterman, *Charities, Trusts and Social Welfare* (Weidenfeld and Nicholson, London, 1979). Both books consider how charity law might be reconciled with the requirements of social justice, a question that I touch on several times in this paper.

<sup>5</sup> A good indicator of this is the fact that statutory reform of charity law has taken place in recent years in New Zealand (Charities Act 2005), Scotland (Charities and Trustee Investments (Scotland) Act 2005), England and Wales (Charities Act 2006), Northern Ireland (Charities Act 2008),, at < <http://budget.australia.gov.au>>-

overcome the challenges in the sector? And, perhaps most fundamentally, what is the point of having charity law in the first place? Only in the light of answers to questions like these that may we evaluate proposals for the reform of charity law with a clear view of what charity law is and of what it could and should be.

In this chapter, I wish to set out some preliminary thoughts in response to the questions I have just posed. That is, what is the need of charity law? In other words, why would the state go to the trouble of enacting, maintaining and supporting the legal rules, doctrines, principles and practices that, taken together, make up charity law? I think that this question is an important one: indeed, if the question were unimportant or irrelevant in some way, the existence or non-existence of charity law would be a matter of indifference, a conclusion so implausible that its premises simply cannot be accepted. Moreover, I think that any account of the necessity of charity law must be robust enough not only to reveal the goals of that body of law, but also to explain why those goals must be achieved notwithstanding the costs to the state that are entailed in achieving them.

Like all law, charity law costs the state time, money and personnel to administer and enforce. And unlike most law, charity law costs the state revenue that it would have collected if there were no charity law; this is because charity law invariably incorporates rules extending advantageous treatment for taxation purposes to those who, in one way or another, are 'doing' charity. In light of these costs to the government, it is reasonable to emphasize that the arguments in favour for charity law had better be a good one.

6 See Arthur Drache, 'Hostage to History: The Canadian Struggle to Modernize the Meaning of Charity' (Paper presented at the Charity Law I the Pacific Rim conference, Ottawa, Ontario. 4-6 October 2001); Blake Bromlely, 'Contemporary Philanthropy - The Legal Concept of "Charity" Any Longer Adequate?' In Donovan Waters (ed), *Equity, Fiduciaries and Trusts* (1993) 59.

## 2.2.0 THE DETAILS OF CHARITY LAW

The details of charity law are particularly tricky, and Lord Simonds' statement that *fnjo-one who has been versed ... in this difficult and very artificial branch of the law can be unaware of its illogicalities,*<sup>7</sup> remains as true today as it was in 1951 when it was uttered. The analysis can begin by concentrating on features that charity law displays when it is viewed at a greater level of generality; in light of these features, the details of charity law may then be evaluated and arguments made for or against their retention. For present purposes, I wish to concentrate on three such general features.

First, charity law is organised around what is usually called the 'legal definition of charity'. The legal definition of charity is a set of criteria that must be satisfied if a purpose is to be regarded as charitable according to law, and only a gift, trust, entity or association whose purpose is charitable according to law is itself regarded in law as charitable. The function of the legal definition of charity is therefore directed at the conferral or withholding of a certain status in law, a status that is described using the word 'charity'. The criteria by which charitable status is conferred or withheld in law vary in detail from jurisdiction to jurisdiction, but in all jurisdictions the criteria are broadly similar.<sup>8</sup> To begin with, the purpose under scrutiny must fall within one of a set of general descriptions of purpose like 'relief of poverty', 'advancement of education' and 'advancement of religion'.<sup>9</sup>The set is open-ended in that it includes a 'catch-all' description capturing purposes that do not fall within any of the other descriptions but are analogous to purposes that have, in the past, been found by state officials to be

<sup>7</sup> *Oppenheim v Tobacco Securities Trust Co Ltd* [1951] AC 297 (HL), 307.

<sup>8</sup> Karen Nelson. "Tax and the Non-profit Sector - The south African Experience" in Paul Bater, Frits Hondius and Penina Kessler Lieber (eds), *The Tax Treatment of NGOs: Legal, Ethical and Fiscal Frameworks for Promoting NGOs and Their Activities* (2004) 193-194.

<sup>9</sup> In this way, the legal definition of charity is broader than the non-legal understanding of that concept as confined to poor relief: see *Commissioners for Special Purposes of Income Tax v Pemsel* [1891] AC 531 (HL).

charitable."<sup>11</sup> And, in addition, with the exception of purposes answering the description 'relief of poverty', it must be proved as a matter of fact - on the evidence, or by way of a presumption, depending on the purpose and on the jurisdiction - that carrying out the purpose under scrutiny will benefit the public in some way. This criterion is known as the 'public benefit test' of charity law.

Secondly, through charity law the state extends special, favourable treatment to those whose purposes satisfy the legal definition of charity." The state also puts at the disposal of those who must administer a gift or trust for charitable purposes resources that enable the terms of the gift or trust to be varied if this is appropriate.<sup>12</sup> An organisation with a charitable purpose may be exempt from paying certain taxes that it would otherwise have had to pay or may qualify for other privileges that it would otherwise not have qualified for. Gifts to organisations with a charitable purpose may attract state subsidies by being allowed as deductions for the purposes of calculating taxable income or in other ways.<sup>13</sup>

Finally, an entity with a charitable purpose may come within the purview of a regulatory authority established to oversee the 'charitable sector', and may benefit from this. For example, an authority may be empowered by government to register charitable trusts, entities and associations for regulatory and other purposes, and it may be that

<sup>10</sup> In England and Wales, the 'catch-all' description is set out in section 2(2)(m) and 2(4) of the Charities Act 2006. In Australia, it takes the form of the so-called 'fourth head' of charity referred to by Lord Macnaghten in *Commissioners for Special Purposes of Income Tax v Pemsel* [1891] AC 531. For a purpose to fall within the 'fourth head' of charity under Australian law, it must not only be analogous to an existing charitable purpose; it must also be within the 'spirit and intendment' of the preamble to the Statute of Charitable Uses 1601: see *Royal National Agricultural and Industrial Association v Chester* (1974) 48 ALJR 304 (HCA). The requirement that a purpose be within the 'spirit and intendment' of the preamble has been frequently criticised and is likely to be abandoned once a statutory definition of charity is introduced (see above n 5).

<sup>11</sup> Although it is worth noting that the opposite was once the case: see the discussion of the Mortmain Act 1736 in Jones, above n 1, Chapters VII and IX.

<sup>12</sup> *Morice v Bishop of Durham* (1804) 9 Ves Jun 399; 32 ER 656 (Sir William Grant MR); (1805) 10 Ves Jun 522; 32 ER 947 (Lord Eldon LC); *Re Endacott* [1960] Ch 232 (CA).

<sup>13</sup> See, eg, Internal Revenue Code (US), Section 170 (deductions); Income Tax Act 2007 (UK), ss 414- 430n

when raising funds or awareness of purposes in the community there are reputational benefits to be gained by being a registered charity.<sup>14</sup>

I think that any attempt to change charity law must be sensitive to these three features. Consequently, it must explain why the state might extend special, favourable treatment through the tax , the need for regulatory law, and the requirement why only to gifts, trusts, entities and associations whose purposes both fall within certain general descriptions of purpose and satisfy a public benefit test except in the case of purposes within the description 'relief of poverty'.

In what follows, I begin the task of providing such an explanation from a cultural perspective. From that perspective, I argue that charity law reflects and expresses the society's commitment to values rooted in the society. I also argue that charity law expresses the state's endorsement of certain purposes in light of certain goods and services and is the means by which the state provides incentives to pursue the purposes that it endorses. I explain how these expressive and incentive aims may be reconciled with justification of the charity sector.

### **2.3.0 THE ROLE OF CULTURE IN SHAPING CHARITY**

Charitable acts are fundamentally influenced by the ethos and cultures of a particular society.<sup>15</sup> Kenya is a cosmopolitan society and the practices influencing acts of charity can best analyzed from historical perspectives of various cultures constituents of the Kenyan society. A full outline of the history of the world's philanthropy<sup>16</sup> which

<sup>14</sup> Note that a large number of charities choose to remain on the register in England and Wales even though their annual income is less than £5,000 and consequently they are not required to be registered by the Charities Commission. To perform a search of the register, see <<http://www.charitycommission.gov.uk/showcharity/registerofcharities/registerhomepage.aspx>>

<sup>15</sup> Kerry O'Halloran, Myles McGregor-Lowndes, Karla W. Simon, *Charity law & social policy: National and International Perspectives on the Functions of the Law Relating to Charities*, Library of Public Policy and Administration, Springer Science and Business Media, 2008, page 123

<sup>16</sup> Philanthropy is defined as 'the disposition or active effort to promote the happiness and wellbeing of one's fellow-men'. It is closely akin to charity and may be regarded as charity grown up: .like, the impulse to help the needy, which may be casual and

directly influences our giving philosophy cannot be attempted here; but we may illustrate a few of its features.

### 2.3.1 African communities practice of philanthropy

"I honor you by giving . . . You honor me by receiving."<sup>17</sup> From the beginning, such words were understood not as formal decrees but natural blessings through ritual, ceremonies, spiritual events and familial activities as well in governance systems, political processes and other means of engagement.<sup>18</sup>

In most African Societies, gift giving has been part of the rites performed for birth, puberty, marriage, death and other major ceremonies. Giving is a form of sharing, not charity. The focus is on the exchange and the relationship of the giver and receiver. Differences between these values and traditions and those of mainstream philanthropy have caused many in the African societies to be uncertain in their pursuit of private support as well as hesitant in their offers of formal gifts.

The acts of charity practiced by various African societies have evolved and now can be found as institutional philanthropy.<sup>19</sup> To enhance institutional philanthropy by communities, programs<sup>20</sup> must be designed to:

superficial emotion, develops in some minds into a settled disposition and steady life effort , see Karen Wright ,*Generosity Versus Altruism: Philanthropy and Charity in the US and UK* , Civil Society Working Paper 17 .The Centre For civil Society, London School of Economics , London,2001, p 2

17 See Mindy L. Berry, 1999, Native-American Philanthropy: Expanding Social Participation and Self Determination, page 3. <[www.cof.org/files/Documents/Publications](http://www.cof.org/files/Documents/Publications)> (last accessed 10th August 2012.)

18 ICNL; Kanyinga, karuti and Winnie Mitullah (2007) " The Non Profit Sector in Kenya; what we Know and What We Do Not Know." *The Institute for Development Studies (IDS)*, University of Nairobi. Page 7.

19 Examples of how communities are using the techniques of institutional philanthropy include formation of partnerships with other entities as a means of achieving self-sufficiency and self-determination as well as leveraging human and financial resources; and establishment of tribal foundations, registered under Societies Act chapter 108 , as a way to contribute to tribal services and infrastructure needs

20 It is critical to keep in mind the unique character and scope of communities giving when developing ways to implement these recommendations. To stimulate more philanthropy, a program must be designed at the local level, respecting tradition as well as the different styles and forms of giving in the diverse communities. See Barbara L. Ciconte & Jeanne Gerda Jacob, *Fundraising Basics: A Complete Guide*, Jones & Bartlett Learning, 2008 Business & Economics , page 345.



- (a) Expand understanding of the various forms of communities' philanthropic ways of life.
- (b) Promote increased communities philanthropy; and
- (c) Build the capacity of communities' nonprofits to stimulate giving.

### 2.3.2 Christianity and Ancient Societies' Charity

The word charity is derived from the Latin *caritas* and can be traced to the Greek

21

*charis*. In the Western religious traditions, charity has become synonymous with the Greek terms *agape*.<sup>22</sup> Thus, as a theoretical conception, charity has meant both possessive and selfless love, as well as favor, grace, mercy, kindness, righteousness, and liberality. In its practical application, charity denotes the distribution of goods to the poor and the establishment and endowment of such social-welfare institutions as hospitals, homes for the aged, orphanages, and reformatory institution

Documents of ancient Mesopotamia and Egypt indicate that charity in the sense of social justice was considered a divinely decreed principle.

As an applied virtue, charity is expected of everyone, for whoever gives charity will be blessed by the Lord.<sup>24</sup> In medieval Judaism, the highest form of charity is not to give alms but to help the poor rehabilitate themselves by lending them money, taking them

21 Chicago: Charity Summary | BookRags.com, <<http://www.bookrags.com/research/charity-eorl-03>> (accessed April 7, 2012).

22 Other related words are philanthropia, eleemosun (or eleos), and even *philia* and *eros*; and the Hebrew words *zedakah*, *gemilut*, *hesed*, and *caritas* (or *carus*).

23 The reforms of King Urukagina (c.2400 BCE) were praised because "he freed the inhabitants the powerful." But ideals of charity, social justice, and the principle of social consciousness developed not only because the divinity had so ordained but also because social circumstance, human oppression, and suffering demand them. The goddess Nanshe and later the god Utu (or Shamasli), the orphan's mother and father, were the guarantors of justice, cared for the widow, sought out justice for the poorest, and brought the refugees shelter. See Hugh Dawson, *John Winthrop's rite of passage, the origin of the 'Christian charities'* Discourse, University of Carolina press 1991 p 219.

24 Deuteronomy . 15:7-10.

into partnership, or employing them, for in this way the desired end was achieved without any loss of self-respect for the recipient.<sup>25</sup>

Under the influence of the great philosophers Socrates, Plato, and Aristotle and the Stoics, charity was perceived as a duty toward all *"broken and destitute humanity wherever found"*. It was a moral and religious obligation, a social and economic need.<sup>26</sup>

### 2.3.3 Islamic Giving

Zakat (Obligatory Charity)<sup>27</sup> is one of the major 5 duties required by God from all.<sup>28</sup> Zakat is the obligatory charity set as 2.5% of the net income, paid year around whenever the person receives an income. It is described in the Quran as a known and obligatory portion of the income.

The Quranic law provides that Zakat is paid as soon as the money is earned which is total agreement with modern economic and monetary laws, which state that the circulation of money is a vital factor for the prosperity of any economy when the money is paid as soon as it is earned there is more circulation, than if it is stacked away and

25 Ibid (n 12) p 217, But notwithstanding occasional references to liberality toward the gentiles, in Jewish tradition "charity begins at home" and for many centuries the object of charity was the fellow Jew - the individual, the family circle, and the community.

26 Ibid (n 12) p218, The pre-Socratic philosophers had held that justice and equality were principles of divine origin,, as had Pythagoras, who stressed equality and harmony in social relationships. "All human laws are nourished by one, which is divine". Writes Heraclitus. There are no political or economic laws, only moral laws.

27 Quran (7:156) "My mercy encompasses all things, but I will specify if for the righteous who give Zakat"

28 The others being the Shahada (declaration of faith), Salat (contact prayers), Fasting the month of Ramathan and Hajj (Pilgrimage to Mecca).

29 Explain the concept of zakat by reference to the Quran , Retrieved from<<http://answers.yahoo.com/question/index>> (Accessed on 12th April 2012)

paid after the end of the year.<sup>30</sup> According to the Quran, zakat should be based on individuals' income.<sup>31</sup>

The recipients of this type of charity are clearly mentioned in Quran; Charities shall go to the poor, the needy, the workers who collect them, the new converts, to free the slaves, to those burdened by sudden expenses, in the cause of GOD, and to the traveling alien.<sup>32</sup>

Analysis of these literatures shows that religion as a way of life provides a strong foundation for charity and altruism through scripture and a sense of duty taught within the churches synagogues and mosque.<sup>33</sup>

#### **2.4.0 THE ROLE AND PURPOSE OF CHARITY SECTOR**

Laws permitting charities and not-for-profit organizations permit and protect activities that have undeniable impact on society, but are not largely controlled or directed by the government.

Further, where the income of not-for-profit organizations is exempted from taxation, or where contributions to such organizations are made deductible for tax purposes, allowing such organizations involves real, financial cost. What justifies these tax benefits, these indirect subsidies? Further, why should taxpayers tolerate the unavoidable risk of tax abuse that granting such tax benefits entails? These are tough questions, and they require strong responses.

There are at least three economic and five social or political justifications;<sup>34</sup>

30 Besides, if the money is going to a good cause, why make the recipients who are in great need, have to wait till the end of the

31 [3:133] "You should eagerly race towards forgiveness from your Lord and a Paradise whose width encompasses the heavens and the earth; it awaits the righteous, and [3:134] "who give to charity during the good times, as well as the bad times."

32 Quran : 9:60, 2:273 and 2:277; [9:60]

33 Terrance S. Carter and Ryan M. Prendergast, *Human Rights Tribunal Finds Social Organization Discriminated In Expelling Falun Gong Practitioner*, *Church Law Bulletin* No. 33, May 26, 2011, Available on line at <<http://www.churchlaw.ca>> . (Last accessed on 25th November 2011).

### 2.4.1 Economic Justifications:

**1. Efficiency.** Private, voluntary organizations can provide public goods and services with higher quality and lower cost than the governmental authorities.<sup>34</sup> There are cost savings to the extent that individuals devote time and energy to the solution of public problems (e.g., assistance for the ailing or the aged) on a free and voluntary basis.

Additionally, there is the factor of market knowledge. A small, local not-for-profit 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 governmental agency.<sup>36</sup>

Charitable organizations provide programs and services to the community. Most of the times, Charities are formed or expanded to react to a community needs not being met by the government. Charities also tend to have the ability to act faster than government in response to an issue. Charities do not have to wait for a majority of citizens to agree upon a proposed solution. Rather, they have the ability to react to a specialized need or a request by a small group of citizen

**2. Market failure.** The phenomenon of market failure is well known in discussions of business sector. Although the law of supply and demand is an extraordinarily powerful force in the production of goods and services in the most cost-effective way, there is often "market failure" in the provision of needed public goods or services.<sup>37</sup> The theory

34 ' Leon E. Irish *The Role and Purpose of the Not-For-Profit Sector*', , The President International Center for Not-for-Profit Law (ICNL), March 1995

35 United Nations Development Programme, *Joint Venture Public-Private Partnerships for Urban Environmental Services*, PPUE Working Paper Series, Vol. II, (New York: UNDP, 2000): quote at p.8.

36 National Center for Non-profits Boards. *Ask NCNB: What You Should Know about Non-profits: What is the Non-profit Sector?* Available Online at <<http://www.ncnb.org>> (Last accessed on 25th November 2011).

37 An essential role for government is to identify those areas of market failure where there is a real need for public goods because they enhance the quality of life (e.g., parks) or constitute part of the economic infrastructure that is necessary for the business sector to flourish (e.g., railroads), and to meet those needs.

is based on the premise that not enough people desire a service or program to attract for-profit corporations to provide such services. Market failures occur when a nation's

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economy is unable to allocate resources efficiently among individuals. It is a wide ranging failure that usually results due to externalities. Signs of market failure include inequality,<sup>38</sup> few raw materials that allow an economy to build and trade goods,<sup>40</sup> and government intervention that chokes the trade and use of resources.<sup>41</sup> Several different factors outside of these can induce the problem, although these are among the most common.

A conspicuous sign of market failure is interventions of the government through regulations. Government regulation occurs when a nation's political class attempts to control how companies operate.<sup>42</sup>

38 Wise GEEK, *What Are the Signs of Market Failure?* < <http://www.wisegeek.com> > (Last accessed April 7, 2012).

39 Inequality occurs when one group or class of citizens consistently have more income or resources than another. This classic scenario comes from the feudal system of past history. The lords had land, castles, and resources that extended well past the resources of the serfs, who were made to work for the lords. This was a market failure because every individual in the economy was unable to succeed. The limitations placed upon serfs — who were often unable to keep the goods produced by their hands — made it difficult for them to rise above their lowly service. See *Ibid* Note 31.

40 Most countries have fixed borders, which limit their abilities to gather resources. Market failure occurs when a nation's borders are so small that few resources exist to produce goods internally. Therefore, the nation must find willing trade partners who will provide the necessary resources or finished goods for economic advancement. Trade, however, is a two-way avenue. The nation must be willing to give up some of its goods — however limited they may be — in order to induce economic advancement and avoid market failure. See Alison L. Booth, Dennis J. Snower *Acquiring Skills: Market Failures, their Symptoms and Policy*, Cambridge University Press, 2005, page 4.

41 Government intervention is often a common issue or problem that creates market failure. Price controls and regulations are among the top two items that ultimately create market failure. Minimum wage is a common price control; companies receive mandates on how much compensation they must pay to employees. If the minimum wage is higher than the market, however, goods will have higher prices, creating potential market failure when consumers cannot purchase these goods. See *Ibid* Note 31.

42 Even when nations have copious economic resources, too much regulation can restrict the use of resources. This leads to lower production output and higher prices as the government attempts to control supply and demand. Regulations also add costs because a company must alter its operations to satisfy the government, who can make rules and requirements with no economic reasoning. Excessive government control in command economies completely destroys the market. See Alison L. Booth, Dennis J. Snower *Acquiring Skills: Market Failures, their Symptoms and Policy*, Cambridge University Press, 2005, page 3.

Laws that permit individuals and groups to come together to meet the gaps created by market failure in the public sector play a vital role in enriching the society and assuring that those public goods and services to which individuals are willing to devote their own resources will be provided.<sup>43</sup> Most charitable giving seems to occur because of the direct benefits received by the donor.<sup>44</sup>

A thriving charitable sector is seen as one solution to "market failure"—the idea that there are collective goods, or public goods, which are not profitable enough for businesses to provide them at the rate the public needs or wants them.<sup>45</sup> For example, education provides benefits to society that exceeds those that can be accurately valued in a market transaction.<sup>46</sup> As a result education is undervalued, and thus under provided, in a market economy that relies on profits to motivate behavior. Nonprofit education organizations, entities not motivated by financial gain, can make up the market shortfall. This type of market failure provides an economic rationale for the government to subsidize businesses or nonprofit organizations to encourage the greater production of undervalued goods and services.

Economic theories also engage the notion of "government failure"—the failure of government to adequately provide certain services because it does not have the

43 See Lester M Salamon, 'Of Market Failure, Voluntary Failure, and Third-Party Government: Toward a Theory of Government-Nonprofit Relations in the Modern Welfare State' (1987) 16 *Non-profit and Voluntary Sector Quarterly* 29.

44 To the extent people do have interdependent utility functions; interdependence does not seem to matter *on the margin* since most attempts to solicit donations do not appeal to the welfare of those helped by the additional donation. See generally Andreoni, James. 1990. "Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving." *Economic Journal* vol. 100, no. 401 (June): 464-477 See also Mominsh, *The Legal Framework of NGO Enhancement*, <<http://www.msu.edu/user>> (Last accessed April 7, 2012)

45 Boris. Elizabeth T. "Nonprofit Organizations in a Democracy." in *Nonprofits and Government: Collaboration and Conflict*. 2006. The Urban Institute. Washington DC. p. 18.

46 Sherlock. Molly E. and Jane G. Gravelle. "*An Overview of the Nonprofit and Charitable Sector*." Congressional Research Service. Washington DC. November 17, 2009. p. 36

resources to do so or because there is an inadequate political will for their provision.<sup>47</sup> Partnerships between nonprofits and the government may be one way to more adequately provide such services by bringing more resources and will to bear on a specific need.

Private motivations for giving significantly reduce the argument for government intervention because charity will reduce or eliminate the gap between the 'market failure' level of charity and redistribution and the socially optimal level of charity and redistribution.

**3. Support for free markets.** The not-for-profit laws provide indirect support for the success and growth of market economies by increasing the players in the market especially wherever the government would enjoy monopoly thus making it be a situation where the market is unregulated by any party other than those players and transactions in the market.<sup>49</sup>

Charitable organizations provide a mechanism for promoting individual initiatives for the public good. Charitable organizations provide a means by which members of a community can take action in an attempt to change the community they live. These actions may take the form of developing a local neighborhood program or, on a larger scale, developing an organization that responds to world relief efforts.

#### **2.4.2 Social and Political Justifications:**

**1. Freedoms of speech and assembly.** The freedom of speech and the freedom of association are enshrined in the constitutions of most, if not all countries.

However, it is the laws permitting not-for-profit organizations to exist that make these

47 Boris. Elizabeth T. "Nonprofit Organizations in a Democracy." in *Nonprofits and Government: Collaboration and Conflict*. 2006. The Urban Institute. Washington DC. p. 18.

48 Ibid page 21

49 Ibid 21, page 4.

constitutional rights real and meaningful.<sup>50</sup> Further, the right to speak freely is, for most individuals, a right that has little meaning unless implemented through laws permitting interests groups to be formed. Most of us are not important enough for our individual voices to be heard, but if we can band together to form, for example, a society for the protection of battered women or the prevention of cruelty to animals, our collective voices will be heard. Laws that permit and protect not-for-profit organizations give meaning to the freedom of speech.

**2. Pluralism and tolerance.** There are many differences among the members of any society, and individuals and groups have diverse interests and needs. Laws permitting charitable organizations allow individuals and groups to pursue their individual interests.<sup>51</sup> By allowing the pluralism that results from permitting not-for-profit organizations, we express as a society the fact that we value and respect the diversity among us.

Charitable organizations provide an avenue for public participation. People are able to pull together and work toward a common goal with intent to benefit the community and thus charitable organizations provide an opening for pluralism and solidarity.

