Recent Changes in Laws Regarding Nonprofit Corporations and Charitable Trusts in Japan

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I. Preface

In 2008, Japanese nonprofit corporation law, that was originally enacted almost 100 years ago, was fundamentally reformed. The Japanese government is currently also at work reforming the law governing charitable trusts, which has not been revised since 1923, when it was enacted. The laws on nonprofit corporations and charitable trusts have seen much change over the past decade. This article summarizes the status quo and discusses the latest trends.

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II. OVERVIEW OF LEGAL INFRASTRUCTURE REGARDING JAPANESE NONPROFIT CORPORATIONS

Nonprofit corporations are generally understood to be corporations that are prohibited from distributing profit to their members. They can earn profits but cannot distribute them. In Japan, there are many kinds of legal entities under the umbrella of nonprofit corporations. Chart 1 shows the numbers of each kind of nonprofit corporation.

<table>
<thead>
<tr>
<th>Status of legal entities</th>
<th>Number of existing entities</th>
<th>As of implementation of relevant law</th>
<th>The year of implementation of relevant law</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Interest Corporations</td>
<td>9,470</td>
<td>Dec. 2016</td>
<td>2008</td>
</tr>
<tr>
<td>NPO Corporations</td>
<td>51,014</td>
<td>Jan. 2017</td>
<td>1998</td>
</tr>
<tr>
<td>Approved NPO Corporations</td>
<td>1,237</td>
<td>Jan. 2017</td>
<td>2012</td>
</tr>
<tr>
<td>Medical Services Corporations</td>
<td>53,408</td>
<td>Jan. 2017</td>
<td>1948</td>
</tr>
<tr>
<td>Private School Corporations</td>
<td>8,020</td>
<td>Jan. 2017</td>
<td>1949</td>
</tr>
<tr>
<td>Religious Corporations</td>
<td>181,810</td>
<td>Dec. 2014</td>
<td>1951</td>
</tr>
<tr>
<td>Relief and Rehabilitation Corporations</td>
<td>164</td>
<td>Jan. 2017</td>
<td>1995</td>
</tr>
</tbody>
</table>

Among these nine types of entities, the last five are governed by a special law, such as the social welfare law, which governs social welfare corporations. This article leaves this group to one side and examines the legal structure for the initial four entities: general corporations, public interest corporations, NPO corporations, and approved NPO corporations.

1. General Corporations and Public Interest Corporations

a) Before the 2008 reform

In 2008, the legal framework for Japanese nonprofit corporations was fundamentally reformed. One purpose of this change was to make it easier to incorporate nonprofit corporations. Before the reform, there existed a category of nonprofit corporations called public interest corporations that were based on the Civil Act (kōeki hōjin), but one could not incorporate such corporations without the permission of the ministry in charge. For example,

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if the purpose of the organization was to promote education, the Ministry of Education, Culture, Sports, Science and Technology (MEXT) had jurisdiction over the corporation. It was criticized however that the criteria used for granting permission by each ministry were different, that it was cumbersome to obtain permission in cases where more than one ministry had jurisdiction, and that it was altogether difficult to incorporate public interest corporations based on the Civil Act.

b) It is easier to incorporate general corporations

In the reform, two new types of nonprofit corporations were introduced, namely, general corporations² and public interest corporations. As all that is required to set up a general corporation is to enter it at a registry, it has after the reform become much easier to incorporate nonprofit organizations. Public interest corporations are general corporations that have obtained additional authorization (nintei).³

The principal objective of a public interest corporation must be to operate a business which promotes the public interest. General corporations, on the other hand, are not required to exist to promote the public interest. One can use a general corporation as an organization that promotes the mutual benefit of its members. For example, university alumni associations are often organized as general corporations.

General corporations are association-type corporations (general incorporated associations, ippan shadan hōjin) and foundation-type corporations (general incorporated foundations, ippan zaidan hōjin). Association-type corporations have members, while foundation-type corporations do not. When a general incorporate association applies for the status of a public interest corporation and is authorized, it becomes a public interest incorporated association. When a general incorporated foundation applies for the status of a public interest corporation and is authorized, it becomes a public interest incorporated foundation (see Chart 2).

