The income sources of civil society organizations (CSOS) under the Ethiopian CSO laws: a lesson drawing analysis*

Abstract

Civil society organizations (CSOs) can raise income from diverse sources, which, basically can be categorized as businesses, passive investments and non-trading. This article seeks to examine the nature and regulation of these income sources under the CSO laws of Ethiopia. Employing the doctrinal legal research method, the article argues that though the existing legal framework attempts to play its social role through relaxing the income generating activities of CSOs, it also suffers with several shortcomings. To name the main ones: the way CSOs are allowed to engage in business activities is not sufficiently considerate of competing interests; no adequate place is given for differential treatment approach; and there are also legal gaps, with potential practical difficulties, regarding the non-trading income sources of CSOs. The CSOs Proclamation has to be redrafted in light of these. Otherwise, the subsequent enabling regulation and directives should be framed in a way to counter the concerns, through the lens of best practices available in other jurisdictions.

Key terms: civil society organizations (CSOs), public benefit organizations (PBOs), differential treatment, the CSOs Proclamation, business.

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1. INTRODUCTION

Civil society organizations (CSOs) are one of the three important sectors in a society.[1] Despite the term 'civil society' is a sweeping concept, it can be defined to include all non-market and non-state organizations outside of the family in which people organize themselves to pursue shared interests in the public domain and encompass organizations that are known variously as, nonprofit organizations, non-governmental organizations (NGOs), charities, foundations, associations, community-based organizations and the not-for-profit media.[2] All these play a vital role under different capacity including as service provider, as an advocator, as watchdog and other roles including building active citizenship.[3]

Based on the nature of their beneficiaries, CSOs are generally divided in to public and private benefit organizations.[4] Those established to pursue the public benefit purpose are known as public benefit organizations (PBOs), and the rest referred as private or mutual benefit organizations (MBOs). The latter types are mainly allowed to engage in any lawful purpose, including for example, the advancement of one family's interest such as trust funds for a founders' children's education.[5] But, PBOs are established and required to benefit the public at large, thus, they have the public benefit status.

Irrespective of their type, it is obvious that CSOs need to derive income, to carry out the objectives they are established for. This is why, despite the approach varies, countries around the world allow CSOs to generate income from diversified sources.[6] There is a common practice of classifying these sources into three: business activities which generate 'business income'; passive investments which generate 'passive income'; and non-trading or gratuitous

[1] World Economic Forum (WEF), The Future Role of Civil Society, World Economic Forum in collaboration with KPMG International, (2013), p. 5, available at http://www3.weforum.org/docs/WEF_FutureRoleCivilSociety_Report_2013.pdf last accessed on 20 June, 2020. The other two sectors are the government (state) and the commercial sector.

[2] UNDP, NGOs and CSOs: A Note on Terminology, Annex 1, p. 123, available at https://www.undp.org>publications last accessed on 25 July, 2020.

[3] Rachel Cooper, What is Civil Society? How is the term used and what is seen to be its role and value (internationally) in 2018, *K4D Helpdesk Report*, (2018), p. 9.

[4] Klaus Hopt *et al*, Feasibility Study on a European Foundation Statute, Final Report to European Commission, (2015), p. 52.

[5] European Foundation Centre (EFC), Comparative Highlights of Foundation Laws: the Operating Environment for Foundations in Europe, Brussels, Belgium, (2015), p. 8.

[6] The practices of the various jurisdictions in this regard, can be, for instance, grasped from *Id*; Hopt *et al*, *supra* note 4; and Natalia Bourjaily and Melanie Lyon, Comparative Study of Laws and Regulations Governing Charitable Organizations in the Newly Independent States, *International Charity Law: Comparative Seminar*, Beijing, China, (2004).

income sources.[7] The regulation of these activities and the factors taken into account are different from jurisdiction to jurisdiction.

In Ethiopia, the concept of CSO, in its modern sense has emerged recently, mainly after the 1974 famine and the 1984 drought.[8] The earliest forms of CSOs in Ethiopia were traditional community-based organizations such as *idir, iqub*, and other informal self-help organizations.[9] For a long period of time, the sector was mainly regulated by the 1960 Civil Code of Ethiopia, without having a separate legal regime and regulator.[10] It was in 2009, that the country enacted a law that separately and specifically deals with CSOs; the Charities and Societies Proclamation (here in after, the CSP).[11] After an overwhelming critics, mainly for the foreign fund restriction imposed on Ethiopian Charities and the restriction on the area of operations of the Ethiopian Resident and Foreign Charities,[12] the CSP was repealed and replaced by the Civil Society Organizations Proclamation No. 1113/2019 (here in after, the Proclamation).[13]

The Proclamation recognizes CSOs as non-governmental, non-partisan, not for profit entity, voluntarily established and registered entities to carry out any lawful purpose.[14] Looking into the classification, based on for whose interest they are established for, the Proclamation recognized two forms of CSOs: Charitable Organization and Association. While the latter is established primarily to protect the interest of its members, a Charitable Organization is established to benefit the general public.[15] Thus, both PBO and non-PBO forms of CSOs are recognized under the Proclamation.

The Proclamation allows CSOs to raise income from different sources.[16] In general, they are permitted to generate income from business activities, passive investments and non-trading sources. Within this, there are several issues that trigger this work. For instance,

[7]Peter Pajas, Economic Activities of Not-for-Profit Organizations, *Conference Report in Regulating Civil Society Conference*, Hungary, (1996), pp. 3-5.
[8]International Center for Not-for-Profit Law (ICNL), NGO Law Monitor: Ethiopia, available at http://chilot.files.wordpress.com last accessed on 19 December, 2020.
[9]*Id*.
[10] Civil Code Proclamation, *Negarit Gazzeta*, (1960), Arts. 404-544. [Here in after, Civil Code].
[11] Charities and Societies Proclamation No. 621/2009, *Federal Negarit Gazzeta*, (2009).
[12]*Id*, Arts. 2 (2), (3) (4) and 14 (5). To have the glimpse of the critics, see Debebe Hailegebriel, Restrictions on Foreign Funding of Civil Society: Ethiopia, *International Journal of Not-for-Profit Law*, Vol. 12, No. 3, (2010), pp. 18-27.
[13]Organizations of Civil Societies Proclamation No. 1113/2019, Federal *Negarit Gazzeta*, (2019). As of September 2019, the Government is preparing a draft regulation to supplement this Proclamation; the Civil Society Organizations, Council of Ministers Regulation, (2019.) [Here in after, draft Regulation].
[14] *Id*, Art. 2 (1).
[15] *Id*, Arts. 2 (4), (5), 18 and 19.
[16] *Id*, Arts. 63 (1) and 64 (1).

the Proclamation allows CSOs to engage in business and passive investment activities without attaching the necessary restrictions. The way these activities regulated is inviting for CSOs extensive commercial engagement. This begs the question, whether the Proclamation takes in to account other competing interests, most importantly, unfair competition on the commercial sector and abuse of non-profit entities for personal gains. The other main concern is that the opportunity to engage in business undertakings is provided equally for all CSOs, irrespective of their nature and objectives. The author finds it worthy to analyze the potential implications of this inclination to 'one fits all' approach than 'a differential treatment' approach.[17] There are also other gaps, such as lack of the required specificity in regulating the non-trading income sources of CSOs and inadequate incentives towards domestic charity giving, whose potential practical impacts need to be assessed.

Making a critical assessment on the nature of the income sources and their regulation under the Ethiopian CSOs legal regime,[18] from the perspective of the above (and related) point of concerns, is at the heart of this article. To this end, doctrinal research method is dominantly used, where the relevant legislations and literatures are exploited to analysis the core issues of the paper. The general literature and prevalent international practices are used as a mirror to reflect on the case in Ethiopia and to draw relevant lessons.

The article is organized in six parts, including this introduction. Part two intends to shed light on the income sources of CSOs and their regulation in light of the prevalent international practices. The context of Ethiopia's CSO laws is discussed under part three, four and five; each respectively examines the business activities, passive investments and gratuitous income sources of CSOs in Ethiopia. The article offers concluding remarks, in the final part.

2. INCOME SOURCES OF CSOS: GENERAL OVERVIEW OF PREVALENT INTERNATIONAL PRACTICES

[17]For the purpose of this article, the expression "one fits all approach" refers to providing similar or largely similar legal treatments or opportunities for CSOs, irrespective of their type, purpose, areas of operation, financial capacity, etc. In contrast, "differential treatment approach" is employed to refer to the differential legal treatment of CSOs taking in to account various factors (such as the type, purpose, areas of operation, and financial capacity of CSOs) and circumstances like potential impacts on competing interests.

[18]Regional governments do have the power to enact their own CSO laws that govern CSOs operating only in one region. Currently, only the Amhara Region has such laws. These regionally enacted laws are a direct replica of the federal laws. Thus, it is not a mistake to consider the Proclamation as the main CSO law of Ethiopia and the points raised in the paper are mainly true to the regional laws too.