**3. Social stability and the rule of law.** It is inevitable and unavoidable, that there are differences among us and that these differences will find expression in one way or another. We come from different ethnic backgrounds, speak different languages, and practice different religions, we have different sexes, different ages, and pursue different professions and avocations. These differences will come out, sooner or later, and they will be expressed in a licit or an illicit manner, either legally or illegally. A principal and appropriate role for laws for the not-for-profit sector is to impose

<sup>50</sup> It is by being able to form any club for any purpose, a domestic animals breeding society, a foundation for the promotion of ancient culture and language, and so forth, that individuals actually realize the freedom of association.

<sup>51</sup> For examples chess, folk music, soccer, preservation of a particular language or culture.



transparency and accountability on not-for-profit organizations as a *quid pro quo* for

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permitting such organizations to have legal existence and the protection of the laws.

Nonprofit organizations provide a means for drawing public attention to societal issues.

They make it "possible to identify significant social and political concerns, to give voice to under-represented people and points of view, and to integrate these perspectives into social and political life".<sup>5</sup>

#### 4. Democracy<sup>54</sup>

A strong not-for-profit sector is essential for the long-term success of democracy.

Democracy is an inherently imperfect and often messy form of government. It is the only form of government, however, that assures that the government will generally serve the interests of the people, rather than the people being victimized and exploited by the government.<sup>55</sup>

A strong, vigorous not-for-profit sector that is protected, yet 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.<sup>56</sup>

In the capitalist economy, the charitable sector can be seen as a bridge between capitalism and democracy. Nonprofit organizations develop a sense of community among the citizens by providing a means to engage in social welfare.

52 Thus, rather than driving a group underground (in order, e.g., to preserve their language and culture), the laws for the not-for-profit sector allow that group legal existence and the protection of the law, so long as they meet minimal standards of legality and responsible behavior.

53 Douglas, James. "Political Theories of Non-profits Organizations." In *The Nonprofit Sector*, edited by Walter W. Powell. New Haven and London: Yale University Press, 1987.

54 By democracy, incidentally, we do not mean any particular form of it -presidential, parliamentarian but rather the simple right of citizens, through fair and universal vote, to replace their existing government with another one. The right, in that colorful American phrase, "to throw the rascals out."

55 Foley M. and Edwards, B., "The Paradox of Civil Society," *The Journal of Democracy*, 7 (3):39 (1996).

56 James Bohman and William Rehg (Eds.), *Deliberate Democracy - Essays and Politics*. MIT Press (1997) (found in Roland Rich (2003) at < [www.cdi.nnu.edu.au](http://www.cdi.nnu.edu.au) >). (Last accessed on 12th April 2012)

5. **Privatization of public properties and services.** The privatization process has gone a long way towards moving many of the assets and operations of state owned enterprises into the private, business sector. There is now keen interest in using not-for-profit organizations to accomplish similar privatization of social and cultural organizations.<sup>57</sup>

The government will not provide a service because of high cost or limited interest by the public. If there is not a large presence of constituents demanding a response from the government, then the government is not likely to act. A small group of individuals can create a nonprofit organization to provide mutually desired services rather than trying to convince a majority of citizens to support such efforts. There is also a cultural resistance to "big" government. Citizens are skeptical about the government being involved in all aspects of community life.<sup>59</sup>

### **2.5.0 CHARITY LAW AS AN INSTRUMENT TO CONFER PRIVILEGES**

Charity law makes possible, to those whose purposes have achieved a certain legal status certain legal status to enjoy certain tax privileges and this is a characteristic that HLA Hart famously identified as 'power-conferring' rules.<sup>60</sup> For Hart; the power conferring rules of a legal system do not impose duties or obligations, but instead

<sup>57</sup> Hungary has already adopted a law creating special not-for-profit organizations to serve this purpose and the Czech Republic is far advanced in considering adoption of such a law. At a minimum, sound procurement laws that assure fairness and a level playing field in the competition for governmental grants, contracts, or assets is a necessity. See National Council of Voluntary Organizations (NCVO), Charity Giving: Research Briefing-The Tide has Turned, Research Quarterly, NCVO .London June 2001,p 23

<sup>58</sup> Damary Monila, Nonprofit Organizations definition and Examples , Retrieved from <<http://www.learningtogive.org/papers/paper41.html>> (Last Accessed on 23 March 2012)

<sup>59</sup> Woodin, T., Crook, D., and Carpentier, V. (2010). *Community and Mutual Ownership: A historical review*. York: Joseph Rowntree Foundation.

<sup>60</sup> HLA Hart, *The Concept of Law* (2nd ed, Clarendon Press, Oxford, 1994) 27-28. See also HLA Hart, *Essays on Bentham: Jurisprudence and Political Theory* (Oxford University Press, Oxford, 1982) 218-219.

empower individuals to bring about, usually by following certain procedures and satisfying certain conditions, changes in the legal position of themselves and others.<sup>61</sup>

The law might take the form of the creation or extinguishment of rights, powers, duties, obligations, privileges or immunities.<sup>62</sup>In the case of charity law, the legal definition of charity, setting out the criteria according to which charitable status is conferred or withheld, establishes conditions that must be met by those who would invoke the power-conferring rules of charity law to change the legal position both of themselves and of others.<sup>63</sup> By meeting those conditions, individuals or entities are enabled to bring about an array of legal changes, from generating the rights, powers and obligations that characterise a charitable trust, to acquiring the right to claim tax exemptions, to acquiring the right to be registered as a charity by a regulator.<sup>64</sup>

If charity law is best understood as a set of power-conferring rules, then the need and point of charity law is likely to become clearer in light of reflection on the point of power conferring rules. According to Hart, the 'social function' of power-conferring rules is to 'provide individuals with facilities for realizing their wishes'.<sup>65</sup> For Hart, this is one of the great contributions of law to social life.<sup>66</sup>

61 Ibid.

62 See generally Wesley Newcomb Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning* (Yale University Press, New Haven, 1919) 36.

63 As Neil MacCormick argues, among the formal features of power-conferring rules is that they must be 'invoked' if they are to be effective in bringing about changes in the legal position of the person who invokes them or of any other person: *HLA Hart* (2nd ed, Stanford University Press, Stanford, 2008) 99. A person invokes the power-conferring rules of charity law by claiming charitable

64 see Carolyn J Franlz and Hanoch Dagan, 'Properties of Marriage' (2004) 104 *Columbia Law Review* 75; Hanoch Dagan, 'The Limited Autonomy of Private Law' (2008) 56

Where he an analogy of the the power-conferring rules of family law, under which those whose relationships achieve a certain status - marriage, or civil partnership, or perhaps some broader status triggered by cohabitation as a couple - may thereby change their legal position in respect of matters such as asset division in the event of relationship breakdown.

65 Hart, *The Concept of Law*, above n 15, 27 (Hart's emphasis).

66 Hart, *Ibid* above n 15, 27 (Hart's emphasis)

## **2.6.0 CONCLUSION**

In practice and to encourage charities to engage with social inclusion issues, combined with lack of increased government funding of community organizations, lack of government/community sector partnerships, and corporate privatizations, suggests that we may need above all to relook the charity law. This analysis may seek to widen the definitions of what is charitable and free up tax regimes. This means acknowledging that tax benefits inevitably entail an element of state intervention, and insisting that charities should be accountable and be properly regulated, failure to which they lose beneficial tax treatment. A good example of the state requiring this conformity and regulations is apparent in anti-terrorism legislations.

## CHAPTER THREE

### 3.0.0 REFORMING THE TAX LAW FRAME WORK: A MODERN APPROACH TO DEFINING CHARITIES IN KENYA

#### 3.1.0 INTRODUCTION: THE STORY OF A FAILED 'CHANNEL'

The underlying problems confronting jurists across the common-law world are, then, fundamentally the same. The charity law applies to entities defined by reference to a concept of charitable purpose. The concept of charitable purpose at law takes a technical definition which is unsatisfactory. The puzzle for all common-law countries is how to satisfactorily define these organizations. This puzzle is compounded by a supplementary problem. As pursuing charitable purposes is a gateway to accessing preferences, the supplementary puzzle is: what preferences should particular organizations enjoy, if any?

The legislative framework for the legal constitution of non-profit organisations (NPOs) in

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Kenya is broad and includes the NGO Co-ordination Act<sup>2</sup>, "The Companies Act", the Societies Act<sup>3</sup>, The Trustees (Perpetual Succession) Act<sup>4</sup>, and certain rules and by-laws such as those requiring community based welfare groups to register under the Ministry of Home Affairs. Such varied legal constitution may make it cumbersome for the administrators of tax to harmonise exemption rationales and purposes and to administrate the exemption service to these organisations in the absence of clear and inclusive criteria.

Kenyan's statutory provisions make frequent reference to 'charity' and 'charitable purposes' but the references are not in any way uniform or with an explicit meaning. The concept of

<sup>2</sup> Karen Nelson. "Tax and the Non-profit Sector - The south African Experience" in Paul Bator, Frits Hondius and Penina Kessler Lieber (eds). *The Tax Treatment of NGOs: Legal, Ethical and Fiscal Frameworks for Promoting NGOs and Their Activities* (2004) 192

<sup>2</sup> Act no.19,1990

<sup>3</sup> Chapter 486, Laws of Kenya.

<sup>4</sup> Chapter 108, Laws of Kenya.

<sup>5</sup> Chapter 164, Laws of Kenya.

"charitable purposes" which trigger off the definition of charities for the tax reliefs and privileges is not altogether satisfactory. In some ways, the definition of income tax charity may be thought to be too narrow and bodies which deserve tax relief do not qualify as "charities". In other ways, the trust law concept of "charitable purpose" may be thought to be too wide, so that bodies qualify as income tax charities which perhaps should not do so.

### **3.2.0 GENERAL CONSTITUTIONAL AND LEGAL FRAMEWORK.**

The Constitution of Kenya inter alia provides for the following: citizenship for all Kenyans;<sup>6</sup> the creation of a sovereign and democratic constitutional state;<sup>7</sup> a Parliament consisting of a National Assembly and the senate (representing the counties at the national legislative level);<sup>8</sup> Forty seven counties with defined legislative and executive powers;<sup>9</sup> and an independent judiciary.<sup>10</sup>

Most significantly, the Constitution includes Bill of Rights which enshrines the fundamental rights and freedoms enjoyed by all persons and groups including the freedom of association.<sup>11</sup> These fundamental rights cover equality, privacy, property, freedom of expression, freedom of association as well as a number of socio-economic rights, for example, the rights to housing and basic education.

The fact that the right to freedom of association guarantees individual's freedom to establish, to join or take part in the activities of an association is of great significance to civil society and

<sup>6</sup> *The Constitution of the Republic of Kenya*, August, 2010, Article 12

<sup>7</sup> *Ibid*, article 1

<sup>8</sup> *Ibid*, chapter 8( article 93-128)

<sup>9</sup> *Ibid*, chapter eleven (Articles 174-200)

<sup>10</sup> *Ibid* chapter Ten ( Articles 159-173)

<sup>11</sup> *Ibid* Chapter four. Articles 19 -56

more specifically the charitable institutions in Kenya. This allows individuals to associate with others in order to achieve a common objective and the state may not in principle prevent the establishment of associations.<sup>12</sup>

### **3.3.0 TYPES OF ORGANIZATIONS GENERAL LEGAL FORMS**

Kenya is a Commonwealth country with a common law system. In Kenya, the laws seem to recognize and confer rights (and obligations) to organizations that are legally institutionalized and hence Community Based Organizations and *Harambee*<sup>13</sup> groups are only recognized under the Department of Culture in the Ministry of Gender & Children Affairs administratively. The CBOs and Harambee groups which most commonly feature in rural life and form the largest single block of Kenya's Non-profit sector. This denies a large pool of philanthropic activity the legal support and as consequent they fail to reach the masses.<sup>14</sup>

There are four primary types of not-for-profit organizations under which charitable institution may fall:

#### **3.3.1 Nongovernmental organizations**

The NGO Coordination Act<sup>15</sup> defines an NGO as "a private voluntary grouping of individuals or associations, not operated for profit or for other commercial purposes but which have organized themselves nationally or internationally for the benefit of the public at large and for the promotion of social welfare, development, charity or research in the areas inclusive of, but

12 Ibid, article 36. See Tessa Brewis, *Summary of Regulatory System for NGOs in South Africa*, Non Profit Consortium, <http://www.ngorei.net.org/Li> (Last accessed on April 8, 2012).

13 Harambee meant pooling together .It refers to pulling together of resources by communities for the purposes of implementing basics service projects ai resolving societal development issues in general. See generally, Karuti Kanyinga W.Mitullah and S.Njagi, (2007) *The Non Profit sector in Kenya, the Si. and Financing*, The Institute for Development Studies, University of Nairobi, Aga Khan Development Network, P 9.

14 See generally, Karuti Kanyinga W.Mitullah and S.Njagi, (2007), *The Non Profit sector in Kenya, the Size scope and Financing*, The Institute for Development Studies, University of Nairobi, Aga Khan Development Network, P 17.

15 Act No. 19 of 1990, Laws of Kenya

not restricted to, health, relief, agriculture, education, industry and the supply of amenities and services".<sup>16</sup>

In July 2006, the Ministry of National Heritage presented Sessional Paper No. 1 of 2006 to the Kenyan Parliament.<sup>17</sup> The Sessional Paper, which subsequently was passed by the Parliament, seeks to, inter alia: promote interaction between NGOs and the communities where they work in an effort to improve service delivery; integrate government and NGO policies to affect the "social and economic transformation" of Kenya; and involve the individual in NGO and

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government affairs.

### 3.3.2 Companies

A number of charities are registered as companies whose liability is limited by guarantee. Under the Companies Act, a group or association of persons can incorporate as a private or public limited company.<sup>19</sup> A private company requires at least two and no more than 50 members excluding past and present employees while a public company requires at least seven shareholders.<sup>20</sup>

The Companies Act offer little support to the charitable companies and the only little and social benefit offered is recognition that they can be exempted from the use of the word 'limited'<sup>21</sup> and the requirement that every company must have a company secretary.<sup>22</sup>

<sup>16</sup> *NGO Coordination Act*, Section 2 and *NGO Co-ordination Regulations*, 2nd Schedule as amended by legal notice 11 of 1992.

<sup>17</sup> The Sessional Paper was developed by the Ministry in consultation with various stakeholders in the NGO sector. The intention was that the Sessional Paper contents will be reflected in a bill to be presented to Parliament for formal enactment. Although its contents currently may not be binding, the Sessional Paper serves as a useful indication of the government's future policy in relation to the NGO sector.

<sup>18</sup> Sessional Paper No. 1 of 1996. See Country Information: Kenya - U.S. International Grant making at <http://www.usig.org/countryinfo/kenya.asp> Insert Name of Site in Italics. ( Web last accessed on 8 Apr. 2012 )

<sup>19</sup> *Companies Act*, Section 4(1).

<sup>20</sup> *Companies Act*, Section 30

<sup>21</sup> Section 19-21 of the *Companies Act* that requires that every company's name must end with world limited. However Companies formed for charitable purposes may be exempted upon meeting certain qualifications.

<sup>22</sup> Section 178 of the *Companies Act* requires that every company must have a company secretary but under section 178A, the minister may on advice of the council and registration board exempt certain classes of companies, NPOs and charitable organisations from the requirement.



### 3.3.3 Societies

Under the Societies Act, a society is "any club, company, partnership or other association of ten or more persons, whatever its nature or object, established in Kenya or having its headquarters or chief place of business in Kenya."<sup>23</sup> A branch of a society also qualifies as a society. The definition specifically excludes trade unions, cooperatives, corporations, and certain other entities. A society's governing documents are called the Constitution or Rules of the Society<sup>24</sup> Societies are registered and regulated by the Registrar of Societies.<sup>25</sup>

### 3.3.4 Trusts

A trust is an entity created to hold and manage assets for the benefit of others. Trusts can be established or incorporation under the Trustees (Perpetual Succession) Act<sup>26</sup> which is an Act of Parliament to provide for the purpose of perpetual succession to property and for purposes connected thereto. Under the section 3 of the Act, trustees who have been appointed by anybody or association of persons established for any religious, educational, literary, scientific, social, athletic or charitable purpose, or who have constituted themselves for any such purpose, may apply to the Minister in the manner provided in the Act for a certificate of incorporation of trustees as a corporate body.<sup>27</sup>

<sup>23</sup> *Societies Act*, Section 2

<sup>24</sup> *Societies Act*, Section. 2.

<sup>25</sup> *Societies Act*, Section 8.

<sup>26</sup> Chapter 164 of laws of Kenya

<sup>27</sup> The trustees shall when issued with certificate become a body corporate by the name described in the certificate, and shall have perpetual succession and a common seal, and power to sue and be sued in their corporate name and, subject to the conditions and directions contained in the certificate, to hold and acquire, and by instruments under the common seal to convey, transfer, assign, charge and demise any movable or immovable property or any interest.

### 3.4.0 LANGUAGE AND HYPOTHETICAL UNCERTAINTY AND DEFINITIONAL EXCLUSIVITY<sup>28</sup>

Under legal notice number 68 of 1999<sup>29</sup> issued pursuant to The Customs and Excise Act<sup>30</sup> remission is available only to charitable organisations. Under the notice, "charitable organisations" are defined as:

- i) *'...a non-profit making organisation registered as such, or which is exempted from registration, by the Registrar of Societies under section 10 of the Societies Act or by the Non-Governmental Organisation Coordination Board under section 10 of the Non-Governmental Organisations Co-ordination Act, 1990; and*
- ii) *Whose income is exempt from tax under paragraph 10 of the First Schedule to the Income Tax Act.*

The language, and underlying concepts which seek to describe organisations and purposes that are eligible for exemption under the Income Tax Act, the VAT Act and the Customs and Excise Act are unclear and exclusive and to that extent constrain the realisation of exemption benefits by NPOs.<sup>31</sup>

The ITA describes an income tax exempt organisation as:

*'...an institution, body of persons, or irrevocable trust, of a public character, established for the purposes of the relief of poverty or distress of the public, or for the advancement of religion or education ...established in Kenya, or whose regional headquarters is in Kenya, in so far as the Commissioner is satisfied that the income is to be expended either within Kenya or in circumstances in which the expenditure of that income is for purposes which result to the benefit of the residents of Kenya.'*<sup>32</sup>

The Customs and Excise Act and the VAT Act describe exempt organisations as 'charitable organizations' which it defines as:

*'...non-profit making organisation registered as such, or which is exempted from registration, by the registrar of Societies under section 10 of the Societies Act or by the*

28 This subtitle is heavily borrowed from :Connie Ngondi-Houghton. "PROMOTING PHILANTHROPY IN KENYA". *Making the Case for Tax Law Reforms to Create an Enabling Fiscal Environment for the Growth of Philanthropy*, A Study Report of the K-REP Development (Nairobi, Agency CCML 2004) p 66.

29 Legal Notice No.68 of 10th June 1999

30 Chapter 472 of the Laws of Kenya

31 Connie Ngondi-Houghton *Making the Case for Tax Law Reforms to Create an Enabling Fiscal Environment for the Growth of Philanthropy: PROMOTING PHILANTHROPY IN KENYA* A Study Report of the K-REP Development Agency (CCML, NAIROBI 2004

32 *Income Tax Act* Chapter 470 ,Laws of Kenya paragraph 10 of the FISRT schedule

*Non-Governmental Organisation Co-ordination Board under section 10 of the Non-Governmental Organisations Act, 1990; and 'whose income is exempt from tax under paragraph 10 of the First Schedule to the Income Tax Act'*<sup>33</sup>

. The above citations illustrates that the Income Tax Act definition is broader and different in language and interpretation from the Customs and Excise Act and the VAT Act. The Income Tax Act's description uses broad characteristics and categories of forms such as 'an institution', and 'body of persons', into which almost any organisation may fit. Whereas it uses the critical principles and characteristics of 'public character', and 'benefit of the residents of Kenya', it omits the critical principle of 'non-profit'. 'Benefits of the residents of Kenya' is also too broad a criteria which, when left without specific guidance leaves tremendous discretion on the part of the Commissioner to decide what it constitutes. However, eligibility for exemption does not translate into automatic exemption. Like with all other tax payers, organisations desiring exemption have to apply, especially those registered under the NGO Act and the Societies Act.

Under these two Acts, trusts and foundations do not qualify as charitable organisations and hence not exempt organisations because even though they are exempt under the Income Tax Act, they are neither registered under the NGO Act, and the Societies Act, nor exempted from registration under any of them.<sup>34</sup>

The principal characteristic is that of 'non-profit' or that it is a society, or an NGO, and in addition that it be one that is exempted from registration under the Societies Act and the NGO Co-ordination Act. Under the two Acts, all exempt organisations must be exempted from income tax under the Income Tax Act, but not all those exempt under income tax are eligible under the two Acts. This latter characteristic subjects organisations seeking exemption under these two Acts to the criteria required for exemption under the Income Tax Act in addition to the specific criteria under the Acts, and to that extent restrict the exempt organisations only to

<sup>33</sup> *VAT Act*, Chapter 476, laws Of Kenya, Third schedule paragraph 7.

<sup>34</sup> Connie Ngondi-Houghton(n 22 ) ,47

those that are established for the exclusive purposes listed in the exempting provisions of the Income Tax Act.

If exemption under the Income Tax Act determines eligibility for exemption under all other tax laws, then the criteria for exemption under this Act is conclusive. This calls for precision, inclusivity in its definition of exempt organisations and purposes and simplicity of the process.

Though the three laws are clear on intent, the lack of uniformity in the definition and description of tax exempt organisations and purposes may be construed as indicative of a lack of a clear and wholesome conceptualisation<sup>36</sup> of the idea, function, scope, complexity and basic characteristics of NPOs and the evolving concept of *charity*. This situation is not surprising, given the fact that fiscal legislative recognition of the importance and the role of NPOs is quite a recent phenomenon in Kenya. Before the enactment of the NGO Act in 1990, there were no specific provisions in tax legislation dealing specifically with exemptions for NPOs. Some charities however did get an exemption using broad exemption clauses, and their image and social visibility to obtain exemptions.<sup>37</sup> Recognition of the NPO sector as being of such fiscal weight as to warrant legislative consideration for exemption is therefore a relatively new phenomenon on the Kenyan scene.'

### **3.5.0 RESTRICTIVE LIST OF EXEMPT PURPOSES**

The list of exempt purposes in various Acts consists of some categories that are unclear and imprecise yet restrictive in reference to the numerous other activities and purposes for which

35 Houghton C.N, *Philanthropy in East Africa: The Nature, Challenges and Potential*. A study by Allavida, 2004. p7

36 This problem may be attributable to the Ministry of Finance as the body that sets fiscal priorities, and the KRA as the administrator of fiscal policies.

37 See Republic of Kenya (1994), *Social Dimensions of Development in Kenya: An Approach to Human-Centered Development and Alleviation of Poverty: Conceptual Framework and Project Profiles*. Government Printers Nairobi. 1994.

38 See generally. Kisinga Faith, *Analysis of the Kenyan Tax Regime and its Impact on the non-profit sector, philanthropy and local resource Mobilisation: A Case for Legislation that supports Community Development, Through Enabling Local Resource Mobilisation.2006*. A report of Ufadhili, the Centre for Philanthropy and Social Responsibility. Available from IDS, University of Nairobi.

non-profit organisations are established. In the categories such as relief of the poor and relief of distress of the public almost any non-governmental development activity may fit. This situation of broad discretion in the light of linguistic ambiguity precipitates subjectivity on the part of the Commissioners as the administrators of the Acts. It risks abuse and misuse of the provisions by opportunists which may lead to undue fiscal leakage and the consequent withdrawal or narrowing of the available benefit. It may also leave many NPOs uncertain as to whether their purposes and activities fit within the meaning and intent of the provisions.

The four categories of purposes are exclusive in their effort to reflect NPO purpose and activity and are not reflective of a contemporary understanding NPO purposes and of the practice in their activities. They are more reflective of the post-independence era when the understanding of development, charity and public benefit did not for instance include activities intended to alter the social order towards social justice, but was focused on basic needs and amelioration of suffering.<sup>39</sup> Purposes and activities such as 'human rights', 'democratization', 'public policy', 'advocacy' are completely omitted, hence leaving out a significant and important segment of the NPO sector. It also does not include evolving activities such as 'environmental conservation', and 'promotion of philanthropy'. In the absence of statutory definitions therefore, these provisions may greatly limit the potential for exploitation of the tax benefit facility for the promotion of philanthropy in Kenya.

The meaning of the term NPO as contemplated by the fiscal laws is exclusive and narrow, focusing mainly on those organisations registered under the NGO Co-ordination Act, the Societies Act, The Companies Act, The Trustees (Perpetual Succession Act), and the Trustees Act. This selective focus ignores the reality of the compositions of the Non-Profit sector which consists not only of NGOs, Societies and Trusts, but also cooperative societies, unions, associations, clubs, kinship and welfare associations, and many of other socioeconomic and

39 Connie Ngondi-Houghton(n 22 ) ,67

cultural organisations such as self-help groups, and women and youth associations.<sup>40</sup>

Even though the language of the Societies Act might seem to include these organisations in its ambit, it does not accord them legal status in as long as they are not formally registered under the Act.<sup>41</sup> Further, though these informal organisations mainly have recognition from the under the department of culture in the Ministry of Gender & Children Affairs, such recognition does not accord them legal status.

