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IRCM Tax Issue - Tany Meva

Problem Statement: In, 1998, Tany Meva (TM) sought an IRCM tax exemption (*interest income tax*), from the Ministry of Budget. The Ministry of Budget refused, stating there was no specific legal entitlement to TM for such an exemption. Paying the IRCM (a 25% tax on interest earned on local bank deposit accounts) is a significant hardship for TM (as well as other foundations and NGOs working for the public good). TM seeks assistance from its Board Members and USAID to help them resolve this issue.

Background:

USAID provided US\$27 million in Non-Project Assistance (cash transfers) to the Government of Madagascar, in response to environmental policy reform actions it took over the period 1992-1997. Following the terms of the NPA program agreement, the GOM deposited the local currency equivalent of approximately US\$12 million into a National Environmental Endowment Fund. This fund was used to capitalize the Tany Meva Foundation, the first national-level environmental foundation in Africa. The Foundation was established as a perpetual endowment to ensure long-term sustainable support for environmental actions in Madagascar.

Of the original endowment, TM currently has approximately (*see also Attachment 1*):
2 million dollars invested in an offshore account in the USA (Vanguard Asset Manager);
7 million dollars invested in a local Malagasy Treasury Bills;
2 million dollars invested a local interest-bearing bank deposit account (*subject to IRCM see below*);
1/2 million dollars invested in a local savings account (Caisse d'épargne).

Tany Meva uses the interest paid on these accounts to: 1) insure the security of the original capital investment, for instance by setting aside funds to cover depreciation rates; and 2) fund local grants (environmental activities).

Within its initial 18 months (97-98) of grant making operations, Tany Meva has disbursed over \$450,000, and financed over 50 projects (everything from helping community groups undertake city park restorations to helping small farmers around protected areas improve their sustainable agricultural techniques). If Tany Meva can successfully maintain its investment capital, the organization provides one long term solution to addressing sustainable financing issues for environmental activities in Madagascar.

Issue: Tany Meva (TM) is a charitable organization making investments in local communities in Madagascar and working for the social good of the country. To ensure the best sustainable use of the foundations' assets, TM pursues all means (including tax exemptions) to prevent erosion of their capital assets. Tany Meva received a blanket exemption of all taxes on their original 12 million dollar endowment grant, they have also received an annual exemption from IBS (*tax on the profits of corporations*) based on Article #01.01.03--5 of the General Tax Code. In 1997, TM received an exemption from paying IRCM (*interest income tax*). TM believes that the 1997 exemption was based on Article #02.08.43 of the General Tax Code, which states that "*The interest, arrears, and all other products, are exempted of tax, when they include revenues from industrial, commercial, artesnial, agricultural, or mining exploitation professions.*" This Article was repealed from the General Tax Code under Finance Law #97/047, in January of 1998. In, 1998, TM sought an IRCM tax exemption, from the Ministry of Budget, based on Interministeriel Arrêté (26/01/96) recognizing TM as a public benefit foundation and the

Bilateral Agreement signed between US Government through KEPEM and the Malagasy Government. The Ministry of Budget refused, stating there was no specific legal entitlement to TM for such an exemption (*see Attachments 2 and 3*). It is surprising to note (since normally a Foundation implements activities based on interest earned from their investments) that the *Foundation Law* or original agreements do not apparently ensure exemption from an interest income tax.

Paying the IRCM (a 25% tax on interest earned on local bank deposit accounts) is a significant hardship for TM (as well as other foundations and NGOs working for the public good). During FY 1998, the total amount TM paid out in IRCM taxes was equal to approximately 28% of the total amount available to the Foundation for grants. TM seeks assistance from its Board Members and USAID to help them resolve this issue.

Recommended Solutions/ Actions

Immediate Action #1 - Obtain Legal Advice on Taxation Issues & Clarify Taxation

Problem Statement: There is a significant amount of confusion in terms of taxation issues for TM at the moment. TM should consider hiring a local tax lawyer to review the latest tax codes and determine which taxes they are liable for, and which they are exempted from (including TVA, which the IMF representative stated he believed TM should not be paying). The lawyer should also return to the Foundations initial legislation and agreement with the Government to determine if this legislation/agreement allows for a perennial exemption of taxes, or to determine if it could be modified to do so. The Lawyer also needs to help TM definitively identify what qualifies as an IBS tax, an IRCM tax, etc, as there appears to be some confusion both at TM and at the Ministry of Budget. A legal interpretation of whether the interest earned from local bank deposits should be classified as "property revenues" (*patrimony de revenue*) would also be useful, as would a clarification of whether the IBS tax is equivalent to the "corporate taxes" described in the Foundation Law 95-028, Art 31.D. As a follow-up action, TM should consider having a tax lawyer periodically review the tax codes and make recommendations to the Foundation on how they should proceed. USAID could help develop the scope of work for this assistance and could potentially provide a grant to TM to pay for it. This work could also be followed up by the USAID-supported Sustainable Financing Technical Advisor, who should be in country by mid-April or May, 1999.

Immediate Action #2 - Move funds from the taxable bank deposit account: TM should consider immediately moving the majority of the 2 million dollars they have in an IRCM taxable bank deposit account (the IRCM is being automatically withdrawn by the bank), to another, non-taxable account. Treasury Bonds may be of most interest at the moment as they carry a relatively high interest rate, can be cashed out after 4 weeks, and can be sold the next day on the secondary market and thus are fairly liquid. This, however, should probably only be seen as a short term solution, as normally a having diversified portfolio is considered a more secure way to manage money. Treasury Bonds, although currently paying around 19%, are subject to variable interest rates and there is a chance of Government default (although very low). TM may also wish to talk to the President of the Caisse d'épargne, who may be willing (for a 2 million dollar deposit) to open an account with a higher interest rate. USAID SPO has been working with Caisse d'épargne, and feels it is a matter worth pursuing, and would be willing to help facilitate this meeting.

