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Comments on the Draft "Law on Non-Governmental Organizations" Republic of Mongolia

Introduction. The International Center for Not-for-Profit Law (ICNL) has been invited by the International Bank for Reconstruction and Development (World Bank) to provide technical comments on the Draft "Law on Non-Governmental Organizations" (the Draft), which is currently pending in the Mongolian Parliament. ICNL is honored to have been asked to provide these comments, and it hopes that they will be helpful in considering possible changes to the Draft.

ICNL is the only international organization working to provide research services, education, and technical assistance to help develop the legal and fiscal rules of the not-for-profit sector world-wide. It has worked in all continents and regions. Under a contract with the World Bank, ICNL is presently completing its research on the laws and regulations affecting NGOs in over 100 countries and preparing a *Handbook on Good Practices for Laws Relating to Non-Governmental Organizations*. It is with this background that these comments on the Mongolian Draft law have been prepared.

General Comments. The persons who worked to develop the Draft we have been asked to review are to be commended for their effort to provide a basic, comprehensive law governing the NGO sector in Mongolia. They have obviously studied laws governing NGOs in other countries, and their Draft thus shows considerable effort to develop a sound and modern legal system for the NGO sector. The Draft includes features that conform to generally accepted international practices, as set out in the World Bank Handbook. Most importantly, the Draft recognizes the importance of maintaining an independent and self-sustaining NGO sector. However, the Draft as it stands needs considerable improvements. It has certain organizational problems as well as several gaps and inconsistencies. Some of the problems we have identified may be due to inadequate translation or our lack of understanding of the general legal situation in Mongolia. Nonetheless, it is our view that the Draft would benefit considerably from additional work. To that end, we propose that enactment be delayed for at least one or two months so that we can provide additional materials (e.g., new laws that have been enacted or are awaiting enactment in countries such as Estonia, the Czech Republic, and Macedonia) as well as additional in-person input from international experts.

As a general matter, we suggest that the structure of the Draft needs to be reorganized so as to provide a clearer set of rules for those who must comply with the law and enforce it. In the first place, it would be clearer if the registration provisions were set out in a special chapter at the beginning of the law, after the definitional provisions. After that there should be a separate chapter devoted to structural and governance provisions. We would also suggest removal of the tax provisions from this Draft -- NGO tax issues are best addressed in the general taxation laws and they

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ordinarily are not be covered in a law regulating general aspects of NGOs. In addition, the translation of the Draft we received contains some cross-references to provisions that do exist (e.g., Article 35 (2) refers to a non-existent Provision "7" of Article 12). Moreover, the relationship between certain provisions is confusing and needs clarification (e.g., Article 7, which refers to activities that are forbidden to NGOs and Article 25, which deals with reasons for denying registration of an NGO). Finally, there seems to be fundamental confusion about what NGOs are -- specifically, that they are not-for-profit and non-profit-distributing organizations (see, for example, Articles 6 and 10). There is similar confusion about the nature of foundations (Article 10).

In general, therefore, we believe that although the Draft is an excellent starting point, it would be *significantly* improved by a careful editing, reorganization, and reworking of some of the substantive provisions. We have provided a few of our more technical suggestions in the detailed comments contained in the following article-by-article analysis. Bracketed references "WBH" are to relevant portions of the draft *Handbook on Good Practices for Laws Relating to Non-Governmental Organizations*, prepared by ICNL and soon to be published by the World Bank. It is our hope that these referenced provisions will be translated, along with our comments, so that they will be clearer to the drafters. More importantly, however, we hope that we will be able to provide detailed in-person commentary and drafting assistance so that the legislation that is enacted in Mongolia in a short time will be a model of clarity and compatibility with international norms.

ANALYSIS

Chapter One - General Provisions

Article 3 - Laws governing NGOs typically do not cover political parties, labor unions, or religious organizations, which are usually governed by separate legislation. [WBH-Chptr. B, Sec. 1(a)] Article 3 thus complies with international practice.