After the enactment of the NGO Act in 1990, reference to the NPO or charity sector is mainly taken to refer to NGOs only and hence misleading policies and laws into focusing only on NGOs which form only a very small percentage of the possible target sector.<sup>42</sup> This is an important issue to bear in mind in the pursuit and making a suitable definition of what is a charitable foundation in Kenya because, for the desired fiscal benefits to impact the sector, and society as a whole, they will need to be accessible to the sector as a whole, and especially those parts of the sector which command greater economic significance than others.<sup>43</sup>

### **3.6.0 COMMON LAW DEPENDENCE AND IMPLICATIONS**

The legal definition of charity has evolved over many centuries, from judicial authorities developed and refined by the courts. Indeed, this legal definition of charity is often far removed from a lay person's perception of charity. The approach of the courts has been to rely on the House of Lords decision in *Commissioners for special Purposes of Income Tax v. Pemsel*<sup>44</sup>, a tax case from 1891, in which Lord Macnaghten set out a number of guidelines to

40 Connie Ngondi-Houghton (n 22 )page 67.

41 Section 2 of the Societies Act defines ' a society as including ' any club, company, partnership or other association of ten or more persons, whatever its nature or object, established in Kenya, or having its headquarters or chief place of business in Kenya, and any branch of a society.'

42 In her report, Making the Case for Tax Law Reforms to Create an Enabling Fiscal Environment for the Growth of Philanthropy, promoting philanthropy in Kenya, Connie Ngondi-Houghton CCML Consultants November 2004 estimates that NGO in Kenya constitute 1% that is about 3000 entities of the sector to the exclusion of the rest of the sector which consists of over 300,000 entities and which may have greater fiscal implications, given the fact that the sector as a whole (including religious worship organisations) is a sizable economic force

43 Connie Ngondi-Houghton(n 22 ) ,87

44 (1891), AC 531

assist in the determination as to whether a purpose was a charitable purpose.<sup>45</sup> According to Lord Macnaghten, for a trust to qualify as a charitable trust it must be either for:

- (a) The relief of poverty,
- (b) The advancement of education,
- (c) The advancement of religion, or
- (d) Other purposes beneficial to the community.

In addition to falling within one of the above heads of charity, the purpose must possess sufficient public benefit, that is, it must benefit the community or an appreciable section of the community) and be exclusively charitable. In laying down these guidelines in *Pemsel*, Lord Macnaghten was not purporting to create a new test but rather to consolidate, in a contemporary fashion, the approaches or earlier cases such as *Morice v. Bishop of Durham*<sup>46</sup> which had attempted to distil the essence of charity from an Elizabethan statute, the Statute of Charitable Uses 1601. The purpose of the Elizabethan Statute was to rationalize the administration of private charities by specifying the purposes to which funds could be devoted to charity and to ensure that funds dedicated were actually applied to the uses specified by the donors. The Statute did not set out to nor did it define 'charity'.

The Preamble to the Statute did however set out the purposes for which property might be set aside for charitable purposes and provided an overview of the rich 'showcase' which made up English charity at the turn of the seventeenth century. Coming as it did in 1601, after the social and religious turbulence of the sixteenth century; the Statute represented the secular approach of Elizabethan England to philanthropy and constituted a step away from the more religiously motivated almsgiving which had dominated the 1500s.

<sup>45</sup> Case law and other written material discussing the definition of "charitable activities" or "charitable purposes" almost always make reference to the Preamble to the Statute of Elizabeth and to Lord Macnaghten's decision in *Pemsel*'s case. Each of these is an important link in the development of the common law applicable to the definition. However, neither can be taken in isolation.

<sup>46</sup> 1805, 10 Ves Jr.522

Thus the past four hundred years have seen the evolution of a common law definition of charity, supported by judicial precedent and reliance upon the spirit and intendment of the Elizabethan preamble.<sup>47</sup> A question which has arisen on a number of occasions in the past and with greater persistence in the last fifty years is whether this definition of charity continues to serve us well.<sup>40</sup>

Confusion start off from the reliance on the common law and individual charities generally do not have, and cannot be expected to have, a working knowledge of 400 years of case law, or to be able to understand how more recent court decisions involving other entities may affect their own status. As a result, applications for charitable status are sometimes made with little understanding of the principles that are to be applied, and therefore with unreliable formed expectations of whether charitable status is likely to be achieved.<sup>48</sup>

The 'flexibility' of charity law under common law is regarded as one of its most encouraging features. It is undeniable that the law has allowed many purposes to be charitable that were not so considered, or which did not exist, at the time of the Statute of Elizabeth. However, the clarification of the definition of charity through the common law relies on litigation. Modern charities as well as companies have demonstrated an unwillingness to litigate to achieve charitable status because of perceptions of the high costs involved and the uncertainty of the

47 See Nuzhat Malik, Defining "Charity" and "Charitable Purposes" in the United Kingdom *The International Journal of Not-for-Profit Law* ,page 35 , Volume 11, Number 1 November 2008 at <<http://www.icnl.org/research/ijournal>> (Accessed on 16th April 2012).

48 See generally. National Council of Social Service 1976, *Charity Law and Voluntary Organisations*, Report of an independent committee of inquiry (Lord Goodman, Chairman) to examine the effect of charity law and practice on voluntary organisations, Bedford Square Press, London, (Goodman Report), p 15.

49 Ibid Note 44 ,page 37.



outcome. Many cases that are brought to the courts stop with the decision of the primary judge.

In recent times, few have reached the intermediate appellate level.<sup>50</sup>

A further drawback of the common law is that judges have no control over what cases come before them. They decide the issues in the disputes that are brought before them and then only at the level in the court hierarchy at which the parties decide to stop. The ability of the common law to respond to changes in the priorities and expectations of charities is limited as a result.<sup>51</sup>

World-wide, there have been numerous reviews of charity law in the past fifty years, many of which have considered the need to update or modernize the definition of charity.<sup>52</sup> It is worthwhile mentioning the volume of work that has been done by these reports in the past for two reasons. Firstly, it serves to highlight the wealth of material and considered opinion on the definition of charity which is already in existence; and secondly, as many of these reports differ in the recommendations that they make, it indicates the complexity of the issues involved and that the difficulty lies not in recognizing the relevant concept of charity but in defining it.<sup>53</sup>

50 Connie Ngondi-Houghton (n 22), 76, The high court has not been asked to decide a case on charitable purposes since 1974 and has not heard a case on PBI since 1942.

51 See Welcome to Charities Definition Inquiries website, [http://www.cdi.gov.au/report/cdi\\_chap4.htm](http://www.cdi.gov.au/report/cdi_chap4.htm) (accessed April 8, 2012).

52 Reform Commission Consultation on Charitable Trust Law General Proposals (2005); Joint committee on Taxation, 'Historical Development and Present Law of the Federal Tax Exemption for Charities and other Tax-Exempt Organizations, Scheduled for a Public Hearing Before the House Committee on Ways and Means on April 20, 2005' (JXZ-29-05. 2005) Office of the Scottish Charity Regulator, 'Monitoring Scottish Charities' (2005); Panel on the Nonprofit Sector, Strengthening Transparency Governance Accountability: A final Report to Congress and the Nonprofit Sector (2005); Canada Revenue Agency, Consultation on Guidelines for Sport and Charitable Registration under the Income Tax Act (Canada Revenue Agency, 2008); Canada Revenue Agency, 'Consultation on proposed Guidelines for Research as a Charitable Activity'(Canada Revenue Agency, 2008) and Parliament of Australia Senate Inquiry into the Disclosure Regimes for Charities and Not-for-Profit Organizations' (2008).

53 Patrick Kilby, *The Development of NGO Support Organizations: The Early Years of the Australian Council for Overseas Aid*, Page 84, *The International Journal of Not-for-Profit Law* **Volume 11, Number 1 November 2008** at <http://www.icnl.org/research/journal/voll1iss1/voll1iss1.pdf> Accessed on 16th April 2012.

### **3.7.0 DEFINITION OF CHARITY: THE PREAMBLE TO THE STATUTE OF ELIZABETH**

The Charitable Uses Act 1601,<sup>54</sup> referred to as the Statute of Elizabeth, was enacted to address abuses of trusts established for charitable purposes. The Preamble to the Statute set out a list of charitable purposes that were to be covered by its provisions.<sup>55</sup>

While the Statute has been repealed, the Preamble has retained a place in the determination of charitable purposes. Charitable purposes are said to be those that are within the spirit and intendment of the Statute of Elizabeth, or those analogous to purposes that have been judged to be charitable within the Preamble. Ford and Lee note that the courts:

*Reason by analogy from case to case, holding to be charitable trusts which may not come directly within the statute or even its spirit and intendment, but which are comparable to cases which have been held to be charitable*<sup>56</sup>

The issue now is whether clarity and consistency would be enhanced by replacing reference to the Preamble to the Statute of Elizabeth with an alternative mechanism for defining charitable purpose. The continued reference to the spirit and intendment of the Preamble to the Statute of Elizabeth has, by and large, provided considerable flexibility. Charitable purposes have been found in objects far removed in form from those set out in the Preamble in line with changes in the community's needs and in the way those needs are addressed. The process of determining charitable purposes by analogy has led to the inclusion of many purposes not considered charitable in 1601.<sup>57</sup>

However, it is submitted that this process is ambiguous and could lead to inconsistencies. Guidance on what is charitable and what is not can be made considerably clearer by other means other than referring to the spirit and intendment of the Preamble to the Statute of

54 The provisions of the 1601 Act were mainly concerned with establishing a body of Commissioners and vesting it with powers to supervise and inspect charitable trusts.

55 Reference may also be made to *Chesterman, M 1979, Charities, Trusts and Social Welfare, Widenfeld and Nicolson, London, Part 1*

56 *Ford, HAJ and Lee, WA 1990, Principles of law of Trusts, The Law Book Company, Sydney, p.822.*

57 *Report of the Committee on the Law and Practice Relating to Charitable Trusts 1952, HMSO. London, Cmd 8710, (Nathan Report), p*

Elizabeth. Hereinafter a number of options for defining charitable purpose are discussed, including providing a comprehensive, but not exhaustive list of charitable purposes.<sup>58</sup>

### 3.8.0 IS IT POSSIBLE TO DEFINE CHARITY?<sup>59</sup>

Texts on the general law relating to trusts and specialist texts on the law relating to charities contain numerous statements to the effect that the task of evolving a satisfactory definition of charity is an impossible one.<sup>60</sup>

In *Re Tetlev*<sup>61</sup> Lord Sterndale Mr. Said:

*I am unable to find any principle (let alone definition) which will guide one easily and safely, through the tangle of the cases as to what is and what is not a charitable gift. If it is possible / hope sincerely that at some time or other a principle will be laid down.*

Earlier in *Re:Foveaux*<sup>62</sup> Chitty J said that the best that could be done was to consider each case upon its own special circumstances. Dixon J (later Dixon CJ) was later to describe this as a 'safe but unenlightening conclusion.'<sup>63</sup>

Picarda refers to the statement of Viscount Simonds in *Inland Revenue Commissioners V Baddeley* that no comprehensive definition of legal charity has been given either by the legislative or the judges.<sup>64</sup>

The judgment in *Baddeley* case was given in 1955. Six years earlier Viscount Simonds had said in *Gilmour v Coats'*<sup>65</sup> that it is a trite saying that law is life, not logic. But it is, I think,

58 Ibid Note 53, page 37.

59 See CHAPTER 3: IS IT POSSIBLE TO DEFINE CHARITY ?, [http://www.cdi.gov.au/report/pdf/10\\_chap3.pdf](http://www.cdi.gov.au/report/pdf/10_chap3.pdf) (accessed April 8, 2012).

60 See, for example, the discussion in *Sheridan, LA 1992, Keeton and Sheridan's The Modern Law of charities, 4th edition. Barry rose Law Publishers Ltd, Chichester, pp 1-10; and Sheridan, LA and Keeton GW1983, The Modern Law of Charities, 3rd edition, University College Cardiff Press, Cardiff, pp 23-29). *Jacob's law of Trusts in Australia* says that the term "charitable trust defies satisfactory short definition' (Meagher, RP and Gummow, WMC 1997, *Jacobs Law of Trust in Australia, 6th edition, Butterworths, Sydney, p 182.*)*

Reference is made to *Re Nottage (1985) 2 Ch 649 at 656). where Rigby LJ said that it was probably impossible to define what a charitable bequest is. He added that is was certainly not advisable to attempt do so.*

61 (1923) 1 Ch 258 at 266.

62 (1895) 2 Ch 501 at 504.

63 *Hobart Savings Bank v Federal Commissioner of Taxation (1930) 43 CLR 364 at 374-375.*

64 (1955) AC 572 at 584. Picarda, writing in 1999, says that this is still true. (*Picarda, H 1999), the Law and Practice Relating to charities, 3rd edition, Butterworths, London, p 8.*

65 (1949) AC 426 at 448-449

comprehensively true of the law of charity that it has been built up not logically but empirically.<sup>66</sup>

Lord Macnaghten's four heads of charity propounded by him in 1891 in *Pemsel's case*<sup>67</sup> are valuable though they have proved they are by no means exhaustive even as a guide. In no way have they replaced the need to refer to the Preamble in some cases. This was emphasized in 1949, 58 years after *Pemsel's case*, by Viscount Simonds in *Gilmour v Coats*<sup>68</sup> where he said that it had been over and over again to the statute of Elizabeth to which the courts had looked for guidance.

In the above circumstances the requirement that we provide options for enhancing the clarity and consistency of the existing definitions in Kenya presents us with a difficult task. However, the fact that the law is said to be uncertain and to a degree unpredictable in our view provides a sound reason why we should attempt the exercise.

### **3.9.0 THE NEED FOR AN EFFECTIVE AND WORKING DEFINITION OF CHARITY**

The main purpose of a well-designed classification structure for charities and other community organizations is to confer a special status on those organizations that recognize and supports altruistic "public good" activities by:<sup>69</sup>

- (a) Giving these organizations a special public status that attracts public support.
- (b) Sustaining public support for those charitable organizations by ensuring they devote their financial resources to the provision of "public goods".
- (c) Encouraging private donations to these organizations through tax incentives.
- (d) Supporting their work directly through income tax and consumption tax concession.

<sup>66</sup> The fact that is so obviously true has probably been the main reason why attempts to define charitable purpose have either not been made or have failed. Yet occasionally there has been a judicial call for a definition. See the dissenting judgment of Lord MacDermott in *Oppenheim v Tobacco Securities Trust Co. Ltd.* (1951) AC 297

<sup>67</sup> *Income Tax Special Purposes Commissioners v Pemsel* (1891) All ER Rep. 28; (1891) AC 531

<sup>68</sup> (1949) AC 426 at 442.

<sup>69</sup> The objectives of good classification have been put very well by Australian Council of Social Service in its submission to the Charity Definitions Inquiry in Australia, 2004

(e) Safeguarding the integrity of this special status by ensuring that any special public status is conferred fairly, consistently and transparently.

(f) Safeguarding the integrity of the tax system

### **3.10.0 APPLICATION OF LORD LORD'S *MACNAUGHTEN* HEAD OF CHARITY IN KENYA**

#### **3.10.1 RELIEF OF POVERTY**

The first heading of charity, "relief of poverty" has very strong ties with the 1601 Preamble of the Statute of Charitable Uses, which made specific reference to the relief of "impotent and poor people".<sup>70</sup> The case law has made it clear, however, that poverty is a relative concept and does not require the recipient to be destitute or on the breadline; rather it has been described as being satisfied where "needy persons have to go short in the ordinary acceptance of the word, regard being had to their status in life and so forth" ,<sup>71</sup>

Clearly evidence of poverty is required before a gift can be held to be charitable. In refusing to uphold as charitable a gift to the employees of the firm and their dependants in *Re Cullimore's Trusts* <sup>72</sup> Porter M.R. explained what was necessary:

*"Mere kindness, generosity, or benevolence on the testator's part is not enough to constitute a charitable purpose; there must also be an element of poverty or need on the part of the object, or else the gift must be dedicated to some purpose, such as education, religion or the like which the law regards as charitable. There is nothing here to show that the persons whom the testator meant to benefit were to be poor persons. "*

On the other hand, once the intention of the donor is to relieve poverty, particular form of words or technical language does not have to be used in order for the trust to be recognized as charitable.

<sup>70</sup> See Charity Law: The Case for Reform, *Charity law report*, July 2002 NUALA, <<http://www.lawsociety.ie/Documents/members/charityreport.pdf>> (Last accessed April 8, 2012).

<sup>71</sup> Per Evershed J. in *Re Coulthurst* (1951) Ch. 661 at 666.

<sup>72</sup>(1891)27 LR. Ir. 18, at 24

As Budd J. explained in *In the Matter of the Trusts of the Will and In the Matter of the Estate of Mona MacCarthy, Deceased,*'

*"it is not necessary to find that the relief of poverty be expressed in a testator's will as the object of his gift before the gift can be held charitable; it is sufficient if the Court can find that the relief or poverty was intended by the testator. "*

Public benefit comes into the matter in two ways: firstly, is there an element of utility about the gift, i.e, does it actually relieve a need attributable to the recipient's condition? Secondly, does the gift benefit an appreciable section of the community so that one can say that there is a public benefit attached to the gift?

It is suggested that public benefit should no longer be presumed in the case of organizations relieving poverty and that instead the issue should be decided on a case by a case basis. In real terms this would require trusts for poor relations or poor employees to exhibit the same level of public benefit as any other type of trust seeking charitable status.

This would remove one layer of complexity from the law and re-emphasize public benefit as the over-riding consideration. It would bring 'legal' charity closer to the general public perception of what is charitable and make the law easier to understand and explain to the general public.

Even if the number of potential beneficiaries is smaller, there may be sufficient indirect public benefit from the relief of their poverty to render the cause charitable. Relieving poverty may improve beneficiaries' prospects in terms of health, employment etc., and it therefore may make a broader social and economic contribution. The proposal herein does not rule out consideration of the indirect public benefit. It merely focuses attention on it by raising the question, in each case, of whether the benefit in question will arise.

### 3.10.2 ADVANCEMENT OF EDUCATION

Under the exciting charity and tax legislation in Kenya, a broad definition needs to be given to the concept of education and what it encompasses. Thus, as was pointed out by Lord Hailsham in the case of *Inland Revenue commissioners v. McMullen*,<sup>74</sup> the courts have refused to restrict 'education' to formal classroom instructions or to render it devoid of the exercise of skill or pleasure.

Accepting that aesthetics or art or culture are just as important expressions of learning has enabled the courts to uphold as charitable gifts to choral group or gifts supporting drama and arts in general.<sup>75</sup>

In the words of Keane J., as he then was, giving judgment in *Re The Worth Library*,<sup>76</sup>

*"[G]ifts for the advancement of education. . . . would embrace, not merely gifts to schools and universities and the endowment of university chairs and scholarships; 'education' has been given a broad meaning so as to encompass gifts for the establishment of theatres, art galleries and museums and the promotion of literature and music. In every case, however, the element of public benefit must be present and, if the benefit extends to a section of the community only, that section must not be numerically negligible "*

The element of public benefit is strictly applied under the second heading of charity unlike in the case of relief of poverty. Where the beneficiaries are numerically negligible, the trust will be held not to be charitable. This was the situation in the cases of *Re McEnery*,<sup>77</sup> where Gavan Duffy J. held that a bequest to enable the testator's nieces and nephews and their male

74 (1981) AC 1

75 *Re Shakespeare Memorial Trust* (1923)2 Ch.398; *Royal Choral Society v. IRC* (19-13)2 All ER 101.

76(1994)1 I.L.R.M. 161, at 193:

77 (1941)I.R 323. Indeed, a similar result was arrived at in the more recent case of *Re Davoren* where having regard to *Re McEnery* and the English authorities of *Re Compton* (1945) Ch. D. 123 and *oppenheim v. tobacco Security Trust Co.* (1951) A.C 297, counsel on both sides conceded that a bequest to certain named relations of the testatrix to provide their direct descendants with post primary and third level education at the discretion of the trustees lacked the requisite public benefit.

descendants to obtain professions was too narrow as the testator intended to benefit specific individuals

Broadly, education in charity law should mean what it means in contemporary speech. That might commonly be taken to mean to give knowledge to, or develop the abilities of, somebody by teaching, training or instruction, or to bring up children or young people in particular manners, habits or ways of life. In today's context, with an emphasis on life-long learning for all, education includes education for adults in the same breadth of areas as for children and young people.

### 3.10.3 ADVANCEMENT OF RELIGION

*"There is probably no subject in the world about which opinions differ so much as the nature of religion, and to frame definition of it which would satisfy everyone must obviously be impossible"*

By advancement of religion is meant an advancement of worship. Thus, to benefit from the third Pemsel heading, a body while it is not required to demonstrate public benefit, will be required to prove that its purposes fall within the definition of religion.

To qualify as advancing religion, "a religious charity must not only be so constituted as to satisfy the legal definition of religion, including having objects or purposes of a religious nature, but its activities must also advance religion. It is not sufficient that a body adheres to religious purposes; it must actively promote or advance the spiritual teachings or doctrines of that religion."<sup>80</sup>

Whether or not to promote religious harmony is a purpose for the benefit of the public is a question of law to be answered by forming a view on the evidence in light of current standards and social and cultural considerations. If tangible and objective benefits cannot be shown,

<sup>78</sup> Similarly, education might commonly be taken to mean the systematic instructions, schooling or training of children and young people, or, by extension, instruction of adults; and the development of mental or physical powers; and the changing of (some aspect of) character.

<sup>79</sup> Fraser, *The Golden Bough* (abr. Ed., 1954), p. 16 "

<sup>80</sup> O'Halloran, *Charity Law* (Roundhall, Sweet & Maxwell, 2000) at p.151



public benefit can be demonstrated by evidence of the "approval by the common understanding

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of enlightened opinion for the time being".

We further support that public benefit is depicted by a religious charity in any of the following ways:

- i. The promotion of religious harmony and tolerance could result in tangible benefits of reduction in conflict and crime.
- ii. Understanding other's religious beliefs lead to more appropriate provision of services both in the public and the private sphere.
- iii. promoting religious harmony and tolerance

#### **3.10.4 OTHER PURPOSES BENEFICIAL TO THE COMMUNITY**

The fourth and final head of charity - other purposes beneficial to the Community - is considered by most commentators to be the vaguest of the four heads and to require a much high standard of public benefit to be displayed than any of the preceding categories.<sup>82</sup> At the same time, it provides something of a safety net for many aspiring charities, who find refuge under its umbrella when they fail to bring themselves within the definitions of poverty, education or religion, to a certain extent,

The undefined nature of the fourth category perpetuates the idea that the *pemsel* definition of <sup>83</sup> charity is a flexible one, capable of judicial extension to keep pace with contemporary times.

On the other hand, this final category of charity is the one that has most undergone a metamorphosis since its inception in the Elizabethan preamble in 1601.<sup>84</sup> The antecedents of 'other purposes beneficial to the community' manifested themselves in the preamble in the

81 See *National Anti-Vivisection Society v IRC* [1947] AC 31 at page 49

82 David M. Schizer, *Subsidizing Charitable Contributions: Incentives, Information and the Private Pursuit of Public Goals*, (Columbia Law Sch. Ctr. for Law & Econ. Studies, Working Paper No. 327, 2008), available at < <http://papers.ssm.com> >

83 Hemphill, PC July 1990, 'The Civil-law Foundation as a Model for the Reform of Charitable Trusts Law' in *The Australian Law Journal*, Vol 64, p 409

84 Hemphill (Ibid Note 74), p 409.

form of mending bridges, causeways and highways; maintaining houses of correction; and marrying off poor maids. Referring to these various exploits in *Morice v. Bishop of Durham*,<sup>85</sup> Romilly M.R. coined the phrase 'a trust of general public utility'

Lord MacNaghten in *Pemsel* later reinterpreted this as meaning 'other trusts for the benefit of the community not falling within the preceding heads'. Did this broaden the category beyond those activities mentioned in the Preamble? In *Attorney General v. National Provincial and Union Bank of England Ltd* Viscount Cave took the following view:

*"Lord Maenaghten did not mean that all trusts beneficial to the community are charitable, but that there were certain charitable trusts which fell within that category; and accordingly to argue that because a trust is for a purpose beneficial to the community it is therefore a charitable trust to turn round his sentence and to give it a different meaning. So here it is not enough to say that the trust in question is for public purposes beneficial to the community or is for the public welfare; you must also show it to be a charitable trust"* <sup>86</sup>

At present many diverse charities find legal sanctuary within the fourth heading. Organizations which are involved in healthcare<sup>87</sup> or in assisting the elderly<sup>88</sup>, animal welfare groups<sup>89</sup> and gifts which benefit a particular locality.

The modern purpose of the fourth category is to allow the definition of charity to keep pace with the changing face of society. If charity is a fluid concept capable of change and adaptation and if as Lord Simonds stated in *National Anti-Vivisection Society v. IRC*<sup>90</sup> what is charitable in

<sup>85</sup> *Morice v. The Bishop of Durham* (1805) 10 Ves.522 at 532.

<sup>86</sup> *Attorney General v. National Provincial and Union Bank of England Ltd* (1924) AC 262, at 265.