2.1.Business Activities of CSOs

By their nature, CSOs are non-profit legal entities.[19] Thus, they shall be organized and operate primarily without the aim to gain profit. This does not however mean that a CSO cannot engage in business activities[20] and generates profit to advance its objectives.[21] Generating some profit is not prohibited as long as the organization's primary purpose is not for profit and abides by the general principles of non-profit operation including the principle of non-distribution which prevents distributing profits to owners, members, officers, directors, agents, employees and other private parties that may directly or indirectly exercise control over the organization.[22]

The business activities of CSOs raise two basic questions. First, to what extent CSOs should be permitted to conduct them at all and second, how should profits from such activities is to be taxed?[23] The focus of this article is the former question. When it comes to permissibility of CSOs engagement in business activities, there are various regulatory approaches, but, in one way or another they can be grouped under the following three basic models.[24]

The first model allows CSOs to operate in any kind of business activities without limitations, except the basic restrictions that normally arise from the non-profit nature of CSOs, such as the principle of non-distribution of profit and not taking business activities as their primary purpose.[25] This model sometimes referred as a 'non-primary purpose business model' since it allows CSOs to engage in businesses despite they are not related to their primary purpose.[26] From countries adopting this mode, we can name France,[27] Venezuela,[28] Slovakia,[29]

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[19]European Center for Not-for-Profit Law (ECNL), Legal Regulation of Economic Activities of Civil Society Organizations, Policy paper, (2015), p. 3.

[20] The term 'business activities' in the context of CSOs, can be defined as an active sale of goods or services that is pursued with frequency or continuity. See Volker Then *et a*l, *the European foundation, a New Legal Approach*, Cambridge University Press, (2006), p. 329. Passive investments and irregular sale of goods and services that does not create any competition against the commercial entities are traditionally excluded from this definition. See also ECNL, *Id*, p. 5. Countries also use the term 'economic activity' to refer active trade activity of CSOs, excluding passive investments. In common understanding, passive investments are also considered as economic activities, so, to avoid confusions this article employs the term 'business activities'.

[21] *Id*, p.3.

[22] *Id*.

[23]Leon Irish, *et a*l, China's Tax Rules for Not-for-Profit Organizations, A Study Prepared for the World Bank, (2004), p. 32.

[24] ECNL, *supra* note 19, p. 7.

[25] *Id*, p. 8.

[26] Hopt *et al*, *supra* note 4, p. 87.

[27] Law No. 2003-709, 2003 on Philanthropy, Associations, and Foundations; in ICNL, Non Profit Law in France, available at https://www.cof.org/content/nonprofit-law-france last accessed on 13 April, 2021.

[28]ICNL, Non Profit Law in Venezuela, (as updated in December, 2020), available at https://www.cof.org/content/nonprofit-law-venezuela last accessed on 13 April, 2021.

Germany,[30] Denmark,[31] Kenya,[32] and Montenegro.[33] These countries, however, strictly regulate the business activities from various perspectives such as unfair competition,[34] tax exemption,[35] and adverse effect on the primary mission.[36] Some countries in this model also require CSOs to establish subsidiaries to carry out unrelated business activities such as Bosnia and Herzegovina,[37] Czech,[38] and Romania.[39]

Under the second model CSOs are allowed to engage in business activities but attached with certain conditions. The most important condition is the 'relatedness' rule, which require a relationship between the business activities and the purpose of the organization.[40] The required relationship is expressed in different ways, but can be summarized into three. Firstly, the business activities pursued by the CSO should be related to its 'statutory purpose'.[41] This is also known as the doctrine of primary purpose, and adopted by many jurisdictions including Russian,[42] England and Wales,[43] Australia,[44] Serbia,[45] Poland,[46] Malta,[47] Croatia,[48]

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[29] Act No. 213/1997 on Non-Profit Organizations Providing Generally Beneficial Services, Section 30(1) and (2); in ICNL, Non Profit Law in Slovakia, available at https://www.cof.org/content/nonprofit-law-slovakia last accessed on 13 April, 2021.

[30] German Federal Civil Code, Chapters II, Sections 80-88 and Fiscal Code of 1976, as amended, Art 65; in ICNL, Non Profit Law in Germany, available at https://www.cof.org/country-notes/nonprofit-law-germany last accessed on 13 April, 2021.

[31]EFC, *supra* note 5, p. 23.

[32]Public Benefit Organizations Act, 2013, Section 65 (1); in ICNL, Non Profit Law in Kenya, available at https://www.cof.org/content/nonprofit-law-kenya last accessed on 13 April, 2021.

[33]Law of Non-Governmental Organizations, as amended in 2017, Art 29; in ICNL, Non Profit Law in Montenegro, available at https://www.cof.org/country-notes/montenegro last accessed on 13 April, 2021.

[34] For example, France. See ECNL, *supra* note 19, p. 8.

[35] *Id*. Such as Germany.

[36] *Id*, p. 10.

[37] Law on Associations and Foundations, (2002), Art 4; in ICNL, Federation of Bosnia and Herzegovina, Law on Associations and Foundations, available at https://www.legislationline.org/download/id/4643/file/BiH_law_associations_foundations_2002_en.pdf last accessed on 13 April, 2021.

[38] Civil Code of the Czech-Republic, Act No. 89/2012 as amended; in ICNL, Non Profit Law in Czech-Republic, available at https://www.cof.org/content/nonprofit-law-czech-republic last accessed on 13 April, 2021.

[39] Ordinance 26 on Associations and Foundations, 2000, Art 47; in ICNL, Non Profit Law in Romania, available at https://www.cof.org/content/nonprofit-law-romania last accessed on 13 April, 2021.

[40]ECNL, *supra* note 17, p. 8.

[41]*Id.*

[42] The Civil Code of the Russian Federation, Parts One, Two, Three and Four; and Federal Laws No. 231-FZ, 2006 Art 50(4); in ICNL, Non Profit Law in Russia, available at https://www.icnl.org/resources/civic-freedom-monitor/russia last accessed on 13 April, 2021.

[43] Charities Acts of 1992 and 2016; in ICNL, Non Profit Law in England and Wales, available at https://www.cof.org/country-notes/nonprofit-law-england-wales last accessed on 13 April, 2021.

[44] The Australian Charities and Not-for-profits Commission Act, 2012; in ICNL, Non Profit Law in Australia, available at https://www.cof.org/content/nonprofit-law-australia last accessed on 13 April, 2021.

[45] Decree No. 88/2010 on Endowments and Foundations, Art 45; in ICNL, Non Profit Law in Serbia, available at https://www.cof.org/content/nonprofit-law-serbia last accessed on 13 April, 2021.

[46] Law on Public Benefit Activity and Volunteerism, Art 20 (4): in ICNL, Non Profit Law in Poland, available at https://www.cof.org/content/nonprofit-law-poland last accessed on 13 April, 2021.

Philippines,[49] Sweden,[50] Portugal,[51] Slovenia,[52] and Indonesia.[53] Secondly, the business activities should be 'incidental/auxiliary' to the primary purpose of the CSO.[54] This is the case, for instance, in South Africa,[55] Finland,[56] Hungary,[57] Latvia,[58] Italy,[59] and Austria.[60] Lastly, CSOs may be obliged to identify the business activities that they wish to carry out in their 'establishing documents'.[61]

Within the second model, still, there are other limitations that can be exploited. For instance, the organization's legal form can be used as a factor, where the possibility to engage in business activities is permitted only for certain legal forms.[62] Qualify the purpose of the business activity, register the business activities as any other for profit legal entity and limitation on the utilization of the earned income are also among the requirements.[63] Countries use a mix of the limitations discussed above, not necessarily stick to one or two of them.

The third model prohibits CSOs from engaging in business activities. This is also known as the exclusive doctrine and it is founded on the premise that CSOs must exclusively pursue the non-commercial purposes for which they are established.[64] Thus, CSOs should not spend their resource on business activities, but must retain it or spend excess funds on their statutory

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available at:

[47] EFC, *supra* note 5, p. 23.

[48] Law on Foundations, No. 106/2018, Art 34; in ICNL, Non Profit Law in Croatia, available at https://www.cof.org/content/nonprofit-law-croatia last accessed on 13 April, 2021.

[49] Revised Corporation Code of the Philippines, 2019, Section 86; in ICNL, Non Profit Law in Philippines, available at https://www.cof.org/country-notes/nonprofit-law-philippines last accessed on 13 April, 2021.

[50] EFC, *supra* note 5, p. 24.

[51] *Id*.

[52] Foundations Act, No. 70/05, Art 2; in ICNL, Non Profit Law in Slovenia, available at https://www.cof.org/country-notes/slovenia last accessed on 13 April, 2021.

[53] Law No. 16 on Foundations, 2001, Art 7; in ICNL, Non Profit Law in Indonesia, available at https://www.cof.org/content/nonprofit-law-indonesia last accessed on 13 April, 2021.

[54] ECNL, *supra* note 17, p. 9. 'Incidental', means, less important than the main purpose of the organization, which does not necessarily have to be 'related' to the statutory purpose.

[55] Non-Profit Organizations' Act 71 of 1997, as amended; in ICNL, Non Profit Law in South Africa, available https://www.cof.org/content/nonprofit-law-south-africa last accessed on 13 April, 2021.