Article 4 - This article is incomplete and should contain definitions of additional terms used throughout the Draft. For example, the term "mission statement" is defined in Article 19, not in this article.

Provision 1 refers to conflicts (actual or potential) between officers' personal or business interests and the interests of the NGO. Such issues may also arise with respect to directors and employees. Prohibitions on conflicts are properly dealt with as a whole in Chapter 2 which contains other rules on structure and governance. [WBH - Sec.14]

Provision 2 is unclear and its relationship to other parts of the Draft is also unclear (at least in translation).

The meaning and content of **Provision 3** are unclear, at least in translation. To the extent it deals with the required quorum for a meeting, it should be included in the structure and governance section of the Draft. To the extent that it deals with appropriate organizational meetings before registration, then it seems misplaced.

Provision 4, concerning the definition of a "related person," is useful, but it should be broadened to also apply to officers, board members, and employees and persons related to them.

Article 5, consistent with international standards, explicitly recognizes the exercise of freedom of association through the voluntary creation of NGOs, and forbids any penalty for a person's membership in an NGO. This provision also permits foreign residents to establish NGOs, which is similarly commendable. [WBH - Chptr. A and Sec. 3].

Article 6 refers to the "distribution of dividends from income" as an "NGO "principle." There seems to be some fundamental confusion here or perhaps simply a very bad translation. In international practice, no earnings or profits of an NGO may be distributed, as such, to any person. This is the *primary* defining characteristic of a not-for-profit organization. [WBH - Secs. 15 and 16]

Article 7 - The intent behind this anti-discrimination provision is admirable, but it should be made clear that individuals could form a group to promote the common interests of certain minorities, such as particular ethnic groups, working women, French-speakers, etc. without violating this provision. In addition, it should made be clear that an NGO is permitted to provide assistance only to poor people. (As written, the Draft prohibits "discrimination" based on "property.") It is also extremely important to revise the phrase, "as well as other conditions," because it is vague and difficult to administer, granting undesirable administrative discretion to the State Registry Office.

Article 8 broadly outlines the relationship between the State and NGOs. These provisions seem appropriate for the purpose of encouraging an open and participatory partnership between the State and NGOs (e.g., participation in policy making and legislative processes). **Provision 4**, however, seems unclear and perhaps out of place. In addition, it does not adequately identify which agencies have supervisory power over NGOs' financial activities. Perhaps it should refer specifically to the provisions of other laws which govern the State's financial oversight powers over legal persons.

Chapter Two - Structure

This Chapter should be fundamentally reorganized. ***Articles 21*** and ***22***, which are general provisions, should come before ***Articles 11*** to ***18***, which deal with more particular issues, including some definitions (which might, for example, be moved to ***Article 4***). We also would suggest that the specificity of the rules in ***Articles 16*** to ***18*** may well be unnecessary as part of the law itself but rather should be left to the charter of each individual NGO.

Article 9 - **Provision 2** seems unclear, but it may mean that an NGO is defined by its form, as established. What this article seems to do is to create a flexible type of legal entity called an a non-governmental organization, but it does not clarify whether such organizations may be both membership organizations and nonmembership organizations. If it is intended that membership organizations are the only ones that may be formed as NGOs (as opposed to foundations under **Article 10**), then this

should be clarified. It would be generally more flexible to permit both membership and nonmembership organizations to be NGOs under **Article 9**.

The distinction in **Provisions 3** and **4** between "public service" and "mutual benefit" NGOs is a generally useful way of distinguishing among NGOs for levels of regulatory oversight and possible tax and other financial benefits and one we endorse [WBH - Sec.1(b) and Chptr. J]. **Provision 6** appears to be redundant, but if it is not intended to be, its purpose should be clarified.