<sup>87</sup> Normally referred to as gifts to benefit the 'sick, disabled or aged' it has been held that these criteria should be read disjunctively (See *Rowntree Memorial Trust Housing Association v. Attorney General* (1983) Ch.159) so that a gift for a hospital is charitable in nature *Barrington's Hospital v. Commissioner of Valuation* (1957) 1R 299 where Kingsmill Moor J. stated that, "the care of the sick of the community in general or any limited portion of the community is an element of the purposes and is no less charitable if the rich benefit as well as the poor". *Gleeson v. Attorney General* unreported, high court, Kenny J. April, 6 / 973

<sup>88</sup> See, for example, *Re McCarthy's Will Trusts* (1958) 1R. 311, where Budd J. held that a gift to a benevolent fund for 'elderly or infirm' nurses was charitable.)

<sup>89</sup> Ireland has viewed such trusts as charitable as far back as 1890 with the case of *Armstrong v Reeves* (1890) 25 L.R Ir 325. See also *Swife v. Attorney General* (1912) 1 IR 133 where gift to the "Dublin Home for Starving and Forsaken Cats" upheld as charitable.

<sup>90</sup> [1948] AC 31

the past may in changing times cease to be viewed by the public as charitable in the future, then it follows, that new categories may spring up which are within the contemplation of the legislation but which nevertheless may be recognized in future. One might think for instance, of environmental groups as just one example of such a category.

The difficulty that arises, however, can be simply stated. The breadth and scope of 'other purposes beneficial to the community' is clearly capable of expansion. However, this expansion can only occur on foot of judicial interpretation, which requires litigation. Thus, in the absence of judicial engagement and given the fact that Kenya has no body similar to the Charity Commissioners of England and Wales (who regularly pronounce on whether a body is charitable or not and make their decisions and reasoning publicly available), we may need to legislate "the heads of charity in Kenya" and legislate a commission with the mandate to pronounce future acceptable charitable purposes.<sup>91</sup>

### **3.11.0 OTHER OPTIONS FOR CHARITABLE PURPOSE IN KENYA**

Before setting out the options, we need to stress one matter. That is, whatever option is adopted for determining whether a purpose is a charitable purpose, there needs clearly to be spelt out a number of additional characteristics or conditions which must be present before an entity is to be regarded as charitable. We now turn to devise principles necessary for the formulation of charitable purposes in Kenya and thereafter demonstrate how charitable purposes can be synthesized with illustrations.

<sup>91</sup> Charity law report NUALA, <http://www.lawsociety.ie/Documents/members/charityreport.pdf> (accessed April 8, 2012).

### 3.12.0 SUGGESTIONS FOR NEW DEFINITIONS AND DEFINITIONAL FRAMEWORKS

A Charity should have aims all of which are, and continue to be, recognized by law as exclusively charitable.<sup>92</sup> We propose the following guideline in what should constitute charity

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body as an entity:

**(i) Directed to the provision of something of clear benefit to others in society;**

All entities must meet the "public benefit" test. Although the question of whether an entity meets this test is considered on the facts of each case, the courts have developed a number of general tests for determining whether the benefiting group is the public - or at least an "appreciably significant section" of the public".<sup>94</sup>

Through cases such as *Re Compton* and *Oppenheim v Tobacco Securities*,<sup>95</sup> it has been established that the number of beneficiaries must not be negligible. In addition, (and even if the number of beneficiaries is large), those beneficiaries must not be determined on the basis of a personal relationship such as blood or contractual ties. If they are, the entity will not be for the public benefit. Instead, it will be for the benefit of private individuals and therefore not "charitable".<sup>96</sup>

92 Lyons, M and Hocking, S 2000, *Dimensions of Australia's Third Sector*, Centre for Australia, Community Organizations and Management, University of Technology, Sydney

93 The Review of the Register of Charities, (n.d.). Retrieved from <http://www.charity-commission.gov.uk/publications/rrl.aspx>

94 See Taxation of Maori Organizations, A Government Discussions Document, Part I - Summary of proposals chapter - Docstoc - Documents ..,< <http://www.docstoc.com/docs/22590331/Part-I-Summary-of-proposals-chapter>> (Last accessed April 8, 2012)

95 (1951) AC 297,49

96 The House of Lords (Lord Cross) in *Dingle v Turner* has questioned the *Re: Compton* and *Oppenheim* and *Oppenheim* tests, suggesting that the existence of a personal connection such as blood ties or contract should not be determinative of whether an entity provides a public rather than a private benefit.

Consequently, there is now a degree of uncertainty even in Kenya about whether trusts whose beneficiaries are determined by a blood or a contractual relationship will satisfy the 'public benefit' test."<sup>97</sup>

The public benefit test need to be changed, so that in applying the public benefit test, an organisation would ineligible for registered charity status simply because its purpose is to benefit a group of people connected by blood ties.<sup>98</sup>

There are impacts of changing the public benefit test so an entity would not cease to be eligible for charitable status simply because its purpose is to benefit a group of people connected by blood ties. These include:

- (a) The proposed change appears fair and reasonable and takes into account the unique cultural situation that exists in Kenya and thus would provide greater equity across the nation.
- (b) A greater number of organisations would be classed as charitable and thus able to apply for funding from a number of funding agencies that can only fund charitable organisations or activities. This would mean more competition for available funding.
- (c) A greater number of organisations would also be able to achieve donee status. This may encourage more support to organisations by way of voluntary donations.

**(ii) Directed to things that overall are not harmful to humankind;**

What an organization is set up to do will have different effects depending on the standpoint from which they are viewed. <sup>99</sup>

<sup>97</sup> See Taxation of Maori Organizations, A Government Discussions Document, Part 1 - Summary of proposals chapter - Docstoc - Documents ..., < <http://www.docstoc.com/docs>Summary-of-proposals-chapter> (accessed April 8, 2012).

<sup>98</sup> Report of the *Inquiry into the Definition of Charities and Related Organizations*, Charities Definition Inquiry, 2001, Page 24, < <http://www.acwa.org.au/sites>>. last accessed on 14 April 2012.

<sup>99</sup> For example, the preservation of a particular species of animal will be beneficial because it both contributes to zoological science and may have environmental benefits or may preserve a gene pool necessary for some public good.

This calls for requirements that the objectives be in existence before the organization is accepted as charitable. They must not be so wide or vague that they cannot be enforced by the courts or charity commissions.

**(iii) Is independent;**

The independence of trustees is essential<sup>100</sup>. They must take their own decisions and exercise their discretions solely in the interests of the charity. In an ideal world, those outside the trustee body would recognize this and not seek to put pressure on or otherwise influence trustees.

**(iv) Is able to show that any personal, professional or commercial advantage is and will continue to be incidental to carrying out its charitable aims;**

Organisations providing professional or commercial advantage to members will not generally be acceptable as charities. However, it has been accepted in some cases that the advantages to those individuals is outweighed by the benefit to members of the public in receipt of that professional service,

**(v) Does not impose conditions on access or membership that in practice restricts the availability of facilities in a way that results in the organization as whole not benefiting the public;<sup>101</sup>**

To restrict benefits to the rich is not charitable, although a charity may charge for its services. Access may though properly be limited in certain circumstances.<sup>109</sup>

<sup>100</sup> Charity trustees must not be controlled or directed by anyone outside the charity (except where they have to comply with general legal requirements - such as health and safety - which an outside body is there to enforce); act on the instructions of the person or body which appointed them as trustees, such as members of the charity or central or local government; or comply with any external or internal directions if, in doing so, they would be acting outside the charity" aims.

<sup>101</sup> Submission to Inquiry into Definitional Issues Relating to ... <<http://www.cdi.gov.au/submissions/135-AustralianDemocrats.doc>> (Last accessed April 8, 2012).

<sup>102</sup> Example the nature of the charity's aim may be a ground to limit such as where in order to deliver benefit to the public, it is reasonable to expect the members to have reached a certain standard of skill or knowledge or possess particular qualifications (such as a performing orchestra or choir); or where a membership structure is adopted where that is appropriate for the better delivery of benefits (providing all

### **3.13.0 ILLUSTRATIVE SYNTHESIS OF OTHER OPTIONS FOR CHARITABLE PURPOSES IN KENYA**

#### **a) Advancement of human rights, conflict resolution or reconciliation or ethnic harmony or equality and diversity'**

This part of thesis explains why the advancement of human rights should be recognised as a charitable purpose. It also considers the various ways (including political campaigning) in which a charity may promote human rights.

The concept of human rights is virtually unanimously endorsed by the countries of the world even if strict observance of these rights is intermittent.<sup>101</sup>

There are many ways in which a charity might seek to promote human rights, including:<sup>104</sup>

- i. monitoring abuses of human rights;
- ii. obtaining redress for the victims of human rights abuse;
- iii. relieving need among the victims of human rights abuse;
- iv. research into human rights issues;
- v. educating the public about human rights;
- vi. providing technical advice to government and others on human rights matters;<sup>105</sup>
- vii. contributing to the sound administration of human rights law;
- viii. commenting on proposed human rights legislation;
- ix. raising awareness of human rights issues;

those might benefit can join and there are objective criteria for deciding membership). See The Review of the Register of Charities, <<http://www.charity-commission.gov.uk/publications/rrl.aspx>> (Last accessed April 8, 2012)

103 The United Nations Convention on the Rights of the Child, for example, has been ratified by 191 countries (only two countries have failed to do so).

104 Speaking Out Guidance on Campaigning and Political. Retrieved from <<http://www.charity-commission.gov.uk/publications/cc9.ast>> ( Web last accessed

105 A human rights charity may provide technical advice to governments, NGOs and other relevant bodies on the creation, improvement and implementation of legal, regulatory and administrative systems for the not-for-profit sector in countries abroad. A charity with appropriately-worded objects may also provide technical advice to governments and to domestic and foreign public authorities on the adoption and implementation of human rights legislation, including training for administrators in the application of that legislation. See The advancement of human rights, conflict resolution. <[https://www.charitycommission.gov.uk/Charity\\_requirements\\_guidance](https://www.charitycommission.gov.uk/Charity_requirements_guidance)>(web accessed on 14th April 2012.

- x. promoting public support for human rights;
- xi. promoting respect for human rights by individuals and corporations;
- xii. international advocacy of human rights;

In order to achieve the degree of certainty in the expression of its objects that are necessary for charitable status, individuals creating charities for the promotion of human rights need to specify the body of rights that they seek to promote.<sup>106</sup>

There is an obvious public benefit in promoting human rights. For individuals whose human rights are thereby secured, the benefit is immediate and tangible. There is also a less tangible, but nonetheless significant, benefit to the whole community that arises from our perception that the fundamental rights of all members of the community are being protected.<sup>107</sup>

**b) Advancement of Preservation and Conservation Purposes**

Bodies set up for preservation<sup>108</sup> and/or conservation purposes may encompass very wide and immensely varied groups.

They may include bodies set up for one or more of the following purposes:

- (i) the preservation of:
  - (a) a specified building or complex, sometimes including a garden or other land, of historic/architectural importance or a site where a building has been or where its remains can still be seen;
  - (b) historic buildings in general (building preservation trusts; and
- (ii) the conservation of:
  - (a) a particular animal, bird, or other species etc or 'wildlife' in general;

<sup>106</sup> There are several different codes of human rights. The most widely accepted are the Universal Declaration of Human Rights and subsequent United Nations human rights conventions and declarations. Outside the auspices of the UN, there are other international and regional codes, as well as codes which have been established by individuals and NGOs.

<sup>107</sup> See advancement of human rights, conflict resolution,

[http://www.charity-commission.gov.uk/Charity\\_requirements\\_guidance/Charity](http://www.charity-commission.gov.uk/Charity_requirements_guidance/Charity) (accessed April 8, 2012).

<sup>108</sup> Preservation' can be taken to include restoration work in so far as this is necessary and complementary to the aims of preservation and to providing public access



(b) a specific plant species, habitat or area of land, including areas of natural beauty and scientific interest;

(c) Flora, fauna and the environment generally.

The charitable, organisations for preservation and conservation will need to demonstrate that they satisfy a criterion of merit<sup>109</sup> and they are set up for the benefit of the public,<sup>110</sup>

### **c) The advancement of amateur sport**

The advancement of amateur sport means the advancement of any sports or games which promote health by involving physical or mental skill or exertion and which are undertaken on an amateur basis.<sup>111</sup>

- i. Examples of the sorts of charities and charitable purposes falling within this description include:
- ii. Charities advancing sport at a local club e.g. local football, rugby, tennis clubs etc;
- iii. Multisports centres;
- iv. Other organisations concerned with the promotion of a particular amateur sport or game.

The community participation in healthy recreation by providing facilities<sup>112</sup> for playing particular sports is the reasons for recognition the purpose as charitable.<sup>113</sup> The law would

109 Preservation organisations seeking registration should provide independent expert evidence that is authoritative and objective, from a reputable body or individual, that their building or site is of sufficient historical or architectural significance to merit preservation for the public benefit. Examples of the former would include buildings which have played a significant role in industrial and technological advance as well as those which have architectural or historical merit. Acceptable objects for organisations concerned with the general conservation of the environment include:

a) *To promote the conservation, protection and improvement of the physical and natural environment and*

b) *To promote the conservation of the physical and natural environment by promoting biological diversity [or biodiversity].*

110 A possible object for such organizations is *"to promote the conservation protection and improvement of the physical and natural environment" and "to promote the conservation of the physical and natural environment by promoting biological diversity [or biodiversity]"*.

111 Charity Requirements and Guidance Commentary on the Descriptions of Charitable Purposes in the ..,

[https://www.charitycommission.gov.uk/Charity\\_requirements\\_guidance/Charity\\_essentials/Public\\_benefit/corcoml.aspx](https://www.charitycommission.gov.uk/Charity_requirements_guidance/Charity_essentials/Public_benefit/corcoml.aspx) (Last accessed April 9, 2012).

regard the promotion of any particular sport, for its own sake, as charitable. However, charities are able to encourage participation in sporting activity as a means to a variety of charitable ends. The effect of this would be to enable members of the public to take part in sports capable of promoting physical health and fitness<sup>114</sup>, and whose facilities are available to all who wish to take advantage of them, can now become charities.

In this regard, any sports association can be a charity provided that two criteria are satisfied:

- (i) The sport in question must be capable of improving physical health and fitness<sup>115</sup>; and
- (ii) The club must have an open membership, that is, access to the club's facilities must be genuinely available to anyone who wishes to take advantage of them.<sup>116</sup>

**d) The advancement of arts, culture, heritage or science**

'Culture' is a broad term often used in the context of advancing art or heritage.<sup>117</sup> The advancement of art should covers a wide range of charitable activity including promoting various forms of art at a national/professional and local/amateur level, the provision of arts

112 By 'facilities' we mean not just land, buildings and equipment, but also the organising of sporting activity

113 See, *Supporting Voluntary Activity: a White Paper for Supporting Voluntary Activity and for Developing the Relationship between the State and the Community and Voluntary Sector*, 2001, (the 'White Paper'). Also, see. *Supporting Voluntary Activity: a Green Paper on the Community Voluntary Sector and its Relationship with the State*, Department of Social Welfare, Dublin, Stationery Office, 1997 (the 'Green Paper').

114 Sports that is capable of providing 'healthy recreation' are those sports which, if practiced with reasonable frequency, will tend to make the participant healthier, that is, fitter and less susceptible to disease. Fitness includes elements of stamina, strength and suppleness (there may be others), but it will be enough if a sport contributes to just one of these elements.

115 There are some sports that seem to require a pre-existing level of fitness in participants, such as caving or mountaineering. In principle, there is no reason why these sports should not rank as healthy recreation, even though the physical preparation for undertaking them may contribute as much to health and fitness as actually taking part

116 Open membership is essential if a club is to meet the requirement of public benefit that applies to all charities. A club that operates restrictions in its

117 See The Charity Commission of England and Wales, Charity requirements and guidance <[http://www.charitycommission.gov.uk/Charity\\_requirements\\_guidano](http://www.charitycommission.gov.uk/Charity_requirements_guidano) (last accessed on 26th June 2010)

facilities and encouraging high standards of art. 'Art' includes abstract, conceptual and performance art and representational and figurative art.<sup>118</sup>

'Heritage' might be regarded as part of a country's local or national history and traditions which is passed down through successive generations. It might also include activities concerned with preserving or maintaining a particular tradition where the benefit to the public in preserving it can be shown.<sup>119</sup>

The advancement of science includes scientific research and charities connected with various learned societies and institutions.

Examples of the sorts of charities and charitable purposes falling within this description include:

- i. Art galleries, arts festivals and arts councils.
- ii. Charities that promote, or encourage high standards of, the arts of drama, ballet, music, singing, literature, sculpture, painting, cinema, mime, etc, e.g. theatres, cinemas and concert halls; choirs; orchestras; music, operatic and dramatic societies;
- iii. The promotion of crafts and craftsmanship;
- iv. Local or national history or archaeology societies;
- v. Local arts societies;
- vi. Charities that preserve ancient sites or buildings;
- vii. Charities that preserve a specified monument, building or complex of historic/architectural importance, or the preservation of historic buildings in general, such as building preservation trusts;

<sup>118</sup> Charitable Status and Sport - The Charity Commission ..., <http://www.charity-commission.gov.uk/publications/rrl1.aspx> (accessed April 9, 2012).

<sup>119</sup> Commentary on the Descriptions of Charitable Purposes in the ..., [https://www.charitycommission.gov.uk/Charity\\_requirements\\_guidance/Charity\\_essentials/Public\\_benefit/corcoml.aspx](https://www.charitycommission.gov.uk/Charity_requirements_guidance/Charity_essentials/Public_benefit/corcoml.aspx) (accessed April 9, 2012).

viii. The preservation of historical traditions, such as carnivals, country/folk dancing

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societies, Kenyan's dancing styles and highland dancing societies, folk clubs,

ix. Scientific research projects.<sup>121</sup>

**e) The advancement of animal welfare**

The advancement of animal welfare includes any purpose directed towards the prevention or suppression of cruelty to animals or the prevention or relief of suffering by animals.

Examples of the sorts of charities and charitable purposes that would within this description include:<sup>122</sup>

*i.* Charities promoting preventing or suppressing cruelty to animals;

*ii.* Animal sanctuaries;

*in.* The provision of veterinary care and treatment;

*iv.* Charities concerned with the care of animals that are abandoned, mistreated or lost;

**f) The advancement of health or saving of lives**

The advancement of health includes the prevention or relief of sickness, disease or human suffering, as well as the promotion of health. It includes conventional methods as well as complementary, alternative or holistic methods which are concerned with healing mind, body and spirit in the alleviation of symptoms and cure of illness. To be charitable there needs to be sufficient evidence of the effectiveness of the method to be used. Assessing the efficacy of different therapies will depend upon what benefits are claimed for it (i.e. whether it is diagnostic, curative, therapeutic and/or palliative) and whether it is offered as a complement to  
123  
conventional medicine or as an alternative. Each case should be considered on its merits.

The relief of sickness extends beyond the treatment or provision of care, such as a hospital, to the provision of items, services and facilities to ease the suffering or assist the recovery of

120 Ibid note 91

121 This may include charities connected with various learned societies and institutions.

122 Ibid note 91

123 Ibid note 91

people who are sick, convalescent, disabled or to provide comforts for patients. The saving of lives includes a range of charitable activity directed towards saving people whose lives are in danger and protecting life and property.

**g) The advancement of citizenship or community development**

The advancement of citizenship or community development covers a broad group of charitable purposes directed towards support for social and community infrastructure which is focused on

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the community rather than the individual.

Examples of the sorts of charities and charitable purposes falling within this description include:

- i. The promotion of civic responsibility and good citizenship, such as good citizenship award schemes, Scout and Guide groups;
- ii. The promotion of urban and rural regeneration.<sup>124<></sup>
- iii. The promotion of volunteering;
- iv. The promotion of the voluntary sector;
- v. Promoting the efficiency and effectiveness of charities and the effective use of charitable resources;
- vi. The promotion of community capacity building.<sup>127</sup>

124 Ibid note 91

125 Ibid note 91

126 Charitable regeneration organizations can achieve this by the maintenance or improvement of the physical, social and economic infrastructure and by assisting people who are at a disadvantage because of their social and economic circumstances. This may include providing financial or other assistance to people who are poor; providing housing for those in need and help to improve housing standards generally in those parts of an area of deprivation where poor housing is a problem; helping unemployed people find employment; providing education, training and re-training opportunities and work experience, especially for unemployed people and providing financial or technical assistance or advice see Charities Commission reports , < [www.charity-commission.gov.uk/Library/guidance](http://www.charity-commission.gov.uk/Library/guidance)> last accessed 14th April 2012.

127 "capacity building ' for this purpose would mean making a positive difference to the capacity and skills of the members of the community in question because they participate with other members of that community in activities directed towards meeting their needs in some way. Sometimes this process is described as 'empowerment', see Office of the Scottish Charity Regulator, 2011, Meeting the Charity Test; Guidance for applicants and for existing charities <http://www.oscr.org.uk/niedia> > (last accessed 12th April 2012.)

vii. Charities concerned with social investment,

**h) The advancement of environmental, protection and improvement**

The advancement of environmental protection and improvement includes preservation and

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conservation of the natural environment and the promotion of sustainable development.

Conservation of the environment includes the conservation of a particular animal, bird, or other species or 'wildlife' in general; a specific plant species, habitat or area of land, including areas of natural beauty and scientific interest; flora, fauna and the environment generally. Charities concerned with environmental protection or improvement may need to produce independent expert evidence, that is authoritative and objective, to show that the particular species, land or habitat to be conserved is worthy of conservation.<sup>127</sup>

Examples of the sorts of charities and charitable purposes falling within this description include:<sup>130</sup>

- i. Charities concerned with conservation of the environment generally;
- ii. Charities concerned with conservation of a particular species;
- iii. To promotion of sustainable development and biodiversity;
- iv. The promotion of recycling and sustainable waste management;
- v. Research projects into the use of renewable energy sources.

**3.14.0 CONCLUSION:**

It is proposed that all organisations wishing to become a charity must demonstrate that they exist to benefit the public, or a substantial section of the public as a requirement for a universal public benefit test. The test will be based on common law and build on existing case law so that

<sup>127</sup> See speech by Barry Gaberman, Senior Vice President, The Ford Foundation at the Center for Public and Nonprofit Leadership, Georgetown University Building the Global Infrastructure for Philanthropy presented, 2003, Page < <http://cpnl.georgetown.edu>>accessed on 5th may 2010

<sup>129</sup> Commentary on the Descriptions of Charitable Purposes in the ..., <[https://www.charitycomission.gov.uk/Clarity\\_requirements\\_guidance/Charity\\_essentials](https://www.charitycomission.gov.uk/Clarity_requirements_guidance/Charity_essentials)> ( Last accessed on April 9, 2012).

<sup>130</sup> Ibid note 91

'the interpretation of charitability will continue to evolve as social and economic circumstances change.

The charitable purposes should be legislated so that charities and the public can understand more easily. The categories should be chosen on the basis that they 'should reflect on major areas of charitable endeavour which have, or should have, strong public recognition.

Like all other modern social and economic entities, charities need to be able to respond to changes in their operating environment. That may mean responding to changes in the needs of the community, finding innovative ways to meet peoples' needs, reacting at the time to rapid and significant shifts in the extent to which their services are directly funded by governments, or finding innovative ways to fund their operations. While the communities expect that charities will be able to respond quickly to such changes, their responsiveness can be hampered by having to wait for the law to 'catch up' and thus the recommendation to legislate the 'heads of charity'.<sup>131</sup>

131 Welcome to Charities Definition Inquiries website, <<http://www.cdi.gov.au/report/cdi>>accessed April 9, 2012).

## CHAPTER FOUR

### 4.0.0 PROMOTING CHARITY IN KENYA THROUGH TAX EXEMPTIONS AND PRIVILEGES

#### 4.1.0 INTRODUCTION

This thesis proceeds from a basic hypothesis that by charity law promoting public benefit, it has an important role in facilitating the growth and consolidation of civil society or the third sector.

Favorable income tax treatment of charitable contributions comes from the policy assumption that this will create an incentive to support what is arguably a public good or service, or at least curtail the disincentive to give created by the income tax's impact on disposable income.<sup>1</sup>

Tax deductibility for donations provides an indirect government mechanism to pay for charitable goods and services. This policy has two special features. First, it divides the cost of support for these goods and services between citizens and government.<sup>2</sup> Second, it allows citizens direct control over what is funded, by creating what amounts to a "matching grant" through tax discounts for private gifts.<sup>3</sup>

#### 4.2.0 DESIRABILITY OF TAX RELIEFS

Many debates are taking place on the value of more favorable tax policies in encouraging charitable giving; however, there is no clear consensus about the impact of such incentives.

While there are some who believe that the lack of tax incentives contributes to low levels of

<sup>1</sup>This idea is clearly evident in the early debates surrounding the provisions of the personal income tax. For example, the debate from the U.S. House of Representatives on the Revenue Act of 1913 (which created the first income tax of the 20th century) contains this argument from an unidentified congressman (Desmond, 1967) where he says ' It seems to me that it is desirable that there should be no curtailment imposed by this act upon the benevolent members of the community. If a man wants to make a gift to charity, he ought to be encouraged to do so and not [be] discouraged. He ought to be encouraged to make such a gift rather than be penalized for doing so' See G.Becker Human Capital: *Theoretical and Empirical Analysis with Special Reference to Education*, ( 1964), USA National Bureau of Economic Research, General Series,, P 7.