[56] EFC, *supra* note 5, p. 23.

[57] *Id*, p. 23-24.

[58] *Id*.

[59] *Id*.

[60] *Id*.

[61]ECNL, *supra* note 19, p. 9. In such cases, the organizations are allowed to engage only in activities indicated in their governing documents that are related to their primary purposes.

[62]*Id*, p. 10. As highlighted in the introduction, there are different legal forms of CSOs such as charities, associations, foundations etc.

[63]*Id*, p. 11.

[64]Barbara Bucholtz, Doing Well by Doing Good and Vice Versa: Self- Sustaining NGO/Nonprofit Organizations, *Journal of Law & Policy*, Vol. 17, (2009), p. 412.

purposes.[65] But, the number of countries applying this regulatory model is decreasing.[66] Even those few countries which generally prohibit CSOs from engaging in business activities, allow them to engage indirectly through establishing a business corporation.[67]

Within the permissibility framework there are other important issues, worth to mention. First, whether the CSO can directly carried out the business activities or indirectly by establishing affiliated/subsidiary commercial organizations.[68] In this regard, the approaches are diversified. For instance, countries which generally allow operation only through subsidiaries, may allow direct operation for small CSOs since setting a subsidiary business entity creates significant administrative and financial burden for them.[69] Second, in permitting CSOs to engage in business activities there is a need to take into account competing interests such as the effect on the commercial sector and possible abuses of the organizations for personal gains.[70] In most cases, unrestricted or extensive business activities are not allowed. Third, the business activities of a CSO may aim at generating surplus/profit for support of charitable activities of the organization or to recover costs of the organization (cost sharing).[71] The latter involves charging a small price for the goods/services the CSO provides, for the sake of recovering its cost, not to generate profit from the activities. Regulating the two differently is recommended, even to the extent of not considering cost sharing activities as business activities.[72]

2.2.Passive Investments of CSOs

If they are allowed, CSOs may engage in passive investment activities such as investing in stocks and hold minority ownership interests in profit-making enterprises, place funds that are not immediately needed in interest-bearing bank accounts, lease buildings they own to other organizations or sale of assets.[73] From such activities, it is possible to derive 'passive

[65] *Id*.
[66]ECNL, *supra* note 19, p. 12.
[67]*Id*. See also TUSEV: Monitoring Matrix on Enabling Environment for Civil Society Development, Country Profile Turkey, (2013), available at http://monitoringmatrix.net/wp-content/uploads/2013/12/Matris-Turkey-report_-22.05.2014_final.pdf last accessed on 5 May, 2020.
[68] Then *et al*, *supra* note 20, p. 219. In the second case, the affiliated organization transfers profit generated from the business activities to the CSO.
[69] ECNL, *supra* note 19, p. 12.
[70] Gallagher, J. G., 'Peddling Products: The Need to Limit Commercial Behavior by Nonprofit Organizations'; in Competing Visions: The Nonprofit Sector in the Twenty-first Century, Washington, DC: The Aspen Institute, (1997), p. 6.
[71] Irish *et al*, *supra* note 23, p. 32.
[72] Then *et al*, *supra* note 20, p. 333.
[73] Irish *et al*, *supra* note 23, p. 57.

income', which in common understanding includes interest, dividends, rents, royalties, and gains from the sale of assets.[74]

Though, CSOs are permitted to invest, being subject to the same regulations as any other for-profit legal entity, they may be imposed with some restrictions, mainly on the type of investments.[75] This is intended to limit the risk involved in certain types of investments and for other concerns. However, imposing restrictions that are too severe are not recommended since they may unnecessarily impede the growth of CSOs.[76] Since, passive investment activities are not considered as 'business activities', most of the requirements imposed on the latter, such as the 'relatedness rule', are mainly not applicable to them.[77] This gives an option for some CSOs which because of their nature may not be able to engage in business activities that have direct relationship with their objectives.

2.3.Gratuitous Income Sources of CSOs

These are income sources from purely gratuitous transfers made to CSOs, in which the transferor receives nothing of substantial value. The typical ones include donations/gifts, government subsidies, inheritances and membership fees.[78] CSOs can also derive such income by engaging in fundraising activities.[79] Unlike business activities, there are no strict substantial restrictions on gratuitous income sources of CSOs, except for some procedural prescriptions.[80]

3. THE REGULATION OF CSOS' BUSINESS ENGAGEMENT UNDER THE CSO LAWS OF ETHIOPIA

3.1.The Permissibility to Engage in Business Activities

Thus far, CSOs in developing countries, like Ethiopia, have been enjoying generous support from foreign sources.[81] In the long term, it is difficult to assess whether this assistance will remain wax and wane. Therefore, it is important for CSOs to diversify and secure their sources of funding by engaging in business activities. In this regard, Art 63 (1) (b) of the Proclamation reads as follows;

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[74] *Id*, p. 30.
[75] ECNL, *supra* note 19, p. 18.
[76] *Id*, p. 30.
[77] Then *et al*, *supra* note 20, p. 329.
[78] Irish *et al*, *supra* note 23, p. 45.
[79] *Id*.
[80] *Id*.
[81] Yntiso Gebre, Civil Society and Income Generation Activities in Ethiopia, *Tracking Trends in Ethiopia's Civil Society (TECS*), Research Paper, (2012), p. 23.

> Any Organization have the right to *engage in any lawful business and investment activity* in accordance with the relevant trade and investment laws in order to raise funds for the fulfillment its objectives. However, the profit to be obtained from such activities *may not be transferred for the benefit of members*. (Emphasis added).

Reading the above provision, it is possible to discern that CSOs are given with a wider opportunity to engage in business activities. The conditions attached are: First, it should be lawful. Thus, CSOs should not engage in business activities outlawed or declared illegal under the relevant laws and also should respect the relevant trade and investment laws. Second, the profit derived from the business activities may not be transferred for the benefit of 'members'. Art. 64 (5) of the Proclamation extends the restriction to 'workers'. However, the Organization's income and resources may be distributed to members or employees for payment of 'legally permitted service fees'.[82] For instance, salaries paid to employees will not be considered as a violation of the non-distribution principle as it fits to the expression, 'legally permitted service fees'.

The 'non-distribution' provisions of the Proclamation failed to mention founders, officers, or board members of CSOs. It may be argued that the fact that CSOs by definition are non profit entities entails the application of the non-distribution principle to these individuals too. One of the concerns here is that profit may be indirectly distributed to leaders of CSOs through paying them excessive salaries.[83] The Proclamation allows payment of 'legally permitted service fees' (for members or employees). However, unless a clear description is made for the expression 'legally permitted service fees', this alone cannot solve the possible abuses associated with excessive salaries. The '80/20 rule' adopted by the Proclamation, which requires CSOs established for the benefit of the general public to allocate 80% of their total income for operational activities and 20% for administrative costs, may give some guidance in this regard.[84] The logic behind dividing the expenses of CSOs as operational and administrative and put a cap on the latter stems from allegations that CSOs spent more than 60% of their budget on administrative matters, including payment of excessive salaries or

[82] Proclamation, *supra* note 13, Art. 60 (1) (d).
[83] Irish *et al*, *supra* note 23, p. 34. For instance, in France, one of the criteria used for distinguishing between taxable and nontaxable business income of a PBO is whether the managers of the organization receive more than a minimal salary or whether the required "financial disinterestedness" exists for the organization's board and management. Excessive payments may pave a way to treat the PBO as a commercial entity. See the Tax Code Art 261, 7.1 and French Tax Administration Guidelines; in ICNL, Non Profit Law in France (as updated in January 2021), available at https://www.cof.org/sites/default/files/documents/files/France/france-country-note-032020.pdf last accessed on 10 April, 2021.
[84] Proclamation, *supra* note 13, Art. 63 (2).

benefits for their leaders.[85] The Proclamation, considers salaries and benefits of administrative employees as administrative costs, thus, may help to address the concern.[86] Previously, income generated from business activities was not allowed to be used to cover administrative costs.[87] However, the Proclamation fully lifted this restriction.[88] The author believes that this move is not considerate of the fact the restriction was one means of fighting potential abuses of CSOs for personal benefits. Thus, even if absolute prohibition may found inappropriate, at least, providing a threshold regarding the level of income [derived from businesses] that can be used to cover administrative costs should be the way forward.

There are also few prescriptions under Art 64 of the Proclamation that are relevant to business activities of CSOs. It provides general guidelines as to 'income generating activities' (IGAs), including business activities. Among other things, it requires a CSO engaged in IGAs to inform the Agency within fifteen days.[89] Here, the purpose of the notification is not clear, for instance, whether the Agency has a power to prohibit a CSO from engaging in business activities.[90] As the Proclamation attached no other substantial pre-condition to the business engagement of CSOs, it seems that what the Agency can cross check is whether the business activity the organization engaging is lawful or not. However, once a CSO is permitted to operate in business activities, it is required to comply with the relevant tax, commercial registration and business licensing, and investment laws, including opening separate bank account and keeping separate books of account for its business.[91]

[85]Yntiso Gebre, Reality Checks: The State of Civil Society Organizations in Ethiopia, *African Sociological Review*, Vol. 211, **(**2017), p. 27.

