

## ABHANDLUNGEN / ARTICLES

### **Enabling Civil Society in Japan Reform of the Legal and Regulatory Framework for Public Benefit Organizations**

*Karla W. Simon \**

- I. Introduction.
- II. Context of the “Public Benefit Corporation System” Reforms
- III. Background of the PBC Reforms – The Pre-2008 Legal Environment and its Defects
  - A. The Complexity of the Pre-2008 Legal Regime and the Gaps Therein
  - B. Discretion of the Oversight Authorities
  - C. Failure to Integrate the SNPC Legislation with the PBC System
  - D. Failure to Integrate the SNPC Tax Regime into that for PBCs
  - E. Issues with Regard to Dissolution Under the Old Legal Framework
  - F. The Issue of “Ministry-related” PBCs
- IV. Reform of the PBC System
  - A. Overview
  - B. Process of Achieving the Reforms
  - C. Details of the Reforms
- V. Analysis of Aspects of the PBC Reform Legislation
  - A. Freedoms of Association and Religion
  - B. Overlap and Complexity
  - C. Problems with the Authorization Process
  - D. Addressing Issues of Conflict of Interest/Accountability Within the Organization
  - E. Addressing Issues of Disclosure/Transparency to the General Public
  - F. Ministry-related Subcontractor Type NPOs
  - G. The New Agency for Certifying Qualification and Dealing with Oversight
  - H. Impact of the Transition
- VI. Tax laws Before the Reforms
  - A. Tax Exemption
  - B. Tax Deductions for Contributions to Japanese NPOs by Individuals and Corporations
- VII. Tax Reforms for PBCs and Their Donors
- VIII. Accounting Standards for PBCs and How they Affect the Legal and Fiscal Reforms
  - A. Process of Adopting the New Standards
  - B. Application of the Prior Standards (as of 2004)
- IX. Conclusion

## I. INTRODUCTION

The late 1990's and the first decade of the 21<sup>st</sup> Century have witnessed remarkable changes in the legal and regulatory framework for the not-for-profit (NPO)<sup>1</sup> sector in Japan. These reforms are taking place in the context of pressing social and economic needs to which the Japanese government is responding on several levels – with deregulation, decentralization, and increased privatization leading the way in the government and private business sectors. As with the other two sectors, the not-for-profit sector has experienced its share of government and public notice, which has resulted in the development of more enabling legislation to permit organizations to come into being and obtain tax benefits in the hope that such organizations can assist the long-term goal of creating a more responsive and interactive Japanese society. The movement in this direction is part of an effort to reform the highly bureaucratized and controlling state, and its success will determine how well Japan performs in meeting the needs of its people in the coming decades of the 21<sup>st</sup> Century.

---

\* I am particularly grateful to Morihisa Miyakawa and Tatsuo Ohta of the Japan Association of Charitable Organizations (JACO) for their continuing interaction on the development of this paper. Ohta-san and Miyakawa-san are frequent contributors in international forums where reforms of laws affecting civil society are discussed. Each has made invaluable contributions to the development of the legal framework for civil society organizations in Japan, and some of their important work is described in the articles cited in this paper. Others in Japan who have assisted my research include Prof. Masayuki Deguchi of the University of Ethnology, Prof. Yoshi Nomi of the University of Tokyo, and staff members at the Ministry of Internal Affairs and Communications (MIC) (formerly called the Ministry for Home Affairs and Communications (MHAC) in English).

I am also grateful to Robert Pekkanen, Chair of the Japan Studies Program and Assistant Professor at the Henry M. Jackson School of International Studies at the University of Washington and my co-author for the book chapter cited at note 38, below, whose ongoing research with respect to civil society in Japan informs mine. Any remaining errors in interpretation or substance remain my own.

Financial support for this project was received with appreciation from the Summer Research Grant Program of the Columbus School of Law, Catholic University of America.

1 This term is used as it is most commonly around the world, to apply to all organizations in the not-for-profit sector. In Japan, the use of the term “NPO” briefly had currency at the time the *Tokutei hi-eiri katsudô tsuishin-hô* (Law on the Promotion of Specified Nonprofit Activities, Law Nr.7/1998) was passed in 1998 (*see infra*, text at note 9), but most Japanese now use the term NPO more broadly and refer to those organizations as SNPCs or as SNPOs. (*See, e.g.*, T. SHIGERU, *The Emergence of NPOs and the Implications for Local Governance*, in: Furukawa / Menju (eds.), *Japan's Road to Pluralism: Transforming Local Communities in the Global* (Tokyo 2003), also available at [http://www.jcie.or.jp/thinknet/pdfs/pluralism\\_tamura.pdf](http://www.jcie.or.jp/thinknet/pdfs/pluralism_tamura.pdf)). Indeed, it will become necessary to use the term NPO more broadly as the legislation passed in 2006 becomes effective, for it refers to *hi-eiri hôjin*, or “not-for-profit corporation” as a generic term to cover both public benefit and mutual benefit foundations and associations. This paper focuses most specifically on a segment of the NPO sector, public benefit corporations or those referred to as PBCs. *See infra*, text at note 2. Despite that specific focus, there will be discussion of SNPCs and reform of their legal framework, as it relates to the PBC reforms.

Although the final chapter in the NPO legal reform process has yet to be written because the reforms are only now in the process of being fully implemented, it is useful at this stage to look at the rather considerable changes already underway. In addition it is useful to place these developments in the larger context of Japan's current modernization efforts in the areas of administrative reform and corporate law reform. It is impossible to overemphasize the importance of the developments discussed in this paper. They are transformative – they portend the creation of a more open society in Japan, with citizens being empowered to establish private, not-for-profit organizations more easily and enabling those organizations to attract contributions more effectively. There is little doubt that such organizations can continue to create important partnerships with government (especially local governments) and business to help solve some of the real world problems facing Japanese society today.

## II. CONTEXT OF THE “PUBLIC BENEFIT CORPORATION SYSTEM” REFORMS

The legal framework for the NPO sector in Japan, as will be described in more detail in Section III, below, involved several subsets of organizational forms at the time of the adoption of the public benefit corporation (PBC) system reforms in 2006. These included mutual benefit corporations, such as alumni/ae associations (*chûkan hôjin*); PBCs formed under Article 34 of the *Minpô* (Civil Code) of 1896/1898<sup>2</sup> (*kôeki hôjin*);<sup>3</sup> special public benefit corporations (private schools, social welfare corporations, medical corporations, and religious corporations) formed under legislation adopted in the early 1950s as adjunct to the Civil Code;<sup>4</sup> and specified nonprofit activities corporations (*tokutei NPO hôjin* or *tokutei hi-eiri katsudô hôjin*),<sup>5</sup> which have existed since 1998. This paper looks most closely at the PBCs as they have been the focus of the most recent reforms, but it places the 2006 reforms of their legal framework and the 2008 tax reforms in the context of other aspects of legal developments surrounding the NPO sector and its various sub-sectors since the mid-1990's.

---

2 Law No. 89/1896 and No. 9/1898, jointly implemented in 1898.

3 PBCs are also variously referred to in English as Public Interest Legal Persons or PILPs, Public Interest Corporations or PICs or *kôeki hôjin*, the Japanese term. *Kôeki* is translated variously as public benefit or public interest. This paper will use the terms “public benefit,” “PBC” and “*kôeki hôjin*” instead of “public interest” or one of its related acronyms, as the latter term conveys a smaller universe of purposes and activities than the former. There is an implied majoritarian theme in “public interest,” which does not exist when the term “public benefit” is used.

4 See explanation of these organizations, *infra*. Public benefit organizations recognized in Japan also include “charitable trusts.”

5 See *supra* note 1.

Although there had been some activity in the direction of possible legal reforms<sup>6</sup> for the NPO sector prior to “Great Awaji-Hanshin Earthquake” of 1995,<sup>7</sup> that event focused the attention of the public, the media, and sector representatives on the importance of creating more flexibility in the structural framework surrounding NPO activities. For example, groups that wished to volunteer to assist in providing relief to the earthquake victims reported that they were unable to do so because they could not obtain legal status. According to Tatsuo Ohta, President of the Japan Association of Charitable Organizations (JACO, the leading umbrella group for the PBC sector) the “inconveniences [they faced] included their inability to become contracting parties due to the lack of corporate status and to own assets in their names (as a result, for example, they were unable to install telephone lines and obtain real estate under their names).”<sup>8</sup> The media and other attention to these issues led to the Government’s recognizing the need for legal reforms to facilitate volunteer activity and the not-for-profit sector. All political parties agreed that such changes were merited, and the political agreement on this point led to the enactment of legislation for a new legal form called the *tokutei hi-eiri katsudô hôjin* (Specified Nonprofit Activities Corporation, or SNPC) in 1998.<sup>9</sup> This new focus

---

6 See T. OHTA, Public Benefit Organizations in Japan: Present Situations and Remaining Challenges, 4 INT’L J CIVIL SOC. L. 4, 72 ff. (recounting the attempts by the Japan Association of Charitable Organizations (JACO) in the early to mid-1980’s to develop a reform effort, which ended in no legislation, due to lack of interest by the political groups at the time). See also Y. YAMAOKA, Japan, in: Th. Silk (ed.), *Philanthropy and Law in Asia. A Comparative Study of the Nonprofit Sector in Ten Asia-Pacific Societies* (San Francisco 1999) 173. (reference to the formation of the Coalition for Legislation to Support Citizen’s Organizations (C’s) in November 1994), available at <http://www.ngo-jica.org.ar/PDFs/YAMAOKA.pdf>. The C’s organization played an important role in lobbying by the sector for a better legal framework, which led to the 1998 SNPC legislation. See also T. YAMAMOTO, The Recent Debate on the Role of NPOs in Japan and Private-Sector Responses, *Civil Society Monitor*, No. 2 (Spring 1997), available at <http://www.jcie.or.jp/civilnet/monitor/1.html#3> (crediting Akira Matsubara of the C’s with his work in the development of the SNPC legislation).

7 Widely recognized as the event that precipitated the entire reform process, the earthquake aroused Japanese public opinion about the role of civil society initiatives to respond to needs that the government was not adequately addressing. See, for example, the view articulated by T. YAMAMOTO, *supra* note 6 See also OHTA, *supra* note 6 at 75.