<sup>2</sup> Arthur c Brooks INCOME TAX POLICY AND CHARITABLE GIVING -<<http://www.docstoc.com/docs/40295485/INCOME-TAX-POLICY-AND-CHARITABLE-GIVING>> (last accessed on April 9, 2012)

<sup>3</sup> See chapter one page 23



giving in many countries, many others believe there is little relationship between the two.<sup>4</sup> Even in the United States, where dozens of studies have explored philanthropic motivation and behavior, there is an ongoing debate regarding the role and impact of tax incentives/ What is clear is that while tax policy varies greatly from country to country, in general most countries offer restricted fiscal incentives for giving to NGOs. Those that do provide such incentives typically impose strict limits on both the levels of deductibility and the amount of the available tax reduction.<sup>6</sup>

Effective strategies to promote philanthropy through more favorable tax incentives include increasing the amount of deductions and tax credits available to donors, and increasing the number and kinds of nonprofits able to receive contributions eligible for tax incentives. Success in enacting and implementing such strategies will require strong collaboration among government, profit-making, and charity sectors.<sup>7</sup>

Tax based promotion policies are not always appropriate for a particular country or culture, or easy to create and/or administer. Many countries are debating legitimate roles for their

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For instance in a roundtable discussion organized by Alliance Magazine on the issue of "How to Get Philanthropy Going" many discussant including representatives from Brazil, India, the Philippines, and South Africa - mentioned that tax incentives were important (see Alliance, Volume 9, Number 4, December 2004).

5 SALAMON, Lester, "The Changing Context of American Nonprofit Management" in *The Jossey-Bass Handbook of Nonprofit Leadership and Management* <[www.philanthropy.org/SEMINARS/documents/salomon](http://www.philanthropy.org/SEMINARS/documents/salomon)> (last accessed 20th April 2012)

6 For example, in Brazil, the cap on deductions is 2% of taxable income and limited to gifts in support of cultural projects and a special fund for children. Throughout Latin America business leaders cite the lack of tax incentives as one of the principal obstacles to raising social capital. Regulatory Reform, Philanthropy, and Social Change in Latin America, Executive Summary, PASCA Program, Harvard University, March 2000. Respondents in the recent APPC study of giving among high net worth individuals in six Asian countries also recommend tax incentives as a method of increasing philanthropy in their countries. *E-Seal*, Issue 7, December 2002, European Foundation Centre.

7 A noteworthy example can be found in Australia where, in 1999, encouraged by a coalition of foundation trustees, the government introduced a range of new tax incentives that appear to have had a positive effect on giving. Early research suggested that the total amount donated and claimed as deductions by individual Australian taxpayers increased by 11% thereafter. The new incentives included immediate tax benefits for workplace giving, cash donations, and donations of property, and established a new form of private charitable trust intended to provide businesses, families, and individuals with greater flexibility, privacy, and control in starting their own philanthropic trusts. Subsequently, 131 new trusts were established. See Paula D. Johnson, Stephen P. Johnson and Andrew Kingman, *Promoting Philanthropy: Global Challenges and Approaches*, Bertelsmann Foundation December 2004.

philanthropic and nonprofit sectors and understandably wish to create thoughtful policies and structures. In addition, many are trying to guard against the misuse of fiscal incentives. Furthermore, the fiscal challenges faced by many countries make it politically difficult and sometimes imprudent to reduce tax revenue. Indeed, there are concerted efforts by national governments and multilateral financial institutions to limit fiscal incentives that could decrease tax revenue.

In most countries, tax policy reform will need to be approached in concert with other initiatives to promote philanthropy. In much of the world, the government's emphasis on tax limitations and restrictions reflects the general distrust and suspicion of the nonprofit sector generally. New policies and tax incentives are only likely to be implemented if government and public attitudes towards the role of philanthropy and civil society are similarly reformed.

In an era of government shrinking support to social welfare, charities or non-profits provide possibilities for the voluntary provision of goods and services. They can also potentially function as partners with public agencies keen on devolving responsibility for providing certain public goods and services.<sup>8</sup> At the political level, any displacement of philanthropy means that some non-profit funding decisions and works including social welfare are turned over to the government.

In the final analysis, the effects of government subsidies to NPOs are complex and hard to predict with precision. However, at the very least, public policy and private management need to take into account the potentially grave secondary impacts for failure to rejuvenate the charity sector.<sup>9</sup>

<sup>8</sup> In the United States, the federal government has gone so far as to establish a White House Office of Community and Faith-Based Initiatives, charged with cultivating the relationships between governments and both religious and secular non-profits. See Bonnie Koenig, *Going Global for the Greater Good: Succeeding as a Nonprofit in the International Community*, Jossey-Bass, 2004 p.13

<sup>9</sup> Steinberg, Richard (1985). "Empirical Relations between Government Spending and Charitable Donations." *Journal of Voluntary Action Research*. Vol. 14, no. 2, pp. 54-64.

This chapter will first discuss the tax laws and fiscal provisions affecting charities and shows how those provisions are have failed to nurture charity. We will then analyze those areas in which reform is most necessary if Kenya is to provide an enabling fiscal environment for the charity sector.

#### **4.3.0 CRITICISM OF LAWS AND POLICIES INFLUENCING LOCAL PHILANTHROPY IN KENYA**

The Income Tax Act constrains philanthropy/fund-raising for social development and poverty eradication in two ways. First, any income to charity emanating from any income generating activities, or from financial investment undertaken to support their programs is taxable as income (gains or profits from business). Further any company or individual donating money, or rental space or use of property to an organization is taxed (against profits from business). However there is provision for exemption from taxation for 'not-for -profit organisations. All such organisations are exempt from Income Tax and some are eligible for exemption from VAT and Customs duties. NGOs and religious bodies fit in the categories described in the exemption provisions of the Income Tax Act. Application for exemption is however cumbersome, monotonous and take time to be approved.<sup>10</sup>

The Customs and Excise Act constrains philanthropy by not allowing exemptions where the gift is in kind. A person who makes a claim for a donation to be allowed under section 15(2) (w) of the Act is required provide proof of the donation to the Commissioner.

The proof of the donation required shall be in form of a receipt issued and certified by the recipient of the donation and shall be accompanied:<sup>11</sup>

(a) a copy of the exemption certificate issued by the Commissioner to the charitable organization, or the Minister's approval of the project to which the donation is made;

<sup>10</sup> See chapter Five Page 120

<sup>11</sup> The receipt produced as proof of a donation should contain , the full names and address of the donee; the Personal Identification Number (PIN) of the donee; date of donation; purpose for which the donation was made and the amount of donation The Income Tax (charitable Donations) Regulation 2007, Regulation 5.

(b) a declaration from the donee that the donation shall be used.<sup>12</sup>

It is difficult for the small organization to access the commissioner or to be issued with certificate required or access the minister for the purposes of exemption required under The Income Tax (charitable Donations) Regulation 2007, Regulation 3. Further unlike their corporate counterparts who enjoy tax deductions for capital investments, trusts and foundations are offered no tax relief when it comes to capital investments so that their can increase their endowments and thus their philanthropic efforts.

Further constrains are in the procedures for application for exemption and in the requirement for the approval of the treasury for gifts whose duty exceeds Ksh.10, 000. The constrain is further enhanced by the requirements of Rule 29 of NGO Regulations of 1992 which requires NGOs to apply for exemption to the minister of finance, through the NGO Co-ordination Board. The board therefore acts as a clearing house for exemptions. The same requirement applies for exemption from VAT.

. . . 13 . . .

The Societies Act ~ define a society to include any club, company, partnership or other association of ten or more persons, whatever its nature or object, established in Kenya, and requires that such should register themselves under the Act within twenty eight days of their coming together.<sup>14</sup> This is a constrain on resource mobilization in the sense that people cannot legitimately come together to pool resources or to collect resources or fund-raise for a common purpose for a period longer that twenty days, without being required to encumber themselves with the formalities of registration and therefore subjecting themselves to the very broad powers of the registrar of societies. This is a serious restriction of the right of association.

<sup>12</sup> *The Income Tax (charitable Donations) Regulation 2007, Regulation 3.*

<sup>13</sup> Chapter 108, Laws of Kenya

<sup>14</sup> Societies Act .Section 4

The Public Collections Act<sup>15</sup> was enacted to provide for the regulation of collection of money and property from the public.<sup>16</sup> It requires notification to the government administration of the collection of funds giving minute details of the process. It is a tedious and technical process which would be discouraging to the villagers wishing to come together to collect funds for whatever purpose. It criminalises collections outside the provisions of the Act and subjects' collectors and promoters directly to the authority of public administrations and police.<sup>17</sup>

The Chiefs Authority Act<sup>18</sup> also subjects any collections of funds to the regulation of the chief. The provisions are not clear on how the chief is to regulate the collection. These provisions have been abused by the chiefs, and led to the undermining of the 'harambee' spirit at the local community level.

#### **4.4.0 TAX EXEMPTIONS AND PRIVILEGES APPLICABLE TO NGOS IN KENYA.**

NPOs, NGOs and other charitable institutions like other artificial and human persons in Kenya are liable to pay the various taxes. There are however provisions for exemption for NGOs under prescribed circumstances and criteria. Moderately specific classes of NGOs enjoy exemption from specific classes of taxes, and a comprehensive statement can only be made after analysis of the various provisions. The exemptions are not automatic upon the formation of a charitable institution, but voluntary and upon application or claim to the relevant authorities.

The NGOs regulations for instance provide that:

*Any organisation seeking exemption from Tax may ...apply through the NGO Coordination Board to the minister for the time being responsible for finance for the grant of the*

<sup>15</sup> Chapter 106, Laws of Kenya

<sup>16</sup> Preamble, *Public Collections Act*.

<sup>17</sup> Though tedious, the Act however provides an accountability structure and mechanism which, if applied strictly would ensure that public funds are collected for legitimate purposes and used for those purposes, For example Section require the full particulars of collection be given.

<sup>18</sup> Chapter 128, Laws of Kenya

exemption... <sup>>19</sup>

The main tax laws that expressly affect charity in Kenya are:

a) The Income Tax Act<sup>20</sup>

21

b) -The Customs and Excise Act"

c) -The Value Added Act<sup>22</sup>

We now take turn to consider the exemptions and privileges under each of the cited legislative regime.

#### 4.4.1 Exemptions under Income Tax Act

The main direct tax which Kenyans pay is income tax which is administered, governed and regulated under the Income Tax Act. Under the Act, income tax is charged for each year of income upon all the income of a person, whether resident or non-resident, which accrued in or was derived from Kenya.

Part II of the Act describes taxable "income" for purposes of the Act as including:

- a) *Gains or profits from- i) a business, for whatever period of time carried on; ii) employment or services rendered iii) a right granted to another person for use or occupation of property*
- b) *Dividends or interest*
- c) *Employment or services rendered*
- d) *An amount deemed to be the income of a person under this Act or by rules made under this Act.*
- e) *Gains accruing in the circumstances prescribed in and computed in accordance with, the EIGHTH SCHEDULE.* <sup>24</sup>

19 *Non-Governmental Organisations Regulations(1992),.*

20 Chapter 470 of Laws of Kenya

21 Chapter 472 of Laws of Kenya

22 Chapter 476 of Laws of Kenya

23 Section 3(1) of the Income Tax Act

24 Section 3(2) of *The Income Tax Act.*

For income to be exempt from income tax, an organization must have been established solely to relieve poverty or distress of the public, or to advance religion or education. In addition, the Commissioner of Income Tax must conclude that the income is expended either wholly within Kenya or in ways that benefit the residents of Kenya.<sup>25^</sup>

Section 10 of the First Schedule of the Income Tax Act provides that the income of an institution, body of persons or irrevocable trust, of a public character, established solely for the purposes of poverty alleviation or distress of the public, or the advancement of religion or education, all for public benefit, shall be tax exempt. Section 13 provides that the income of a registered trust is exempt from income tax

Under Section 13 (2) The Minister of Finance is empowered by notice in the Kenya Gazette to provide that income or a class of income which is accrued in or was derived from Kenya shall be exempt from tax to the extent specified in the notice.

This is captured under the FIRST SCHEDULE which provides that income accrued, derived from or received in Kenya, which is exempt from tax, is as follows:

a) *The income of a person who, or organisation which is exempt from income by or under any Act for the time being in force, to the extent provided by that Act.<sup>26</sup>*

27

b) *Subject to section 26 , the income of an institution, body of persons, or irrevocable trust, of a public character established solely for the purposes of the relief of the poverty or distress of the public, or for the advancement of religion or education- [established in Kenya; or whose regional headquarters is situated in Kenya, in so far as the Commissioner is satisfied that the income is to be expended either within Kenya or in circumstances in which the expenditure of that income is for purposes*

<sup>25</sup> *Income Tax Act*, First Schedule, Section 10.

<sup>26</sup> The proviso that tax can be exempted under any other Act is good as it increase the flexibility of the exemption but it is a clear indication of variety of regimes that tend to bring confusion and complexity in for the charity sector. This also attests to different meanings or definition that can be attributed to charities.

<sup>27</sup> Section 26 of the Act deals with income from certain settlements deemed to be income of the settlor.

*which result to the benefit of the residents of Kenya.* <sup>28</sup>

Further relevant provisions for consideration relates to allowable deductions from taxable income. This is granted under Section 15(1) which provides:

*'For purposes of ascertaining the total income of a person for a year of the income there shall, subject to Section 16,<sup>29</sup> be deducted all the expenditure incurred in that year of income which is expenditure wholly and exclusively incurred by him in the production of that income.'*

With regards to deductions allowed from business income, section 15(2) lists allowed expenditures as including among other things:

- a) Expenditure incurred by a person for the purposes of a business carried on by him-being.*
- b) a sum paid to a scientific research association approved for the purposes of this paragraph by the Commissioner as being an association which has as its object the undertaking of scientific research related to the class of business to which the business belongs; or*
- c) a sum paid to a university, college, research institute or other similar institution approved for the purposes of this paragraph by the Commissioner for the scientific research mentioned in sub-paragraph<sup>30</sup>*

The typical sources of revenue for NGOs are donations, membership dues, and interest and dividends on investments. There is general agreement that these items should not be taxed. There are, however, two different ways of arriving at this result. One approach assures that NGOs are not taxable on these ordinary sources of revenue by defining those sources as not constituting "income" for tax purposes. The other approach recognizes these receipts as income but confers exempt status on charities.

Generally accepted tax theory defines income as any receipt during a defined period of time

<sup>28</sup> First Schedule, Clause 2

<sup>29</sup> Section 16 lists deductions that are not allowed.

<sup>30</sup> Scientific research for purposes of this section has been defined by section 15 (6) "...activities in the fields of natural or applied science for the extension of human knowledge, and when applied to any particular business includes- i) scientific research which may lead to or facilitate, an extension of that business or of business in that class, ii) Scientific research of a medical nature which has a special relation to the welfare of workers employed in that business, or in business of that class.'



that is either expended or that increases net worth. Under this approach and in common understanding, it is clear that dividends and interest are generally considered income for tax purposes. Accordingly, the approach It is recommended that we recognize all receipts of a charity or none governmental organization donations, membership fees, interest, dividends, and capital gains- as income, but to advocate tax exempt status for all charities.<sup>31</sup>

Every charity and NGO, whether organized for mutual benefit or for public benefit, and whether a membership or non-membership organization, should be exempt from income taxation on moneys or other items of value received from donors or governmental agencies, membership dues, if any, and any interest, dividends, rents, royalties or capital gains earned on assets or sale of assets.<sup>32</sup> Since charities as defined here preclude the possibility of personal benefit or the distribution of profits,<sup>33</sup> there is a powerful argument that they are not proper objects of an income tax in any system.<sup>34</sup>

#### **4.4.2 Deductibility of Charitable Contributions**

As of January 2007, individuals and corporations generally can deduct any cash donations to a charitable organization from their income tax, provided the charitable organization:<sup>35</sup>

- a. Is registered or exempt from registration under the Societies Act or the Non-Governmental Coordination Act, 1990 and its income is exempt from tax under the provisions above.<sup>36</sup>

31 This approach leaves several open questions - should those who make donations receive a tax preference? Should trade or business income of a charity be exempt? And how should charities organizations can dealt with under other tax laws? These questions are dealt with in the succeeding sections.

32 Checklist for NPO (NGO) Laws, International Centre for Not-for-Profit Law< [http :< www.sdn.org/gy/csoc/report](http://www.sdn.org/gy/csoc/report)> (Last accessed April 9, 2012).

33 Unfortunately, most countries around the world including Kenya assume that Charities, like for profit entities are natural subjects of taxation, and that not applying tax to them is a matter of grace and exemption.

34 In countries, such as New Zealand, which have fully integrated their corporate and individual income taxes, there is no need to impose separate income taxes on corporations. There is a single income tax and it is imposed on corporate profits once, at the shareholder level and at shareholder rates. Profits at the corporate level are subject to a tax, but ill dividends are "franked" -that is, the shareholder receiving franked dividends is entitled to take a credit against his or her own taxes for the taxes paid at the corporate level

35 *The Income Tax (charitable Donations) Regulation 2007*, legal Notice Number 101.

36 Income Tax Act, Section 15(2)(w)

- b. The Minister of Finance can also approve projects to which deductible contributions may be made.

The Income Tax (charitable Donations) Regulation 2007 gazetted under legal Notice Number 101 has restricted definition of what constitute charitable organization. Charitable organization according to the notice means a non-profit making organization established in Kenya and which is of a public character; and has been established for purposes of the relief of poverty or distress of the public, or advancement of education.<sup>38</sup>.

Expenditures of a capital nature by a person on the construction of a public school, hospital, road or any similar kind of social infrastructure can be deducted as well with prior approval of the Minister.<sup>39</sup> Furthermore, deductibility is permitted for expenditures on scientific research to advance the donor's business, including sums paid to approved scientific research institutes or universities, provided certain conditions are satisfied.<sup>40</sup>

Individuals and business entities should be entitled to an income tax deduction or credit with respect to donations made to charities. A separate and different question is whether a contributor to a charity should get a tax credit or a tax deduction. The distinction is of great importance in a tax system with a progressive rate structure. A tax credit reduces the amount of tax owed, often unit-for-unit, whereas a deduction only reduces the amount of income that is subject to tax. Where rates are progressive, deductions tend to favour higher income tax payers, who are paying a higher rate of tax on income. Tax credits give each taxpayer the same tax preference for a contribution of the same amount, and hence represent greater equity as a matter of tax policy and hence recommended to adopted.

Another question that must be dealt with in any scheme of taxation is the limits, if any, put on

<sup>37</sup> Income Tax Act, Section 15(2)(w)

<sup>38</sup> *The Income Tax (charitable Donations) Regulations 2007*, paragraph 2.

<sup>39</sup> *Income Tax Act*, Section 15(2)(x).

<sup>40</sup> *Income Tax Act*, sec. 15(2) (n).

the amount of tax preferences that can be achieved.<sup>41</sup> Empirical studies<sup>42</sup> show that few business entities contribute more than 12% of their income, so it is an essentially non-constructive debate whether deduction limits should be higher than that.

The same is not true of individuals, however, and where there is no limit on allowable charitable deductions wealthy individuals can avoid paying any taxes by contributing to charity an amount equal to their taxable income each year. In a democracy, it is appropriate that each citizen who is financially able should bear a fair share of the costs of government and it is therefore not a best practice to allow boundless deductions.

#### **4.4.3 Exemption and Remission under the Customs and Excise Act and VAT Act<sup>43</sup>**

The Customs and Excise Act is an Act of Parliament 'to provide for the management and administration of the customs, for the assessment, charge and collection of customs and excise duties.<sup>44</sup> Under the Act the Minister of Finance has powers to grant remission. Remission can be defined as a reduction or lessening of tax or duty payable on imported goods whether imported directly or by consignment.<sup>45</sup>

Section 138 (1) of the CEA provides that:

*'The Minister may, by order in the Gazette, remit in whole or in part any import duty, suspended duty, or dumping duty payable by any persons on goods, aircraft, vessel or vehicles imported by that person, if he is satisfied that it is in the public*

41 For example, in Russia individuals can claim deductions only up to 3% of their income, and business entities are limited to 1%. In the United States, by contrast, individuals can claim deductions for up to 50% of their income, and in Australia there is no limit at all. See Yulia Checkmaryov, 'Taxation of Grants in Russia' The International Journal of Not-for-Profit Law, Volume 7, Issue 2, February 2005, A quarterly publication of the International Center for Not-for-Profit Law, p2. Accessed at <<http://www.icnl.org/knowledge/iinj/vol7i.ss2/>> Last accessed on 5th August 2010.

42 Paul R. McDaniel, Federal Matching Grants for Charities Contributions: A substitute for Income Tax Deductions, Tax Law Review, Volume 27, 1972 p. 124

43 Chapter 472 of Laws of Kenya

44 Preamble, Chapter 472, Laws of Kenya.

45 Before 1990 there was no legal provision under which NPOs could seek exemption from the payment of import duty, custom duty and excise. Some NGOs which had sufficient public visibility however obtained exemptions under memoranda of understanding on a case-by-case basis. See Bernard Sihanya, (1996) 'Regulatory Regimes Governing NGOs in Kenya'. A Report prepared for the Country Reports for the Database Project on NGO Laws and Regulations, conducted by the International Centre for Not-for-Profit Laws (ICNL) and the World Bank, Washington D.C. 1996) p25.

*interest to do so.*

Section 138(2) lists goods eligible for this remission.<sup>46</sup> Part A (12) of the Third Schedule of the Customs and Excise Act describes goods for which remission may be granted and pooled with the provisions under Section 138(2); the entire requirements can be summarised to have the following goods exempted and with necessary conditions:

- a) *bona fide* gifts.<sup>47</sup>
- b) that receiving or importing organisations be 'charitable organisations' as described and have tax exempt status under paragraph 10 of the First Schedule to the Income Tax Act.

Gifts to charitable institutions are exempt from customs duties under the following circumstances:

- (a) Goods donated or purchased for donation to a non-profit organization or government-approved institution for: their official use; free distribution to the poor and needy; use in medical treatment, education, religious or rehabilitation work; or other purposes approved by the government.<sup>48</sup>
- (b) Certain goods, including some passenger motor vehicles, and office, audio and visual electronic equipment are excluded from the custom duties exemptions. Textiles, new and used clothing, footwear, and certain foods also are excluded from the customs duties exemption but a remission of the duty may be granted if the goods are donated or purchased for donation to registered homes for poor and needy persons. The remission is subject to ministerial approval.

<sup>46</sup> Section 138(2) provides that "Remission under subsection (1) shall only be in respect of: such other goods including motor vehicles and computers, excluding passenger vehicles of an engine capacity exceeding 3000c and four-wheel drive passenger motor vehicles of an engine capacity exceeding 4000cc, building materials, office equipment, stationery, office furniture textiles, new and used clothing, footwear, maize, wheat, sugar, milk and rice donated or purchased for donation by any person to non-profit making organisations or institutions approved by the government, for their official use or for free distribution to poor and needy persons, or for use in medical treatment, educational, religious or rehabilitation work or for other government approved projects.

<sup>47</sup> The provision excludes office equipment, stationery and office furniture

<sup>48</sup> *Customs and Excise Act*, Section 138(1)(c)

(c) Remissions also may be granted when the goods are imported during periods of civil strife, national calamity or disaster as declared by law or where intended for use in officially recognized refugee camps in Kenya.<sup>49</sup>

c) Treasury must approve any duty exemption that exceeds a certain threshold.<sup>^</sup>

The Value Added Tax Act<sup>51</sup> imposes form of a consumption tax on goods delivered in, or imported into Kenya; and on certain services supplied in Kenya. Under the Act, remission or exemption is limited to particular goods, purchased by particular organisations and to be applied to specified uses.

The Powers of remission is stipulated under Section 23 (1) which provides; Subject to subsection (3), the minister may, by order in the Gazette, remit wholly or partly tax payable in respect of any taxable supply or class of taxable supplies, if he is satisfied that it is in the public interest to do so. The requirement for gazettelement by the minister makes the exercise rigorous and lengthy not worth to pursue when the amount t be remitted is minimal.

Section 23 (3) of the Act provides for the Scope of remission and persons and goods entitled to remission. Remission under the section provisions is granted only on goods donated or purchased for donation by third parties to non-profit making organisations or such other organisations approved by the government. This can be construed to mean that goods directly purchased by non-profit making organisations do not benefit from these provisions.

The section goes on to extend remission for purchases towards natural disasters and calamities.<sup>52</sup> The EIGHTH SCHEDULE<sup>53</sup> PART (A) Clause 9 (I) (a), (b) and (c) describes:

- a) 'charitable organisations' for purposes of zero-rating on imports and purchases, and requires the treasury's approval in writing for tax levels above would exceed Ksh. 500,000, and;

<sup>49</sup> *The Customs and Excise (Remission) (Charitable Organisations) Order* 1999 as amended by Legal Notice 46 of 2004

<sup>50</sup> *Customs and Excise Act*, 3d Schedule, Section 12.

<sup>51</sup> Chapter 476, Laws of Kenya

<sup>52</sup> Section 23(3) (iv) of *The VAT Act* limits remission under this section to only 50% of tax payable.

<sup>53</sup> The eighth schedule deal with ' Public Bodies. Privileged Persons and Institutions with Zero rated status on Imports and Purchases'

b) Goods being bona fide gifts for eligibility for zero-rating for NPOs and limits zero-rating for NPOs to 50% of tax payable.