Article 10, at least in translation, reveals fundamental confusion about what foundations are. There seems to be a lack of coherence about the difference between the civil law concept of foundation and the US tax law concept of a "private" foundation. While the former is relevant in the Mongolian context, the latter has very little applicability and should be avoided. The Draft should be clarified so that it is clear that foundations are intended to be non-membership organizations, as they generally are in civil law countries. It should also make clear whether or not foundations may be organized only for public purposes (as in Polish law) or for private purposes as well (as in German law). However, allowing foundations to be established for private purposes does not make them "private" foundations in the US tax law sense, it merely makes them "private purpose" foundations.[1] Consistent with these suggestions, Article 10 should therefore be thoroughly reconsidered and re-written. We will be happy to send along some of the foundation law provisions that might serve as models for those revisions.

More specifically, **Provision 1** suggests that a "foundation" is an NGO that collects donations and undertakes public services. This is useful because it does not limit the foundations in Mongolia to being only grant-making entities. However, in contrast to the public benefit slant of **Provision 1**, **Provision 3** suggests that a foundation may be "for-profit" and may "distribute net income among founders." This is simply not consistent with international norms. As discussed above, *all* NGOs should be precluded from distributing earnings and profits, as such, to any private person, including founders

Article 11 describes (in **Provision 3**) the unpaid bank loans of "owners." This is confusing because NGOs do not have "owners."

Article 12 should probably be entitled "Powers and Duties of the Board of Directors." The 25% limitation on members of the Board who may be heirs of founders, while possibly useful in diluting the perpetuation of the control of the founders, is perhaps unduly arbitrary. It also does not deal with the problem of control through legal entities controlled by the founders.

As suggested above, the issues covered by ***Articles 16-18*** should be included in the charter or by-laws of the organization, not in the law. [WBH - Sec. 10] Most of these provisions are sensible, but it might be a better approach for the law to be silent on specifics and simply require that certain things be dealt with in the charter. One

[1] It is on this point in particular, as well as others that deal with confusions about provisions of US tax laws, that in-person discussion would be most helpful and would eliminate some misunderstandings.

thing that is not mentioned in the Draft but that should be dealt with in the charter of a membership organization is the rules for obtaining membership, withdrawal, and exclusion.

Article 19 and ***Article 20*** seem overly bureaucratic and should probably be eliminated. Most laws governing NGO do not have such provisions. They require only that the charter state the purposes of the organization.

Article 21 provides for the establishment of a charter as the fundamental governing document. It is seems arbitrary to require a 5 person Board of Directors. Smaller NGOs may well be adequately directed by a smaller Board of Directors. It is also unclear why a Board of Directors must meet at least 4 times per year.

Article 22 provides a list of rights and obligations of NGOs. In general, the provisions are sound, though the article does not include the obligation to make NGO reports available to the public for scrutiny. Such a rule would enhance the level of transparency and public trust in the sector. [WBH - Sec. 28]

Chapter Three - Registration

Articles 23-25 provide the general rules for registration of NGOs, and they conform quite well to international standards. [WBH - Chptr. C] It is important, however, that **Article 7** be tightened to preclude the State Registry Office from adding arbitrary and excessively bureaucratic registration criteria. It should be noted that **Provision 5** of **Article 25** refers to "Provision 8 of Article 22," which does not exist. It might be useful to reorganize the Draft so that the registration procedure is stated earlier in the law.

Chapter Four - Taxes, Income, Expenditures, and Finance

Article 26 generally states the types of income received by NGOs and is consistent with the international norms set out in the World Bank Handbook. [WBH - Chptr. J.] **Provision 2**, seems to be stating a principal purpose test for qualification as an NGO as opposed to a for-profit entity. While most such tests are stated in terms of activities and expenditures rather than income, it is possible that the proposed rule will work appropriately also. [See WBH - Appendix 1 for a fuller discussion of these issues.]