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c) **Authorization to become a public interest corporation**

There are many requirements for attaining the status of a public interest corporation, including that the corporation’s principal objective is to operate a business which promotes the public interest,\(^4\) that the corporation has an accounting base and technical capability necessary to operate the business for public interest purposes,\(^5\) and that the charter of the corporation has a provision providing that its residual assets will be given to another public interest corporation, the state, or an equivalent.\(^6\) If authorization is given, a general incorporated association becomes a public interest incorporated association, and a general incorporated foundation becomes a public interest incorporated foundation. Public interest corporations receive a more favorable tax treatment than general corporations.

Who assesses whether a corporation meets the requirements to obtain the authorization to become a public interest corporation? When an application is submitted, the Public Interest Commission (Kōeki Nintei-tō Inkai) within the Cabinet Office will assess whether the corporation meets the requirements to be a public interest corporation and gives its opinion to the Prime Minister, who grants the status of a public interest corporation to the corporation. Before the 2008 reform, as mentioned in 1(a), different ministries had authority over such corporations depending on what kind of activities each corporation was engaged in. After the reform, the Public Interest Commission came to be in charge of assessing all cases. It should be noted, however, that when a general corporation applying for the status of a public interest corporation engages in activities in only one prefecture, the governor of that prefecture, instead of the Prime Minister, grants the status, and an equivalent commission under the governor, instead of the Public Interest Commission, assesses the case and gives its recommendation to the governor. **Chart 3** shows the number of public interest corporations.

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\(^4\) Article 5(i) of Act on Authorization.
\(^5\) Article 5(ii) of Act on Authorization.
\(^6\) Article 5(xviii) of Act on Authorization.
The objective of a public interest corporation must be to operate one or more of the twenty-three categories of businesses listed in the law. Chart 4 shows the twenty-three categories of possible business for public interest corporations that are listed in the law and the number of public interest corporations that are engaged in each business.

Two key characteristics of the 2008 reform are that it

1) made it easier to incorporate nonprofit activities as a general corporation, and

2) created the Public Interest Commission, which assesses whether a general corporation meets the requirement to obtain the status of a public interest corporation.

* As of 1 December each year. Data and chart are provided by Cabinet Office.

A: Public interest incorporated associations authorized by the Prime Minister
B: Public interest incorporated foundations authorized by the Prime Minister
C: Public interest incorporated associations authorized by governors
D: Public interest incorporated foundations authorized by governors

7 The twenty-three categories are listed in the Appendix of the Act on Authorization.
Chart 4: 23 categories of public interest corporation businesses

As of 1 December each year. Data and charts are provided by Cabinet Office.
2. **NPO Corporations and Approved NPO Corporations**

Another category of Japanese nonprofit corporations is the NPO corporation *(tokutei hieiri katsudō hōjin)*, including the approved NPO corporation *(nintei tokutei hieiri katsudō hōjin)*. Approved NPO corporations are NPO corporations that have had additional approval from the tax authorities.

The NPO corporation is well known in Japan and is commonly used when a person or entity incorporates its public interest activities as a corporation. An NPO corporation has the purpose of promoting the sound development of nonprofit activities to benefit society. To organize an NPO corporation, it is necessary to apply for authentication (ninshō). The authentication requirements, however, are easy to meet, and it is said that nearly all applicants obtain authentication. 8

When an NPO corporation meets additional requirements and is approved, it becomes an approved NPO corporation and obtains more favorable tax treatment. The requirements for being approved are difficult to meet. For example, the corporation must receive a major part of its revenue from donations. The number of approved NPO corporations is small compared to the number of NPO corporations. 9 *Chart 5* (following page) shows what kinds of activities Japanese NPO corporations (including approved NPO corporations) engage in.

3. **Why Japan has General Corporations, Public Interest Corporations, and (Approved) NPO Corporations**

This article has addressed two systems of nonprofit corporations. One includes general corporations and public interest corporations, and the other covers NPO corporations and approved NPO corporations.