The Third Schedule Clause 7 of the VAT Act describes services eligible for exemption as including 'social services' provided by the charitable organisations. The Third Schedule Clause 16 (a) (b) (d) (e) includes as exempt services, those rendered by 'professional and labour associations', by educational, political, religious, welfare and other philanthropic associations to their members'; entertainment of a charitable nature, entertainment organised by a charitable organisation to further their objects.

The Third Schedule Clause 18 exempts accommodation and restaurant services within establishments of charitable or religious organisations; operated by educational training institutions or by medical institution. If an organization is excluded from a VAT system, 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 system, it cannot apply for a refund. Although exclusion from the VAT system is not desirable from a tax point of view, small charities might rationally prefer it in order to be relieved of compliance burdens.

The best situation for a charity is to be included in the VAT system but to be zero-rated. This means that, though the charity pays VAT on the goods and services it buys, it does not have to pay output VAT, and it gets back as a rebate the input VAT paid plus the amount of any imputed VAT on goods and services it sells to others. The general approach is to give charity a favorable VAT rate, but not a zero rate.<sup>54</sup>

Customs duties are among the most contentious and difficult of issues faced by Charities in practice. If the law provides for exemption for charities, customs officials often disregard the law, and charities must spend a disproportionate amount of time getting more senior

<sup>54</sup> For example, if the general rate of VAT is 20%, the special rate for charities might be 10 %.

officers to actually approve the exemption. At the same time, laws allowing customs exemptions for charities tempt charlatans and crooks into the Charity sector with the prime motive of establishing a charity to get customs exemption.

If customs duties are imposed on legitimate charities, however, they can dramatically increase the costs of operations. The problem 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.<sup>55</sup>

The best practice in this area is to provide customs duty exemptions to charities and to have a fair but thorough process for assuring that only genuine charities qualify for the process, but then to have a certification, licensing, or similar process that ensure that a charities exemption from customs duties will be honored at the border. To protect against the improper use of the exemption, it is appropriate to provide that imports will be exempt only if they are going to be used by the charity in its operations. Any item sold by a charity (e.g., a truck or automobile) within a short period (say 2-3 years) would be subject to customs duties at the time of sale.

#### **4.4.4 Other Taxes**

There are other ancillary taxes and levies, apart from the ones analyzed above, for which registered charities are subject and which might significantly reduce their capital or resource necessary for the purposes beneficial to the community. These include among others, transfer fees , stamp duty, capital gains tax and City Council property rates. In Kenya charities owning property are neither exempt from property transfer stamp duty nor municipal property rates which can amount to a lot of money.<sup>56</sup>

<sup>55</sup> It is a problem, though, for even the smallest charity, which might want to import a fax machine or computer to make its work more productive.

<sup>56</sup> Connie Ngondi-Houghton, "PROMOTING PHILANTHROPY IN KENYA", Making the Case for Tax Law Reforms to Create an Enabling Fiscal Environment for the Growth of Philanthropy, A Study Report of the K-REP Development (Nairobi, Agency CCML 2004) p

#### 4.5.0 TAX TREATMENT FOR CHARITIES TRADE INCOME

Income derived directly from business activities which are carried out by NPOs may be exempted from taxation only if:

1. The income is applied to the limited purposes set out in Schedule 1(10); or
2. The business activities are directly related to the limited purposes set out in Schedule 1(10).<sup>57</sup>

In that regard charities in Kenya, can only legally engage in income generating activities that are related to their central purposes if they would like seek exemptions from income tax. Further the income or gains from such business is generally taxable except where such income or gains are applied solely to the purposes of the NPO<sup>58</sup> and either the business is carried on in the course of the actual execution of those purposes<sup>59</sup> or the work of the business is mainly carried on by beneficiaries of the activities of the NPO or the gains or profits consist of rents received from the leasing or letting of land and chattels leased or let therewith. This provision seems to require that to be granted tax exemption on trade income charities have to fuse or combine their philanthropic objects with for-profit objects.

There is no minimum or maximum limit to this benefit. It risks abuse where the balance may favour the for-profit activities and where costs and infrastructure used in the for-profit may be reflected as having been used in the charitable activities. This provision allows only narrow bounds and a precarious environment for charities to generate their own income. International practice shows varied efforts by countries to open up space for NPO trading, and for tax

<sup>57</sup> SCHEDULE 1 clause 10 provides: "... that any such income which consists of gains or profits from a business shall not be exempt from tax unless those gains or profits are applied solely to those purposes and either-

- i) the business is carried on in the course of the actual execution of those purposes; or
- ii) the work in connection with the business is mainly carried on by the beneficiaries under those purposes; or the gains or profits consist of rents (including premiums of similar consideration in the nature of rent) received from the leasing or letting of land and chattels leased or let therewith.'

<sup>58</sup> This use/destination -of -income test, use-of-income test addresses the fear of erosion of the tax base and the creation of opportunity for

<sup>59</sup> This is relatedness test, The general test of relatedness seeks to address the concern of unfair competition.



exemption on trade income.<sup>60</sup>

Often the most effective way for a charity 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 charity wants to promote may be to publish and a magazine devoted to that topic. Publishing a magazine is a means for achieving the end of promotion of the art or culture. Exempting income from such related activities makes good theoretical sense.

Charities should be allowed to engage in economic activities so long as those activities do not constitute the principal purpose or activity.

Any net profit earned by a charity from the active conduct of a trade or business could be-:

- (a) Exempted from income taxation,
- (b) subjected to income taxation,
- (c) Subjected to income taxation only if the trade or business is not related to and is not for the furtherance of the not-for-profit purposes of the organization, or
- (d) Subjected to a mechanical test that allows a modest amount of profits from economic activities to escape taxation, but imposes a tax on amounts in excess of the limit.

The tests involved in selecting among these possible tax rules are complex and technical.

Under a "destination of income" test, alternative (a) would apply to a properly formed charity. Thus, all income from economic activities would be exempt from tax as long as all

<sup>60</sup> Recent South African provisions for instance are certainly more progressive than the Kenyan position but not as liberal as those of Canada though broader than those of the US. In SA trading or business activities of PBOs are allowed under the following conditions:

- a) the de minimis rule/technical test which provides that gross income from business undertaking or trading activity must not exceed the greater of 15% of the gross receipts of the organisation, or R25000;
- b) Related trading activities that are integral or related to the sole object of the organisation are allowed if carried out on a basis substantially directed at cost recovery, and does not result in unfair competition in relation to taxable entities
- c) Unrelated trading activities that are of an occasional nature allowed if substantially carried out with voluntary assistance.
- d) any other activity approved by the Minister.

of the profits earned from the active conduct of a trade or business are committed for and actually used to carry out the principal purposes for which the charity was formed.<sup>61</sup>

Kenya being a country with a developing market economy, it may be appropriate to strike the balance in favour of tax exemption for all profits destined for use by a charity to carry out its statutory activities.

On the other hand, the problem of unfair competition can become a serious issue, particularly when the scale and number of economic activities by charities begins to pose a threat to private enterprises/<sup>2</sup>

In Kenya indigenous philanthropy has not developed to the point where charities can rely on contributions raised either from private grant makers or from public fundraising efforts to finance their activities. The ability of such organizations, and particularly public benefit organizations, to raise money through business activities designed to support their not-for-profit activities is therefore critical to their existence.<sup>63</sup>

There are countries' laws that require charities to form separate business subsidiaries to conduct any income-generating activities.<sup>64</sup> This law may create unnecessary burdens for charities seeking to raise funds to support their not-for-profit activities. Not only is this kind of law an obstacle to financial sustainability, but have compliance problems.

61 Thus, an organization that spent 99% of its time and money making profits from a purely commercial activity would be treated as a tax exempt charity if each year it gave all of its profits to charitable causes. Whether such an outcome would actually exist in practice would depend on whether the proper authorities would accept that such an organization was or was not properly registered as a charity. They might, for example, require it to reregister as a business entity, depending on the circumstances.

62 Obviously, if a large and wealthy Charity can engage in a particular activity (e.g. book publishing) without paying taxes, it has an economic advantage over its for profit competitors. See Walter W. Powell, Richard Steinberg, *The nonprofit sector: a research handbook*, Yale University Press (2000) p 288.

63 The importance of income from economic activities to support of a viable NGO sector is demonstrated by research showing that on average, in four countries surveyed, private fees and charges make up 46.1 percent of NGO revenue. Private fees as a source of revenue range from a low of less than 29 percent (Romania) to 47 percent (Czech Republic) and 55 percent (Hungary and Slovakia). See *International Grant Making: Funding With a Global View*, Grant Craft, Ford Foundation, 2007 p58.

64 Macedonia is one country that does not permit Charities to engage directly in business activities for any reason but allows Charities to form separate business subsidiaries to conduct any income-generating activities Ibid note 62 p 101

Laws permitting charities to engage in economic activities and creating appropriate tax incentives must of course contain some limitations to ensure that charities are not formed primarily to conduct business. Unfortunately, in many countries, there have been abuses involving businesses that have registered as charities in order to gain tax preferences.<sup>65</sup> Preventing such abuses is certainly an important consideration. However, it is not necessary to deny charities either the ability to conduct economic activities entirely or to tax benefits for all income earned from such activities in order to curb abusive business practices. These problems can be dealt with instead by limiting the availability of a tax exemption for profits earned from economic activities to those charities that meet an appropriate test

An investment club could invest funds contributed by the members, accumulate substantial profits, and then distribute the profits to the members upon termination. If such an organization received a tax exemption for its investment earnings, it would be little more than a tax-subsidized mutual fund, an obvious abuse. Laws granting tax exemptions for passive investment income need to limit the exemption accordingly.

A second issue relates to the creation of appropriate incentives for the establishment of endowments. We might consider enactment of laws containing special incentives for the creation of endowments (e.g. by providing a special tax credit for such donations), as well as tax exemptions for investment income and incentives for charitable giving. Indigenous philanthropy has not yet developed to the point where it could be used to create sizable endowments organizations, such as community foundations or family foundations, might well be achievable, and could be used to create an additional source of income to sustain charities.<sup>66</sup>

65 Betsy Buehalter Adler, Silk, Adler and Colvin, 'Legal Dimensions of International Grant making, Council on Foundations', International Donor-Advised Funds Winter 1998, p 78.

66 International Centre for Not for Profit Law, SURVEY OF TAX LAWS AFFECTING NGOS IN CENTRAL AND EASTERN EUROPE, 2002, <<http://siteresources.worldbank.org>> (Last accessed April 9, 2012).

It may be desirable, in connection with legal reform of the tax laws governing passive investment income, to include provisions restricting unlimited accumulation of earnings, and ensuring appropriate management of endowed funds, by among other things, setting fiduciary standards for fund managers.

Keeping in mind concerns about unfair competition, and those on the risk of undermining the charitable purpose of the organisations, this study proposes:

- a) That trading by tax exempt charities should henceforth be permitted, although within a carefully structured fiscal regime which facilitates oversight by the Commission<sup>67</sup> and limits the opportunity for abuse.
- b) It is specifically recommended that the *de minimis* rule/technical test be applied, and that therefore no tax implication should arise in respect of 'trading income' from a substantially related trading or business activity up to a limit of say KSH X per annum or Y% of gross receipts whichever is greater<sup>68</sup> or
- c) That gross receipts derived from related trading be tax-exempt to the extent that the gross receipts from such income-generating activities do not exceed one half of the gross receipts (including donations) of the organisation concerned.
- d) That 'unrelated' trading by charitable organizations be permitted without restriction, but only if conducted within the structure of a separate wholly-owned or controlled subsidiary' and that the income derived would be subject to normal tax.
- e) That the test of 'relatedness' be kept, and be elaborated and expounded in meaning to mean 'that the conduct of the business activity must have a significant causal relationship to the achievement of a tax-exempt purpose.'<sup>69</sup>
- f) That certain one-off trading activities by exempt NPOs approved by the charities

67 See chapter 4 on the proposed commission

68 Figures here need to be rationalized, and may consider among other things precedents from other countries such as US \$1000 for USA and SA R25000, and KRA policies and revenue goals.

69 See Barnett Baron 'Philanthropy and Homeland Security', Foundation News and Commentary, May/June 2004, p 234

commission may be tax exempt on their income.

h) That these provisions be reinforced by substantial penalties for economic and financial fraud and misallocations.

#### 4.6.0 TAX PERCENTAGE LAW DIRECTIVES<sup>70</sup>

Another tax based approach to promoting charity is "percentage laws" which appears to be gaining popularity, particularly in Eastern and Central Europe.<sup>71</sup> The taxpayers may direct that 1% of his taxes be paid to designated charitable organization and public institutions (e.g. museums, hospitals, libraries) and probably additional 1% to religious organizations. Taxpayers who do not want to support any organizations can either direct their 1% to a special government fund named in the tax law or simply not to declare any intention. The *1% Law* may prove very successful because not only that it will contribute towards increasing the image of the civil sector but also provided for decentralization and democratization in decision making in the field of supporting civil organizations.<sup>72</sup>

Additionally it will have the following benefits:

- (1) Charities will enter into efforts to convince the general public that they should support them and strengthen the communication between the nonprofit sector and society.

<sup>70</sup> Both Hungary and Slovakia have made a step forward by introducing a "1% Law." The 1% Law grants private individuals the right to designate, in a statement, the use of a specified portion of their tax paid for the taxable year. See Timothy S. Burgett, Grantmaking and Embargoed Countries: an Overview Using Kosovo as a Case Study World Vision International and Timothy R. Lyman, Day Berry and Howard Foundation, Legal Dimensions of International Grantmaking, Council on Foundations, Summer 1999 p.54

<sup>71</sup> see Balazs Gerencser and Judit Oprics, *The Role of Percentage Designation in Creating a Culture of Giving*, Non-profit Information and Training Centre (NIOK) Foundation, July 2007 < <http://szazalekosadoinany.honlaphat.hu> > Last accessed 14th April 2012

<sup>72</sup> Hungary's groundbreaking "1% law," adopted in 1996, began a chain reaction in the region. While it is too soon to fully know the overall impact of percentage laws, such programs show some clear gains. For example, in the first year after the Slovakia percentage law was adopted, over 300,000 taxpayers used the system to give in excess of 2.3 million Euros. More broadly, there is general agreement that such programs raise the public awareness of the nonprofit sector. But critics question the extent to which percentage laws represent true "philanthropy," given that such contributions are a tax designation rather than a voluntary donation. Moreover, there is concern that some governments that have established percentage laws have abolished tax incentives for other forms of philanthropy, thus limiting the growth of a broad philanthropic culture, see Balazs Gerencser and Judit Oprics, *The Role of Percentage Designation in Creating a Culture of Giving*, Non-profit Information and Training Centre (NIOK) Foundation, July 2007 < <http://szazalekosadomany.honlaphat.hu> > Last accessed 14th April 2012.

Charities are going to become more accountable, professional and transparent with the aim of building trust among stakeholders.

- (2) Furthermore, the requirement for providing the community with an insight into its operation increases the transparency of Charities and decreased potential misuse of means.
- (3) The 1% provision would also be a new mechanism for decentralization in the field of supporting Charities. Taxpayers' involvement in the redistribution process makes public funds available for a much larger segment of the nonprofit community including small local organizations. It also contributes to the democratization in the decision making process by providing the taxpayers with the possibility to be let free to decide on the use of a given part of their personal income tax.<sup>73</sup>

Taxpayers largely will accept this law mostly because of the possibility to choose the activity they would support. At the end, the 1% Law will proof to be more important because taxpayers will express their willingness to contribute to solving or alleviating social and economic problems, among others the difficulties caused by deficient government funding.<sup>74</sup>

#### **4.7.0 PAYROLL GIVING<sup>75</sup>**

Payroll Giving is a scheme that enables employees to give to any charity straight from their gross salary (before tax is deducted), and to receive an immediate tax relief of up to the sum donated.

Payroll Giving provides charities with regular and reliable donations, allowing them to plan ahead and budget for the future. Besides it is quick and easy to set-up and administer, Payroll Giving is also a great way for businesses to demonstrate commitment to the causes that their

<sup>73</sup> International Centre for Not for Profit Law Analysis of Tax Benefits for Charitable Donations by, <<http://www.docstoc.com/docs>> (accessed April 9, 2012).

<sup>74</sup>For more please read: "Citizens' votes for Nonprofit Activities in Hungary", survey prepared by Agnes Vajda and Eva Kuti (NIOK <http://www.niok.huA/indexe.htm>) accessed on 7th July 2010

<sup>75</sup>

Giving is also referred Workplace Giving or Give As You Earn (GAYE) Introduced in 1987 In UK , Payroll Giving is a simple, tax efficient scheme which allows employees to give money to the UK registered charity of their choice by having a deduction taken straight from their gross pay. There is no tax for the charity to claim back as no tax was deducted.

employees care about. It is beneficial to the employees in that it is an easy, tax-effective way to give to charity - so it costs employees less to give more. The system is easy to opt in and out of giving and donors have full control over their giving.

#### **4.8.0 CONCLUSIONS**

The most important tax laws provide tax benefits to charities to a limited extent. We have made analysis tax benefits to charities and indeed it have been said that tax benefits are the most prominent form of government support to charity. The issue therefore is not one of initiating tax exemption, but that of expanding the ambit of the current benefits and the scope of the charities that can access them.

Perhaps the greatest challenge currently facing the charities in Kenya is assuring the sector's financial sustainability.<sup>76</sup> There are a number of areas in which reform of the existing tax laws in Kenya is necessary in order to ensure the continuing financial sustainability of charities by among other things, providing for tax exemptions and creating incentives for private philanthropy. As indicated in this chapter, despite some progress, much work remains to be done if the tax laws in our country are to promote a liberal fiscal enabling environment for the sector.

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Government of Kenya, 2007, 'Basic Report on Well-being in Kenya', Kenya National Bureau of Statistics (formerly the Central Bureau of Statistics) Ministry of Planning and National development.

## CHAPTER FIVE

### 5.0.0 REGULATION REFORMS: REGISTRATION, REPORTING AND MONITORING OF CHARITIES

#### 5.1.0 INTRODUCTION

Promoting public trust and confidence is central to the survival of charitable institutions. Both trust and confidence have a role to play in facilitating public support to the sector.<sup>1</sup> This chapter delves into making analysis of the regulatory framework of charities and recommends the introduction of measures to encourage charities to become more accountable and more transparent in their activities, for example, by making available accurate and relevant information about their activities, achievements and governance.<sup>2</sup> More precisely, the chapter examines the desirability of having an independent authority or body<sup>3</sup> assume some of the key roles which Kenya Revenue Authority and the NGO council currently plays in the charity sector and wider not-for-profit sector field, as well as offering ideas about that body's structure and operations.

#### 5.2.0 EXISTING LEGAL FRAMEWORKS AND SCOPE OF REGULATION

The regulatory scheme for NPOs in Kenya is complex, combining substantive and procedural statutes, common law rules embodied in case law, and mostly administrative practices.<sup>4</sup> In

<sup>1</sup> Trevor A. Q.C. Carmichael, 'Charity Law Development in the Commonwealth Caribbean' in Paul Bator, Frits Hondius and Penina Kessler Lieber (eds), *The Tax Treatment of NGOs: Legal Ethical and Fiscal Frameworks for Promoting NGOs and their Activities* (2004) 5961.

<sup>2</sup> Charities and Fundraising - The Charity Commission for England <<http://www.charity-commission.gov.uk/publications>> (Last accessed April 12, 2012)

<sup>3</sup> In a paper entitled *Regulating Virtue: A Purposive Approach to the Administration of Charities in Canada* delivered at a conference at the University of Toronto in January, 1999, Lorne Sossin, of Osgoode Hall Law School indicated that the Charities should know to whom to turn in case of various issues and indeed while operating in a governmental structure.

<sup>4</sup> See Sihanya, *The Regulatory Regime Governing NGOs in Kenya*, Nairobi (1996)



addition, Kenyan legislation regulates an organization substantially through enforcement of the organization's founding documents.<sup>5</sup>

The various regimes mostly focus on registration regulations where most of the aspiring organizations are denied registration. No regulatory mechanism is implemented after that. Within this context, I examine issues of local law relevant and relating to the existing legal framework for regulation of the charity sector and NPOs.

### **5.2.1 General Powers.**

The powers of a voluntary association are determined by its constitution. The powers given to the charitable entities and other NPOs in its constitution can be the same powers given to a corporate body, such as a company.

The trust deed of discretionary trusts habitually gives the trustees the widest possible powers to enable them achieve the objects of the trust.<sup>6</sup> Charitable Companies generally have the same wide powers to carry out their objects and purposes as any other company.<sup>7</sup> In the event that an organisation was to act beyond the scope of its objectives, an interested party could bring a High Court application.<sup>8</sup> In principle, it may be possible for intended beneficiaries of non-profit organisations to seek action against a non-profit organisation, if they are acting contrary to the founding documents. The focus must remain within the various types of organization that can carry charitable activities and as follows:

### **5.2.2 Non-Governmental Organizations**

An NGO's governing documents must prohibit the organization from distributing funds to members other than for legitimate reimbursement of expenses incurred in carrying out the

5 : Country Information: Kenya - U.S. International Grant making..< <http://www.usig.org/countryinfo/kenya.asp> >(Last accessed April 12, 2012).

6 Trusts do not have separate legal personality and therefore act through their trustees.

7 These powers can include the power to purchase movable and immovable property, to invest company funds in any way, to borrow money, to open and operate bank accounts and to employ staff. Subject to the doctrine of *Ultra Vires*, See Mark Elliott , The Ultra Vires Doctrine in a Constitutional Setting: Still the Central Principle of Administrative Law [1999] Cambridge Law Journal Vol. 58 129

8 *Ibid*, (n 4) 132

organization's objectives.<sup>9</sup> The documents must also stipulate rules for awarding contracts to members or officials.<sup>10</sup> However, the law does not specify particular language for these clauses.

An NGO's governing documents must prohibit distribution of assets to members." The law does not otherwise address whether donors can retain a proprietary interest in their donations. In the event of dissolution, whether voluntary or involuntary, the NGO must use its assets to pay creditors. Any surplus remaining must be transferred to an organization pursuing similar objectives.<sup>12</sup>

### **5.2.3 Other Non-Profit Organizations**

The rules of a society must stipulate the purpose for which funds can be used, and must

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prohibit distribution of funds to members. ~ However; Kenyan law does not specify particular language for these clauses.

Further the law does not require trusts or companies to prohibit inurement and does not explicitly require companies, societies, or trusts to prohibit proprietary interest. Trusts not incorporated under the Trustees (Perpetual Succession) Act are dissolved in accordance with the law of equity.<sup>14</sup> The Act does not explicitly prohibit distribution of assets to members upon the Society's dissolution.

### **5.3.0 GRANTING OF THE EXEMPTIONS AND MONITORING**

Monitoring is by KRA who administer tax benefits and are expected to assure donors and the government that their money is going to be used for the right purpose. Under the VAT Act Conditions for remission provided for under regulations 4 of the *Value Added Tax*

9 NGOs Coordination Regulations, Second Schedule, Section 4(a) NGO Co-ordination Regulation 2nd Schedule

10 NGOs Coordination Regulations, Second Schedule, Section 4(c) NGO Co-ordination Regulation 2nd Schedule.

11 NGOs Coordination Act, Second Schedule,

12 NGO Coordination Act of 1990 and Regulations, Second Schedule and Prototype Constitution, Clause 7.0, Part VIII, sub clause 7(3).

13 Societies Act, Schedule, Section 11.

14 Trustees (Perpetual Succession) Act, Section 16(2)

*(Remission) (Charitable organisations) Order, 1999* such as making quarterly returns to the Commissioner-General on all goods on which remission is granted; making records of such goods available for examination by the commissioner-general or the authorized officer, and restricting disposal of exempt goods. These measures are laudable because they will assist the sector to curb abuse and thus repairing its reputation but are passive on the part of KRA, and rest on the initiative of the organization.

Moreover, compliance can be burdensome. The schedules that list the length of time that must lapse between importation and sale changes often vary according to the item, and keeping it up to date is particularly onerous for NGOs with small numbers of staff, and those that operate outside of Nairobi and may not have easy access to updated information.

#### **5.4.0 TREATMENT OF NPOS ON VALUE ADDED TAX**

Under section 23 of the VAT Act, the Minister may by order in the gazette remit tax payable; if he is satisfied it is in the public interest to do so.<sup>15</sup>

The government's reluctance to grant VAT and Customs tax exemptions is reflected both in the onerous application procedures prescribed in the Acts, and in the limits placed on items for exemptions.<sup>16</sup> Thus, there is a good deal of pressure both from within and from without for the tax collection to be thorough and assiduous. The effect of the consequent reluctance to grant exemptions to NPOs is to increase the burden on those organisations that receive in-kind gifts sourced from outside Kenya.

Application for exemption under VAT Act is made to the Minister of Finance through the

<sup>15</sup> The list of goods given under the section are remitted only if they are donated or purchased for donation by any person to an NPO or any institution approved by government for free distribution to the poor ... or for medical treatment, educational, religious or rehabilitation work...and such remission shall not exceed 50% of the tax payable.