8 *Id.*

9 These are called *tokutei NPO hôjin* or *tokutei hi-eiri katsudô hôjin* in Japanese. T. OHTA makes it clear that the contributions of volunteers and unregistered volunteer organizations to the relief efforts after the earthquake “were the direct driving force that led to the SNPC legislation.” *Id.* As this paper focuses on the more recent reforms, it is not the place to go over the very interesting history of the development of the SNPC legislation. A good source for such a discussion is R. PEKKANEN, Japan’s New Politics: The Case of the NPO Law, in: *Journal of Japanese Studies* No. 26, 1 (2000). See also YAMAOKA, *supra* note 6.

In addition to the Government’s focus on SNPCs and creating a more enabling environment for civil society, the debate surrounding that issue was also informed by problems in the PBC sector. One of the issues addressed in the Cabinet in 1996 was the cozy relationships between some ministry-created PBCs and the ministries themselves. See, *infra*, discussion in text.

on civil society also led the Diet (Parliament) to create a new “committee on third sector organizations.”<sup>10</sup>

In spring 2002, however, the Cabinet of the Japanese Government indicated publicly that it had become aware that the initial approach – the original SNPC legislation – was insufficient to address the needs of the sector as a whole, and it returned to the subject of legal reform for the broader NPO sector. At that time it began to consider possible far-reaching reforms of the fundamentals of the legal and fiscal framework not only for PBCs (*kôeki hôjin*)<sup>11</sup> organized under Article 34 of the Civil Code (the PBC System), but also for other legal forms of public benefit bodies. To assist the Cabinet in its deliberations, three special commissions were appointed by Prime Minister Junichiro Koizumi. The first of these terminated without issuing a report.<sup>12</sup> The second was chaired by Shiseido Co.’s honorary chairman Yoshiharu Fukuhara and was known as the Fukuhara Commission.<sup>13</sup> The third was the Tax Commission, which published only one preliminary report. That was, however, quite influential in convincing the Ministry of Finance to agree to reforms of the tax structure in the context of the general tax reform package passed by the Diet in 2008.<sup>14</sup>

The process initiated in 2002 to reform the framework for the PBC System came on the heels of

- the reforms carried out in 1998,<sup>15</sup> which created the SNPC as a new legal form, and
- tax legislation affecting a subset of SNPCs passed by the Diet in 2001.<sup>16</sup>

As the Government and the Diet began the discussion of the PBC System reforms in 2002, they were also considering additional changes in the SNPC legislation and the related tax law, which aimed to broaden the application of the SNPC legislation and to permit tax deductible contributions to be made to a larger subset of such organizations. The amendments to the original SNPC legislation and to the tax rules affecting SNPCs were passed in 2002, as discussed below. The approach to the broader issues – those

---

10 Committees now exist in both houses of the Diet. See PEKKANEN, *supra* note 9.

11 See *supra*, note 11.

12 See *infra*, discussion in text.

13 It held 26 meetings and published its final report on 19 November 2004. According to Ohta, “the government and ruling coalition parties scrutinized and accepted almost all contents of the report.” See *infra* for a discussion of the process leading to the 2006 reforms.

14 See *infra* Section VII.

15 The author has discussed the process of these reforms elsewhere. See remarks at RIETI, available at <http://www.rieti.go.jp/en/events/bbl/04051801.html>. She was privileged to have been invited by Japanese civil society activists to participate in the reform process during the time leading up to the enactment of the 1998 legislation. See also T. YAMAMOTO, *supra* note 6.

16 The Japan Center for International Exchange (JCIE) discusses in some detail the contentious nature of the debate around the types of tax benefits to be accorded to the then-new SNPCs. See JCIE, New Tax Bill Gives Partial Victory to NPOs, in *Civil Society Monitor* 6 (2001). available at <http://www.jcie.or.jp/civilnet/monitor/6.html>.

bringing into effect reforms of the PBC System<sup>17</sup> – is now taking shape, with the first set of laws implementing those reforms having been adopted in late May 2006, with an effective date of December 2008, and a subsequent transition period for existing organizations.<sup>18</sup> In addition, the tax legislation that will make the current indirect fiscal support mechanisms for the sector more accessible has recently been enacted.<sup>19</sup>

Importantly, all the deliberations about reform of the legal framework for NPOs have occurred within the context of the larger administrative reforms taking place in Japan. These date back to the latter part of 1998 and are now part of substantial structural reforms to Japan's bureaucratic state,<sup>20</sup> which began under Prime Minister Koizumi.<sup>21</sup>

---

17 As discussed in more detail in Section III, the "PBC System" involves in the first instance the organizations allowed to be set up as juridical persons under Article 34 of the Civil Code, which came into effect in Japan in 1898. Added to the more general rules applicable to associations and foundations and contained in the Civil Code were special laws enacted after the Second World War. These allowed the incorporation of special kinds of legal entities which were permitted to engage in public service delivery in certain fields. See Section III, *infra*.

18 The legislation was adopted on May 26, 2006. The three new laws contain a total of 768 individual articles. The General Not-for-Profit Foundation and Association Act (*Ippan shadan hôjin oyobi ippan zaidan hôjin ni kansuru hôritsu*, Law No. 48/2006, 344 articles), the Charitable Status Recognition Act (*Kôeki shadan hôjin oyobi kôeki zaidan hôjin no nintei tô ni kansuru hôritsu*, Law No. 9/2006, 66 articles), and the Transition, Modification, and Repeal Act (*Ippan shadan hôjin oyobi ippan zaidan hôjin ni kansuru hôritsu oyobi kôeki shadan hôjin oyobi kôeki zaidan hôjin no nintei tô ni kansuru hôritsu no shikô ni tomonau kankei hôritsu no seibi tô ni kansuru hôritsu*, Law No. 50/2006, 458 articles), each address different aspects of the new regime, as discussed below. See M. MIYAKAWA, An Outline of the Three PBC Related Reform Laws, *International Journal of Civil Society Law* 4/4 (2006) 64-71.. The reforms have entered into force effective on December 1, 2008. See email from M. MIYAKAWA on July 22, 2008, on file with the author. See also Cabinet Office Description of PBC Reforms, available at <http://www.cao.go.jp/picc/english/english.html>, and JCIE, Japan's Nonprofits Prepare for a New Legal System, *Civil Society Monitor* 12 (2007), available at [http://www.jcie.org/researchpdfs/CSM/CSM\\_No12.pdf](http://www.jcie.org/researchpdfs/CSM/CSM_No12.pdf).

19 See *infra* Section IV.  
A chart showing the relationship between the old system and the new system for PBCs is available at <http://www.cao.go.jp/picc/english/overview.pdf>.

20 Prime Minister Shinzo Abe pledged to carry forward the sorts of reforms initiated by Koizumi. See Statement of Prime Minister Shinzo Abe on the Basic Principles of the FY2007 Budget Formulation (Cabinet Decision), December 1, 2006, available at [http://www.kantei.go.jp/foreign/abespeech/2006/12/01danwa\\_e.html](http://www.kantei.go.jp/foreign/abespeech/2006/12/01danwa_e.html). The governments of Yasuo Fukuda and Taro Aso expressed no changes in the policy. The Minister for Internal Affairs and Communications (MIC) in the new Yukio Hatoyama government is Kazuhiro Haraguchi (formerly called the Ministry for Home Affairs and Communications (MHAC) in English). This Ministry at the present time oversees the PBC System at the national level. There is no "Minister for Decentralization Reform" within the Cabinet Office, but Mr. Haraguchi is the Minister responsible for "Promotion of Regional Sovereignty," which probably amounts to the same thing from a policy standpoint.

Koizumi's interest in these issues has a forerunner in his predecessor as Prime Minister Ryûtarô Hashimoto's reform package. Hashimoto's term of office ended in 1998, and what he accomplished was quite significant. See Basic Law for Central Government Reform

The thematic back-drop of administrative reform is crucial to understanding aspects of the debate about PBCs and the tax regime that applies to them. Contextualizing the reforms as a means of creating more flexibility for Japan's citizens to engage in social and economic development processes on their own, without the need to be led by government policy-makers, can be seen as part of the process of making Japan a more modern and efficient society and economy.<sup>22</sup> In addition, the reforms will make it easier for Japanese citizens to set up organizations that will permit Japanese society as a whole more easily to face the problems of the 21<sup>st</sup> Century, such as an aging population, environmental degradation, etc.<sup>23</sup> Finally, the tax reforms will make it easier for Japa-

---

(*Chûô shôchô tô kaikaku kihon-hô*, Law No. 103/1998), which was enacted in June 1998, and which provides for not only the reform philosophy but also the details of the overall administrative reform, discussed in *Central Government Reform in Japan*, January 2001, available at [http://www.kantei.go.jp/foreign/central\\_government/frame.html](http://www.kantei.go.jp/foreign/central_government/frame.html). More specifically, the Law includes the enhancement of the functions of the Cabinet, the sweeping reorganization of national administrative organs (into one Cabinet Office and 12 Ministries), the streamlining and efficiency improvement of the administration, and the establishment of the Incorporated Administrative Agency system. See T. SHINODA, Hashimoto's Leadership in Administrative Reform, IUJ Research Institute Working Paper Asia Pacific Series 8 (1999), available at <http://www.iuj.ac.jp/research/wpap013.cfm>.

Koizumi also created the position of Minister of Deregulation and Administration Reform, which has special authority to make recommendations to each minister. See O. WATANABE, *Structural Reform and Deregulation in the Japanese Economy* (2002), available at <http://www.jetro.go.jp/en/jetro/profile/speeches/2002/sep12.html#05>.

For more recent developments, see also editorial, "Another step in bureaucratic reform", *Japan Times*, 28 December 2004, commenting on the Cabinet decision of December 24, 2004, which included the PBC System Refroms, and placing the PBC reforms in the context of the broader administrative reform process.

The Ministry of Economy, Trade, and Industry also called for deregulation and a more favorable tax environment for civil society in 2002. See "Panel calls for deregulation to expand NPO activity", *Japan Policy & Politics*, 20 May 2002, available at [http://findarticles.com/p/articles/mi\\_m0XPQ/is\\_2002\\_May\\_20/ai\\_86028289](http://findarticles.com/p/articles/mi_m0XPQ/is_2002_May_20/ai_86028289).

21 In the December 2000 Cabinet Office "Outline of Administrative Reform," the issue of studying PBCs was raised, in particular the way in which the "administration" interacted with PBCs through "support or entrustment" from government. See FY 2004 Annual Report on Public Interest Corporations, available at [http://www.soumu.go.jp/daijinkanbou/kanri/pdf/040730\\_1\\_g1\\_e1.pdf](http://www.soumu.go.jp/daijinkanbou/kanri/pdf/040730_1_g1_e1.pdf).

