



TAX MANAGEMENT FOR NOT FOR PROFIT ORGANIZATIONS (NPOs)

Understanding the NPO Tax Landscape in Kenya

SUBJECT : TAX PLANNING FOR PBOs / NPOs

Venue: Safari Park Hotel, Nairobi 31st July 2015

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How the PBOs Act, 2013 defines “PUBLIC BENEFIT”

“Public Benefit Activity” means an activity that supports or promotes public benefit by enhancing or promoting the economic, environmental, social or cultural development or protecting the environment or lobbying or advocating on issues of general public interest or the interest or well-being of the general public or a category of individuals or organizations.

What is PLANNING?

A management process, concerned with defining goals for company's future direction and determining on the missions and resources to achieve those targets. To meet the goals, managers may develop plans such as a business plan or a marketing plan. (Source: webcrawler.com)

Planning (also called “forethought”) is the process of thinking about and organizing the activities required to achieve a desired goal (Source : Wikipedia)

REMEMBERING THAT

Tax not recovered is TAX ON THE AGENT even if such are personnel taxes e.g. PAYE

Best tax planning is “PLANNING” to comply by :-

- a. Operating within the law**
- b. Reduce or avoid exposure (legal avoidance arrangement of affairs)**

Do Not Abuse PBO Status

❑ Non-declaration of financial assets in off-shore financial accounts

❑ VAT Fraud

- **Missing records, running unregistered hotels & hostels, etc**
- **VAT on Commercial Rent**
- **Not having an ETR machine for VAT (where applicable)**

RENT

- **From 1 January, 2016 (Finance Bill 2015)**
 - **Pay 12% of gross rent received every month**
 - **Elect / Apply to pay tax quarterly based on “rent surpluses”**

STRUCTURING AND RESTRUCTURING THE BUSINESS

A. Align the Business to the Income Tax Act

- i. **The Non-Profit must be an institution, body of persons, or an Irrevocable Trust:-**
 - **of a public character**
 - **established solely for the purposes of the relief of the poverty or distress of the public,**
 - **or for the advancement of religion or education**
- ii. **established in Kenya; or**
- iii. **whose regional headquarters is situated in Kenya.**

- iv. The Commissioner is satisfied that the income is to be expended either in Kenya or in circumstances which result in the benefit of the residents of Kenya**
- v. Gains or profits from business are applied solely to the purposes (relief of poverty or public distress, advancement of religion or education)**

B. STRUCTURE AND INCOME GENERATION

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

C. KNOWING THERE IS TAX.....

Plan to reduce or avoid exposure by closely monitoring events and activities that may / give rise to :-

- i. Corporation Tax**
- ii. Value Added Tax**
- iii. Customs Duties**
- iv. Excise Duties**

C. KNOWING THERE IS TAX..... Contd.....

- ☐ **WHT deducted when a NPO does not have a valid tax exemption certificate is a sunk resource.**
- ☐ **Those without Exemption Certificates can be taxed at the corporate rate of 30% on taxable “GAINS” or “PROFITS” made !!**
- ☐ **Where goods are subsequently sold – the NPO is liable for VAT and Customs Duty.**

MANAGING TAX EXEMPT OR TAXABLE STATUS

- **Directors must take ultimate responsibility for directing the affairs of a charity, and ensuring that it is solvent, well-run, and delivering the charitable outcomes for the benefit of the public for which it has been set up.**
- **Directors must act with integrity, and avoid any personal conflicts of interest or misuse of charity funds or assets.**
- **A PBO CEO to ensure that if transactions are entered into involving people or organizations connected to the charity they must be properly handled and conflicts of interest declared and managed.**
- **Charitable funds and assets be used reasonably and only in furtherance of the charity's objects**

MANAGING TAX EXEMPT OR TAXABLE STATUS

- **Directors must ensure that their charity has adequate financial and administrative controls in place, and that they comply with their statutory obligations to maintain the accounts and records of their charity.**

- **There should be a clear audit trail of where bank accounts are held, what they are held for and who has access to them**

- **Directors should not only ensure that financial controls are put in place but also that sufficient information is reported back at Trustee meetings to satisfy them that the controls are being properly observed.**

MANAGING TAX EXEMPT OR TAXABLE STATUS

It is important that the financial activities of any PBO / NPO is properly recorded and financial governance is transparent.

PBOs / NPOs are accountable to their donors, beneficiaries the public and the government (NGOs Coordination Board and KRA)

Donors to a PBO / NPO are entitled to have confidence that their money is going to legitimate causes and reaches the places that are intended.

New Forms of Not-for-Profit Entities

According to Dr. Eric John Abrahamson (2013) (*in “A Century of Philanthropic Innovators – Beyond Charity” by The Rockefeller Foundation Centennial Series in Innovations for the next 100 years*)

Donors can be divided generally into 7 groups

The seven (7) are existing and ancient forms of “DONORS / GRANT MAKERS”. Some types have existed since Biblical times !!

There are also NEW (EMERGING) DONOR types / grant makers.