<sup>16</sup> It is useful to try and understand the government's stance. Previous studies have found that has found out through the survey, that this reluctance to grant exemptions is rooted in the government's wish to maximize tax collection, See generally Connie Ngondi-Houghton *Making the Case for Tax Law Reforms to Create an Enabling Fiscal Environment for the Growth of Philanthropy: PROMOTING PHILANTHROPY IN KENYA* A Study Report of the K-REP Development Agency (CCML, NAIROBI 2004) p 98.

Commissioner General, by submitting a certificate of registration received from the NGO Board, and evidence that the goods to be purchased or imported will be used for charitable purposes. The Commissioner General then considers the application and transmits it to the Minister of Finance with a recommendation. Organisations that are granted exemption must make quarterly reports to the Commissioner General on all goods on which exemption is granted, and must make their records available for audit.

Prior to 1998, NGOs and other charitable organisations applied for duty and VAT exemption directly to the Minister of Finance. In 1998, responsibility for screening applications was shifted to the Commissioner General of Income Tax, who was given broad vetting powers. In official terms, this change was instituted to enable the department of Income Tax to monitor NGOs more closely and, in theory, stem abuses of these exemptions.<sup>17</sup>

Like under the Customs and Excise Act, remitted goods have got to be gazetted by the minister and zero rated goods have in addition got to be approved by the Commissioner of Social Services. The new process is cumbersome, time wasting, and provides plenty of occasions for rent-seeking by having to pass through so many hands. It discourages small resource-strapped organisations whose claims are likely to be small from accessing this benefit.

#### **5.5.0 THE TAX AUTHORITY AS DECISION MAKER AND REGULATOR**

It is submitted that the tax authorities or their superior, the Finance Minister determine the regulations and exemptions. I now turn to an examination of the reasons why as a generality, the tax authorities should not be the people to make decisions about whether an organization does or does not qualify for tax concessions based on their status as a charity.

17 Ngondi-Houghton *Milking the Case for Tax Law Reforms to Create an Enabling Fiscal Environment for the Growth of Philanthropy: PROMOTING PHILANTHROPY IN KENYA* A Study Report of the K-REP Development Agency (CCML, NAIROBI 2004) p 15.

The issue has arisen in such diverse countries such as Scotland,<sup>18</sup> South Africa<sup>19</sup> and in many European nations. The officials who work in tax authorities are trained to raise taxes. The culture in which they work has an innate bias which leads employees to try to maximize tax revenue. Giving them the authority to accept or reject an application that may produce significant tax revenue loss puts them in conflict of interest situation.<sup>20</sup>

A second element relates to the role of tax authorities in enforcing compliance. While tax authorities put out huge amounts of information to the public and spend millions of shillings on communication, the thrust of their efforts is to promote compliance with the law. It is extremely helpful in advising charities and non-profits about compliance, clearly one of the KRA's functions. This should not be confused with any sort of "nurturing" role. It need to a lesser extent, a new body which "helps" or "advises" charities, presumably to meet their charitable goals and to assist them to operate in an efficient manner. This is *not* a function which can or should be given to a division or a department of KRA.

Most officials in tax authorities have no formal training or background geared to the decision making necessary to determine the legal nature of a charity. In a situation where success is measured by increasing the efficiency of tax collection and maximizing that function, it is to be expected that exemptions from tax will be granted reluctantly.<sup>21</sup>

18 See *The regulation of Charities in Scotland* by S. R. Moody, senior Lecturer in Law, University of Dundee, published in issue 4 of the International Journal of Not-For-Profit Law <<http://www.icnl.org/journal/volliss4/index.html>> accessed on 15th July 2010

19 See *The Ninth Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa* (more commonly called the Katz Report < <http://www.icnl.org/journal/volliss3/index.html>> Accessed on 15th July 2010.

20 The 1999 decision of the Supreme Court of British Columbia, *Blair Longley v. M. N. R.*, demonstrates exactly the problem. 27 7 1999 *Carswell* BC 1657. Blair Longley came up with a scheme under which people could make payments to a registered political party and then have the funds flowed back for their personal benefit. He asked the tax authorities for an opinion on the scheme and was told that it was not legal. The case reports that there was an internal legal that the scheme *was legal*, albeit exploiting a loophole in the drafting of the tax legislation. In due course, Longley alleged that he had been misled by officials and brought action. In the end result, he was awarded damages for the "public misfeasance" by the Revenue officials which included \$50,000 as "punitive damages".

21 In a conversation with an official from Kenya Revenue Authority who deals with the issue of charities the following point was made; The official told us that the KRA officials were unhappy with having this jurisdiction because they are not trained for it, and expressed hope that the review of the overall situation would result in KRA being stripped of what it views as an onerous obligation.

Simplifying administration is important to tax authorities, and the fewer exceptions there are to the general tax regime, the better it is. Tax departments are large bureaucracies, with people being moved or transferred from department to department regularly. As a result, few remain long enough to develop expertise which significantly affects the quality of decision making. KRA, quite properly, operate on a system of extreme confidentiality about tax information. This instills employees with a secretive approach to their work. It is submitted that this is inappropriate in the context of dealing with many issues relating to charities.

Lastly, a problem faced by all those who make applications to the treasury and the commissioner to have their payment of duty be exempted on imported goods, is precisely the length of time it takes to have an application processed. I had interviews with various persons, and it is a settled phenomenal that applications usually take 1 to 3 months . I am not referring to the occasional contentious application which may take months to evaluate and exempt, but the normal time it takes to handle the typical application, well as other routine matters. This lead to accumulation of the port storage charges and custom warehouse rent which the applicants must also 'beg' for waiver because the goods are awaiting clearance at the port and various private depots.

#### **5.6.0 ADVANTAGES AND PRINCIPLES OF A REGISTRATION, REPORTING AND MONITORING REGIME**

I have identified what I believe are significant benefits for charitable organisations and to the government arising from a registration, reporting and monitoring regime.

These benefits are:

- a) The benefit of tax exemption would be more likely to be extended only to those organisations that fall within the definition of being charitable.
- b) It is less likely organisations would use charities to enter into tax avoidance arrangements.

- c) There would be more information for the intended beneficiaries of charities about the benefits to which they are entitled.
- d) There would be better targeted advice and support given to existing and new charities, thus encouraging best practice within the sector.
- e) Both the public and grant making organisations would be able to ascertain quickly the bona fides of a charity through its registration number.
- f) Policy formulations would be based on better information on the charitable sector.
- g) There would be improved accountability to the public. An organisation that solicits funds from the public would need to provide information that would then be made available to the public.
- h) There would be better accountability to the Government because of the benefits they get from tax-exempt status and the effect of donee status in fundraising; charities need to be accountable to the Government.

When considering how the registration, reporting and monitoring of charities should happen I based my decisions on the following principles.

- a) In determining whether an organisation is charitable, the focus should be on its activities rather than its legal form.
- b) Compliance costs, for both the charities and the government, should be held to a minimum.
- c) As far as possible, there should be a "one stop shop" for the legislative requirements of charities. The regulatory entity should be a centre of excellence, providing advice to government and the charitable sector, and promoting best practice within the sector.
- d) There should be a transparent system of accountability to the public and government to reinforce the integrity of the charitable sector. The relationship between the

government and charitable sector should be based on a positive culture of collaboration and support.

#### **5.7.0 ORGANISATIONAL STRUCTURE: OPTIONS**

Based on the principles identified, I considered two alternatives for the structure of the regime:

**a) A semi-autonomous body within an existing government department with a statutory advisory board**

Under this option I considered for the registration, reporting and monitoring functions to be undertaken by a semi-autonomous body within an existing government department, say Kenya Revenue Authority, with a statutory advisory board from the charitable sector. I believe this option is considerably inferior to a Charities Commission. Semi-autonomous body would not have sufficient status and independence to gain support and sense of ownership required from the charitable sector. I believe this option also fails to recognise the independence and importance of the charitable and voluntary sector. These issues would impact significantly on its ability to carry out its recommended roles.

**b) A Charities Commission<sup>22</sup>**

The preference is for a Commission for Charities to assume responsibility for the registration, reporting, and monitoring of Kenyans charities. Accordingly I recommend that a Commission be established with its own statute and regulations. It is my strong view that a Charities Commission would be most acceptable to the charitable sector. This is important as it would mean the costs of monitoring and enforcement is likely to be less if the sector supports and

<sup>22</sup> I would like to make some observations about The Charity Commission for England and Wales. The English Commission is a body which merits close examination by anybody who wants to import the concept of an independent decision maker into Kenya, see The Charity Commission for England and Wales, 2003, Our vision, mission and values: sets out our aims and ethos, from <[http://www.charity-commission.gov.uk/About\\_us/About\\_the\\_Commission](http://www.charity-commission.gov.uk/About_us/About_the_Commission)>, ( Last accessed on 4th March 2010)



has confidence in the organisation. Any lesser alternative would fail to adequately recognise the importance and independence of the charitable sector.

The Commissioners would be responsible for governance of the Commission, including appointing a Head of Operations to be designated as the Chief Executive Officer or the Registrar. That person would be responsible for day-to-day operations and functions such as staffing, annual budgets, etc.

Establishing a Charities Commission and including representatives of the charitable sector, would reinforce and demonstrate the complementary nature of the work carried out by the charities on the one hand and the government on the other. It would also perpetuate the cooperative spirit that need to exist between the sector and the Government which is tangibly expressed through this work.

Another function of the Commission is to promote public trust and confidence in the charitable sector. The Commission will do this by encouraging good governance and management practices, by providing educational material and other help. This will enable

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organisations to be more effective.

Registering and monitoring charities is another way to let the public know that the charities are doing what they say they are doing. Information collected by the Commission and available on the public Register at the website which means potential donors and supporters can look at a registered charity's purpose, activities, beneficiaries and financial information, to help inform their decisions. The public can be confident that organisations on the Register have proved they have a charitable purpose and have met the prescribed criteria. The charities commission would be a "one-stop shop" for the legislative requirements of charities.

23 Charities Commission, *Role of the Commission* <<http://www.charities.govt.nz/about/role>> (accessed April 12, 2012).

It is suggested that the monitoring, advice and support functions would extend beyond financial matters to the activities of charitable organisations.

This is to ensure the activities of these entities are, and continue to be, charitable and in accord with their stated objectives. The Commission must also provide an educative function for charities; for example developing best practice, training resources and trust documentation templates.

It is further suggested that of the Commission's functions can probably best be divided into what can be described as "front office" and "back office" functions. Essentially, the front office functions include such things as governance, policy formation, interpreting data received from charities, monitoring their activities and offering support and advice.<sup>24</sup> This may involve dealing directly with the organisation and, if appropriate, providing advice and support. Similarly, information from the annual returns would be examined and possibly necessitates further follow up. The back office functions would include processing and collating the registration and annual return data. This may include contracting specific expertise wherever required.

### **5.8.0 FUNDING**

The Commission should be funded partly by way of fees payable by charities and partly by the taxpayers through Government. Charities produce public goods and benefits that are of immense value to the nation. Accordingly, the difference between the income generated through fees and the actual cost of the Commission's functions, including establishment costs, be provided by Government. The functions currently carried out by Kenya Revenue

<sup>24</sup> For example, having received a registration form, the Commission would need to establish that the applicant organisation concerned met the legal definition of a charity.

Authority and the NGO council can be transferred to the commission and hence the budget for these functions should also be transferred to the proposed Commission.

Since the majority of Kenyans charities are small, it is suggested that the registration and annual return fees are set at a moderate level. For re-registration following de-registration,<sup>25</sup> it is recommended a significantly higher fee; say at least twice the level of the registration fee. The Commission should also be able to generate additional income through, for example, the sale of publications.

### **5.8.1 Registration**

In examining the options for a system of registration two alternatives are considered:

- a) Simple registration where organisations just declare they are charitable and this is accepted unless challenged."<sup>6</sup>
- b) Formal registration where there is a checking process to ensure the organisation is eligible.

I am in favour of formal registration as it has persuasive advantages.<sup>27</sup> A formal registration

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process would encourage the organisation applying to consider more carefully the conditions for eligibility, and provide more certainty that the organisation applying is eligible.

<sup>25</sup> where the deregistration is based on an alleged breach of the law (other than a "mechanical" failure) or on the basis that the charity no longer carries on charitable activities, deregistration should come only after the Charity has had an opportunity to make a formal submission (similar in nature to what would occur after a refusal to register) to the Board of the Commission, with a subsequent appeal into the Court system if the Board upheld the deregistration.

<sup>26</sup> Submitting information should be possible either in hard copy or on-line. The signed registration form should be sent to the Commission, accompanied by the following essential documents ; A current copy of the Trust Deed, Constitution or other governing document, a Copy of the organisation's authorisation to submit the application and the Registration fees.

<sup>27</sup> The International Center for Not-for-Profit Law, (1997) "Handbook on Good Practices for Laws Relating to NGOs," The World Bank. Page 7.

<sup>28</sup> Existing charities should also go through the proposed registration process. However as a transitional measure, those existing charities with Kenya Revenue Authority or the NGO council letter confirming view of their charitable status should be able to use that letter to gain a provisional registration. Formal registration would have to be complete later.

Registration makes it more likely that the privilege of tax exemption is extended only to those organisations that fall within the definition of a charity. Those organisations who wish to claim charitable status would be required not only to set out their aims and objectives but also describe the activities which they will undertake to meet these.<sup>29</sup> Registration should also provide greater certainty that the beneficiaries of charitable organisations receive the benefits to which they are entitled.

Registration documents should be available to the public, enabling any member of the public to scrutinise information on file about charities. This increased accountability would enhance confidence in organisations seeking public donations and other funding. More, and better, information would be available to government and to the sector itself to allow for better informed policy-making. Having a registration number through which information may be accessed would reduce the requirement on charities to supply information to a range of funders and government agencies.

The registration process should involve an active formal approval of the charitable status of the organisation, on the basis of information supplied in a declaration. This information should be publicly available.<sup>30</sup>

29 Charitable organisation - Factbites, <http://www.factbites.com/topics/Charitable-organisation> (accessed April 12, 2012).

30 At the very least, I would expect that the new organization would consider expanding the internet search engine to allow searches of registered organizations by key words linked to filed purposes and activities. Make all documents in a file available to public search, excluding only such documents which relate to ongoing issues which the Commission is considering. The following documents should be available to the public:

- (a) An annual report on the Commission's activities.
- (b) A regular report of decisions of the Commission with an emphasis on "why" such decisions are taken, both in cases of registration and refusals to register.
- (c) The issuing of press releases when issues relating to a charity surface in the media providing that the issue in question relates to the Commission's jurisdiction.
- (d) Inviting public discussion on issues of concern to the Commission including the appropriateness of certain registrations.
- (e) The publication of precedents.
- (f) The issuing of user friendly guidelines on registration, what types of organizations are eligible and the legal obligations of registered organization.

Registration would automatically confer donee status. All charities should be required to register before a tax exemption is available, including those that are charitable under any other Acts of parliament, and charities with overseas purposes. The Commission may refuse to register an organisation if in view of the commission the objects or activities of the organisation are not charitable or the name of the charity is misleading or offensive, an office holder in the organisations is not suitable;<sup>31</sup>

### **5.8.2 Information to be collected**

I considered what information the Commission should collect as part of the registration process. I believe the information should fulfill the following basic functions:

- a) Enables the Commission to determine whether the organisation qualifies for charitable status for tax purposes
- b) Inform public policy
- c) Ensure that charitable purposes are reflected in the objectives and activities of the organisation
- d) Identify and discourage the use of charities for tax avoidance
- e) Provide the basis for the public register.

I worked on the principle that only information necessary to the purposes of the Commission should be collected. It is suggested that it would need to include basic identification and contact information; the form of the organisation, eg, trust, incorporated society or company, the principal aims and objectives of the organisation; and the names of the members of the governing body. The level of information required by the Commission would be reasonably constant and that any major changes would be made after appropriate consultation with the sector. The Commission may consider classifying charities according to features such as

<sup>31</sup> Guidance on suitability could be based on some of the criteria listed in section 19 of the Companies Act.

expected longevity, those which raise money from the public and those with overseas charitable purposes.

### **5.8.3 Reporting by the Commission**

It is submitted that the Commission be required to report annually to both the Government

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and to the charitable sector. ~ In addition to its written report, it is also recommended that commission convene an annual workshop or conference to specifically examine the work of the Commission over the previous year and its plans for the future including those issues raised by the sector itself.

Such an event would have the character of an Annual General Meeting, highlight the work of the Commission and the sector generally, and provide accountability to both the government and the charitable sector. It is recommended that when reporting to the Government, the Commission report to the Minister of Finance and the Minister Responsible for the Community and Non-governmental organizations and parliament.

### **5.8.4 Monitoring<sup>33</sup> and Enforcement**

The Commission should have the power to investigate the affairs of a registered charity, and any organisation holding itself out as such. The Commission should encourage compliance through education and assistance before using sanctions, where irregularities are detected. Sanctions could be monetary or non-monetary, and could involve the appointment of a temporary managing trustee, or, in extreme circumstances, de-registration.

The advantages that accumulate to the charitable sector through effective monitoring include:

32 i suggest there are two distinct elements to this independence: accountability of the Commission within the system of government and the manner of making appointments to the Commission. One aspect is that the Commission should *not* be part of a government to them. On the other hand, if, for example, the suggestion of the creation of a standing Parliamentary Committee is adopted, it would make sense that the Commission's Annual Report to submitted to the parliamentary committee.

33 I considered the monitoring role of the Commission on the basis of three principles that monitoring should maintain the integrity of the register, enhance the charitable sector and ensure that the funds of registered charities are being used as required by the organisation's founding document.

- a) Improving the charitable sector's credibility with the public
- b) Enabling education and support programmes for the sector to be better targeted.
- c) Enabling irregularities to be detected and dealt with at an early date, to the benefit of all concerned.

The Commission should have the power to investigate the affairs of a registered charity either where the reporting process shows irregularities or when information received suggests irregularities. This would require an investigating capability within the Commission's office. In investigating a charity, the Commission must have the statutory authority to require that the terms of the governing document are carried out in an appropriate manner and the power to replace the governing body or appoint a temporary managing trustee if necessary and appropriate. I recommend therefore that where organisations are found to be in breach of their obligations, the actions of the Commission should be designed to encourage compliance through education rather than punishment, in the first instance.

However, where an organisation chooses not to comply, any monetary penalties must be against officers or trustees of the governing body who should not be able to be indemnified from the funds of the charity. This would ensure beneficiaries are not penalised by unlawful actions of the officers or trustees of the organisation. It is strongly recommended that the investigative powers of the Commission extend to other bodies that are not registered charities but hold themselves out as being so, especially where they are involved in public fundraising activities.

Deregistration should be a last resort. It is recommended that the Commission publish lists of deregistered organisations and their office holders and make the information available to the

public. After deregistration, following an investigation by the Commission, the report on the investigation should be made available to the public.<sup>34</sup>

### **5.9.0 REPORTING BY REGISTERED CHARITIES THROUGH ANNUAL RETURNS**

Each charitable organisation should be required to submit an annual return within a prescribed period, " so that the Commission can determine whether the organization continues to qualify as a charity. Only information necessary to the Commission for this purpose should be collected. This information would be publicly available.

As with the information required for registration, there would be a number of benefits from gathering information in annual returns. These include:

- i. Enabling the Commission to fulfill its monitoring role.
- ii. Providing much needed data to better inform government policy making.
- iii. Assisting the charitable sector to develop better policies and practices.
- iv. Improving accountability through assisting donors, funders and the general public to access information about individual organisations and the entire charitable sector.
- v. Allowing individual organisations to refer potential funders to the publicly available information which would reduce the need to repeatedly supply basic information as now occurs.

### **5.10.0 REGULATION OF FUNDRAISING AND PUBLIC COLLECTIONS**

There is the general public tend to have a negative perception of fundraising. It is in part fuelled indeed by the perception that it is under regulated. Although it does acknowledge

<sup>34</sup> As is the case in the United Kingdom, See generally see The Charity Commission for England and Wales, 2003, Our vision, mission and values: sets out our aims and ethos, from <[http://www.charity-commission.gov.uk/About\\_us/About\\_the\\_Commission](http://www.charity-commission.gov.uk/About_us/About_the_Commission)>, ( last accessed on "4th March 2010)

<sup>35</sup> When looking at the options for reporting requirements the following issues should be considered and incorporated in the regulations; what date charities should report, Should all charities file an annual return, should the annual return be in a standard format and whether they should file audited accounts.



that this may not be the reality and recognises the extent of existing regulation. Such perceptions may in the longer term undermine public trust and confidence in the sector. There is damage to the sector's credibility caused by bogus fundraisers, suggesting there is a need to identify mechanisms to deter such practices.

#### **5.10.1 Self-regulation of fundraising**

A key issue for review is the creation of a self-regulatory scheme to promote good practice in charity fundraising, since a scheme 'which the sector itself helps to set up and run has the best chance of success. It is proposed that membership of the new body would be voluntary and members would be expected to abide by its codes of practice; those who did not would be named, shamed and, ultimately, thrown out of the scheme. It also proposed that this self-regulatory regime be in addition to statutory regulation. The process should be governed by an oversight board, and I suggest the name the Charitable Fundraising Standards Board (CFSB)<sup>36</sup> as suitable and used hereafter for the purposes of this discussion. The CFSB would validate and supervise self-regulation; ensure 'quality control'; improve compliance; approve and monitor complaints procedures; and promote a wider public understanding of standards of good fundraising practice.

There should also be a 'public promise framework' for donors, based on the Donors' Charter. This would be a clear and concise statement of what the public can expect from fundraising organisations and should be written in such a way as to make it possible to hold practitioners to this promise. All organisations should sign up to and promote the same promise, which would be agreed by the CFSB. Given the publicity surrounding 'chugging' and media concerns with the cost-effectiveness of fundraising, it is recognised that a clear process of

36 A Proposal for Implementation by Arthur B.C.Drache, Q.C. With W. Laird Hunter Arthur B.C.Drache, Q.C. Drache, Burke-Robertson & Buchmayer, Ottawa, Ontario Canada, 1985

self-regulation would go some way towards defining acceptable practice in the face of such criticisms as well as addressing malpractice and fraud monitor compliance and adjudicate on complaints where necessary.

### **5.10.2 Licensing of public collections**

There is identifiable need for a clearer statutory basis for the regulation of public collections. The current law is restrictive, inconsistent and outdated. For example, it is not clear whether 'face-to-face' fundraising methods, soliciting direct debit contributions in the streets, are covered by existing legislation. The latter is a very common development and has been the subject of some controversy, with some suggesting that it is intrusive and a potential nuisance, other than it is an effective means of raising funds

The objective should be aimed 'to create a fair and cost-effective system of licensing which facilitates responsible fundraising but deters bogus collections and prevents 'nuisance' to the public. It

is proposed that in the future all charitable, philanthropic or benevolent organisations wanting to undertake collections in a public place would be required to obtain a licence from the local authority. A licence would be required for both house-to house and street collections, although very small, local collections (such as carol singing or a single, small collection in one pub or shop) may be exempt.

One of the principles of the proposed system is that all eligible licence applications would be granted provided capacity exists. The proposal is therefore that a duty should be placed on local authorities to provide fair access to collecting opportunities to all eligible organisers. Organisations that have been refused a licence would be able to appeal to a magistrates court, bringing this appeals system in line with others relating to licence applications and ensuring consistency between different types of fundraising activity.

37 Charity Law Reforms - The Government's plans, <[http://www.charitybags.org.uk/charity\\_law\\_reforms\\_and\\_the\\_charities\\_act\\_2006.shtml](http://www.charitybags.org.uk/charity_law_reforms_and_the_charities_act_2006.shtml)> (Last accessed April 12, 2012).

### 5.11.0 CONCLUSION

I believe that the time has come in the evolution of the administrative and legal framework of charities under the Income Tax Act for an independent decision-making and supervisory body to be constituted. The existing arrangement which sees the treasury and Kenya Revenue Authority administer a body of rules which are modified only slowly and with extreme expense is inadequate. These 'administrators' are put in the conflicting position of being the legislated as administrators but also an adjudicator without jurisdiction.

Whatever the system may be adopted certain principles are fundamental such as "fairness", "speed", "cost", and consistency ", " lack of political interference, societal values" and "appeal options", to name some of the key considerations. The creation of an independent quasi-judicial administrative commission with clear, legislated jurisdiction, independent appointments capable of hearings throughout the country and a process to both administratively determine qualification and adjudicate the status of difficult cases will address the significant current problems associated with determining charitable status under the Income Tax Act.

Specifying clear procedural deadlines, including a mechanism for deemed approvals and review, would establish the administrative framework which could properly and expeditiously deal with the cases put to it. Having said that, I believe that there is no point in creating a Commission (or indeed adopting either of the other two options) if there is not going to be sufficient funding.

This work had a primary role to assist those contemplating whether there should be a charity commission for Kenya. As I said at the outset, my view is that the question is not whether but how. By fashioning a broad picture of what could be a Charity Commission in Kenya and setting out adequate measures in details, I hope that I offer a picture which will move those still concerned with whether to take the next step.

## **CHAPTER SIX**

### **6.0.0 CONCLUSIONS AND RECOMMENDATIONS: THE ESSENCE OF THRIVING CHARITY SECTOR**

#### **6.1.0 INTRODUCTION**

This chapter describes the outcomes of the study undertaken on the reform of charity law in Kenya. The analysis is structured around the main themes emerging from the study.