So why does Japan have both of these systems? One explanation lies in the sequence of lawmaking. Before the Act on NPO Corporations 10 was enacted in 1998, Japan had only public interest corporations based on the Civil Act, 11 and the incorporation of such organizations was very difficult. For this reason, the Act on NPO Corporations was enacted in 1998 to make it easier to incorporate public interest activities. Following this, in 2008, a sweeping reform of the nonprofit corporation law system was undertaken, and general corporations and public interest corporations were introduced. However, as NPO corporations were widely in use, the NPO corporation system was maintained even after the reform of 2008. Today, as shown in *Chart 1*, NPO corporations are among the most common nonprofit corporate structures in Japan.

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8 T. OHTA, *Hieiri hōjin setsuritsu un‘ei gaido bunku* [Guidebook for organizing and running nonprofit corporations] (Kōeki Hōjin Kyōkai, Tōkyō 2012) at 64.

9 See *Id.* at 158–159.
Chart 5: Activities of NPO corporations

As of 31 March 2017. Data and chart are provided by the Cabinet Office.
III. LATEST TRENDS

Even after the reform in 2008, laws related to nonprofit corporations or charitable trusts have changed. Thus the next section of this article outlines the ongoing reform of the Charitable Trust Acts and an act on the utilization of dormant deposits.

1. Reform of Japanese Charitable Trust Law

In 2006, the original Trust Act of Japan, enacted in 1922, which contains not only provisions regarding private trusts but also provisions for charitable trusts, was amended and a new Trust Act was enacted. The provisions on charitable trusts, however, were left as they were, because at the time, as mentioned in II.1., the reform of a section of the legal structure for nonprofit corporations was ongoing. Members of the Japanese Legislative Council (Hōsei Shingi-kai), responsible for trust law, thought it desirable to await the reform of nonprofit corporation laws and then begin the reform of the charitable trust law with reference to the new nonprofit corporation laws.

In 2016, within the Japanese Legislative Council, a section responsible for trust law, was set up and began discussing the reform of charitable trust law. In January 2018, a tentative report was published and the Ministry of Justice started collecting public comment.

Charitable trusts in Japan have not necessarily been used actively as vehicles of charitable activities. In 2017, there were only 472 charitable trusts in Japan.14 The reform responds to certain problems that have been pointed out and is intended to make charitable trusts flexible and easy to use. Some characteristic issues of the reform follow.

First is the matter of a Public Interest Committee-type advisory body15 that will assess whether an intended trust meets the requirements for being a charitable trust and give its recommendation to the relevant authorities. Under current Japanese charitable trust law, one must obtain permission from the appropriate ministry to settle a charitable trust, as was the case with public interest corporations based on the Civil Act before the rule was

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11 See II.1.a) above.
12 Kōeki shintaku ni kansuru hōritsu, Act No. 62/1922.
13 Shintaku-hō, Act No. 108/2006; English translation available at http://www.japanese lawtranslation.go.jp/law/detail/?re=02&ky=%E7%99%BB%E8%AD%98%E7%B0%B4%BF&la=03&page=15&la=01.
15 See II.1.c) above.
reformed in 2008. The members of the trust section of Japanese Legislative Council achieved consensus on this issue. They are of the opinion that the new charitable trust law should introduce a Public Interest Committee-type advisory body and abolish the existing rule which requires permission from the governing ministry.

The second issue is an enlargement of the activities that charitable trusts can engage in. Under current law and related regulations, charitable trusts can give grants but cannot engage in any other activities. Members of the trust section of the Japanese Legislative Council have attained a consensus to broaden the activities that charitable trusts can engage in, for example, managing a museum.