Article 27 seems to be loosely based on US tax law, but it confuses and misapplies it. The US tax rules are extremely complicated, and there is no apparent reason to import them into Mongolia. It is important to understand, however, that the US tax law limit of 50% for contributions by individuals of cash and 30% for contributions by individuals of various assets apply to limit the amount of the donor's deduction, not his or her contribution. The Draft, on the other hand, limits the amount of a *contribution*, regardless of whether the donor claims a deduction. The better rule is to limit the amount of a donor's *deduction*. [WBH - Sec. 31] It is also important to note that the limit in the US for contributions by corporations is 10%. In addition, there seems to be no rational reason for importing the limitation on deductions for donations to "private"

foundations -- those that are defined in the Draft should probably not be treated as NGOs in any case and should therefore not be permissible donees under this Article

Article 28 governs tax exemptions for NGOs It makes a distinction between revenue derived from a business related to the NGO's purposes and income from an unrelated business, taxing the latter but not the former. This is a progressive approach, but it must be recognized that it is often difficult to distinguish between "related" and "unrelated" income. [WBH - Sec. 32 and Appendix I] In addition, ***Article 28*** does not state that several of the types of "income" listed in ***Article 26*** are exempt from tax, and it should do so.

Article 29 limits the deduction from income taxes to amounts contributed to public service NGOs, which is consistent with international practice. [WBH - Sec. 31] The reason for the distinction between "current" and "initial market values" for fixed assets given to non-public foundation in **Provisions 3 and 4** is imported from US tax law, but it seems confusingly applied in this context. If the limitation to initial market value (book value) is a valid one, perhaps it should also be applied to all inventory property regardless of what kind of NGO receives it.

In addition to these general comments, it should be noted that other kinds of taxes are not covered by the provisions of this Chapter, such as property, excise, and value added taxes, as well as customs duties. It may well be that VAT preferences would be more beneficial to NGOs than income tax preferences. We believe it would be useful for a tax expert to discuss the issues with the drafters as soon as possible.

Article 30 - **Provision 2**, prohibiting NGOs from serving as guarantors for business losses of others, is apparently intended to protect the assets of NGOs from outside influences and the risk of loss. Such a rule makes good sense, but it seems misplaced in this Chapter.

Chapter Five - Miscellaneous

Article 31 appears to create a conflict of interest rule, which seems appropriate. However, it might best be moved to the Chapter on structure and governance.

Article 32 seems to be an attempt to limit an NGO's investment in the shares of commercial entities that founded the NGO. If this interpretation is correct, it seems wise.

Article 33 appears to leave financing for foundations largely in their own discretion, subject only to careful management practices and reporting -- a progressive and positive approach. However, it seems unnecessarily bureaucratic to require all project implementation plans to be submitted to government authorities. Perhaps the reason for this rule should be clarified.

Articles 34 and ***36*** are provisions setting out intermediate sanctions for various offenses. They seem sensible and should be acceptable within the context of the general Mongolian rules for civil and criminal penalties. [See WBH - Sec. 29]

Article 35, concerning dissolution, is basically inadequate and requires substantial reworking. It should be made clearer and more explicit. As it stands, it does not provide sufficient guidance to Boards of Directors on procedures to be followed in accomplishing voluntary dissolution and the disposition of assets. It does not give guidance to membership organizations that desire to dissolve themselves. Further, this article does not contemplate procedures for involuntary dissolution in the event that an NGO flagrantly fails to comply with applicable laws. Perhaps that is what is intended by **Article 25, Provision 7**, but if that is the case either the provision should be moved or a cross-reference should be provided. [WBH - Secs. 9,18, and 29]

Conclusion. As this rather brief and cursory analysis demonstrates, the Mongolian Draft contains many elements that comply with generally accepted international practices. However, in its present form, it represents at best only a rough outline of the comprehensive legal framework needed for the Mongolian government to foster a sound and effective NGO sector.

Accordingly we strongly urge that the present Draft not be enacted, and that substantial additional work be accomplished in the near future to bring the Draft more fully into compliance with international standards and practices. At a minimum, we suggest that issues raised in this memorandum be addressed and dealt with before enactment of the law. ICNL stands ready to provide whatever assistance may be necessary to accomplish these goals, including sending additional materials as well as a team of experts to work with the drafting team over the course of the next two months.