22 The package of administrative reform bills that passed the Diet on May 26, 2006, included the PBC reform bills along with four others that the government and ruling coalition called "the most important piece of legislation in the Diet session." A report originating from KYODO NEWS says that the new legislation proposes that the government will streamline the bureaucratic system by reducing the number of government employees by more than 16,600 from the current 332,000, and calls for realignment of the four state-run financial institutions into a single body in fiscal 2008. According to the legislation, Shoko Chukin Bank and the Development Bank of Japan were to be fully privatized, while the Japan Finance Corp. for Municipal Enterprises was to be abolished. See report in *China Economic Net*, available at [http://en.ce.cn/World/Asia-Pacific/200605/26/t20060526\\_7109941.shtml](http://en.ce.cn/World/Asia-Pacific/200605/26/t20060526_7109941.shtml).

23 This theme is consistently referenced in the documents that deal with the content of the reforms. For example, the December 24, 2004 Cabinet Decision speaks of allowing "non-

nese citizens to provide support to civil society organizations, thus “privatizing” their operations in a significant way.

It is also relevant to note that reforms to the PBC System have occurred during a time when the Government and Diet have considered and passed legislation that is designed to make the legal framework for business corporations more consistent with contemporary views of the corporate world and more coherent. In May 2006 a new Company Law<sup>24</sup> went into effect, under wide-ranging amendments to the Commercial Code. It introduces greater flexibility with regard to establishment of companies while at the same time tightening corporate governance standards.<sup>25</sup> It also restates provisions of the Commercial Code enacted in 1899 in modern Japanese.<sup>26</sup> The PBC System reform can thus also be seen as part of a larger restructuring and updating of the legal system regarding all corporations, whether they operate for public benefit or private benefit.

The developments in PBC reform are significant, and they have many positive aspects. Most importantly they create a new legal framework for a large class of public benefit NPOs in a country that had somewhat rigidly adhered to 19<sup>th</sup> Century thinking at least with respect to the traditional Civil Code entities – associations and foundations.<sup>27</sup>

profit entities in the private sector, which are capable of providing a variety of services in response to social needs that cannot be satisfied by the administrative sector or private profit making sector, to play an active role in the social and economic system.” See Document F in the online Documentary Supplement.

This aspect of the reform process is also noted in a report submitted by the Industry Minister, as suggested by a story entitled “Panel calls for deregulation to expand NPO activity,” Japan Policy & Politics, 20 May 2002, available at [http://findarticles.com/p/articles/mi\\_m0XPQ/is\\_2002\\_May\\_20/ai\\_86028289](http://findarticles.com/p/articles/mi_m0XPQ/is_2002_May_20/ai_86028289).

24 (Kaisha-hô, Law No. 86/2005) For the unofficial English translation, see [http://www.cas.go.jp/jp/seisaku/hourei/data/CA1\\_4.pdf](http://www.cas.go.jp/jp/seisaku/hourei/data/CA1_4.pdf).

25 See Reforms under the New Company Law, in: JETRO Japan Economic Monthly August (2005), available at <http://www.jetro.go.jp/en/market/trend/topic/pdf/jem0508-topic1.pdf>. This aspect of the reforms has been objected to by many in civil society. See MIYAKAWA, *supra* note 18, at 69 for a discussion of the relevance of the Company Law reforms to the NPO reforms.

26 *Id.*

27 The same cannot be said, for example, of Germany, from which the 1896/97 Civil Code of Japan was principally adapted, and which moved rather quickly in the 20<sup>th</sup> century to make it easily possible to incorporate an association. See *Vereinsrecht* (the German Association Law), which allows for both registered and unregistered associations and does not require the former to have permission to register. See *Bürgerliches Gesetzbuch* (BGB) (Civil Code), § 21 through § 79. Modern foundation laws in Germany also do not require *a priori* permission, speaking only of “recognition” of foundations. See, eg, the 2004 Law on Foundations from Brandenburg State, available at [http://www.stiftungen.org/files/original/galerie\\_vom\\_05.12.2005\\_16.19.53/brandenburg.pdf](http://www.stiftungen.org/files/original/galerie_vom_05.12.2005_16.19.53/brandenburg.pdf). In Germany the foundation legal form is provided for in the Civil Code § 80 through § 88, with greater details as to their establishment and supervision found in the laws of the German *Länder* (states).

Research conducted in Japan by Professor Robert Pekkanen suggests that the Meiji Civil Code drafters deliberately made it more difficult to form associations and foundations under the Japanese Civil Code in order to keep citizens more involved in work than in associa-



As described below, the reforms, when they are fully implemented, will make it easier to set up associations and foundations without an *a priori* permitting or approval process, they will create a new public benefit commission to grant PBC status and to oversee (parts of) the sector, and they will clarify and amplify the existing cumbersome regime for tax exemption and tax deductibility of contributions.

On the other hand, the PBC reforms will not entirely rationalize the current highly complex legal framework; they do not do away with all possibly redundant legal forms;<sup>28</sup> they do not create opportunities for access to government funds under mechanisms such as those used in the Republic of Korea,<sup>29</sup> they will continue to make the administration of the law somewhat cumbersome by setting up commissions at the prefectural level;<sup>30</sup> and they will take some years to be fully implemented, as indicated above.<sup>31</sup>

---

tional life. See R. PEKKANEN, Japan: Social Capital Without Advocacy, in: Alagappa (ed.), *Civil Society and Political Change in Asia: Expanding and Contracting Democratic Space* (Stanford 2004) 223-258. See also Y. YAMAOKA, *supra* note 6 at 164; Yamaoka-san thinks that in this respect the Japanese Civil Code shows the effect of influence by the French and Italian Civil Codes of the time, which were not particularly friendly toward the corporate form. On the other hand, France moved away from hostility toward associations in 1901, when on the first of July Parliament enacted the famous Loi d'Association, available at <http://mjp.univperp.fr/france/1901association.htm>, which guaranteed freedom of association to all French citizens.

28 These might include, for example, Social Welfare and Private School corporations and the SNPCs. See chart in text *infra* at 11. The new legislation will not, however, make charitable trusts subject to the new regime of qualification for public benefit status.

29 In 2001 the Korean Parliament enacted the Nonprofit Private Organization Support Act, which establishes a funding mechanism whereby the government makes annual grants available to organizations that apply for them in a competitive process. See, P.S. KIM / M.J. MOON, NGOs as Incubators of Participative Democracy in South Korea: Political, Voluntary, and Policy Participation, in: *International Journal of Public Administration* 26/549 (2003) 561-563. See also, Ministry of Home Affairs and Government Administration (MOGAHA) presentation to a Study Tour of Vietnamese government officials, organized by the International Center for Civil Society Law, available at [http://www.iccs.org/pubs/05-04\\_IJCSL.pdf](http://www.iccs.org/pubs/05-04_IJCSL.pdf). One of the issues raised in the FY 2004 Annual Report on Public Interest Corporations (the latest available) is the need to distinguish para-statal or GONGOs from real NPOs, an issue that may only partially be addressed in the reform legislation. See FY 2004 Annual Report on Public Interest Corporations, *supra* note 21.

30 This aspect of the law is consistent with Japan's Local Autonomy Law (*Chihô jichi-hô*, Law No.67/1947), adopted in 1947, which established the prefectural system (see K. STEINER, *Local Government in Japan* (Stanford 1965) for discussion of Local Autonomy Law). Japanese experts suggest that this devolution of authority to the prefectural governates should not be a problem in large part because they exercise this authority currently under the old PBC System. Notes of conversations in Tokyo with Ministry of Home Affairs and Communications (MHAC) staff are on file with the author. As indicated, MHAC (now MIC) is the principal agency of government involved with oversight of the old PBC system at the national level, with general reporting responsibilities for the entire sector, and with 324 PBCs subject to its specific oversight and control as of the end of 2003. See FY 2004 Annual Report on Public Interest Corporations, *supra* note 21. The question of how the new

Given the importance of the developments in Japan, not only for Japan but also as a model for other countries in East Asia,<sup>32</sup> this paper describes the legal and tax situation for NPOs/PBCs as it existed in Japan prior to the adoption of the reforms, the origins of the PBC System reforms, the process of the reforms, and their substance. It also discusses future reform prospects, as the application of all the rules will depend on their implementation by the Public Benefit Commission.<sup>33</sup> The paper refers to an online document-

---

Commission will set national standards is discussed *infra*.

One can also defend this structure by noting that it is consistent with the principle of “subsidiarity,” placing the legal oversight in bodies most closely connected with the place in which the organizations operate.

At present the prefectures certify or register SNPCs as well as a majority of PBCs (as of the end of 2003, the central government was exercising jurisdiction over 7,009 PBCs, as opposed to 18,987, under the jurisdiction of the prefectures), and they are thus experienced in dealing with NPOs. The American experience with use of Delaware as a place of incorporation for both for-profit and not-for-profit organizations illustrates the forum-shopping problem in the context of the United States, but it is unlikely to be relevant in the more vertically integrated context of Japan.

- 31 This may not be altogether such a bad thing. New Zealand, which adopted a new system of charities registration, with a Charities Commission, in summer 2005, had to delay the effective date of the opening of the Register. The reasons given in the May 2006 Update (on the new legislation) include the following: “The development of the Charities Register is a major project, which we want to ensure is done as well as possible. Establishing, testing and implementing the Register in the most effective way needs more time than originally anticipated.” See Charities Commission May Update, available at <http://www.charities.govt.nz/news/updates/may-2006.htm>. Registrations actually began in February 2007, which means that the delay in actual implementation in New Zealand is similar to that expected for the Japanese reforms.

The five year transition period is discussed in MIYAKAWA, *supra* note 18, 70-71.

- 32 The Ministry of Civil Affairs (MoCA) in China, which has been considering the development of a “charity law,” has looked to the Japanese reform legislation with interest. For information on a recent draft of the charity law, see International Center of Civil Society Law, Comments on the Draft Charity Law for the Peoples’ Republic of China, in: International Journal of Civil Society Law 5/1 (2007) 12-27. The legal personnel charged with drafting the legislation indicated to the author that they have had the PBO Reform legislation translated into Chinese. Currently the General Principles of Civil Law (GPCL), as well as the anticipated provisions on juridical persons of the new Civil Code, both provide that there must be permission from oversight ministries in order for citizens or entities to establish all not-for-profit legal entities. Notes of conversation on file with the author. For a detailed analysis of the legal framework for NPOs in China and its recent development with a comparison to the Japanese reforms, see K.W. SIMON, *Regulation of Civil Society in China: Necessary Changes after the Sichuan Earthquake and the Olympic Games*, 32 FORDHAM, INT’L L. J. 943 (2009).