[86] For the details regarding costs considered as administrative expenses, see the Proclamation, *supra* note 13, Art. 63 (2). The '80/20 rule' of the Proclamation is imposed on only Charitable Organizations, which, are required to be established for the benefit of the general public (Art. 2 (4) of the Proclamation). But, the author sees no tenable reason why this should be the case, since the problems resulting the rule are not peculiar to Charities and the income generation opportunities are also equally provided for other forms of CSOs too.

[87]Income Generating Activities by Charities and Societies Directive No. 7/2011, Art. 6 (1). [Here in after, IGA directive].

[88] Proclamation, *supra* note 13, Art. 64 (4).

[89] *Id*, Art. 64 (7). The notification to the Agency is after a CSO started the business activity, not in advance.

[90]The draft Regulation, *supra* note 13, Art 15 (4), also requires CSOs to notify the Agency within ten consecutive working days since they have received their business license. It is not helpful to understand the concerns being raised against the Proclamation. Besides, while, the Proclamation requires the notification to be made 'within fifteen days from engaging in IGAs', the draft is saying 'within ten consecutive working days from receiving their business license'. It is confusing; hence, the draft should be reconsidered in this regard. In this regard, lesson can be drawn from the CSP since it had clearly stated that a CSO must first obtain a written approval from the Agency to engage in IGAs (CSP, *supra* note 11, Art. 103 (1)). Then, the IGA directive had set out the conditions the Agency has to look for, to permit or not.

[91] Proclamation, *supra* note 13, Art. 64 (2) and (3).

When it comes to the way CSOs can engage in business, the Proclamation allows them to engage either directly or through establishing separate subsidiary business organization.[92] It also allows them to operate as a sole proprietorship, though; it is not clear how a CSO can operate as a sole proprietorship. Besides, from business organizations it only mentions company.[93]

As highlighted under part two, CSOs may undertake business activities just to recover the costs they incur. This is known as 'cost sharing', where CSOs collect fees and charges with the intention to recover the full or part of their cost of providing services for their beneficiaries, but not to generate surplus/profit.[94] These activities are, especially important for CSOs operating in communities who cannot afford to buy their services. The best alternative, for such instances, is to at least demand payment from those who can afford to pay for the services.[95] However, the Proclamation has no indication in this regard, but, the draft Regulation does and it defines cost sharing as follows;

> [Cost sharing] means an arrangement whereby, in order to achieve their objectives, Organizations operating *for the benefit of third parties*, share costs in cash or in-kind with the beneficiaries of their services; and includes an arrangement whereby, an Organization provides chargeable services for individuals who are not beneficiaries of its charitable aim in order to maintain and expand its free services.[96]

The plan seems to allow cost sharing for Charitable Organizations, which are recognized as a PBO under the Proclamation. This is a good stand that the final version of the Regulation should take. The draft also empowers the Agency to issue cost sharing directive and the author is of the opinion that the Regulation must incorporate detailed prescriptions towards the clear implementation of 'cost sharing' including which CSOs can take part in it and under what circumstances. In general, it is possible to say that the Proclamation permits CSOs to engage in any profit making activities without serious substantive limitations being attached. The first condition, being 'lawful', is the obvious one for any kind of activity. The same can be said for the other condition, which restricts the distribution of profits to members. Even in

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[92] *Id*, Art, 64 (1).
[93] *Id.*
[94] Getachew Zewdie, The Cost Sharing Directive (1/2006 EC), *Tracking Trends in Ethiopia's Civil Society (TECS*), Policy Brief 11, p. 4.
[95] *Id*, p. 2. Income generated from secondary beneficiaries enables cross subsidization of primary beneficiaries.
[96] The draft Regulation, *supra* note 13, Art. 18 (1). Sub article two of the same also declares that "Any Organization operating for the benefit of third parties can provide its services to its beneficiaries for free or a nominal fee in accordance with the principles of cost sharing."

the absence of such stipulation, the nature of CSOs does not allow distribution of profits to members.[97] The ramifications of this stance of the Proclamation are discussed below.

3.2.Business Activities of CSOs *vis a vis* Competing Interests

The repealed CSO laws used the 'relatedness rule'; hence, CSOs were allowed to engage in business activities that are directly related to their statutory purposes.[98] This requirement was subject to criticism, since it places CSOs which cannot produce marketable goods and services, in a disadvantaged position.[99] Accordingly, suggestions were made for its elimination, which the current Proclamation has bought. While it is important to enable CSOs to engage in business activities, there is also a need to ensure that other risks do not emerge. Key among these would be that a business activity either poses a challenge to the CSO core mission itself causing mission drift (such as too much attention on the business/profit) and adversely affects the commercial sector such as when CSOs use certain competitive advantages to unfairly compete with the commercial sector.[100] The 'relatedness' requirement is a good instrument to mitigate these risks, so, the fact that the Proclamation totally scrapped it is not considerate these. Of course, CSOs working in areas such as governance, democracy and rights rather than service provision, are least likely to be able to comply with the 'relatedness' requirement and engage in business activities. However, their concern could have been addressed through differential treatment, such as allowing small scale unrelated business activities.[101]

The prevalent international practice is indicative that the business activities of CSOs are permitted in a way that balances competing interests, such as unfair competition with the commercial sector and abuse of non-profit entities for private gains.[102] These concerns will be high when wider tax privileges are granted to CSOs. In Ethiopia, for instance, income tax exemption is granted for non-profit organizations (including CSOs).[103] This exemption

[97] Proclamation, *supra* note 13, Art. 2 (1) - being 'not-for-profit' is one of the defining features of CSOs.
[98] CSP, *supra* note 11, Art. 103 (1). See also IGA directive, *supra* note 87, Arts 3 (5) and 5.
[99] Yntiso, *supra* note 81, p. 51.
[100]Gallagher, *supra* note 70, p. 6.
[101]For instance, in France, if the business activity of a PBO is considered as creating unfair competition with the commercial sector, it will be imposed with the 'relatedness rule', which otherwise is not applicable. See Tax Code of France, Art 206, 1 and French Tax Administration Guidelines; in ICNL, Non Profit Law in France, available at https://www.cof.org/content/nonprofit-law-france last accessed on 10 April, 2021.
[102]For details about the experiences of various jurisdiction in this regard, see Hopt *et al*, *supra* note 4; EFC, *supra* note 5; Bourjaily and Lyon, *supra* note 6; ECNL, *supra* note 19; Then *et a*l, *supra* note 20; Irish *et al*, *supra* note 23; and OECD, Report on Abuse of Charities for Money Laundering and Tax Evasion, (2008).
[103]Income Tax Proclamation No. 979/2016, Federal *Negarit Gazzeta*, (2016), Art. 65 (1) (m). [Here in after, ITP].

includes, the income derived from business activities of CSOs, excluding unrelated business income, i.e., income derived from business activities not related to the non-profit organizations core missions.[104] Since there is neither serious substantive limitation nor a restriction on the scale and types of business activities, there is a possibility for CSOs to operate in wider business activities, all income tax exempt, as long as the income is construed as 'related business income'.

It may be argued that as long it is for non-profit ends, the business activities of CSOs and its tax exemption should not be restricted. However, such arguments failed to appreciate the adverse impacts it may inflict on the commercial sector. It needs to be remembered that the commercial sector has also its own key role to play in the economy of the country.[105] So, there should not be confusion between business and non-profit activities that would distort the market and put private businesses at a competitive disadvantage.

The ever expanding commercial involvement of CSOs can be further thriven due to the absence of clear regulation over the re-investment power of their subsidiary business entities. This could be problematic in the context of modern competitive trading practices. These profit-making enterprises are intended to raise funds for non-profit purposes, but in practice the profits may rather re-invested to grow the business or increase market share, which would give rise to questions as to where the altruism and public benefit really lies. It should be also clear that if the parent CSO (the one that established the business organization) do not receive sufficient amount, it cannot fully undertake its charitable activity. Not only the business organizations established under a CSO, but also the re-investment power of the CSOs themselves should be clearly regulated. The initial capital of IGAs, such as the starting capital of a subsidiary commercial entity, is to be allocated from the CSO's fund. Unless there is a clear restriction in this regard; the CSO may use the profit it derived from its business

[104] *Id*. This prescription was made in the Income Tax Proclamation because the CSP required 'relatedness' between the business activity of a CSO and its statutory purpose. Since the current CSO Proclamation erased the relatedness requirement, it is not clear whether the income tax laws are going to operate as they are or need to re-shape themselves in line with the prescription of the new CSO laws.

[105] As a matter of fact, it is not charitable activities that can realize sustainable economy for one society, but the market economy. For details in this regard, see Dambisa Moyo, *Dead Aid: Why Aid is Not Working in Africa and How There is a Better Way for Africa*, Penguin Books Limited, (2011). This book reiterates that over the past fifty years $1 trillion of aid has flowed from Western governments to Africa. This has not helped Africa, but, ruined it. Using empirical data, the book shows how, with access to capital and with the right policies, even the poorest nations can turn themselves around. For this, the book underlines that first we must destroy the myth that aid works and make charity history.

activities, to expand or to start another business, while it was expected to use it for its non-profit purpose.[106] It may not also allocate adequate fund for its primary purpose.