These are:

- (a) A synopsis of the issues that require reforms
- (b) An abstract of the proposed reforms
- (c) Future proceedings of the review of Charity Law
- (d) Conclusions.

Before summarizing the major conclusions of the study, it is important to caution the reader about its limitations. Given the nature of the study and lack of raw data, we can only capture the major features and effects in this sort of the study. Some technical changes may have effects on giving and charitable behaviors which I am unable to quantify but I believe are likely to be relatively small in aggregate.

By this study, a theoretical framework, bringing together the laws applicable to the charitable sector, has now been outlined. Arguably the gap in legal theory which surrounded the charitable sector's laws in Kenya has been filled. The doctrine of charitable purpose has been defined, expanded and located in a wider jurisprudence linked to legal analysis of giving cultures and theories. An outline has been sketched in a way that shows how the common law can be developed beyond the currently dominant

doctrine of charitable purpose.<sup>1</sup> It offers a simpler and more cohesive explanation of this legal area.

Around the world, efforts are afoot to encourage increased giving through changes in government strategies. There are many government policies that can and do have an impact on the growth of charity. However, most reform efforts seek to address restraints on philanthropic growth through three approaches adopted in this thesis: (1) improving the regulatory framework for Charitable and civil society, (2) developing tax policies that favor philanthropy, and (3) increasing institutional accountability and transparency.<sup>3</sup> In the view of this, a formal review<sup>4</sup> of charity law in Kenya should be undertaken as a matter of urgency if this jurisdiction is to avoid being relatively disadvantaged by legislative developments occurring in all other jurisdictions in the world.

1 See *Charity Law: the Case for Reform*, the Law Society's Law Reform Committee, Dublin, July 2002, p 85 - 86.

2 There are various report of enquiry including : Reform Commission Consultation on Charitable Trust Law General Proposals (2005); Joint committee on Taxation, 'Historical Development and Present Law of the Federal Tax Exemption for Charities and other Tax-Exempt Organizations, Scheduled for a Public Hearing Before the House Committee on Ways and Means on April 20, 2005' (JXZ-29-05, 2005) Office of the Scottish Charity Regulator, 'Monitoring Scottish Charities' (2005); Panel on the Nonprofit Sector, Strengthening Transparency Governance Accountability: A final Report to Congress and the Nonprofit Sector (2005); Canada Revenue Agency, Consultation on Guidelines for Sport and Charitable Registration under the Income Tax Act (Canada Revenue Agency, 2008) Canada Revenue Agency, 'Consultation on Proposed Policy on Fundraising by Registered Charities' (Canada Revenue Agency, 2008); Canada Revenue Agency, 'Consultation on proposed Guidelines for Research as a Charitable Activity'(Canada Revenue Agency, 2008) and Parliament of Australia Senate 'Inquiry into the Disclosure Regimes for Charities and Not-for-Profit Organizations' (2008).

3 Aisha Ghaus-Pasha, Role of Civil Society Organizations in Participatory and Accountable Governance, **Page 6** ,61*li Global Forum on Reinventing Government Towards Participatory and Transparent Governance*, 24 - 27 May 2005, Seoul, Republic of Korea , <http://uiipanl.un.org/intradoc/groups/public/documents/un>. (Last accessed on 24th March 2012).

4 The review should provide for on-going consultation with the charity sector, it should ensure representation from the charity sector. It should be informed by the findings of similar reviews conducted in other common law jurisdictions particularly as regards their treatment of definitional matters, and should seek opportunities to maximize parity of legislative provision with all other jurisdictions of the world. As a priority, the review should give attention to the need to frame legislative provisions for the introduction of systems to register and regulate charities and their activities, The review should also focus with some urgency on the adequacy of the legislation currently governing fundraising in its many modern manifestations

## **6.2.0 SUMMARY OF ISSUES THAT REQUIRE REFORMS**

This study concludes several important and non-controversial matters that require reform. These include:

- (a) The absence of a coherent/cohesive legal framework that differentiates between and governs the activities of charities and all other NPO bodies;
- (b) The absence of a system for registering charities;
- (c) The absence of a system to regulate charities and to provide for greater transparency and accountability in relation to their fiscal affairs;
- (d) The multiplicity of agencies and lack of any co-ordination of their respective areas of responsibility in relation to charities;
- (e) The absence of modern and consolidated legislative provisions relating to fundraising.
- (f) The unsuitability of current legal structures/forms for much modern charitable activity; and

Other matters of either less importance or more controversial, or perhaps both, that also in view of this writer require reform include:

- (a) The definition and bearing of the public benefit test;
- (b) The subjective test of a donor's charitable intent;
- (c) The retention of the advancement of religion as a charitable head or, at least, the continued statutory exemption of religious organisations and their activities from the public benefit test;
- (d) The constraints on political activity by charities;
- (e) The constraints on trading by charities; and

It should be noted, at least in the view of this writer, that whereas it may be judged to be expedient in the interests of partnership to leave some of these issues to self-regulation by the sector in accordance with good practice guidelines most must be the subject of legislation and assigned to the proposed commission for enforcement

### **6.3.0 SUMMARY OF THE PROPOSED REFORMS**

#### **6.3.1 THE DEFINITION OF A CHARITY**

This work on charity law reform has demonstrated that the law needs to be updated, so that the legal definition of charity is in line with what the public thinks is or should be charitable. The legal redefinition of "charity" and "charitable purposes" in legislation would consolidate the law. The position of the law of charities would be much clearer than in the past. Although it would be the first attempt in Kenya of the legislature to provide a legal definition, it shall have covered purposes within the "spirit and intendment" of the preamble of the Statute of Elizabeth.<sup>5</sup> This statute has shaped the whole law of charities according to the developing needs of the society.

The proposed legislation suited to be called Charities Act would identify a wide range of purposes as charitable. This encourages the establishment of charities, which benefits the public at large. . We recommend the following defining principles. A Kenyan Charity should be an organisation:

- (a) whose overriding purpose is for the public benefit
- (b) which is non-profit distributing
- (c) which is independent
- (d) Which is non-party political

<sup>5</sup> *Charitable Uses Act 1601* 43 Eliz I c 4

The recommendations we have made base the legal definition on the principle of public benefit<sup>6</sup>, but to leave the interpretation of 'public benefit' to be developed through case law is one that is welcome as a statutory definition of public benefit would not be flexible enough to adapt to changing circumstances and could compromise the diversity and independence of the sector.

Similarly, the proposed list of charitable purposes is a fair reflection of popular perceptions of charity.<sup>7</sup> We propose that the heads of charity be synthesized and recognized through legislative provisions.<sup>8</sup>

A charity should be defined as an organisation which provides public benefit and which has one or more of the following purposes:<sup>9</sup>

1. The prevention and relief of poverty.
2. The advancement of education.
3. The advancement of religion.
4. The advancement of health.
5. Social and community advancement.<sup>10</sup>
6. The advancement of culture, arts and heritage.
7. The advancement of amateur sport.

<sup>6</sup>We proposes that that a charity must be able to demonstrate that it provides a clear benefit to the public; where necessary an organisation should be required to provide supporting evidence. Given that this will be a requirement of charitable status, the benefit it provides must be related to its charitable purpose(s).

<sup>7</sup> PATRICK J. MONAHAN Federal Regulation of Charities : A Critical Assessment of Recent Proposals for Legislative and Regulatory Reform, 2000, Page 34

<sup>8</sup> One of the advantages of the multi-category definition is that it will provides a tax-exempt recognition somehow for most of the organizations that fit under the umbrella

<sup>9</sup> Prime Minister's Strategy Unit, UK Cabinet Office, Private action. Public benefit": The Strategy Unit, *Press Release - 25 September 2002* <http://www.privateclientadviser.co.uk/reature/charitism> (Accessed April 12,2012).

<sup>10</sup> The Recreational Charities Act 1958 of UK provide at section 1 (2) provides that "It is a charitable purpose to provide, in the interest of social welfare, facilities for recreation or other leisure-time occupation where those facilities are available either to the public as a whole or to women only."



8. The promotion of human rights, conflict resolution and reconciliation.
9. The advancement of environmental protection and improvement.
10. Other purposes beneficial to the community including the prevention and relief of sickness, disease or of human suffering, including the care, support and protection of the aged, people with a disability, children and young people

It is suggested that we extend the definition of a charity under Social and community advancement to include self-help organisations.

The "user involvement" in the context of self-help is required and the primary purpose is to include the type of mutual support group which is widely available to people suffering from specific illnesses or common circumstances.

We recommend that a self-help organisation<sup>11</sup> which confers public benefit may qualify to be a charity provided that:

- i. Its membership is open on objective public benefit criteria.
- ii. The governance of that organisation reflects the public benefit culture.

The study suggests that the structure, functions and organisation of a charity institution should be grounds for determining its status. It has addressed the problems identified with the current approach to determining the status of charities and related organizations by establishing a set of principles that could be applied to a variety of entities and a

<sup>11</sup> The United Kingdom and Scotland have long-standing traditions of mutual support, founded in a powerful concept of public benefit. This includes ancient orders formed for mutual support, such as the Freemasons, trades unions and workers' welfare organisations; major financial institutions, including building societies and insurance providers; and membership organisations. The building societies, for example, were formed as independent, non-profit making, non-political, mutual organisations, with a powerful public benefit culture, see generally Industry Commission 1995, charitable Organisations in Australia, report no.45 AGPS Melbourne,

variety of situations to ensure consistent outcomes. The principles have been driven by the need to address three key imperatives.<sup>12</sup> They are:

- (a) The need for clearer and more consistent guidance to the charitable and related sector and the wider community,
- (b) The need for a framework that can be used as a basis for government decision making about the level of support provided to charities and related organizations, and
- (c) The need to reflect the social and economic environment of charities and related organizations and to be able to respond to Changes in that environment.<sup>13</sup>

### 6.3.2 FINANCIAL RELIEFS

Effective strategies to promote philanthropy through more favorable tax incentives include increasing the amount of deductions and tax credits available to donors, and increasing the number and kinds of nonprofits able to receive contributions eligible for tax incentives.<sup>14</sup> Success in enacting and implementing such strategies will require healthy collaboration among government, commercial, and nonprofit sectors.

<sup>12</sup> Lyons, M and Hocking, S 2000, Dimensions of Australia's Charity Sector, Centre for Australian community organizations and management .University Of Technology, Sydney ,55

<sup>13</sup> Welcome to Charities Definition Inquiries website, [http://www.cdi.gov.au/report/cdi\\_chap5.htm](http://www.cdi.gov.au/report/cdi_chap5.htm) (accessed April 12, 2012).

<sup>14</sup> A noteworthy example can be found in Australia where, in 1999, encouraged by a coalition of foundation trustees, the government introduced a range of new tax incentives that appear to have had a positive effect on giving. Early research suggested that the total amount donated and claimed as deductions by individual Australian taxpayers increased by 11% thereafter. The new incentives included immediate tax benefits for workplace giving, cash donations, and donations of property, and established a new form of private charitable trust intended to provide businesses, families, and individuals with greater flexibility, privacy, and control in starting their own philanthropic trusts. Subsequently, 131 new trusts were established. See The *'2011 State of the World's Volunteerism Report (SW<sup>VR</sup>)'* - the first report on global volunteerism - was commissioned by the United Nations Volunteers (UNV), to mark the tenth anniversary of the International Year of the Volunteer and to acknowledge the contribution and impact of millions of volunteers around the world . Accessed at <<http://www.probonoaustralia.coiri.au/news/2011>> on 18th December 2011

Charities receive several financial privileges, and this study recommends extension of those privileges, generally supported by the charities likely to benefit.

We recommend that the legislative provisions provide for exemptions to charities in respect of:

- (a) All interest, income, gift aid donations and other annual payments,
- (b) Any non-Kenyan equivalent of such income which would otherwise fail to be assessed as foreign income.

We recommend a charity is exempt from tax on the profits of any trade carried on in the Kenya or elsewhere provided its income is applied solely to charitable purposes and which is either:

- a) Exercised in the course of the actual carrying out of a primary purpose of the charity
- b) Mainly carried out by beneficiaries of the charity.
- c) A non-primary purpose trade the turnover of which falls below certain limits.<sup>15</sup>

We do not recommend and do not think it would be practicable to introduce a tax relief or a compensation scheme for all spontaneous, one-off, small donations given through street collections and similar strategies.

Nor do we think that these would lead to a long-term increase in giving. However, the proposals above for improving Gift Aid scheme, payroll giving and deductions directives should go some way to closing the gap in the present system by allowing more small donations to qualify for tax relief.

15 HM Revenue & Customs: Annex 1 - Tax Exemptions for Charities, [http://www.hmrc.gov.uk/charities/guidance-notes/annex1/annex\\_i.htm](http://www.hmrc.gov.uk/charities/guidance-notes/annex1/annex_i.htm) (accessed April 12, 2012)

We recommend Payroll Giving<sup>16</sup> which can be used by employees (and pensioners in employers' occupational pension schemes) to give to charity. Employees can authorize their employer to deduct charitable donations from their pay.

We believe that, as well as giving cash; businesses should be encouraged to give their skills, expertise and other resources. We propose that the tax system contains some important tax reliefs designed to do this. For example, there be a special tax relief for businesses which donate trading stock, and equipment like computers, to certain kinds of charitable cause.

### **6.3.3 THE ESTABLISHMENT OF CHARITIES' COMMISSION**

Chapter five of this work considers the subject of the establishment of a body to advise and regulate charities in Kenya.

The study recommends the establishment of a Charity commission, intended to take on the roles of registration, regulation, and support of charities. A major concern would be about possible conflicts and tensions between the proposed roles, and most particularly

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between the support role and others. We emphasize the opportunities for partnership with existing voluntary sector organisations as a means of developing a broadly-based structure of support should be exploited.

The constitution and structure of the commission is an issue that will be definitely be addressed through the legislative process and this goes in hand with the importance of independence and the representation of different interests.

<sup>16</sup> This contrasts with Deeds of Covenant and Gift Aid, where the benefit of the basic rate tax relief goes to the charity and only the higher rate tax relief goes to the donor. And, unlike for Deeds of Covenant and Gift Aid, there is no risk that the donor will have to account for tax to Kenya Revenue Authority in respect of the donation

<sup>17</sup> There is general agreement about the need for advice, support and guidance for Charities, but some doubt as to whether one agency with the functions of regulation, monitoring and investigation was best placed to offer it. Ibid note 11.

The Registrar of Charities commissions should act as the first point of contact for charity enquiries, should facilitate access to the other supervisory institutions as appropriate, and should disseminate authorised general guidance for charities.

#### **6.3.4 THE REGISTRATION OF KENYAN CHARITIES**

Charity commission is intended to determine the status of Charities, and to maintain a register of all charities operating in Kenya. We have made clarification of the kind of information the register would hold, and any concern expressed about the public availability of potentially sensitive or personal information can be reviewed by the highest management structure of the commission.

This is together with nature of the "reviews" of the register which commissions might undertake.

The commission should produce a directory for charities, listing and summarising in all leaflets and publications for charities, useful addresses and phone numbers where charities can get more help, and other useful information.

#### **6.3.5 REPORTING AND ACCOUNTABILITY**

The study recommends some relaxation of rules of reporting for smaller charities. This would mean further administrative work for the commission to distinctions between smaller and larger charities.

Apart from tax reliefs, another important way that the tax system can support charities is by being as simple as possible for them to operate. This way the administrative burden on charities, and their compliance costs, can be kept to a minimum and they can focus on their core activities.

### **6.3.6 INVESTIGATION AND ENFORCEMENT**

The study proposes the concentration of investigatory functions in Charity commission. Several powers are proposed for intervention in the affairs of charities. These powers should not be seen as too much, in the sense that as clear limits on the degree of intervention which may be appropriate may be settled through practice and in the sense that they focused on some aspects of a charity's work (for example, general management) but not others (such as the actions of the Trustees or board).<sup>18</sup>

### **6.3.7 THE REGULATION OF FUNDRAISING**

The regulation of public collections might turn to be the most controversial part of these recommendations. The study recommends a dual system, with local collections being regulated primarily by local authorities, and national collections by the commission.

There might be a particular concern about the substantially increased burden of reporting implied by the recommendations and the commission will stray into a level of detail which is neither appropriate to their general remit nor relevant

To address these problems, this work proposes the introduction of fast track registrations. The mode of application for the license and the procedure need to appreciate the differences between different forms of fundraising activity. Collections of future donations through direct debit and credit cards, unlike street collections, leave both a

18 Paul Spicker, Sue Morris and Veronica Strachan, CONSULTATION ON THE REVIEW OF SCOTTISH CHARITY LAW: ANALYSIS OF THE RESPONSES, Centre for Public Policy and Management, The Robert Gordon University, Scottish Executive Central Research Unit, 2002 found at <<http://www.scotland.gov.uk/Publications/2002/04/14545/3130>> (accessed April 12, 2012)

clear record of donations for the purposes of audit and the ability of donors to revoke agreements subsequently.<sup>19</sup>

#### **6.4.0 FUTURE PROCEEDINGS ON THE REVIEW OF CHARITY LAW**

One of the basic aims of this work was provoke research and study in areas related to charity, philanthropy and taxation and more so on matter related to taxation and establishment of a legal regime. We now proceed to make suggestions of areas of future study that this work may have provoked.

The issue of independence from funders may provoke some concerns.

The idea that a charity should not be entirely dependent on government or agency funding but the economic reality is that many charities do receive some sort of public funding from the government. Privately funded charities are also vulnerable to some sort of direction from the individual funders. The role of trustees or management committees has not been indirectly considered in the study, and this is one of the most fertile area of research and study in the future. There is also a need to clarify the circumstances in which trustees may be disqualified and by whom and whether the rules governing the incapacity of trustees are consistent with an emphasis on user empowerment.

There is perhaps a further perspective on charity law legacy which is worth reflecting upon. Not only must we be satisfied that our legacy is appropriate and effective but we must also ensure that it is sufficient to address the increasingly complex social needs of the charity in the millennium.<sup>70</sup> The study of how the Kenya legal landscape impacts on

19. The proposal of a generic system for the regulation of all forms of collection is in the circumstances inappropriate and should be avoided when the commission implements the rule of fund raising.

20 Northern Ireland provides an unfortunate and extreme case study of what can go wrong in a modern western society when a sizeable section of its citizen's feel alienated . See Chesterman M 1979, Charities Trusts and Social welfare, Weiddenfeld and Nicolson London,p82

mutual benefit and social welfare organizations in its tax scheme would be interesting to study.

In Kenya, social enterprises consciously blur the line between charity and for-profit

21

activity." Determining social benefit is no easy task, as nonprofits attempting to qualitatively measure mission success have learned.<sup>22</sup> All these; Social benefit success, time taken to achieve, circumstances that may cause, patterns of changes and forces responsible in the charity sector may be an interesting area of study.

Scandals at Enron, Arthur Andersen, Global Crossing, and other major corporations made Congress in USA to pass the Sarbanes-Oxley Act of 2002.<sup>23</sup> Meanwhile the press continues to report on scandals within the nonprofit sector as well.<sup>24</sup> So far, nonprofit organizations have not been the target of reform legislation by most of the states. Some States have seen the problem and are first to act, with legislation patterned after Sarbanes-Oxley introduced in New York and California.<sup>25</sup>

A new of research area would target the question; what new principles of governance are likely to emerge for the charitable sector? This would be based on an analysis of recent

21 The question is at what point an investment has philanthropic objectives and when does it become a business decision? Much will rest on whether the project is successful and if investors find the activity sufficiently profitable

22 See generally Ronald Seavoy, *The Public Service Origins of the American Business Corporation*, 52 *Bus. Hist. Rev.* 30, 38-39 (1978).

23 The Sarbanes-Oxley Act, enacted on July 30, 2002, imposes on publicly traded companies and their accountants and lawyers new requirements designed to improve corporate governance and thereby rebuild public trust in the corporate sector.

24 See e.g., Margaret Gibelman and Sheldon R. Gelman, "Very Public Scandals: An Analysis of How and Why Nongovernmental Organizations Get in Trouble," paper presented at the International Society for Third-Sector Research at the Fourth International Conference, Dublin, Ireland, July 7, 2000; Marion R. Fremont-Smith and Andras Kosaras, "Wrongdoing by Officers and Directors of Charities: A Survey of Press Reports 1995-2002." 42 *Exempt Organization Tax Review* 25 (October 2003).

25 Attorney General Eliot Spitzer of New York in January 2003 announced the introduction of legislation to protect nonprofit corporations against financial fraud by adopting reforms similar to those enacted by Sarbanes-Oxley. Attorney General's Legislative Program Bill # 02-03. In California, Attorney General Lockyer's staff developed a legislative proposal which emerged as SB 1262, introduced by Senator Sher on February 13, 2004.



developments in the for-profit sector, including consequences of statutes like Sarbanes-Oxley Act and the recent spate of best practice codes of governance.<sup>26</sup>

There are many other initiatives that should be considered, including a need to rethink what it means to be a charity as well as the development of new structures of nonprofit activity to deliver charitable efforts.

#### **6.5.0 CONCLUSION: TOWARD CHARITY SECTOR NEW MODEL FOR SOLVING PUBLIC PROBLEMS**

The conclusions of this work are modest. It is the view of this writer that on balance, the common law legacy has the capacity to continue guiding the development of charity law in Kenya and elsewhere in the common law world in an appropriate and effective fashion.

It has served us reasonably well over the past 400 years and there is no good reason to make a fresh start with a new statute comprehensively codifying charitable purposes. To do so would be to risk having to abandon a wealth of illustrative case law which, bequeathed to the common law world, has provided the benchmarks against which all commonwealth nations have been able to fix the evolution of their respective bodies of charity law.<sup>27</sup> However, it would be prudent to take account of the fact and reasons for the recent rash of charity law reviews and to consider introducing new but limited legislative provisions.

<sup>26</sup> "Findings and Recommendations: Part 2, Corporate Governance," Commission on Public Trust and Private Enterprise (The Conference Board, 2003): "Principles of Corporate Governance" (The Business Roundtable, 2002): "Corporate Governance Practices," adopted by the American Bar Association (2003).

<sup>27</sup> See, *Attorney General v. Pearce* (1740) 2 at 87, per Lord Hardwicke LC who declared that it was extensiveness that constitutes a public charity. See, also, *In re McEnergy, O'Connell v. Attorney General* [1941] IR 323. per Gavan Duffy J.

I propose the introduction of legislative provisions to provide for various suggested propositions and I would welcome the draft Bill pre-legislative scrutiny as a helpful means of ensuring that the details are right and that the result is legislation that is wanted and needed. Once these have been agreed, however, it will take some time for them to become embedded and for charities, voluntary organisations and the wider public to have trust and confidence in them.

In mounting a campaign for tax exemption reforms for charities, involved parties need to prepare to be in the process for a long time. Experiences in South Africa indicate that these types of reforms are not likely to be comprehensively done in less than two years. Logistical plans and resource mobilization should therefore take this into consideration.<sup>28</sup> The emergence of these institutions is certainly not a wholly new phenomenon. The roots of the charity sector reach back deeply in history and we must be careful to avoid falling into a myth of perfect conception that sees the contemporary charity sector as a brand new development with no historical precedent. But there has clearly been a substantial upsurge in literally every corner of the world.<sup>29</sup>

What all of this suggests is the need for a new example, a new approach, for addressing public problems in the twenty-first century. This is my final point. Two such paradigms have dominated our thinking up to now. One of these stresses sole reliance on the market and the other sole reliance on the state.<sup>30</sup> The charity sector is thus one within three

28 See *Report of the Inquiry into the Definition of Charities and Related Organizations*, Canberra, August 2001 <<http://www.treasurer.gov.au/tsr/content/pressreleases/2002/049.asp>>. (Last accessed on 25th June 2010).

29 See *Charity Law: the Case for Reform*, the Law Society's Law Reform Committee, Dublin, July 2002, <http://www.lawsociety.ie/> accessed on 14 March 2011.

30 What we have learned in recent years, however, is that both of these models are bankrupt. The market model, though it has recently staged a remarkable recovery, essentially after collapse in the Great Depression of 1929. The public sector model fell with

distinct sectors actively engaging citizens and each other in joint work for the public good. Voluntarism has an important part to play in achieving such civic engagement. It can provide a source of fuel to propel various institutions to engage in such collaborative efforts and it can serve as the social grease to lubricate the resulting cooperation. Given the suspicions that often exist on all sides; this will not be an easy future to achieve or to manage.<sup>31</sup> It is the one that seems to offer the greatest prospect for the future.

Let's therefore, set about creating such civil societies, and let us encourage volunteers to lead the way. Charities and redistribution will be more "robust" in the sense of finding ways to align the incentives of potential donors and those in need of charity purposes.

the Berlin Wall. See *Bonnie Koenig, 2004, Going Global for the Greater Good: Succeeding as a Nonprofit in the International Community, Jossey-Bass page 33, ><http://www.amazon.com/gp/product/0757966762> Accessed on 14th march 2010*

<sup>31</sup> see Mark Bovens, *Analysing and Assessing Public Accountability* 9 (European Governance Paper No. C-06-01, 2006), available at <http://www.conwex-nelvrortuorff/> (Describing "public accountability" as "a relationship between an actor and a forum, in which the actor has an obligation to explain and justify his or her conduct in the context of the possible conflict between the government and the charities.

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