In the Republic of China (Taiwan), the Civil Code (which is the old Republican era Chinese Civil Code), requires permission for the establishment of NPOs. See, e.g., ROC Civil Code, Art. 46, available at [http://en.wikisource.org/wiki/Civil\\_Code/Part\\_I#Section\\_II\\_Juridical\\_Persons](http://en.wikisource.org/wiki/Civil_Code/Part_I#Section_II_Juridical_Persons); and the 2002 Civil Associations Act of the ROC, available at <http://law.moj.gov.tw/Eng/Fnews/FnewsContent.asp?msgid=1261&msgType=en>.

- 33 See discussion *infra*.

ary supplement for purposes of easy reference. Only one piece of the legislation that will implement the framework for the reforms has been translated into English – the Act on Authorization of Public Interest Incorporated Associations and Public Interest Incorporated Foundations.<sup>34</sup> For the remainder of the legislation, the analysis in this paper is much aided by Morihisa Miyakawa’s article, *An Outline of the Three PBC Reform Related Laws*, published in fall 2006.<sup>35</sup> The author is well-acquainted with the issues raised by the new legislation, as she has frequently visited Japan and participated in the reform processes during the time period leading up to the current reforms.<sup>36</sup>

### III. BACKGROUND OF THE PBC REFORMS – THE PRE-2008 LEGAL ENVIRONMENT AND ITS DEFECTS <sup>37</sup>

#### A. *The Complexity of the Pre-2008 Legal Regime and the Gaps Therein*

According to a co-authored chapter in a book published in 2002 on civil society in Japan (in other words, published just as the Government began seriously to consider “drastic” reforms of the PBC System and a more thorough-going look at the legal situation of civil society), the legal framework was exceptionally complex.<sup>38</sup> As the book chapter and subsequent developments make clear, with the addition of the SNPC form in 1998, there were ten forms of legal entity that could be called public benefit organizations (PBOs) in Japan. Except for SNPCs and small community groups (neighborhood associations), these all required a high level of government involvement and discretion in the process of establishment and oversight of a legally registered entity.

In addition, it should be noted that until 2001 no not-for-profit legal entity in Japan was permitted to be established as a mutual benefit organization (MBO). This was a glaring oversight in the Japanese approach to civil society – the failure to recognize such organizations as legally registered civil society organizations under the Civil Code or related legislation simply failed properly to implement the freedom of association guaranteed by Article 21 of the Japanese Constitution. Passage of the *chûkan hôjin*

---

34 This law has been unofficially translated by the Cabinet Secretariat. See Law No. 49 of 2006, available at <http://www.cas.go.jp/jp/seisaku/hourei/data/AAP11.pdf>.

35 See MIYAKAWA, *supra* note 18.

36 I was privileged to participate not only in the reform process for PBCs, but also in the earlier process that led to the enactment of the SNPC legislation. I was on several occasions an invited guest of the sector and also have had the opportunity to frequently interact with government officials involved with NPO oversight.

37 I am indebted for much of this section of the article to personal discussions about the history of the PBCs in Japan with Tatsuo Ohta, who also summarizes the history and JACO’s views of how the reform process should proceed in OHTA, *supra* note 6.

38 See, R. PEKKANEN / K. SIMON, *The Legal Framework for Voluntary and Not-for-Profit Activity in Japan*, in: S.P. Osborne (ed.), *The Voluntary and Nonprofit Sector in Japan* (Routledge et al. 2001).

(intermediate or in-between organizations) legislation in 2001 temporarily remedied this defect (and it has been permanently remedied with the legislation adopted in 2006).<sup>39</sup>

As a result of the elaborate structure of organization forms present in 2002, when one discusses the PBC System reforms from a theoretical standpoint, a variety of types of public benefit legal entities might have been involved in the process. These types can be categorized as including

- general PBCs (those organized and registered pursuant to Civil Code Article 34);
- special PBCs (those organized and registered pursuant to special laws developed in connection with Article 34, such as private schools, etc.); and
- other organizations that are PBOs (such as charitable trusts<sup>40</sup> and SNPCs).

In addition, as discussed below, the government began to see the rationale, in the context of PBC reform, for providing a more modern system in which both *chûkan hôjin* or MBOs and all types of PBOs except for charitable trusts could easily obtain legal existence, thus separating the issue of legal existence from the question of whether an organization is given public benefit status. The latter could be separately obtained – if desired by the organization in question – by applying a strict set of principles to ensure that the organization provides public benefit.<sup>41</sup>

A chart derived from the 2002 book chapter can be found below. It shows, for example, that both public benefit associations and public benefit foundations (collectively *kôeki hôjin*)<sup>42</sup> were required under Civil Code Article 34 to have permission (*kyoka*) to be established, while social welfare corporations, educational corporations, and medical corporations were also required to have approval from the relevant ministry in order to register.<sup>43</sup> These requirements, coupled with additional regulatory complexity as discussed in the book chapter, made it difficult to set up a public benefit NPO in Japan unless one was content to use the SNPC form also described below.

---

39 See discussion *infra*.

40 *Kôeki shintaku* in Japanese, formed under the Trust Act 1923, Art. 66. There are not many charitable trusts in Japan. For example, statistics from 2002 indicate that only 571 charitable trusts were under management by Japanese trust banks. See Trust Banks in Japan, available at <http://www.shintaku-kyokai.or.jp/html/trustbanks/e-1-2.html>.

41 See Appendix, *infra*, for a listing of the public benefit purposes permitted by the law. See also discussion and criticism of the process of obtaining the status, *infra*.

42 The *kôeki hôjin* forms were permitted by the Civil Code of 1896/98, and they reflect the fact that the Civil Code is based to a great extent on the German Civil Code of the same era. That Code, in turn, emulates the Code of Justinian, which laid down centuries of Roman Law and referred to both associations (*universitas personarum*) and foundations (*universitas rerum* or *bonarum*). Thus the Japanese Civil Code, while reflecting the Civil Code tradition in principal part, deviated from it by not permitting the establishment of ordinary associations as legal persons.

43 These types of organizations were created by legislation during the Occupation, with the thought that they would make it easier to establish an NPO in Japan, at least one designed to carry out necessary social activities to aid in the country's recovery. The similarity in numbers of social welfare organizations and foundations and associations suggest that the theory has not been proven to be correct.

*Categories of Not-for-Profit Public Benefit Legal Entities in Japan*<sup>44</sup>

| <i>Entity</i>   | <i>Governing Law (Date)</i>                             | <i>Purpose of the entity</i>  | <i>Central Permitting Body</i>      | <i>Permitting Standard</i>      | <i>Number of existing entities</i> |
|---|---|---|-------------------------------------|---------------------------------|------------------------------------|
| Association<br><i>shadan hōjin</i>  | Civil Code, Article 34 (1898)                           | Associations with the objective of worship, religion, charity, education, arts and crafts, and other activities for public interest, and not for profit   | Competent Governm't Agency          | Permission<br><i>kyoka</i>      | 11,867                             |
| Foundation<br><i>zaidan hōjin</i>   | Civil Code, Article 34 (1898)                           | Foundations with the objective of worship, religion, charity, education, arts and crafts, and other activities for public interest, and not for profit  | Competent Governm't Agency          | Permission<br><i>kyoka</i>      | 12, 814                            |
| Social Welfare Corporation<br><i>shakai fukushi hōjin</i>                                   | Social Welfare Business Law, Article 22 (1951)          | Corporations established under the law with the objective of social welfare businesses  | Ministry of Health and Welfare      | Approval<br><i>ninka</i>        | 13,307                             |
| Educational Corporation<br><i>gakkō hōjin</i>   | Private School Law, Article 3 (1949)                    | Corporations established under the law for the purpose of establishing a private school   | Minister of Education               | Approval<br><i>ninka</i>        | 11,765                             |
| Religious Corporation<br><i>shūkyō hōjin</i>  | Religious Corporation Law, Article 4 (1951)             | Corporations having the purpose of evangelizing, conducting religious rites, and educating and nurturing believers  | Minister of Education               | Certification<br><i>ninshō</i>  | 183,894                            |
| Medical Corporation<br><i>iryō hōjin</i>  | Medical Law, Article 39 (1950)                          | Associations or foundations whose objectives are to establish a hospital or clinic where doctors and dentists are regularly in attendance, or a facility for the health and welfare for the elderly   | Ministry of Health and Welfare      | Approval<br><i>ninka</i>        | 14,048                             |
| Public Charitable Trust <sup>45</sup>   | Trust Law, Article 66 (1923 – applied 1977)             | Trusts with the objectives of worship, religion, charity, education, arts and crafts, and other purposes in the public interest   | Minister of competent gov't agency  | Permission<br><i>kyoka</i>      | 433 <sup>46</sup>                  |
| Approved Community-Based Organization   | Local Autonomy Law 260 (2) (1991 amendm't)              | Organizations formed by residents of a community  | Mayor or town or village headperson | Notification<br><i>todokede</i> | 841                                |
| Special Nonprofit Activities Legal Person<br>“SNPC”<br><i>tokutei hi-eiri katsudō hōjin</i> | Special Nonprofit Activities Promotion Law (1998, 2003) | Not-for-profit entities whose activities include those in promotion of health, welfare, education, community development, arts, culture, sports, disaster relief, international cooperation, administration of organizations engaging in these activities, etc. (17 examples after the 2002 amendments) | Prefectural Governor                | Certification<br><i>ninshō</i>  | 1012                               |

An additional type of public benefit organization came into existence in 1995. The Relief and Rehabilitation Corporation, which is permitted to be established under the Relief and Rehabilitation Enterprise Law (Law No. 86 of 1995), was added as another kind of PBO. These organizations are designed to address the rehabilitation of imprisoned criminals; they should also be included in the larger group of what constitutes a PBC in Japan – as “Special PBCs.”

As discussed earlier, another type of NPO – the *chûkan hôjin* (“intermediate” *hôjin*) – was added to the legal framework in 2001, and has been used by citizens to establish mutual benefit organizations or MBOs. The process for establishing such organizations is a certification process. This legislation was needed to fill the gap in the legal framework, which did not at the time provide for non-public benefit legal entities to be established.