The large scale commercial involvement of CSOs will also blurred the distinctive role of the third sector. As part of the third sector, CSOs are supposed to engage in needy areas where the government and for profit enterprises are not this much taking part, for different reasons.[107] For instance, the CSP had a list of activities which considered as charitable purposes and tests of public benefit.[108] The current Proclamation has neither of them. In such scenario, CSOs (especially, Charities) may adopt too broad objectives; hence, many of their business activities may be construed as related for the purpose of business income tax exemption. This will invite for large scale commercial involvement of CSOs and confused it with the commercial sector. When there is a need to engage in broad profit undertakings while having non-profit goals, CSOs should not be the choice (since it will deviate from their core character - 'not for profit'), rather 'social enterprises' might be preferred.[109]

The factors mentioned above, especially if taken cumulatively, grant CSOs the incentive to compete unfairly with the commercial sector. There are views which asserted that this is not an issue in Ethiopia as the market is underdeveloped.[110] However, the author believes that such assertions are not tenable, at least, for the following reasons. To begin with, the stances were largely reflected when the business activity of CSOs was imposed with the relatedness requirement and when there were no extensive income tax privileges. Now, the former is totally lifted and income tax exemptions are provided. In addition, it is improper to assume that the adverse effects CSOs business undertakings on the commercial sector, is only the concern of countries with developed market. Even if the level of the impact can be different,

[106]The draft Regulation, *supra* note 13, Art 15 (1), made an attempt in this regard as it requires Charities to ensure that the amount *of the start-up capital of their IGAs do not harm the rights and benefits of their beneficiaries.* However, this prescription is not sufficient to address the concern. First, it worries about the beneficiaries of the Organization, not the commercial sector. Second, it is not clear why it singled out Charities, since the right to engage in IGAs, including by establishing separate business entities, is allowed for all forms of CSOs. Third, it left the determination for the CSOs themselves. This self regulation may not be as effective as providing specific mandatory prescription (such as setting a threshold as to the extent of the income from business can be re-invested or used to start new business. So, before its ratification, the draft should be reframed considering these concerns.

[107]Bucholtz, *supra* note 64, p. 412.

[108] CSP, *supra* note 11, Art. 14 (2).

[109]Social enterprises refer to organizations which engage in commercial activities yet having social objectives as their prime mission. Unlike CSOs, they reward some sort of return to investors, as an incidental to their non-financial mission. While profit-making is the primary motive of for-profit businesses, it is "incidental" for social enterprises. See Mystica Alexander, A Comparative Look at International Approaches to Social Enterprise: Public Policy, Investment Structure, and Tax Incentives, *William & Mary Business Law Review*, Vol.7, No. 2, (2016), pp. 1-34.

[110]Yntiso, *supra* note 81, p. 22.

the risk may exist in developing markets too.[111] As the CSOs scale of commercial undertaking increase together with their ability to use tax shelters; it is more likely that the issue of unfair competition will come in to picture, and this is what evidences pointed to.[112]

Most importantly, empirical evidences clearly showed that in Ethiopia, party affiliated Charitable Endowments are highly affecting the commercial sector.[113] The extensive commercial engagement of the subsidiary commercial entities of these Endowments in profitable areas, compel the private business to compete unfairly with these huge economic conglomerates.[114] Since a lot has been said and wide ranges of issues are entangled with these endowments, this article has no intention to get detail about them.[115] The point the author wants to make here is that unless the regulatory framework put the necessary limitations in place, even in Ethiopia, the third sector can adversely affect the commercial sector. Let alone in the unrestricted trading model as adopted in the Proclamation, even at the time the 'relatedness rule' was intact, there were "charities" that engaged in business undertakings widely to the extent of being characterized as a commercial enterprise by the general public. Though it is undisputedly true their political affiliation is the main factor, it should be also underlined that as there is no legal barrier, other CSOs can do the same (as long as they can develop their financial capacity). Besides, having the legal restriction will help to limit the unwarranted business undertakings of party affiliated Endowments too.

In order to protect the commercial sector from the unfair competition of CSOs business engagement, countries adopt different safeguarding measures. Here are some highlights. Based on their potential to pose serious competition to the for profit sector, some countries create a conceptual distinction between 'economic activities' and 'business/commercial

[111]Kendall Stiles, International Support for NGOs in Bangladesh: Some Unintended Consequences, *World Development*, Vol. 30, Issue 5, (2002), pp. 835-846.

[112] Belete Addis, Income Tax Privileges of Charities and Charity Giving in Ethiopia: A Critical Legal Analysis, LL.M Thesis, Bahir Dar University, (2018), pp. 61-66. This research provides some instances where the tax-exempted non-profit organizations adversely affected the 'for profit entities' in Bahir Dar City Administration.

[113]The notable ones are the Endowment Fund for the Rehabilitation of Tigray (EFFORT) affiliated to the Tigray Peoples Liberation Front (TPLF) and *TIRET* Corporate affiliated to the Amhara National Democratic Movement (ANDM - now operating as branch of the national Prosperity Party/PP in Amhara Region). These entities identify themselves as Charitable Endowments, though, they aggressively engage in profit making activities all over the country using their big and numerous business corporations.

[114]Kibre Moges *et al*, The State of Competition and Competition Regime in Ethiopia: Potential Gaps and Enforcement Challenges, Research Paper Produced by Organization for Social Science Research in Eastern and Southern Africa (OSSREA), (2015), pp. 33-35.

[115]See for instance, Sarah Vaughan and Mesfin Gebremichael, Rethinking Business and Politics in Ethiopia: The Role of EFFORT, the Endowment Fund for the Rehabilitation of Tigray, *the Africa Power and Politics Programme Research Report Series*, (2011); and Mamenie Endale, Some Legal Controversies Regarding Party-affiliated Endowments and Their Participation in Business Activities: The Case of EFFORT and TIRET Endowments, *Bahir Dar University Journal of Law*, Vol .9, No.1, (2018), pp. 72-96.

activities', treating the former more permissively.[116] The permissibility of CSOs to engage in those activities fall under the 'commercial' category is either prohibited or attached with strict conditions.[117] Taking this as a lesson, the Proclamation may define "business" in the context of CSOs than using the broad definition provided under the commercial and tax laws. There are also countries which employed a threshold on the extent/scale of the business activities of a CSO or on the amount of income to be derived from business activities or on the extent of contribution of income from business activities to the annual income of the CSO.[118] If the threshold is surpassed, the organization will not be treated as non-profit entity, but a commercial one.[119] This is presumably on the theory that if the organization has a lot of business activities or generates most of its revenue from business activities, it is more like a business entity than a CSO. Requiring specific purposes which the profit derived from business activities can be utilized for, is also used by some jurisdictions.[120] The intention is that if CSOs are allowed to utilize the profit for whatever or wider purposes, they will tend to increase their scale of commercial involvement. Some empowered the regulator to decide whether the business activity of a CSO would negatively affect the organization's primary aim.[121] The Agency may be entrusted with this task in Ethiopia too, but with clear guidelines in order to sidestepping potential abuse of power and inconsistent decisions. There are also countries which maintain that engaging in business activities should be found necessary for the CSO to meet its statutory goals.[122] For instance, if the organization can meet its goals otherwise, may be because it can raise the required fund from other sources or has sufficient

[116] ECNL, *supra* note 19, p. 5.

[117] For example in Germany, economic activities necessary to pursue statutory purposes of the CSO are fully tax exempt, whereas commercial activities are considered as unnecessary to pursue the statutory purposes and above certain threshold are taxed at the full rate. See the Fiscal Code of Germany, Art 64 and 65; in ICNL, Non Profit Law in Germany, available at https://www.cof.org/sites/default/files/documents/files/Germany/germany-country-note-032020.pdf last accessed on 10 April, 2021.

[118]ECNL, *supra* note 19, p. 9. For example, in Hungary, if 60% or more of the organization's revenue comes from business activities, it will be considered as if established primarily for business motive. See Section 2 (7) of Act CLXXV/2011 on the Freedom of Association, Public Benefit Status, and the Operation and Support of CSOs; in ICNL, Non Profit Law in Hungary, available at https://www.cof.org/sites/default/files/documents/files/Hungary/Hungary-Note-September-2019.pdf last accessed on 10 April, 2021.

[119]EFC, *supra* note 5, pp. 47-48. Compliance with these ceilings can be verified by inspection of annual accounts. See Irish *et al*, *supra* note 23, p. 36.

[120] ECNL, *supra* note 19, p. 10. This is the case for example in Bosnia and Herzegovina, Czech Republic, Kosovo and Slovenia. See ICNL, The Legal Framework for Not-for-Profit Organizations in Central and Eastern Europe, available at https://www.icnl.org/resources/research/ijnl/the-legal-framework-for-not-for-profit-organizations-in-central-and-eastern-europe last accessed on 10 April, 2021.