Potential Action # 3 - Seek an amendment to the Foundation Law: TM should most probably seek an amendment to the Foundation Law which would exclude them from paying the IRCM tax (and potentially other taxes that may arise). Such an amendment would eliminate

"Fiscal Policy" from one Administration to the next. Perhaps the most important reason for pursuing an amendment to the law would be that such an amendment would provide benefits not only to TM but also other charitable foundations (and potentially NGOs) in country. The growth of the charitable foundation/not-for-profit sector, a sector which is very promising in Madagascar, should be fostered for the benefit of civil society. The IRCM tax can be seen as a significant impediment to this sector.

USAID is currently studying the literature on tax laws governing NGOs and Foundations to determine best practices and the feasibility of different approaches. It is interesting to note that a publication distributed by the International Center for Not-for-Profit Law, states that in most countries, NGOs are exempt for interest income taxes, and that: *"Tax exempt status generally means exemption from the income tax, although NGOs are required to pay tax on their unrelated business income, but not their investment income (e.g., interest on accounts or bonds and dividends on shares). Exemption from the national income tax may carry with it exemption from other national taxes and fees, such as value-added tax (VAT) and customs duties. Exemptions from local taxes and fees (e.g., property taxes, stamp duties, etc.) may also be available."*

It should be noted, however, that local Financial Specialists at USAID and IMF perceive a change to the Foundation Law as being a very difficult task to accomplish. The IMF, for example, stated that they are not generally not in favor of legislation that provide "loopholes" to taxation law, as the Government of Madagascar (GOM) has a right, obligation, and fundamental need to legitimately levy taxes to provide basic services to its citizens. The IMF has been working closely with the GOM to close such loopholes and has been working to eliminate ad hoc exonerations. Concern about mis-use or mis-application of the Foundation Law, should it be amended, have also been raised. For instance, there are examples from other countries where political parties have set up "foundations" to meet such "loopholes."

It seems clear that should an amendment to the Foundation Law be sought that a significant amount of attention will have to be given to developing rigorous criteria by which legitimate charitable foundations could qualify for tax breaks. This criteria would then have to be carefully and honestly administrated, and a system of checks and balances developed. Prior to pursuing a formal amendment, TM should probably work to facilitate a "soft agreement" among the various financial actors that such an amendment, if defined rigorously, would be a good idea to ensure the continued growth of the charitable foundation sector in country.

Potential Action #4 - Formalize a request for an ad hoc exoneration for 1999: TM could proceed and formalize their request for an ad hoc IRCM exoneration. It should be noted that the IMF representative stated that they do not have an official position about IRCM exonerations for non-profit organizations carrying out charitable activities but are willing to consider the issue in further detail. He noted however, that the authority for issuing exonerations is vested in the Government of Madagascar (GOM), and the political position of the GOM for the time being is to minimize award of ad hoc requests. The IMF representative stated a concern with "blanket" exonerations for Foundations, particularly in light of historical abuse of such exonerations. It was suggested that in pursuing the possibility of a tax exoneration with the GOM, TM may want to point out that continued taxation of their interest income will encourage TM to increasingly invest in the U.S. where such interest income is tax-free (based on TM's 501(c)(3) status).

Immediate Action #5 - Raise Taxation Issue on the Political Agenda: The US Ambassador and the USAID Mission Director are sensitive to the importance of ensuring the growth of the charitable foundation/not-for-profit sector in Madagascar. They recognize that paying the IRCM

good), and have offered their assistance in helping TM resolve the issue. TM should take advantage of their interest in this issue, while working to ensure their interventions are strategically timed, well placed, and that messages passed are unified. At the moment there appears to be significant confusion surrounding several taxation issues; for instance, it is not crystal clear which taxes TM is or is not liable for, how property revenues are or are not defined, whether TM should pay or not pay TVA, etc. There is also no consensus among many of the key financial stakeholders on how to address this issue.

Perhaps the most effective use of the Director's and Ambassador's involvement would be to have them "flag" the taxation issue as a hardship issue for Foundations and NGOs and express their concern in wanting to work out a solution that ensures the GOM is protected from mis-application or loopholes in tax codes, while also providing the enabling conditions for charitable foundations/NGOs to exist and prosper in country. The Director and TM representatives may wish to visit the DG of Finance to discuss this issue in an open ended manner and to bring it to his attention as a concern. The Ambassador may wish to briefly mention the importance of creating enabling conditions and limiting tax burdens on Foundations and NGOs in her meetings with high ranking Government officials. However we would not recommend that at this moment, either the Director or Ambassador support a specific solution to the problem, until further information is obtained.

Related Action #6 - Address TM Securitization Issues: In developing this issues paper it became clear that more than two-thirds of the annual interest raised by Tany Meva on their endowment, is going to bank accounts used to "secure" the capital (a legal reserve fund, and two depreciation accounts) this leads to a question as to whether TM is "over-securitized". This matter should be addressed by TM and its Board along with assistance from the USAID-supported Sustainable Financing Technical Advisor (in country by mid-April or May, 1999).

Attachment 1
Tany Meva 12/31/98 Financial Overview
1 page summary statement of financing related to this issue

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