On the other hand, the members have not achieved a consensus whether the new charitable trust law should allow natural persons, in addition to corporations, to be trustees. Under the current tax regulation, to receive a tax benefit as a charitable trust, trustees must be a trust company, such as a trust bank. Under the current Trust Business Act, obtaining a license from the Prime Minister is required to carry out trust business; only a corporation can receive a license, not a natural person. Some members of the trust section of the Japanese Legislative Council hold that the new law should relax the qualifications for trustees and allow natural persons to be the trustee of a charitable trust. Other members oppose this move because, in practice, they feel that having banks serve as trustees will keep the charitable trusts reliable.

2. Act on Utilization of Funds Related to Dormant Deposits to Promote Social Purpose Activities

It is a problem for nonprofit activities of all kinds that it is difficult to obtain financing. The concept of social-impact financing is known in Japan, but it does not seem to provide enough.

A new piece of legislation, the Act on Utilization of Funds Related to Dormant Deposits to Promote Social Purpose Activities, may play an important role here.

16 For criticism of this rule, see II.1.a) above.
18 Articles 3 and 4 of the Trust Business Act.
19 Act on Utilization of Funds Related to Dormant Deposits to Promote Public Interest Activities by the Private Sector (Minkan kōeki katsudō o sokushin suru tame no kyūmin yokintō ni kakaru shikin no katsuyō ni kansuru hōritsu), Act No. 101/2016; English translation available at http://www.japaneselawtranslation.go.jp/law/detail/?id=2992.
The purpose of the act is to allow dormant deposits to be utilized to address social problems. A dormant deposit is one in a bank account that meets two requirements. First, the account has shown no activity for a period of ten years or more, and second, the financial institution is unable to contact the owner. According to the Cabinet Office, the value of dormant deposits reaches up to 70 billion yen every year (average 2013–2015).20

The new act provides a procedure to try to locate the owner of the deposit. After the required steps have been taken, and if the owner is not found, the dormant deposit will be transferred to the Deposit Insurance Corporation of Japan (DICJ) and utilized for purposes of public concern. The owner of the deposit, however, may request the funds even after the money is transferred to the DICJ.

There are other two related entities in this system, the Designated Utilization Organization (DUO, 日治事業団体) and the Fund Distribution Organization (FDO, 事業振替団体) (See Chart 6). The Cabinet Office plans to designate only one organization as a DUO. The DICJ will grant the money to the DUO, and then the DUO will select FDOs to grant or loan money. Finally, FDOs will select organizations that carry out social purpose activities and give them grants or loans or make investments in them.

The new act provides new opportunities for financing organizations engaged in social purpose activities. There is some concern, however, that the criteria for choosing which organizations are to obtain financing are not clear.21 The law was promulgated on 9 December 2016, and distribution of the money will start in autumn 2019.22 Before the distribution begins in 2019, a series of necessary arrangements, such as the designation of the DUO, will be made.

IV. SOCIAL ENTERPRISES IN JAPAN

Thus far this article has covered nonprofit corporations and charitable trusts. Now it will shift gears and briefly cover the legal infrastructure of social businesses or social enterprises in Japan.

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Depositors may request for the withdrawal of funds from dormant deposits (total principal and accrued interest) through the financial institutions even after transferred to the DICJ.

Chart 6 is from http://www5.cao.go.jp/kyumin_yikin/english/201702siryoushu_e.pdf.
1. Definition of Social Enterprise

There appears to be no universal definition of “social enterprise.” The Ministry of Economy, Trade and Industry (METI) published a report in 2008 that defines organizations with three elements as social businesses. In outline form, the three elements are (i) that its work mission is to deal with a social problem that needs to be solved, (ii) that the organization continuously engages in business to pursue its mission, and (iii) that the organization develops or utilizes new social commodities or services or ways to provide them, and that the organization creates new social value.

2. Current Status of Japanese Social Enterprises

According to a 2008 study by METI, social businesses often pursue community activities, accounting for 60.7% of all organizations; followed by those working in health, medicine, and welfare (24.5%); education and the development of human resources (23.0%); the environment (21.4%); the development of industry (19.7%); the support of child care (17.5%); and the support of people with disabilities, elderly people, and the homeless (17.5%).