[121]*Id*, p. 11. Czech Republic can be mentioned: generally regulated under Arts 214-418 of the Civil Code and Act No. 89/2012 of Czech Republic; in ICNL, Non Profit Law in Czech Republic, available at https://www.cof.org/content/nonprofit-law-czech-republic last accessed on 10 April, 2021.

[122]Such stipulation is, for instance, found in Lithuania under Art 11 of the Law No. IX-1969/2004 on Associations and Art 3 of the Law No. I- 1428/1996 on Public institutions; in *id*.

funds at its disposal, it will not be allowed to engage in business. Some also take in to account the frequency of the activities, by which, they require the organization to carry out the commercial activities in frequency which is deemed necessary for the support of its statutory purposes.[123] So, when the CSO is allowed to engage in business activity, it is not for indefinite period, but only to the extent it able to derive the necessary fund.

In addition to unfairly competing in the market, CSOs are also accused of soliciting funds for private gain while engaging in business activities.[124] This is the other main competing interest not taken in to account under the Proclamation. The issues discussed above such as the absence of limitation on the scale of business activities and the amount of 'related business income' subject to exemption, increase the concern that the ambiguities might be exploited and abused for private benefits.[125] The CSOs managers and administrators may be driven by personal gain to spend so much time on for-profit activities that they lose sight of the central role of providing socially valuable but privately unprofitable services. In a way, a serious conflict of interest develops between the goals of the CSO and the goals of its commercial activities. Funds raised for charitable purposes may be used as venture capital to start risky moneymaking activities and charitable funds may be used by administrators to bail out failed businesses.[126]

One of the reasons for regulation of the third sector is to control fraudulent activities, where for-profit organizations disguise themselves as non-profit entities in order to make use of their supposed non-profit status to obtain special treatment and use the resultant benefits for personal gain.[127] In this regard, the Proclamation requires all members, officers and employees of a CSO to give primacy to the Organization's interest and to take necessary precaution including avoiding conflict of interest.[128] It also provides controlling mechanisms through auditing and reporting.[129] These may help to limit the opportunities for CSOs to raise private capital, since audits focus on whether CSOs are spending appropriate amounts on

[123]*Id*, p.12. This is the case, for instance, in Serbia. See Art 37 of Law on Associations, Official Gazette No. 51/09, 99/11 and Art 45 of Law on Endowments and Foundations, Official Gazette No. 88/10, 99/11; in ICNL, Non Profit Law in Serbia, available at https://www.cof.org/sites/default/files/Serbia-201907.pdf last accessed on 10 April, 2021.
[124]Judith Bosscher, Commercialization in Nonprofits: Tainted Value? *SPNA Review*, Vol. 5, Issue. 1, (2009).
[125]Belete, *supra* note 112, pp. 66-70.
[126]Yntiso, *supra* note 81, p. 35.
[127] Ayse Dees and Anderson B, the Process of Social Entrepreneurship: Creating Opportunities worth of Serious Pursuit, Center for the Advancement of Social Entrepreneurship, Duke University, 2002; in *id*.
[128] Proclamation, *supra* note 13, A rt. 62 (11).
[129] *Id*, Arts 71-76. These provisions contain general prescriptions, thus, the details should be made in the directive to be issued.

mission-related activities on a year-to-year basis. However, though the prohibition on the distribution of profit has been viewed as a safeguard against straying from the mission, prohibitions of unrestricted commercial engagements have been viewed as an important protective measure.[130] Moreover, permitting CSOs to engage in any business with the mere condition of 'use the proceeds to the primary purpose' cannot be a remedy to the problems emanating from the unrestricted engagement of CSOs in business activities.[131] Having said this, in Ethiopia, we need to also answer the question, to what extent the enforcement is capable enough to avoid those risks. Owing to the underdeveloped controlling capacity of the relevant organs, the problem in practice may remains intact. Hence, having the necessary substantive limitations in place from the very start and then left the other possible misuses to the enforcement organs should be taken as the better way to deal with the problems.

3.3.The Absence of Differential Treatment

'Differential treatment approach' is one of the important instruments to address the concerns raised above related with CSOs engagement in business activities; and it is commonly used across jurisdictions.[132] This helps to effectively use the laws as an instrument for furthering the objectives of CSOs without negatively affecting other competing interests.[133] To attain positive results concerning these, numerous specific factors can be taken in to account.

The Proclamation should have been following the same path. For instance, the type of the CSO and the specific purposes which the Organization established for should have been taken in to account. By type of organization, this article is referring to PBOs and non-PBO CSOs. In this regard, in most countries (despite the difference in the model of permissibility they follow), it is CSOs with public benefit status (PBOs) that are allowed to engage in business activities.[134] Non-PBO CSOs are mostly either totally barred from engaging in the activities or allowed under exceptional circumstances.[135] The Proclamation has no such differentiation,[136] hence, those serving the public at large (Charities) and those serving their own members (Associations) have granted equal opportunity to engage in business activities.

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[130]Tamara Larre, Allowing Charities to "Do More [Good]" through Carrying on Unrelated Businesses, *Canadian Journal of Nonprofit and Social Economy Research,* Vol. 7, No 1, (2016), p 36.
[131] *Id*.
[132]The experiences of various jurisdictions highlighted, here in there, in this article are indicative of this. For instance, differential treatment can be easily inferred by reading the regulatory frameworks of EU member countries, Central and Eastern European countries and others. See Hopt *et al*, *supra* note 4, pp. 86-92; EFC, *supra* note 5, pp. 9-13; Bourjaily and Lyon, *supra* note 6, pp. 47-56; and ECNL, *supra* note 19, pp. 23-24.
[133] Pajas, *supra* note 7, p. 8.
[134] Irish *et al*, *supra* note 23, p. 30.
[135]*Id*, p. VIII.
[136] Proclamation, *supra* note 13, Art. 63 (1), employs the term 'any organization', without qualification.

This is incompatible with the prevalent practices and also looks unjustified. If the government is keen to provide the privilege for both, it should at least give more space to Charities than Associations.

Differentiation can be made even among PBOs, based on their specific purposes. It is recommendable to give more space to those engaging in areas where the 'for-profit-enterprises' are unable or unwilling to take part and to those engaging in needy and socially beneficial supplies such as health and education.[137] However, this is not the case in the Proclamation. Accordingly, CSOs operating in areas where the market can fairly and sufficiently allocate the goods and services (highly competing with the commercial sector) have equal state given benefits and opportunities with those operating in neglected and needy areas. CSOs engagement in key areas such as education and health is investing in human development and these efforts can be expected to have a long-term impact in terms of improving the country's stock of human capital to sustain economic and social development.[138] Thus, apart from addressing the immediate problems facing their target groups, CSOs should be encouraged to envision such long term benefits (especially for those working in remote areas where the lack of human capital is relatively severe).[139]

Other practical factors can also be considered to decide the business engagement of CSOs on case by case basis. Empirical surveys showed that in Ethiopia CSOs are unevenly distributed where most of them concentrated in major cities, accessible locations (along road-sides) and central areas close to Addis Ababa, while the deserving remote villages and developing regions have attracted little attention.[140] The reasons mentioned for this include lack of capacity to mobilize sufficient resources; unwillingness of CSOs to bear hardships by working in remote locations; lack of policy incentives; and the difficulty in convincing donors of the feasibility of projects in inaccessible/remote locations.[141] This justifies why more treatments and incentives should be provided for those CSOs operating in remote areas and in communities who have the greatest need for the services of CSOs. Thus, in Ethiopia's context, the place of operation of CSOs should be used as a key factor for differential treatment.

[137]For instance, the World Bank recommends such approach. See Irish et al, *supra* note 23, p. II.
[138] Yntiso, *supra* note 85, p. 30.
[139] For that matter maximizing public benefit is one of the rationales for the enactment of the Proclamation. See paragraph 5 of the preamble of Proclamation.
[140]Yntiso, *supra* note 85, p. 30.
[141] *Id*.

A distinction between business activities for profit and cost sharing is also recommendable, and the requirements should be less stringent for the latter, such as exemption from business registration and license.[142] The Proclamation has nothing to say in this regard. But in the draft Regulation, it is stated that while determining the operational and administrative costs of the Organization, the benefits derived from voluntary services and a cost sharing activity should not be considered as income, unless they generate money or asset even if they are considered as income under tax laws.[143] The move seems towards the differential treatment of cost sharing. Yet, the treatment here is not sufficient since it is conditioned with 'do not generate money or asset'. It is obvious that cost sharing activities generate money or asset; the point is, it is not generated as a profit. It should be that money or asset that needs special treatment, hence, the draft needs an improvement in this regard, before its ratification.

Coming to the registration and license issue, the Commercial Registration and Licensing Proclamation requires the registration of all commercial activities; hence, cost sharing activities need to comply with the requirements.[144] For reasons of comply costs, activities run to recover costs may be abandoned, thus, better to treat them differently. However, the cost sharing activity need to be allowed for CSOs which most likely will not able to survive or be effective by providing their services for free. Financially capable CSOs should not be allowed to do the same. The forthcoming Directive should take in to account such factors too in setting the conditions for the permissibility of the cost sharing activities.