A more recent chart indicates that the number of PBCs in 2005 was roughly divided in half between associations and foundations as it was in 2000. It also indicates that the major oversight of PBCs is conducted at the prefectural level.<sup>47</sup>

*Number of Public Benefit Corporations (as of Oct. 1, 2005)*

| <i>Regulatory bodies</i> | <i>Incorporated Membership Associations</i> | <i>Incorporated Foundations</i> | <i>Total</i> |
|--------------------------|---|---------------------------------|--------------|
| Central government       | 3,710                                       | 3,131                           | 6,841        |
| Local governments        | 9,052                                       | 9,495                           | 18,577       |
| Total                    | 12,677                                      | 12,586                          | 25,263       |

As shown in [this table], the number of incorporated membership associations is almost equal to that of incorporated foundations. Looking at the number from the standpoint of which regulatory authorities oversee them, associations and foundations governed by local governments account for 73% of the total.

- 44 Original source: PEKKANEN, Japan’s New Politics :The Case of the NPO Law, in: Journal of Japanese Studies 26/1 (2000) 111-148. (numerical data as of 2000), updated and used with permission in the publication cited in note 38 and again here. In its original form the chart omitted two different NPO types, the Relief and Rehabilitation Corporation and the Intermediate Corporation (*chûkan hôjin*), discussed below. It has been updated for this publication to reflect the amendments to the SNPC legislation, which became effective in 2003. The numbers of incorporated associations and foundations have not changed appreciably in the intervening period (there are estimated to be about 13,000 of each), while the number of charitable trusts has increased to over 700. See statistics cited in note 46, *infra*.
- 45 The extent to which a civil law country needs to have “trusts” is questionable, as foundations are essentially trusts. See, e.g., Private Letter Ruling 200302005, September 23, 2002, in which the IRS ruled that a foreign civil law foundation is in the nature of a trust because it lacks associates and will not engage in the conduct of business for profit.
- 46 Ohta notes that some 700 had been set up by fall 2006. OHTA, *supra* note 6, 74.
- 47 This chart is derived from OHTA, *supra* note 6, 77. Although there are slight differences between the 2001 and 2005 numbers, it is interesting to note that they remained about the same. Ohta explains that some additional organizations were registered in the 4 year period while others were de-registered. *Id.*

### B. *Discretion of the Oversight Authorities*

Because of the need for government permission or approval to register most types of public benefit NPOs in Japan under the old system, it had been more difficult for many not-for-profit groups to acquire legal personality (*hōjin-ka*) there than in most other industrialized democracies.<sup>48</sup> Although Article 21 of the Japanese Constitution provides for the freedom of association, this broad guarantee applied clearly only to voluntary and informal groups of citizens<sup>49</sup> and, at least until 1998, when the SNPC law (for the entities called *tokutei hi-eiri katsudō hōjin*) was passed, it did not imply that any group of citizens could easily obtain juridical personality if they wanted to conduct public benefit activities.<sup>50</sup> Small organizations could always operate in Japan informally, without legal status, but they would be at a significant disadvantage; groups that are not legal persons cannot sign contracts or open bank accounts. This means, for example, that as a citizen's group they cannot hire staff, own property, sign lease agreements for office space, undertake joint projects with domestic government bodies, or even, on a mundane level, lease a photocopy machine.<sup>51</sup> Legal status is important not simply because of its operational ramifications, but because it confers legitimacy on the groups themselves and on civil society as a whole.

Furthermore, one of the most important aspects of the PBC System under the Civil Code is that it required strict government supervision of the permitted entities, after they were established. Article 67 of the Civil Code makes that clear, and the various standards promulgated for carrying out this supervision by the implementing Ministry of Home Affairs and Communications (MHAC) and passed down to the prefectural level oversight bodies required rigorous scrutiny.<sup>52</sup>

48 Spain recently passed legislation recognizing that the right to form a foundation is inherent in the freedom of association. According to K.J. HOPT / W.R. WALZ / T.v. HIPPEL / V. THEN (eds.), *The European Foundation* (Gütersloh 2006). The registering authority does not have discretion over registration as long as the legal requirements are satisfied. *See id.*, 111, citing Spanish Act on Foundations, Art. 4.1 (2002).

49 Unincorporated associations, or *jinkaku naki shadan*.

50 *See* OHTA, *supra* note 6, 76, for a discussion of the kinds of programmatic activities that made it difficult to register a PBC under the Civil Code.

Under Japan's Civil Code system, as of 2001 only 26,089 groups had gained legal status as not-for-profit *kōeki hōjin* versus the 1,140,000 American not-for-profit organizations formed as legal entities. This comparison is a little misleading, however, as NPOs in the United States are formed under a variety of state laws, while the figure used for the *kōeki hōjin* in Japan represents only those organizations formed as such; as is made clear in the text, *kōeki hōjin* are only the Article 34 entities and thus one of several types of NPO legal forms. Nonetheless, no one doubts that there are many more NPOs in the United States than in Japan. It is also useful to note that Ohta cites University of Tokyo Professor Emeritus Eiichi Hoshino, "known as the grand master of civil law, describ[ing] the country as [a] 'national monopoly of public benefit.'" *Id.*, 74.

51 *See, e.g., id.*

52 MHAC is now referred to as the Ministry of Internal Affairs and Communications (MIC) (*see* Ministry of Internal Affairs and Communications | Minister, Senior Vice-Minister,

C. *Failure to Integrate the SNPC Legislation with the PBC System*

As discussed, it was in response to citizen and sector pressure after the Great Awaji-Hanshin Earthquake that easier access to legal status for certain not-for-profit public benefit entities was created in 1998<sup>53</sup> under the SNPC law. Certification by the prefectural governor's office is the only requirement for an SNPC to come into existence.<sup>54</sup> In 2002 amendments were made to the SNPC Law and the tax law as it affects SNPCs to address specific issues that had hampered the growth of that part of Japan's not-for-profit sector. A supplementary provision in the original law had stipulated the re-evaluation of the SNPC system within three years, and the effort at review and reform in 2002 was carried out pursuant to that requirement.<sup>55</sup>

The principal amendments that resulted from the process of reform and amendment of the legislation for SNPCs, which were approved in December 2002 and came into effect on May 1, 2003, were as follows:<sup>56</sup>

- The expansion of the authorized fields of not-for-profit activity from 12 to 17 to allow a greater range of not-for-profit organizations to be incorporated under the SNPC Law. The following five fields were added as appropriate SNPC activities: information technology, science and technology, economic revitalization, job training, and consumer protection.<sup>57</sup>

---

Vice-Minister), but the old guidance was issued when it was still called MHAC. These include the "Standards for Establishment and Supervisory Guidance" published by MHAC, pursuant to a Cabinet Decision of September 20, 1996. It is also relevant to consider the standards adopted on February 9, 2001, in the Managerial Board of Meetings of Cabinet Ministers and called "Enhancing the system for supervisory guidance of public interest corporations, etc."

53 The Japan Center for International Exchange has provided a clear analysis of this legislation as well as the extraordinary circumstances of its adoption. JCIE's Civil Society Monitor speaks of it thus: "The bill's passage through the Diet can be regarded as historic both because of the legislative process and because of its having been passed unanimously by all the political parties." See JCIE, Civil Society Monitor 4 (1998), available at <http://www.jcie.or.jp/civilnet/monitor/4.html>.

54 The law also says that if the SNPC operates in more than one prefecture, it must be certified at the national level, by the Cabinet Office. See text of SNPC law as amended, available on the JCIE website at [http://www.jcie.or.jp/civilnet/monitor/npo\\_law.html](http://www.jcie.or.jp/civilnet/monitor/npo_law.html).

55 According to the JCIE, "NPOs played an active part in the amendment process through a liaison council set up in June 1999. The council worked closely with the nonpartisan Parliamentary Caucus on NPOs, which was formed in August 1999. The council submitted an amendment proposal to the Caucus and held public forums throughout Japan to provide the opportunity for legislators to hear local opinions on reforms to the taxation and incorporation systems for NPOs and NGOs." See JCIE, New Legal Reform Efforts Receive Mixed Welcome, in: Civil Society Monitor 8 (2003), available at CivilNet | Civil Society Monitor | Issue 8, available at <http://www.jcie.or.jp/civilnet/monitor/8.html>.

56 See link, *supra* note 54, for the full text of the amended SNPC Law.

57 Ohta notes that there is practically no difference in terms of the types of fields in which SNPCs and PBCs operate. OHTA, *supra* note 6, 75.



- The provision requiring adherence to a pre-set budget (Article 27) was removed in order to allow greater flexibility in operations of SNPCs. According to the Japan Center for International Exchange (JCIE), this reflects the rejection “of the notion that ‘good governance’ implies that organizations must adhere strictly to the budget they establish at the beginning of the fiscal year. [SNPCs] in Japan now have increased flexibility to respond to urgent concerns in their field of activity that may arise after the start of the fiscal year.”<sup>58</sup>
- Measures to prevent criminal organizations from becoming incorporated as SNPCs were strengthened.<sup>59</sup>
- The application process was simplified. The original law had required the submission of 16 types of documents in the application process, but the amendment reduced these categories to 11 and streamlined the process.

While there were no amendments involving PBCs and the Civil Code at this time, the reforms were evidence of the Government’s efforts to liberalize the legal environment for civil society as it began seriously to consider amending the Civil Code to further do so. They also brought the legal regime for SNPCs closer to that for PBCs, by expanding the activities that SNPCs were permitted to undertake.

#### D. Failure to Integrate the SNPC Tax Regime into that for PBCs

Along with these amendments to the SNPC Law itself, the tax law that applied to the approved SNPCs (*nintei NPO hōjin*)<sup>60</sup> also underwent revision during this time period. There had been sharp criticism from the sector, the Cabinet Office, and various ministries because they viewed the tax law as being far too restrictive with regard to giving tax benefits to SNPCs.<sup>61</sup> The Special Diet Committees on Third Sector Organizations recommended prompt attention to the perceived problems.<sup>62</sup> Contrary to the original purpose of the tax reforms in 2001, the provisions that determined eligibility for that

58 JCIE, *supra* note 55, *op.cit.*

59 The well-known *yakuzas* were using the law to incorporate themselves. One of the interesting things about the Great Awaji Hanshin Earthquake is that the *yakuzas* were instrumental in rendering immediate relief services while NPOs had their hands tied. See N.D. KRISTOF, *The Quake that Hurt Kobe Helps Its Criminals*, in: *The New York Times*, 6 June 1995, available at <http://query.nytimes.com/gst/fullpage.html?res=990CEFD7133BF935A35755C0A963958260&sec=&spon=&pagewanted=all>. A similar provision with regard to criminal organizations not being able to avail themselves of the law to become legally registered is contained in the Art 6 (1)(d) of the Law No. 49 of 2006.