METI’s 2008 study shows that 46.7% of Japanese social businesses are NPOs and 20.5% are business corporations. It should, however, be recalled that because nonprofit corporation law was reformed in 2008 and it is now quite easy to incorporate general corporations, these figures might well have changed from 2008.

3. Available Options for Japanese Social Enterprises

The remainder of this article analyzes several options for social enterprises to incorporate themselves in Japan. In what follows, by social enterprises I refer to companies whose mission is to deal with social problems and who engage in business activities, rather than earning money from donations or governmental grants.

When one incorporates a social enterprise, one might be concerned by the following three issues. First, (i) is the director permitted to give social
objectives priority over making a profit? Is the director breaching a fiduciary duty if he or she prioritizes social objectives? Second, (ii) is the corporation permitted to engage in business activities that are not related to the social purposes and that aim to earn profits? Third, (iii) is distribution of assets or profits to members prohibited or limited to some extent?

In relation to the third point, reference should be made to Professor Hansmann’s discussion of nonprofit corporations, where he shows that, because it is prohibited for nonprofit corporations to distribute its assets to members, “the advantage of a nonprofit producer is that the discipline of the market is supplemented by the additional protection […] of the organization’s legal commitment to devote its entire earnings to the production of services.” In other words, as a result of the prohibition against distributing money to its members, the customers of nonprofit corporations can expect that the money they pay will be used to produce the intended services without fear that their money will be distributed to shareholders. For this reason, customers are attracted to buy services from nonprofit producers.

Using Hansmann’s theory, we can understand that when social enterprises are prohibited from distributing their money to their members, consumers – especially so-called ethical consumers, who prefer to buy goods or services from corporations that are trying to address social problems – can expect that some of their money or the profit gained by the company is to be utilized to address social problems. For this reason, customers interested in social problems will be more greatly attracted to purchasing goods or services from them.

In what follows, I note the options for social entrepreneurs to incorporate themselves in Japan and analyze the resulting corporation using the three points of view given above. In Japan, there are no entities specially legislated for the purpose of engaging in social enterprise, such as the benefit corporations found in the U.S. or the community interest companies of the U.K. Social entrepreneurs who wish to incorporate use nonprofit corporations or business corporations.

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28 Id.
29 The ensuing paragraphs represent a summary of my former article written in Japanese and published in New Business Law No. 1104, 13 (Shōji Hōmu, Tōkyō 2017). I have revised my earlier discussion and made some additions to it.
a) Social enterprises organized as general corporations

One option for organizing a social enterprise is to incorporate it as a general corporation. After the reform in 2008, it is quite easy to establish a general corporation. As to the three issues stated above, a general corporation’s directors are by their nature permitted to and obliged to pursue the corporation’s social objectives (first issue), and general corporations are permitted to engage in business activities to gain profit (second issue).

There is, however, one concern to be aware of for general corporations: they are prohibited from distributing dividends to their members but can distribute residual assets to the members with the agreement of a member meeting when the corporation is dissolved (third issue). The reason why a general corporation is not prohibited from distributing its residual assets is that many kinds of organizations, including those pursuing the mutual benefit of their members (e.g., a university alumni association), are expected to incorporate as general corporations. As a result, the assets of general corporations are not completely locked, and there is a risk that the assets of the corporation will not be utilized for social purposes but be distributed to its members upon dissolution. This point may not be attractive for ethical customers who care how their money will be used.

b) Social enterprises organized as NPO corporations or public interest corporations

Another option is to use NPO corporations or public interest corporations.

Related to the three points discussed above, directors of NPO corporations and public interest corporations are by nature permitted to and obliged to pursue the organization’s social objectives (first issue), and they are prohibited from distributing dividends and residual assets to its members (third issue).

Regarding profit-making activities (second issue), there is a limitation on a public interest corporation or a NPO corporation engaging in business activities not related to its social purpose. For example, the law requires that for public interest corporations, expenditures for activities related to public interest purposes must equal at least 50% of all money spent. As a result, an entrepreneur who sells goods that do not directly benefit society and who utilizes the whole profit from their sales to solve social problems cannot meet the requirement of being a public interest corporation.