4. CSOS' MANDATE TO PARTICIPATE IN PASSIVE INVESTMENTS UNDER THE CSO LAWS OF ETHIOPIA

The regulation of passive investments is more or less similar with that of business activities discussed above. Hence, there is no need to get detail here again, except for some peculiar discussions. The Proclamation explicitly allows CSOs to acquire shares in an existing company (and derive dividend).[145] CSOs are also not prohibited to exploit other passive income sources, for instance, those recognized under the Income Tax Proclamation including rental of buildings (they may build and rent out or rent a building which contributed to them by volunteers), royalties, interest (may be earned from their bank deposits or from money

[142] Then *et al*, *supra* note 20, p. 333.
[143] Draft Regulation, *supra* note 13, Art. 18 (3).
[144] Commercial Registration and Licensing Proclamation No. 980/2016, *Federal Negarit Gazzeta*, (2016), Arts. 5 (1) and 28 (1).
[145] Proclamation, *supra* note 13, Art 64 (1).

they lend to others), income from the casual rental of asset, a gain on the disposal of immovable asset, a share, or bond.[146]

The requirements that need to be fulfilled for business activities of CSOs are by large equally applicable to their passive investments. Though its potential effect on the competing interests is not as serious as business activities, the concerns discussed under part three such as the absence of necessary restrictions on the scale of the activities and differential treatment can also be raised here. For instance, unless the level of CSOs capital participation or the number of shares they can hold is limited, they will become *de facto* owner of the commercial organizations. In addition, if there is no a threshold limit on the extent of the re-investment of the proceeds from passive investment activities, the proceeds may not be meaningfully plow back to the statutory purposes. The same goes true to the scale of their engagement in other key money generating activities such as rental of buildings. So, even in cases of passive investments, there is a need to maintain a balance between the level of participation and the primary non-profit purposes of CSOs. It should be remembered that the income CSOs derived from 'passive investments' are fully income tax exempt, whether the activities are related to their objectives or not.[147] The author is not saying that equal restrictions should be imposed on the business and passive investment activities of CSOs. More lenient approach should be applied to the latter, but considerate of the legitimate concerns.

5. NON-TRADING INCOME SOURCES OF CSOS IN ETHIOPIA

According to the Proclamation, "Any Organization shall have the right to solicit, receive and utilize funds *from any legal source* to attain its objective" (emphasis added).[148] Thus, CSOs can raise funds from non-trading sources or gratuitous transfers. No serious restrictions are imposed in this regard as the only thing the provision requires is for source to be 'legal'.[149] Under this category, CSOs may receive financial contributions from donations, inheritance, membership fees,[150] public collections etc. and in-kind contributions (the word 'fund' is

[146] ITP, *supra* note 103, Arts 13-16, 54, 56, 58 and 59.
[147] *Id*, Art. 65 (1) (m).
[148] Proclamation, *supra* note 13, Art. 63 (1) (c).
[149] Charitable committees are subject to limitations that do not apply to other forms of CSOs since they may not solicit funds without the approval of the CSO Agency for each fundraising effort. See *Id*, Art. 49 (1).
[150] *Id*, Art. 60 (2) (d) implies the right of CSOs to collect membership fees.

inclusive of both cash and in kind contributions) such valuable tangible assets like buildings, office supplies, vehicles and services for that matter.[151]

This move of the Proclamation is a big relief for local CSOs, since previously Ethiopian Charities were not allowed to raise more than 10% their annual income from foreign sources.[152] The restriction was made with a view to reduce the vulnerability of sensitive domestic issues to manipulation by imported agendas that may accompany foreign funds.[153] Although it is commendable to have local funds for local projects, it is not a viable and realistic option in the current Ethiopian context where even the government cannot function without foreign funds.[154] Meaningful resources cannot be generated from local sources due to the weak state of the economy, the lack of resolute philanthropists and the lack of a tradition of giving to secular organizations.[155] Accordingly, it is unreasonable to put a total or strict bar on foreign funding, hence, the Proclamation's stance is appropriate.[156]

However, the long-term strategy should be to encourage domestic resource generation and mobilization and to reduce or avoid heavy dependence on foreign donors. For instance, after the foreign fund restriction was made following the enactment of the CSP, many 'rights organizations' were either terminated their operations or changed their commitment to service delivery and development.[157] This shows to what extent the sector was foreign fund dependent, the restriction of which brought a devastating effect. This is indicative that local CSOs need to cultivate the culture of domestic charity giving and deepen their roots in the communities where they operate.

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[151] What about intellectual contributions such as research publications? The author sees no reason why not. They may also receive capital assets such as shares.

[152]CSP, *supra* note 11, Art. 2 (2). The restriction was applicable only if the local charities preferred to operate as 'rights organization'. 'Service delivery and development' based local charities could raise 90% of their fund from foreign sources by registered as 'Ethiopian Resident Charities' (see Arts. 2 (3) and 14 (5) of the same).

[153]Yntiso, *supra* note 85, p. 25. On the other hand, critics viewed the 10% ceiling as a strategy to silence the rights organizations by starving them of funds. See Debebe, *supra* note 12, pp.18-27.

[154]Yeshanew Sisay Alemahu, CSO Law in Ethiopia: Considering Its Constraints and Consequences, *Journal of Civil Society*, Vol. 8, No. 4, (2012), pp. 369-384.

[155] *Id.*

[156]However, it is good to note that a restriction on foreign funding is one of the main worldwide trending issues in the field of CSOs. See Julia Kreienkamp, Responding to the Global Crackdown on Civil Society, Policy Brief, Global Governance Unit, UCL, (2017). The Proclamation's complete removal of the foreign fund restriction may be questioned, in light of this trend. It even allowed a foreign CSO to operate in Ethiopia for a mere purpose of providing funds to local CSOs (Proclamation, *supra* note 13, Art. 62 (6)). So, while applauding the liberal approach the Proclamation has adopted, at the same time, we should not rule out the genuine concern that foreign funding may not be given as a 'free lunch'. Through financing, local CSOs may be used as an instrument to execute the needs of the foreign donors/agents and this meddling may even extend to domestic politics and other sensitive issues.

[157]Abiy Chelkeba, Impact Assessment of the Charities and Societies Law on the Growth and Programs of Non-Governmental Organizations: A Survey Study of Addis Ababa City Administration, LL.M Thesis, Addis Ababa University, (2011), p. 27.

Here, it is worthy to remind local CSOs that the relevance, legitimacy and accountability of CSOs, is now being highly questioned worldwide, and one of the main reasons for this is that many of them lack deep roots in the communities they operate which leads to a growing disconnect between them and their beneficiaries or the constituencies they claim to represent.[158] They have been accused of being illegitimate, out of touch, or in the sector for prestige or money, mainly, due to their failure to uphold their mandate in the face of adversity and their 'follow the money' strategy by which they accept money for programmes and initiatives that are not aligned with their core mandate.[159] Local CSOs in Ethiopia should learn from this, and work hard to deepen their existence in the community, which will eventually help them to raise significant portion of their income from domestic sources. For that matter the level of relation between the society and a CSO may vary depending on its fundraising modalities. Those which raise funds domestically from volunteers using various events may have a better chance to be known by and close to the society than others, such as those extensively engaged in business activities; the public considers the latter as commercial enterprises than non-profit entities.[160]

There are also important trending issues regarding foreign funding which local CSOs need to be aware of. For instance, foreign donors (especially, the established ones) are shifting to effective aid and favoring development/service delivery CSOs.[161] They tend to prefer those engaging in development and poverty reduction and their effectiveness in tackling these than advocacy and rights-based activities. Dwindling donor funding and shifting priorities driven by foreign policy considerations is also pose a threat to the sustainability of domestic CSOs in developing countries.[162] Geopolitical and economic shifts including the expansion of Chinese foreign direct investment in Africa and the changing focus of donor countries from aid to trade with key emerging market economies are shifting the axis of development.[163] In light of this, it is recommended that civil society in developing countries needs to shift its focus and strengthen its ability to mobilize resources from domestic constituencies and reduce excessive dependency on foreign donors.[164] From these trends, local CSOs in Ethiopia

[158]Charles VanDyck, Concept and Definition of Civil Society Sustainability, Centre for Strategic and International Studies, Washington DC, (2017), p. 2.
[159]Cooper, *supra* note 3, p. 13.
[160]Befeqadu Hailu, Inside the Controversial EFFORT; Analysis, available at http://addisstandard.com/analysis-inside-controversial-effort/, published on 16 January, 2017, last accessed, on 13 April, 2021.
[161]WEF, *supra* note 1, p. 7.
[162] *Id*, p. 15.
[163] *Id*.
[164]VanDyck, *supra* note 158, p. 5.

should learn that either to have sustainable financial source or to maintain their operational freedom, they need to work hard in cultivating the domestic culture of charity giving and widen their domestic social base within the larger section of the community.