New Forms of Not-for-Profit Entities

DONOR TYPOLOGY AS A CATALYST

- 1. Communitarians – give out of a sense of belonging to a community**
- 2. Devout donors – motivated largely by faith**
- 3. Investors – pragmatists who view money as a means to create social change**

New Forms of Not-for-Profit Entities

DONOR TYPOLOGY AS A CATALYST Contd...

4. **Socialites** – giving / philanthropy as a social activity
5. **Activists** – a way of fulfilling life purposes
6. **Repayers** – give out of a sense of gratitude
7. **Dynasts** – those born into families with deeply rooted traditions of philanthropy.

New Forms of Not-for-Profit Entities

DONOR TYPOLOGY AS A CATALYST Contd...

New donor / emergent types include :-

- 1. “Venture Philanthropy” – Market approaches to try and change society, improve management and reduce the causes of poverty.**
- 2. “Philanthrocapitalists” – they are looking for investment opportunities to create a product or service that improves the quality of life in a given community.**
- 3. “Philanthromarketers” – promoting the products of the company while positioning the company itself as a good social citizen – in a way “giving back” to society but using it also to commercialize the “give – reap” phenomena. They push a win – win philosophy. *(FCPA Erastus K. Omolo)***

New Forms of Not-for-Profit Entities

For the most part, hybrids have been created by an existing non-profit or for-profit to meet a new objective that could not be met under its existing legal structure (*Source : A New Type of Hybrid, Stanford Social Innovation – Allen R. Bromberger, April, 2011*)

Like a not-for-profit, it has a primary purpose of charity, but like an LLC, it can have equity holders that have a right to distribution of profits.

New Forms of Not-for-Profit Entities

Type L3Cs - encourages an influx of new capital into charitable causes that are too risky for for-profit ventures and that non-profit funds alone cannot sustain.

The L3C effectively creates a market for investment in companies that offer low rates of return, but contribute to the community, unlike the non-profit which offers no rate (and sometimes a negative rate) of return on investments. *(Source : The Possibilities of the L3C, by Nicole Campbell on November 10th, 2009).*

New Forms of Not-for-Profit Entities

Two traditionally separate models : a social welfare model that guides its workforce development mission and a revenue generation model that guides its commercial activities. *(Source : Stanford Social Innovation Review, Informing and inspiring leaders of social change, by Julie Battilana, Mathew Lee, John Walker and Cheryl Dorsey / 13, Summer 2012)*

MISSING THE ROAD TO HEAVEN !

“..... SMALL IS THE GATE AND NARROW IS THE ROAD THAT LEADS TO LIFE, AND ONLY A FEW FIND IT”

Find it ! Yes you can!!

THE CASE.....

Danish Organization for Sustainable Energy Versus Kenya Organization for Environmental Education & NGOs Board (interested party)...High Court Case No. 465 of 2011

Issue

Defendant's unlawful refusal to release assets and equipment to the Plaintiff after termination of project on grounds of fund irregularities.

MISSING THE ROAD TO HEAVEN !

Plaintiff's Case:-

Plaintiff granted funds to the Defendant for implementation of community projects. The funds granted to the Defendant were utilized in acquisition of various assets and equipment.

The Plaintiff commissioned an audit firm to undertake forensic investigative audit which revealed serious irregularities in the administration of the funds disbursed under the project.

The Plaintiff terminated the contracts and directed the Defendant's staff to hand over the equipment and assets in their possession. The Defendant refused.

MISSING THE ROAD TO HEAVEN !

Defendant's Case:-

The assets were purchased by cash donations and should be registered in the name of the Defendant.

The Acts of Breach:-

- ☐ **Diversion and use of the grant funds to finance unrelated activities;**
- ☐ **Failure to put in place an accountable and transparent system to safeguard proper and efficient administration of the funds in the implementation of the projects.**
- ☐ **Irregularities in the implementation of the projects.**

MISSING THE ROAD TO HEAVEN !

Court Ruling

The assets belonged to the projects and ideally should be returned to the Plaintiff who disbursed funds for purposes of continuing the implementation of the projects.

The Defendant was a steward of the assets and equipment on behalf of the Plaintiff for the benefit of the beneficiaries.

There is nothing whatsoever the Defendant can show to attach itself to ownership of the said assets and equipment.

WHAT DO WE LEARN FORM THIS?

KNOWING THE MIND OF KRA (HIDDEN REVENUE !)

1.AUDITED ACCOUNTS AND TAX RETURNS

- ❖ **To establish if monies paid to employees and / or expatriates were taxed accordingly**
- ❖ **To compare salaries figure with the salaries account in the general ledger, if fully disclosed.**

KNOWING THE MIND OF KRA (HIDDEN REVENUE)

1.AUDITED ACCOUNTS AND TAX RETURNS cont.....

☐ Pension Contributions

- **Seek to establish if the organization operates any pension / provident fund scheme and if the scheme is registered or not**
- **Ascertain if excess pension was taxed accordingly**

☐ Management

- ❖ **To tie the names of top management to the organizational structure**

KNOWING THE MIND OF KRA (HIDDEN REVENUE)

1.AUDITED ACCOUNTS AND TAX RETURNS cont.....