30 See II.1. above.
31 Articles 5(xv), and 15 of Act on Authorization.
c) Social enterprises organized as business corporations

When a social enterprise organizes itself as a business corporation, the issue of concern is whether the director is permitted to give social objectives priority over making a profit (first issue). It is understood that the purpose of business corporations is to maximize the value of the corporation. Therefore, one might be concerned that the director of a business corporation who gives social objectives priority over making a profit is breaching his or her duty as a director. There is another related issue: whether a business corporation can validly provide in its charter that it will utilize most of its profit to solve social problems rather than distribute these profits to shareholders, or whether such a provision is invalid even if it is provided in the charter.

Discussion on these issues has not necessarily converged. In my opinion, however, at least in cases where entrepreneurs incorporate new business corporations and all the future shareholders share its social objectives and agree to put such a provision in its charter, there is no reason to deem the provision invalid. Also, in such a situation, no one will complain if directors give the social objective priority.

As shown in this article, there are multiple types of nonprofit organizations in Japan. Japanese laws governing nonprofit corporations have been improved to make it easier to incorporate social activities. The reform of laws on charitable trusts is now under consideration so as to make charitable trusts flexible and easy to use. These reforms intend to ultimately spur public interest activities conducted in the private sector. I hope this article will help readers generally understand the laws governing nonprofit activities in Japan.

SUMMARY

Various types of nonprofit organizations are active in Japan. A common feature of these is that they can earn profits but cannot distribute them to their members. Two systems of nonprofit corporations are known: general corporations and public interest corporations on the one hand, and NPO corporations and approved NPO corporations on the other. The Article examines the legal structure of these four entities. For this, it summarizes the status quo and discusses the latest trends.

In 2008, the Japanese nonprofit corporation law, that was originally enacted almost 100 years ago, was fundamentally reformed. The main purpose of this change was to make it easier to incorporate nonprofit corporations. In the reform, two new types of nonprofit corporations were introduced, namely, general corporations and public interest corporations. There are two types of these
corporations: association-type corporations and foundation-type corporations. Association-type corporations have members, while foundation-type corporations do not. All that is required today to set up a general corporation is to enter it at a registry. Thus it has become much easier after the reform to incorporate such organizations. To turn a general corporation into a public interest corporation it has to obtain an additional authorization. The principal objective of a public interest corporation must be to operate a business which promotes the public interest.

Another category of Japanese nonprofit corporations is the NPO corporation, including the approved NPO corporation. The latter has an additional approval from the authorities. It is for historical reasons that Japan has these two different systems of nonprofit corporations. NPO corporations are among the most common nonprofit corporate structures in Japan.

The Japanese government is currently at work reforming the law governing charitable trusts, which has not been revised since 1922, when it was enacted. In 2016, within the Japanese Legislative Council, a section responsible of trust law, was set up and began discussing the reform of charitable trust law. In January 2018, a tentative report was published and the Ministry of Justice started collecting public comment. Charitable trusts in Japan have not necessarily been used actively as vehicles of charitable activities due to certain problems that have been experienced in practice in the past. The reform responds to these problems and is intended to make charitable trusts more flexible and easy to use.

(The Editors)

ZUSAMMENFASSUNG


Im Jahr 2008 ist das knapp 100 Jahre alte Recht der nicht gewinnorientierenden Unternehmen umfassend reformiert worden. Das Ziel war, die Gründung solcher Unternehmen zu erleichtern. Dafür sind zwei neue Formen des nicht gewinnorientierenden Unternehmens geschaffen worden, nämlich das allgemeine nicht gewinnorientierte Unternehmen und das gemeinwohlorientierte Un-

Die zweite Art nicht gewinnorientierter Organisationen sind die sogenannten NPO Unternehmen. Es hat historische Gründe, dass in Japan diese zwei unterschiedlichen Gruppen von nicht gewinnorientierter Organisationen entstanden sind. Die dort heute am meisten genutzten nicht gewinnorientierten Organisationsformen sind die NPO Unternehmen.