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**Comments on the Draft Law on
Foundations and Endowments of the
Federation of Bosnia and Herzegovina**

April 17, 1997

The International Center for Not-for-Profit Law ("ICNL") is pleased to submit this report analyzing the draft Law on Foundations and Endowments of the Federation of Bosnia and Herzegovina (the "Draft"), in response to a request by Minister of Justice Tadic.

ICNL is engaged in projects worldwide to promote a sound legal and fiscal environment for the not-for-profit sector, of which foundations and endowments play an important part. Within East/Central Europe, ICNL has provided technical assistance to ministry officials and drafting groups in thirteen countries. ICNL has also prepared a "Handbook on Good Practices Relating to Non-Governmental Organizations" (March 1997) for the World Bank. ICNL is sensitive to the unique situation of the Federation, which we have attempted to reflect in these comments.

Introduction

The Draft is an important step toward creating an appropriate legal framework for not-for-profit organizations ("NPOs") in the Federation. Currently, membership NPOs are governed by the Draft Law on Associations.¹ Consistent with civil law principles, the Draft recognizes a second form of NPO based on property, not membership.

Nearly all other countries in the region -- including the Czech Republic, Estonia, Macedonia and Bulgaria -- have adopted a similar course and are creating laws for property-based NPOs. In most countries, these organizations are called "foundations." Because the same rules and benefits generally apply to foundations created by the government, businesses, and private individuals, countries tend not to create separate legal forms for privately-created foundations and government foundations. In contrast, we understand that historical factors in Bosnia and Herzegovina justify this distinction. It is important, however, that this distinction not be used to unfairly disadvantage privately-founded endowments vis-à-vis government foundations.

¹ ICNL is also willing to provide comments on the current Law on Associations if this would be useful to the Ministry.

General Comments

The Definition of an Endowment

Issue: The Draft defines an endowment as property *permanently* dedicated to the fulfillment of certain generally beneficial or charitable purposes. Articles 3(1), 17(1), 18(3), 35(2), and 38. Article 27 states that the basic property of an endowment may not be “decreased or lost by fulfilling the purpose of the endowment.”

Discussion: Other countries have recognized the need to allow “operating endowments” (i.e., non-membership NPOs that seek and use assets for specific projects). Examples include a center that collects funds to help children victimized by war and an organization that receives project funds to promote reconstruction and economic development. These organizations may exist for a limited duration (in the first example, until the last of these children reaches maturity.) They are also designed to seek and spend funds for statutory goals. A significant percentage of NPOs around the world take this organizational form, which is evidenced by the fact that many NPOs currently operating in the Federation are non-membership, project-based organizations.

As a legal matter, these project-based organizations cannot register as associations because they have no members. Accordingly, many countries have expanded the definition of “endowment” (or “foundation” in countries where foundations are created by private individuals) to cover this type of organization. Specifically, they define an “endowment”/privately-established “foundation” as an organization that uses its assets to carry out particular not-for-profit purposes. This definition is generally consistent with the Roman law concept of an endowment/foundation (*universitas rerum*), while providing sufficient flexibility for the NPO sector to grow to meet local needs and conditions.

The alternative to this approach is to draft a separate law governing non-membership, project-based NPOs (sometimes called “institutes” or “public benefit companies”). To provide you with additional information on this approach, we will mail to you the recently-enacted Czech Law on Public Benefit Companies, on which ICNL provided technical assistance.

Recommendations: Consider either expanding the definition of an endowment or drafting a new law to cover non-membership, project-based NPOs.

The Process of Creating an Endowment

Issue: The Draft establishes the following procedure for the creation of an endowment: (1) founders submit the founding decision and request to the Ministry of Justice; (2) Ministry of Justice decides whether to grant the registration request; (3) assuming permission is granted, Ministry of Justice appoints an acting director, (4) Ministry of Justice then appoints a director to replace acting director; (5) within 30 days, the director prepares and submits the endowment’s statute to Ministry of Justice for approval; (6)

Ministry of Justice decides whether to approve the statute; and (7) Ministry of Justice appoints members of governing bodies of endowment, at which time the powers of the director cease.

Discussion: These provisions are unduly complicated and virtually unprecedented in Western Europe and East/Central Europe. Almost every country (with the exception of Austria) requires the founders to submit simultaneously the request, founding decision and statute to the registering authority. If these documents are in compliance with the law, the organization is registered. Additionally, the registering body generally does not become involved in the appointment of members of governing bodies. Instead, members are selected by the founders, oftentimes through the founding decision.

Compared to the Draft's approach, regional practice is significantly less burdensome for both the Ministry of Justice and the organization. According to the Draft, the Ministry of Justice is involved at least five times in the creation of an endowment. Under regional practice, the Ministry decides all issues at one time. Regional practice also eliminates the bureaucratic procedure of appointing two temporary directors responsible for performing components of the formation process.

Recommendation: Consider adopting a more streamlined approach to the formation of endowments.

Internal Governance

Issue: Section 6 is entitled "Management of an Endowment," but a number of internal governance rules are missing.

Discussion: Endowment laws typically contain provisions governing a variety of internal governance issues, including required governing bodies (such as a Board of Directors), quorum requirements, voting rules, conflicts of interest, self-dealing, the procedure for amending the statute and recalling members of governing bodies, the liability of members of governing bodies, and the procedure for calling meetings.