☐ Organization Headquarters

- Establish where the organization is controlled from
- Establish any related party transaction i.e. expenses incurred by the organization on behalf of its headquarters and vice-versa

KNOWING THE MIND OF KRA (HIDDEN REVENUE)

1.AUDITED ACCOUNTS AND TAX RETURNS cont.....

❑Source of Income

- ✓To establish who the main donors / funders are**
- ✓To establish if the organization is engaging in activities that may give rise to tax e.g. sub-letting office space, income generating activities (IGAs) etc.**

KNOWING THE MIND OF KRA (HIDDEN REVENUE)

1.AUDITED ACCOUNTS AND TAX RETURNS cont.....

- **Organization's background information, core activities and area of operation**
- **To establish the probability of having employees working outside Kenya who may be taxable in Kenya.**

➤ **Bankers**

KNOWING THE MIND OF KRA (HIDDEN REVENUE)

2.BANK STATEMENTS

- **To compare the bank statements, cheque counterfoil and payment vouchers for any inconsistencies, untaxed payments etc.**
- **Establish other sources of income to the organization apart from donations e.g. interest earned, sub-letting rent etc.**

KNOWING THE MIND OF KRA (HIDDEN REVENUE)

2.BANK STATEMENTS Contd.....

- **Establish any payments / transfers to foreign bank accounts**
- **To establish bank accounts not disclosed in the audited accounts and investigate them.**

KNOWING THE MIND OF KRA (HIDDEN REVENUE)

3.CASH BOOKS INCLUDING PETTY CASH BOOKS

- ✓ **Pick items that are likely to lead to taxation e.g. consultants, contractors, staff, rent and spin-off cases**
- ✓ **To pick any round sum cash payments for follow-up questions**
- ✓ **Amounts received by the organization not banked if may be taxable**

KNOWING THE MIND OF KRA (HIDDEN REVENUE)

4. PURCHASE INVOICES

- **Seek to establish names of suppliers – providers of goods and services. Source of spin-off information.**

5. LEDGERS

- **Cross checking - to establish any payment that may give rise to tax e.g. travel, subsistence and per-diems, consultants etc.**
- **Seek to establish if advances to staff / loans were subjected to low interest / fringe benefit tax where applicable**

KNOWING THE MIND OF KRA (HIDDEN REVENUE)

6.PAYROLL / PAY SHEETS

- ❖ **To re-compute the payroll to confirm if taxes were computed correctly**
- ❖ **To compare the payroll with the quarterly and end of year returns (if still manual) and check for any errors.**

KNOWING THE MIND OF KRA_(HIDDEN REVENUE)

6. PAYROLL / PAY SHEETS Contd.....

- ❖ **To ascertain if the tax deducted was remitted to KRA in full and on time by comparing the payroll with the P11's (now better under i-Tax System)**
- ❖ **To establish if the taxpayer is registered online (i-Tax System).**

KNOWING THE MIND OF KRA (HIDDEN REVENUE)

7. PAYMENT VOUCHERS AND RELATED INVOICES (CHEQUE PAYMENTS & PETTY CASH)

- **Payments made by the organization to / on behalf of employees that may be construed to be taxable benefits on the employees**

KNOWING THE MIND OF KRA (HIDDEN REVENUE)

8.PERSONNEL FILES

- **Seek to establish benefits given to employees; cash or non-cash**
- **Cross-check contracted compensation information against actual amounts declared in tax records (bonuses, gratuity, airtime etc)**

KNOWING THE MIND OF KRA (HIDDEN REVENUE)

9. WITHHOLDING TAX

- **To verify if WHT returns were filed with KRA and on due dates.**
- **Establish any variance between WHT returns and actual payments**

KNOWING THE MIND OF KRA (HIDDEN REVENUE)

10.ASSETS REGISTER

- ❖ **To establish the location of assets whether at the Office or the employee's residence (BENEFIT)**
- ❖ **To establish if there are any assets assigned to specific individuals and the benefit attached thereto e.g. vehicle(s)**

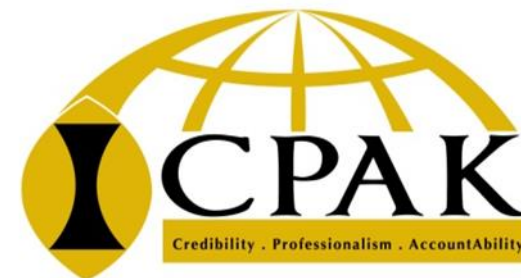
KNOWING THE MIND OF KRA (HIDDEN REVENUE)

RECALLING THAT.....

❖ **Tax not recovered from the liable party is tax on the PBO / NPO.**

❖ **Tax not exempted is TAX DUE from the PBO / NPO.**

Understanding the NPO Tax Landscape in Kenya



END

Thank You !

❁ *Questions / Comments ?*

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