60 There are two categories of SNPCs – those that are registered and those that are “approved” to receive tax deductible donations.

61 See Y. ISHIKAWA, *Challenges of NPOs in Japan – focus on Japanese legislation*, in: *Japan-U.S. Community Education and Exchange Newsletter* October (2003). (on file with the author).

62 JCIE, *supra* note 55.

status for “approved” SNPCs were overly restrictive and the application process was cumbersome and confusing. In fact, after more than a year of operations under the legislation, only 10 SNPCs had been authorized to receive the special tax privileges, a figure representing an authorization rate of 0.1 percent.<sup>63</sup>

The major changes in the tax law enacted in 2003 were as follows:

- Various aspects of the “public support test,” which stipulated that more than one-third of an organization’s total revenues must come from donations and grants, were relaxed. For example, the one-third minimum was lowered to one-fifth for a trial period of three years (this became permanent in 2006).
- The condition requiring SNPCs to conduct their activities in more than one municipality in order to become eligible for tax deductibility was removed. This amendment has made it possible for small-scale community-based SNPCs to obtain tax-deductible status.
- The requirement that SNPCs approved for tax deductibility must submit advance notification to the National Tax Administration Agency before making overseas remittances or taking money abroad was amended. Now, notification is only required for amounts exceeding ¥ 2 million. (Amounts equaling ¥ 2 million or less can be reported to the agency at the end of the fiscal year.)<sup>64</sup>
- The unique type of tax-exempt donation (*minashi kifukin*) available for PBCs was also made available for SNPCs. This “internal donation” system permits up to 20 percent of an organization’s taxable income from profit-making activities that is used for not-for-profit activities to be tax exempt.<sup>65</sup>

Despite these changes, PBCs and SNPCs continued to operate under separate tax regimes, a fact that may have consequences for the acceptance of the PBC reforms. In addition, SNPCs, like other PBOs, remained taxable on all their income from listed business activities as described below.<sup>66</sup>

#### *E. Issues with Regard to Dissolution Under the Old Legal Framework*

The non-distribution constraint on any residual assets at winding-up/dissolution was not generally required by law in order for Public Benefit Corporations to be established under Article 34 of the Civil Code of Japan. PBCs were generally subject to the rules contained in Civil Code Part 1, Chapter 2, on Corporations. This meant that the residuary assets were permitted *de jure*, under Article 72 of the Civil Code, to be distributed in the manner in which the governing documents permitted. On the other hand, Japanese observers suggest that general PBCs were prohibited *de facto* from making any distribu-

---

63 *Id.*

64 For a description of the tax situation until the 2008 reforms, see Section VII.

65 See *infra* for a discussion of how this works.

66 *Id.*

tions to insiders or business entities by the competent regulatory authorities through their strong guidance and discretionary powers with respect to approval of the governing documents for registration.<sup>67</sup> Generally these government agencies required that the governing documents contain provisions imposing the non-distribution constraint on any residual assets at the winding-up/dissolution. This was true whether the oversight entity is the Ministry at the national level or the prefectural authorities.

Special PBCs (those established under special laws developed in connection with Article 34 of the Civil Code) were from the outset *de jure* restricted from distributing assets to non-PBCs and individuals under the respective legislation that applies to them:

- a. Private Schools (Independent Schools) are restricted under Article 30.3 of the Private School Law. Although their residual assets are distributable at winding-up/dissolution under Article 30.3 of the Private School Law in any way the governing documents permit, the recipients of the residual assets are restricted under that article from using them for any purposes other than support for private schools.
- b. Social Welfare Corporations are restricted under Article 31.3 of the Social Welfare Service Law. Although their residual assets are distributable at winding-up/dissolution under Article 31.3 of the Social Welfare Corporation Law in any way the governing documents permit, the recipients of the residual assets are restricted under that article from using them for any purposes other than promotion of social welfare.
- c. Relief and Rehabilitation Corporations are restricted under Article 11.3 of the Relief and Rehabilitation Enterprise Law. Although their residual assets are distributable at winding-up/dissolution under Article 32 of the Relief and Rehabilitation Law in any way the governing documents permit, the recipients of the residual assets are restricted under Article 11.3 of the Relief and Rehabilitation Enterprise Law from using them for any purposes other than relief and rehabilitation.

In addition, SNPCs are restricted from distributing assets to any organization other than those described in the SNPC law sections 11(3) and 32. These include the following:

- i. the national government or a local public organization;
- ii. a Public Benefit Corporation established under the provisions of Article 34 of the Civil Code;
- iii. a Private School Corporation as specified in Article 3 of the Private Schools Law (Law No. 270 of 1949);
- iv. a Social Welfare Corporation as specified in Article 22 of the Social Welfare Law (Law No. 45 of 1951);
- v. a Relief and Rehabilitation Corporation as specified in Article 2.6 of the Relief and Rehabilitation Enterprise Law (Law No. 86 of 1995).<sup>68</sup>

---

67 Notes of conversations on file with the author and email from M. MIYAKAWA on 22 July 2008 (on file with the author).

68 See link, *supra* note 54, for the full text of the amended SNPC Law.

F. *The Issue of “Ministry-related” PBCs*

Many of the old PBCs were ones that were not truly independent of the government. They were either staffed by former government officials or even established by the government agencies themselves to carry out agency work. Tsutomu Hotta, President of the Sawayaka Welfare Foundation, has called these organizations “a hotbed for *amakudari* (the practice of securing employment for retiring government officials.)”<sup>69</sup> Ohta devotes an entire section of his 2006 article on PBCs to this issue, referring to the entities he is concerned about as “ministry-related subcontractor-type” corporations.<sup>70</sup> He states that such entities “monopolize business undertakings entrusted by relevant government departments” in addition to creating scandals and creating a bad reputation for the sector generally because of the air of corruption surrounding them.<sup>71</sup> This concern echoes similar views expressed by the Ministry of Home Affairs; as it indicated in its 2004 report, issues related to these PBCs were specifically intended to be addressed by the proposed reforms.<sup>72</sup>

IV. REFORM OF THE PBC SYSTEM

A. *Overview*

The decision by the Cabinet Office to pursue a reform program related to the NPO sector in general, which is outlined below, came in 2002 as the reforms to the legal framework for SNPCs were pending in the Government and the Diet. Apparently these issues were very much on the mind of the public and the NPO sector, which had been lobbying hard for a generally more open approach to civil society. That would, of course, entail looking more closely at the old PBC System, which had come into being at the end of the 19<sup>th</sup> Century.

The documents developed by the Cabinet Office describing the intended reforms suggest that a fairly complete reform of the PBC System and all related NPO systems was contemplated at the outset. The most far-reaching proposal would have involved completely scrapping the current multiplicity of legal forms and moving to a mutual

---

69 See Public interest corporation reforms come into force, in: SPF Voices, 56/4 (2007). (interview with Tatsuo Ohta and Tsutomu Hotta), available at <http://www.kohokyo.or.jp/english/voices.pdf>.

70 See OHTA, *supra* note 6, 81. See also FY 2004 Annual Report on Public Interest Corporations (the latest available) on the need to distinguish para-statal or GONGOs from real NPOs (issues about “parachuting” retired public servants into related PBCs, grants and subsidies to related PBCs, etc.)

71 OHTA, *supra* note 6, 81.

72 See MOHA, FY 2004 Report, *supra* note 21

benefit – public benefit classification system for all incorporated<sup>73</sup> not-for-profit organizations in the country. According to the Cabinet Decision of March 2002, the first government document released in the reform process, it was originally intended that “there will be a radical and systematic review of the system of public benefit juristic persons, including related systems (NPOs,<sup>74</sup> nonprofit mutual benefit corporations, charitable trusts, taxation, etc.).”<sup>75</sup> The actual 2006 reforms, while extensive enough in terms of the number of legislative amendments being made, are much more moderate in their scope and are directed only at *kôeki hôjin* (PBCs) and *chûkan hôjin* (MBOs). Apparently the SNPCs were suspicious of what the government might do and elected to remain outside the proposed new system until they can see how it will work.<sup>76</sup> The new system does not apply either to them or to the Special PBCs.<sup>77</sup>

The new system, when fully implemented, involves the following:<sup>78</sup>

- A new legal framework for “general not-for-profit corporations” in the Civil Code of Japan.<sup>79</sup> The present general PBCs will fall under the new category of not-for-profit corporations as will *chûkan hôjin*, and those two current legal forms will be eliminated.<sup>80</sup> As described in Miyakawa’s paper, the General Not-for-Profit Association and Foundation Act applies to all organizations that seek to become legal entities irrespective of whether they wish to apply for recognition of “charitable status.”<sup>81</sup>

---

73 Charitable trusts are still not intended to be brought under the Commission that will review public benefit status for corporations. They are reviewed under the “Screening Standards for Permission for Acceptance of Public Trusts, etc.” adopted on 13 September 1994. See MOHA, FY 2004 report, *supra* note 21,

74 *I.e.*, SNPCs.

75 See Document A in the Documentary Supplement, available online at (will be posted online) See also S. ITOH, Governance, Organizational Effectiveness and the Nonprofit Sector: Japan Country Report, available at <http://www.asianphilanthropy.org/staging/about/JAPAN1.pdf>.

76 Notes of conversations with Japanese experts and government officials on file with the author.

77 Ohta attributes to the Finance Ministry a desire to not include the Special PBCs in the reform process, even though there are theoretical and practical reasons for doing so. See OHTA, in: SPF Voices, *supra* note 69, 3.

78 See Excerpt from Report of the Expert Meeting on Reform of the Public Interest Corporation System (full report on file with the author) (Document E) and Cabinet Decision of December 24, 2004 (Document F) for more details.

79 It is important to note that the Japan Association of Charitable Organizations had originally objected to this proposal. See OHTA, *supra* note 6, 84.

80 The third piece of legislation passed in May 2006 will require amendments to the Civil Code and 300 other pieces of legislation. See MIYAKAWA, *supra*, note 18, 68. The 2001 legislation on *chûkan hôjin* will be repealed and all associations and foundations, whether for public or mutual benefit, will easily be allowed to register themselves as legal entities without any permission or approval required. This is significant because it will for the first time bring the Japanese Civil Code into line with, *e.g.*, the German Civil Code in regard to associations and foundations.