Recommendation: Consider including these provisions into the Draft. The Estonian, Macedonian and Bulgarian legislation, which is being mailed to you, provide possible models.

Technical Analysis

Article 3, paragraph 3: This paragraph states that a purpose is generally beneficial or charitable "only if it is related to persons who belong to a certain class, profession, national, language, scientific, or religious group, etc., a certain circle of persons, or persons who live in a certain area or are included in the activities" of certain legal entities. This definition fails to recognize that some generally beneficial activities focus on issues (such as cleaning up the environment or promoting civil society) and are not addressed to

discrete groups of individuals. The model used by other countries in the region (including Hungary and the Czech Republic) is to specify generally beneficial purposes (which is done in Article 2, paragraph 2 of the Draft) but not to define categories of beneficiaries. If this tack is taken, the reference in Article 23 to the “group of persons that the purpose of the endowment is fulfilled for” will need to be deleted.

Article 6: The relationship between Article 6 and Article 2, paragraph 2 is unclear. Article 2 states a foundation may pursue a broad range of public benefit purposes, including culture, environment, and sport. Article 6 suggests that foundations may engage in a more limited set of activities primarily relating to the reconstruction of the Federation.

Article 7, paragraph 2: In virtually all civil law and common law countries, tax issues are addressed separately in the tax law. We were not sure if this is also the norm in the Federation.

Article 8: You might want to consider requiring that the organization’s statute reference (1) the foundation’s duration (if not unlimited), (2) rules governing the opening of branches of the foundation, (3) persons with authority to represent the foundation vis-à-vis third parties, and (4) procedures for amending the statute.

Article 12: This article covers the content and maintenance of the register, but the actual registration procedures are missing.

Article 15: It might make sense to include additional information on what must be contained in a foundation’s annual report, similar to the approach taken in Articles 39-40 for endowments. In addition, this article states that a foundation must submit reports “to the Government.” We assume that the term “government” means the federal ministry with responsibility over the work of the foundation, but we were not sure.

Article 16: The trend throughout the region (Poland, Hungary, Estonia, Macedonia, etc.) is to vest registration authority in the courts, not a ministry. In fact, the Estonian Ministry of Justice recently insisted on revising its foundations law in order to switch registration authority from the Ministry of Justice to the courts. Countries are adopting this approach because they recognize that the registration process should be a legal, not political, decision, and often the best way to ensure this independence is to vest registration authority in the courts. We are not sure if the same conditions apply in the Federation.

Article 17, paragraph 2: It may be unnecessarily expensive and burdensome to require founders to obtain “a court expert evaluation” of contributed property and projected income.

Article 18, last paragraph: This paragraph states that an endowment cannot be founded “if there are no sensible reasons for founding an endowment, or if the purpose of an endowment would obviously not be serious.” This provision lacks criteria and provides little guidance to registering officials.

Article 26: This article indicates that the headquarters of an endowment should be stated in the founding decision. Article 17, which governs the founding decision, should reference this requirement.

Article 27, paragraph 2: Many countries allow endowments to raise funds and pursue statutory goals through economic activities. Particularly important are economic activities related to the endowment's main purposes, such as charging admission to a cultural monument or charging for services provided by an endowment. Not all economic activities, however, should receive tax benefits. ICNL recently prepared a paper on the complex issue of economic activities, which we will send to you by airmail.

Article 28, paragraph 2: Since the Draft permits the government to found a foundation, we were unsure of the policy reasons for also allowing the government to found an endowment.

Article 35, paragraph 3: This paragraph states that an endowment may be terminated if its purpose "is no longer generally beneficial or charitable, or its fulfillment has become impossible, legally or morally non-permissible." This provision is extremely vague and broad, and could be potentially abused.

Article 33: The Endowment Council is an interesting and innovative idea.

Article 36, paragraph 2: Regional best practices suggest that termination should be a last resort, taken for only the most flagrant violations. The law should provide for warnings before sanctions are imposed, and intermediate sanctions short of termination should be available (e.g., fines, suspension of benefits, etc.).

Additional Provisions: The Drafters may want to include provisions governing the establishment of branches of foreign endowments/foundations in the Federation. The Drafters may also want to consider including an article providing that the assets, earnings, and profits of an endowment or foundation may not be used to provide special personal benefits, directly or indirectly, to any person connected with the organization. More generally, it might be useful to include a provision that explicitly prohibits the distribution of any net earnings or profits, as such, to any person. This concept, known as the principle of non-distribution, is the single most important feature distinguishing not-for-profit organizations from for-profit entities.

Conclusion

As stated in the "Explanation of the Need to Adopt this Law through Urgent Procedure," there is a pressing need to enact a comprehensive law governing foundations and endowments in the Federation. The Draft reflects substantial study and careful draftsmanship, and serves as a solid base for the construction this legal framework. We hope that these comments are useful in the process of improving the Draft.

To provide international perspective on these issues, we will send you legislation and comparative information from the region. ICNL also welcomes the opportunity to provide additional assistance on this law or any other not-for-profit legal initiative of interest to the Federation.

For additional information, please contact:

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