In fact, nurturing voluntarism and the culture of charity in the society is cited as one of the reasons for the enactment of the Proclamation and promoting this, is one of the objectives as well as powers and functions of the Agency.[165] However, the Proclamation failed to indicate measures to be used to attain this objective. In this regard, the draft Regulation stipulates that commercial and investment companies are expected to fulfill their corporate social responsibility by engaging in charitable work or supporting other charitable works.[166] Though, the attempt is commendable, the prescription of the draft lacks clarity; such as whether is it mandatory, to what extent the companies are expected to contribute, and how to enforce it? So, before it gets ratified, it should add further details to address these concerns.

Apart from mandatory prescriptions, the government should also devise incentives which would strengthen the solidarity of the Ethiopian society by encouraging all citizens to make contributions for public benefit purposes. Such attempt is made under the Income Tax Proclamation, where, in determining their taxable business income, the taxpayers are allowed to a deduction for the amount of a donation they made to Ethiopian Charities and Ethiopian Societies.[167] Yet, the scope of properties qualified for the privilege (charitable tax deduction) is not inclusive of private donations, but limited to business donations (business income tax payers). This may discourage charity giving; which will reduce the number of donors and the potential income CSOs would have derived from such donations.[168] Thus, widening the coverage of the privilege is recommendable and similar incentives should be available in other areas too.

One of the new developments under the new Proclamation is the establishment of the Civil Society Fund which will be administered by the Agency.[169] The income sources of the Fund

[165]Proclamation, *supra* note 13, preamble, paragraph 6; Arts 5 (4) and 6 (19).
[166]Draft Regulation, *supra* note 13, Art. 22 (1). See also Art. 17 (4) of the same which reads; "The Agency, after assessing procedures for communicating and implementing commercial advertisements in which individuals or commercial entities pledge to donate part of the proceeds from sale to charitable purposes, shall identify ways to promote this and such other methods of charitable giving."
[167]ITP, *supra* note 103, Art. 24 (1) (a). This provision uses the naming *"Ethiopian Charities and Ethiopian Societies*", which is no more available under the new CSO law. We may need to understand it contextually, as it is referring to 'local CSOs'. Of course, the better way is for the Agency to issue clarifying guideline.
[168]Belete, *supra* note 112, pp. 82-84. But, please note that CSOs 'non trading income' is fully income tax exempt. See *Id*, Art. 65 (1) m.
[169]Proclamation, *supra* note 13, Art. 86 (1).

are properties of CSOs dissolved (both under the repealed and the new CSO laws; whether dissolved by the decision Agency or Court) and subsidies from the Government.[170] This fund is intended to be used to encourage volunteerism and development in the sector, and provide incentives to Organizations working with vulnerable groups.[171] If this fund is administered properly, it can serve as one source of income for local CSOs. The Agency is empowered to issue Directives on the administration of the Fund.[172] The author believes that the Directive will serve well if it is crafted in a way that allocate the fund to CSOs doing highly valuable works to the community (such as building health and educational institutions or operating in un-served areas or providing value adding services), but with limited resources. This way, we can encourage CSOs to take part in highly public benefit activities.

The Proclamation also recognizes the right of CSOs to raise money or collect property locally, through 'public collections'.[173] The term is not defined in the Proclamation, but the draft Regulation defined it as "…the process of collecting cash or other types of assets by going to public, work or residential places, or using other means, with or without pay, and after having informed the donor the purpose of the fundraising."[174] This can be made in different means such as organizing concerts, bazaars, exhibitions; putting donation boxes in offices of international organizations, hotels, and malls.

Unlike the CSP, which dedicated separate section for "public collections" including the conditions required to engage in the activity and the effect of doing otherwise,[175] the Proclamation failed to provide sufficient rules about the activity, except for few prescriptions. For instance, it stipulates that when the Organizations collect public contribution, they shall inform to the Agency.[176] The purpose of the notification, the power of the Agency and whether the notification should be made in advance are not clear.[177] The CSP was clear in this regard since it provided the time framework (including advance application) and the factors the Agency should take in to account to decide on a public collection request made by

[170] *Id*, Art. 86 (3).
[171] *Id*, Art. 86 (2).
[172] *Id*, Art. 86 (5).
[173] *Id*, Art. 64 (1).
[174]Draft Regulation, *supra* note 13, Art. 17 (1). The CSP, *supra* note 11, Art. 2 (10) had better and informative definition in this regard, which the draft Regulation better consult to, before its ratification.
[175]CSP, *supra* note 11, Arts. 98-101.
[176] Proclamation, *supra* note 13, Art. 64 (6).
[177]Draft Regulation, *supra* note 13, Art. 17 (2), which is intended to explain Art. 64 (6) of the Proclamation, also deals with the contents of the notification and not drafted in a way to address the concerns being raised here.

a CSO.[178] Thus, the draft Regulation before its final approval and the directive to be issued by the Agency should address the gaps of the Proclamation and consulting the relevant provisions of the CSP may be the first thing to do.

Though, not restricted to public collections, Art 60 (2) (g) of the Proclamation requires the internal rules of CSOs to stipulate whether or not the organization will perform fundraising activities. Does this means, a CSO cannot engage in fundraising events (including public collections) unless it in advance declared its intention to do so in its internal rules? The author believes that this is less likely. To begin with, this is found in the optional list - the mandatory elements that should to be included in the internal rules are provided under Art 60 (1) of the Proclamation. In addition, the other relevant provisions which directly deal with the issues of fund raising do not provide this as a pre-condition to perform fundraising activities.

6. CONCLUDING REMARKS

Provided they are legal and abide by the principle of non-distribution, the Proclamation has permitted CSOs to derive income from diversified sources, which, can be categorized as businesses, passive investments and gratuitous transfers. This article attempts to examine how these income sources are regulated in Ethiopia, including in light of the prevalent international practices. It has found that the Proclamation unveils important developments and attempts to play its social role through relaxing the sphere of IGAs of CSOs. The article welcomes the Proclamation's stance in allowing CSOs to engage in business activities and passive investments as their ability to generate income through activities beyond fundraising and asset administration can play an important role to ensure their sustainability via securing financial stability and independence. The limited private wealth and weak tradition of charitable giving in the country also justifies the permission.

However, the way CSOs are permitted to engage in business activities is not without concern, as the permission is not accompanied by key limitations. For instance, the Proclamation totally lifts the 'relatedness requirement'; and imposes no restriction on the scale of the business activities, the proportion of the income to be derived from the activities, and the re-investment mandate of CSOs. This approach is not considerate of other competing interests likely to be affected, most notably the commercial sector and abuse of non-profit entities for private gains. In this regard, the article highlights some important safeguarding measures

[178] CSP, *supra* note 11, Arts. 100-101.

other jurisdictions have adopted. With careful contextualization, Ethiopia can draw lessons from them in order to protect the commercial sector from unfair competition and to lessen the motive of using CSOs as a disguise for private benefits. The role of the third sector should not be blurred with the commercial and the Proclamation should be considerate of the available business income tax exemptions for CSOs.

Furthermore, the opportunity to engage in business activities is provided similarly for all CSOs. This negates the positive roles the Proclamation could have play, as an instrument to encourage CSOs to operate in high demand areas and to balance competing interests. The article argues for differential treatment that takes in to account key factors. Differentiation can be made, for instance, based on the type (being more permissive to PBOs); specific purposes (give wider opportunities for CSOs operating in critical needy and value adding areas); and place of operations (favor those working in remote/inaccessible areas). The article discussed relevant international experiences, where ample lessons can be drawn from.

CSOs are also allowed to raise income from purely gratuitous transfers such as donations, inheritances, public collections and membership fees. They can also exploit foreign funding, which the current Proclamation puts no restriction. This is good news for local CSOs since it is their principal source of revenue, where, covering their full budget from domestic sources seems impracticable, in the current situation. Albeit this, the article argues that the long-term strategy of local CSOs should be to encourage domestic resource mobilization and to reduce heavy dependence on foreign donors. Doing so will help them to maintain their operational independence and the trends also indicate that securing foreign fund is becoming a delicate situation. One a related note, the article underscore that though it is unreasonable to totally ban or put strict restriction on foreign funding, the latter's role should be carefully scrutinized to make sure it does not import agendas disruptive to sensitive domestic matters.

Suggestions are also made for the draft Regulation to be re-drafted in a way to address the concerns discussed in the article. Moreover, since the regulation and directives issued based on the CSP are lapsed,[179] there is a serious legal lacuna regarding detail prescriptions, thus, both the Council of Ministers and the Agency should act promptly.[180] They can start by consulting the repealed CSO laws and identify the prescriptions to retain, to modify or

[179]Proclamation, *supra* note 13, Art 88 (1), allowed for the previously issued Regulation and Directives to operate for a one year transition period. As this period is already lapsed they are no more authoritative.
[180]*Id*, Art 89, empowered the Council of Ministers to enact Regulation and the Civil Societies Organizations Agency to issue Directives.

overhaul. The discussions revealed that the Proclamation gets rid of important prescriptions of the previous CSO laws which would have been better to retain (at least with modifications) and in some cases made things more worrisome (the way it discarded the 'relatedness requirement' is one indication). A highlight is also made on various relevant experiences, where ample lessons can be drawn as a way out from the problems discussed in the article, as long as they are properly contextualized.