81 MIYAKAWA, *supra* note 18, 66.

- A simplified legal process for incorporation by making it entirely non-discretionary and applying standards similar to those for for-profit corporations. Thus, the General Act permits NPOs to apply for registration at the Registry Office, after a notary has inspected the corporate documents for conformance with the Act.<sup>82</sup>
- Introduction of a new application system for not-for-profit corporations that seek to be classified as “authorized public benefit corporations” or APBCs.<sup>83</sup> This status is determined by a “Public Benefit Corporation Commission (*kôeki nintei-tô iinkai*) (PBCC).”<sup>84</sup> The Commission has been established in the Cabinet Office,<sup>85</sup> and it includes a mix of academics, scholars, and sector professionals;<sup>86</sup> it is discussed in more detail below.
- Establishment of similar “councils”<sup>87</sup> to carry out the authorization and oversight functions at the prefectural level in addition to the one at the national level.
- Dealing with governance, oversight, and various technical problems inherent in the PBC System prior to the reforms.
- Adding the non-distribution constraint for all entities that are classified as APBCs under the new system.<sup>88</sup>

---

82 *Id.*

83 Although the unofficial translation provided on the web at <http://www.cas.go.jp/jp/seisaku/hourei/data/AAPII.pdf> refers to these organizations as “public interest” corporations, I intend to continue using the term “public benefit,” as it is more consistent with the term used in other countries to designate organizations serving the public. JACO had recommended that all foundations be required to be public benefit foundations under the new system, but that view did not prevail. *See* OHTA, *supra* note 6, 85-86.

With the reforms in place, the Japanese situation will be much like that in Germany, where *Stiftungen* (private interest foundations) are permitted. According to a recent study, half the countries in Europe require foundations to have a public benefit purpose, while the other half permit them to have any lawful purpose. *See* K.J. HOPT / W.R. WALZ / T.v. HIPPEL / V. THEN (eds.), *The European Foundation: A New Legal Approach* (Gütersloh 2006) 62.

84 This is variously also translated as “Committee.” *See, e.g.,* MIYAKAWA, *supra* note 18, 64.

85 Art. 32 (1), Law No. 49 of 2006. Technically the authorizing administrative agency is the Prime Minister’s Office itself. *See* Art. 3, Law No. 49 of 2006 but that office delegated the authority to the Commission pursuant to Art. 59, Law No. 49/2006.

86 There are seven members of the Commission; *see infra* for a discussion of the role of the Commission.

87 The “councils” are intended to assist the prefectural governors, who are technically the authorizing administrative agencies at the local level.

88 *See* Art. (5)(xvii), Law No. 49/2006.

*B. Process of Achieving the Reforms*<sup>89</sup>

As indicated in the section on the “context” of the reforms, the approach the Japanese government took to achieve them was consistent with its general effort to reform the bureaucracy and the controlling administrative state. Thus, instead of keeping the reform process strictly within government, the Cabinet Office recognized the importance of receiving public input in order to achieve valid and acceptable reforms for PBCs. This may in part have been due to the way in which the SNPC legislation developed (it ended up being introduced in the Diet as a member’s bill, supported by all the political parties), but it is also due to the increasing awareness of the extent to which Japan needs NPOs to meet its current social development goals. For example, the second in the series of documents released by the Cabinet Office contains this language:

It has become difficult to adequately address the diversified needs of the people through administrative and commercial sectors alone. Private-sector nonprofit activities will thus be positioned positively and developed with flexibility and mobility.<sup>90</sup>

In addition, the government was well aware of the increasing lobbying power of the sector, which was being demonstrated with regard to SNPCs at the time the proposed *kôeki hôjin* reforms were announced.<sup>91</sup>

Accordingly the Cabinet Office first appointed an independent “Expert Commission,” with Akira Iriyama, Executive Director of the Sasakawa Peace Foundation, as its head, in 2002. The Commission met only seven times until January 2003, and its discussions were largely unresolved.<sup>92</sup> No report was released by the Commission.

While this first Commission was proceeding with its consultations, the Administrative Reform Promotion Office in the Cabinet Secretariat released concrete reform proposals in both April<sup>93</sup> and August<sup>94</sup> 2002. The private sector responded to the proposals introduced by convening its own “study commission,” which was headed by JACO and the Sawayaka Welfare Foundation. Much effort went into analyzing the government’s proposals, studying the law in other countries, and developing a list of 22 responses to the Government’s proposals; the private sector response was published in October 2004.<sup>95</sup>

---

89 A description of the reform process until January 2005 from the standpoint of JACO is available at [http://www.kohokyo.or.jp/english/eng\\_02/process%20of%20the%20Reform.pdf](http://www.kohokyo.or.jp/english/eng_02/process%20of%20the%20Reform.pdf).

90 See Document B.

91 At that time, as indicated earlier, the sector was lobbying quite hard for reforms to the SNPC legislation.

92 Ohta was a member of that Commission, and he has reported its inability to reach conclusions. See OHTA, *supra* note 6, 85.

93 See Document B.

94 See Document C.

95 There does not appear to be an English language version of this document. JACO had earlier published its “Standpoint” on the Government’s proposed reforms in 2002. See [http://www.kohokyo.or.jp/english/eng\\_02/standpoint.pdf](http://www.kohokyo.or.jp/english/eng_02/standpoint.pdf).

Other initiatives were also important to developing a unified sector response to the Government.<sup>96</sup>

The Government appointed a second “Expert Commission,” known generally as the Fukuhara Commission, after its Chair Yoshiharu Fukuhara, Honorary Chairman of Shiseido Corporation. The Commissioners included experts, such as Prof. Yoshi Nomi of the University of Tokyo Law School (Vice Chair), as well as sector representatives and government lawyers. The Commission met 26 times during the course of the year between its appointment in 2003 and the release of its report on November 19, 2004.<sup>97</sup> The Working Group on Non-profit Corporations, chaired by Prof. Nomi, held 14 meetings during that period. In addition, the oversight staffs of the Administrative Reform Ministry and the Ministry of the Home Affairs and Communications contributed to the efforts to write useful legislation. The Report of the Expert Meeting (Expert Commission), available as Document E in the Documentary Supplement, discloses the ways in which the Commission’s proceedings influenced the final outcomes of the reform process. This Expert Meeting was followed on December 24, 2004 by a Cabinet Decision that closely tracked the reforms proposed by the Fukuhara Commission and that sets out a detailed analysis of how they should proceed.<sup>98</sup> Approximately one year later, on December 26, 2005, the Cabinet Office released a “Concept of the Legislation” on PBC reform that it intended to and did introduce in the forthcoming regular session of the Diet.<sup>99</sup>

Just five months after the Cabinet Office released the “Concept of the Legislation” to the public, three bills aimed at implementing the reforms passed the Diet on May 26, 2006. As indicated, the legislation was designed to have three parts – the General Nonprofit Corporations Law, the Authorization of Public Benefit Corporations Law (Authorization Law), and the Conversion of Existing Public Benefit Corporations Law (to deal with transition issues and amending over 300 pieces of legislation). The new legislation addresses many issues raised by the Fukuhara Commission and its Working Group on Non-profit Corporations and adopts many of the recommendations of those groups. It is also significant that sector representatives were called to testify before the Special Diet Committee on Third Sector Organizations considering the legislation in both houses of the Diet: Mr. Tatsuo Ohta, President of JACO, testified in the House of Representatives, and Ms. Yayoi Tanaka, formerly of the Sasakawa Peace Foundation, testified in the House of Councillors. Resolutions passed by both houses of the Diet reflect Mr. Ohta’s admonition that the Government must work closely with the sector to develop the rules

---

96 See OHTA, *supra* note 6, 85. The author was also privy to many discussions about the issues both in person and by email.

97 A summary of the report is included in the Documentary Supplement as Document E.

98 See Document F.

99 Email from OHTA, February 18, 2006; this document is available only in Japanese.



and procedures for the implementation of the new legislation, in particular the rules with regard to public benefit organizations.<sup>100</sup>

The importance of the reforms in terms of the current social and economic conditions in Japan is made clear in Article 1 of the Authorization Law, where the purpose of the legislation is set out:<sup>101</sup>

The purpose of this Act is, in view of the fact that the implementation of business voluntarily conducted by organizations in the private sector for public interest purposes has become important for the promotion of the public interest as a result of changes in social and economic situations in and out of the country, to establish a system for authorizing public interest corporations that are capable of implementing such business in a suitable manner, to prescribe measures to ensure suitable implementation of such business conducted by the public interest corporations and thereby to contribute to the promotion of the public interest and the realization of a vibrant society.

### C. *Details of the Reforms*<sup>102</sup>

Many of the details regarding the administration of the reforms are being worked out, and the passage of the legislation is in many ways only the beginning of the implementation of the new legal system for PBCs. The general outline of what the Diet intends is, however, evident from the legislation as passed.

1. Types of organizations affected. Once the system is fully implemented,<sup>103</sup> persons and entities<sup>104</sup> may form legal entities as “general non-profit corporations” (GNPCs)

---

100 Email from M. MIYAKAWA of June 28, 2006, on file with the author.

101 Art. 1 Law No. 49/2006.

102 This section relies in part on the paper written by M. Miyakawa, in particular for the laws that have not been translated into English. A more detailed analysis of the provisions of the three pieces of legislation enacted to facilitate the reforms can be found in MIYAKAWA, *supra* note 18. This section does not address all aspects of the legislation, as that would be too detailed for a general audience. What the article does do is look into issues raised prior to the reform and how they have been addressed in the legislation, and it analyzes the reforms against the backdrop of international standards for legislation affecting NPOs and PBOs.

103 During the five year transition period, a transitional legal form will exist for all the old general PBCs – they will become “Special Civil Code Corporations” (*tokutei minpô hōjin*). See MIYAKAWA, *supra* note 18, 70-71. They will not need to register as general non-profit corporations and can transition directly into the new status. Nonetheless, JCIE points out that many organizations are worried about the “administrative burdens” associated with the new law and the transition period. See JCIE, *Japan’s Nonprofits Prepare*, *supra* note 18, 5. Anecdotal evidence suggests that the administrative burdens are heavy, but they have not deterred JACO from being the third entity to re-register under the new regime. The application documents were described as “voluminous” and the process lasted about three and one-half months, but JACO was formally registered as an APBC on March 18, 2009. Email from M. MIYAKAWA, March 18, 2009, on file with the author.

either in the form of general incorporated associations (*ippan shadan hôjin*) or general incorporated foundations (*ippan zaidan hôjin*). Incorporated associations must have two or more members and there is no minimum endowment requirement. Such associations may have public benefit purposes and activities; if they do not, they will not be able to apply for recognition as public benefit organizations. Incorporated foundations must have a minimum endowment of ¥ 3 Million, but they are not required to have public benefit purposes.

2. Governing bodies and financial supervision of GNPCs. Associations must have a general meeting and directors and may have a board of directors and an auditor. There are special governance rules for all foundations, as discussed below. All organizations of a certain “large,” and as yet undecided, size must have their books and records audited. They must follow accounting rules applicable to NPOs.<sup>105</sup> The GNPC law also deals with a variety of corporate law issues that had not been part of the Civil Code. For example, fiduciary duties and report filing responsibilities are spelled out.<sup>106</sup>

3. Determining public benefit status. Public benefit status is determined at the national or prefectural level. The national level PBCC, which is the principal standard setting body, was formed in the Cabinet Office in April 2007.<sup>107</sup> The law states that the seven members appointed by the Prime Minister are to “exercise their authority independently,”<sup>108</sup> and are to “have excellent knowledge and experience for laws, accounting or activity pertaining to public interest corporations.”<sup>109</sup> The Commission is to make the determinations of public benefit status (upon application by general non-profit organizations). According to the Cabinet Decision, “In order to ensure that the committee properly and promptly performs its duties, including conducting follow-up checks and dealing with complaints, necessary measures will be taken to develop its administration, and discussion will be carried out on how to judge whether the activities in various fields are of benefit to the public from an expert’s perspectives.”<sup>110</sup> The Commission met quite

---

104 This is important because it permits, e.g., an association of associations. This was allowed under prior law as well – the Japan Association of Charitable Organizations is itself a charitable association. See JACO website, available at [http://www.kohokyo.or.jp/english/eng\\_03/about\\_jaco.html](http://www.kohokyo.or.jp/english/eng_03/about_jaco.html).

105 See, *infra*, Section VIII with regard to the accounting system for general PBCs established before the 2006 reforms.

106 See MIYAKAWA, *supra* note 18, 69.

107 It includes professors, a retired appellate judge, the former president of Shiseido Japan (the Chair), and a former member of the Board of the Japanese Institute for CPAs (Deputy Chair). See list of names and affiliations, available at <http://www.cao.go.jp/picc/english/english.html>.

108 Art. 33, Law No. 49/2006.

109 Art. 35, Law No. 49/ 2006 (unofficial translation, using the term “public interest” instead of “public benefit”).

110 Cabinet Decision of Decision of December 24, 2004, Document F in online Documentary Supplement.

regularly after it was appointed to develop guidelines and standards for applications for public benefit status,<sup>111</sup> and it has a large Secretariat to assist it in making its decisions.<sup>112</sup>

4. Criteria for determining public benefit status to allow organizations to become APBCs.<sup>113</sup> The Commission must judge according to clear requirements and not exercise discretion. Issues to be taken into account as to the public benefit requirement per se include:

- having a public benefit purpose as the organization's primary purpose;<sup>114</sup>
- the benefit must be provided for "many and unspecified persons;"<sup>115</sup>
- public benefit activities of the organization must constitute the majority of the corporation's overall activities;<sup>116</sup>
- the organization may not make a profit from its public benefit activities;<sup>117</sup>
- although an organization may carry out profit-making activities, the profits must in principle be used only for the public benefit purposes of the organization;<sup>118</sup>
- there must be no risky investments, etc.,<sup>119</sup> that would tend to harm the possible retention of assets for carrying out the charitable purposes; and
- meeting the non-distribution constraint.<sup>120</sup>

---

111 See JCIE, *Japan's Nonprofits Prepare*, *supra* note 18, 5.

112 Only four of the seven Commissioners may work full-time. See Art. 34. They serve for terms of three years (subject to reappointment). See Art 36. The Secretariat is prescribed by Art. 42.

113 Miyakawa says there are 18 different requirements that must be satisfied in order for a GNPC to qualify as an APBC. MIYAKAWA, *supra* note 18, 65. Ohta says that there are 20 different documents that must be filed for a PBC to become certified as such. See Public interest corporation reforms come into force, in: SPF Voices, 56/4 (2007). (interview with Tatsuo Ohta and Tsutomu Hotta), hereinafter "SPF Voices interview."

114 Art. 2 refers to "scholarship, art, charity or other public interests." A longer list of public benefit activities is set out in an Appendix to the Authorization Law; the list is attached to this article. Strikingly, the unofficial government translation uses the term "business," while Miyakawa's own unofficial translation refers to "activities;" the latter is more consistent with common usage in the not-for-profit field and will be used here.

It is under discussion whether "pursuing members' common interests" may be a secondary purpose. There is a requirement that "special private benefits should not be afforded to association members, councilors, trustees, auditors, employees of the charitable corporation or any other persons described in the regulation who have special interests therein." Art. 5 (iii), Law No. 49/2006.

115 Art. 2 (iv), Law No. 49/2006.

116 Art. 5 (viii), Law No. 49/2006.

117 Art. 5 (vi), Law No. 49/2006.

118 See Arts. 5 (vii) and 15, Law No. 49/2006. A further proposed criterion, that public benefit activities would not be permitted to interfere with activities conducted by profit-making companies, was eliminated as a result of forceful lobbying by the sector. See email from M. MIYAKAWA of June 28, 2006 on file with the author.

119 Art. 5 (v), Law No. 49/2006.

120 See Art. 5 (xvii) and (xviii), Law No. 49/2006.

These rules will have the effect of ensuring that assets originally designated for charitable purposes remain committed to those purposes.

In addition, the criteria used by the Commission must address such transparency and accountability issues as conflicts of interest, a ban on excessive compensation for directors, and a requirement that a board of directors be appointed. Thus,

- a limitation on the number of family members who may be members of the Board of Directors is limited to one-third;<sup>121</sup> and
- public benefit corporations are prohibited from holding stock in companies when it is possible that they may obtain a controlling interest in such companies.<sup>122</sup>

There is also a limitation on the provision of “special private benefits to members, councillors, auditors, etc.”<sup>123</sup> These rules build on the rules contained in the GNPC legislation relating to new requirements for accountability of directors and other persons charged with fiduciary duties to the organization (e.g., auditors).

Further, the law requires a mandated distribution of income by APBCs, stating that:<sup>124</sup>

Retention of any idle and dormant assets or properties, for which there is no plan for usage scheduled in the near future, must not exceed the maximum limitation of an amount of expenditure which will be expected to be incurred in the following year in carrying out the same type and size public benefit activities conducted during the current year.

Finally, it must be noted that authorization will be withheld if the organization fails to obtain a license to conduct the activities it intends to conduct.<sup>125</sup> This means that although there is no discretion with respect to authorization, the authorities will still be able to exercise effective substantive oversight (for example, health officials could withhold a license from a dirty public daycare center). On the other hand, Japanese administrative procedure permits appeals from negative licensing decisions.<sup>126</sup>

---

121 Art. 5 (x), Law No. 49/2006. Limiting the number of family members from the same family sitting on the council, but the sector lobbied against that restriction. *See* email from M. MIYAKAWA of June 28, 2006, on file with the author.

122 This criterion waters down the previous one, which would have only allowed stock-holdings “for purposes of asset management.” *See* email from M. MIYAKAWA of June 28, 2006, on file with the author.

123 Art. 5 (iii), Law No. 49/2006.

124 MIYAKAWA, *supra* note 18, 65. The language in the official translation differs somewhat from this, but the gist of it is captured by Miyakawa. *See* Art. 5 (ix) and Art. 16, Law No. 49/2006.

125 *See* Art. 6 (iv), Law No. 49/2006.

126 *See* Japanese Administrative Procedure Act, Art. 15, available at <http://www.cas.go.jp/jp/seisaku/hourei/data/APA.pdf>.

5. Oversight of APBCs. The Authorization Law sets out rules with regard to “supervision” for APBCs in Article 27 and makes clear in Art. 29 that the authorization may be terminated for cause. Such a termination results in the remaining assets acquired for public benefit purposes being transferred to another APBC.<sup>127</sup> The 2004 Cabinet Decision suggests that the Commission would use the “Standards for Establishment and Supervisory Guidance” published by MHAC, pursuant to a Cabinet Decision of September 20, 1996. As the supervision standards have been adopted by the Commission, they presumably have also had to consider relevant standards adopted on February 9, 2001, in the Managerial Board of Meetings of Cabinet Ministers called “Enhancing the system for supervisory guidance of public interest corporations, etc.”

Ensuring consistency between the national level Commission and the prefectural councils should be relatively easy because of the administration of local governments by the national Ministry of Internal Affairs and Communications.<sup>128</sup> The “Guidelines” for APBC Authorization were published in April 2008 and the answers to FAQs were also published from March to May, item by item.<sup>129</sup> As discussed below, the sector has problems with some of the rules the Commission has developed.

6. Internal governance, reports, and public disclosure. The reporting required of the new APBCs will be greater than that required of PBCs organized under Civil Code Article 34. There will also be increased public disclosure, including disclosure of salaries and other financial information. Some of these issues are also the subject of ongoing discussion.<sup>130</sup> According to Miyakawa, “The obligations on disclosure and accountability are intensified for public benefit corporations as opposed to general not-for-profit corporations. The subject and scope of disclosure is broader and the accountability to the general public is also expanded.” The Cabinet Office document from December 2004 deals specifically with this issue and what the government intended to accomplish through requirements of website publication of reports, etc.<sup>131</sup>

---

127 See Art. 30, Law No. 49/2006.

128 This is carried out under the Local Administration Bureau (LAB) of MIC. See MIC website at <http://www.soumu.go.jp/english/>.

129 See email from M. MIYAKAWA, July 22, 2008, on file with the author. None of this material is available in English.

130 One of the issues of keen interest for the reformers in Government and in the sector is that many PBCs have employed retired government officials from the ministries charged with their oversight. According to the MHAC FY 2004 Report, 3.9% of all national level PBCs have as directors (including full-time managers) ex-national level civil servants, while the prefectural level percentage of ex-prefectural level civil servants is 5%. See FY 2004 report, MHAC, *supra* note 21. This aspect of “parachuting” had worried MHAC officials, who can see the potential for bias if such relationships prevail, making it easier for such organizations to obtain government funding (notes of January 2005 meeting with MHAC personnel, on file with the author).

131 See Document F and discussion, *infra*.

7. Additional requirements for foundations. All foundations must have an endowment of a minimum of ¥ 3 million, three or more directors/trustees, an auditor, and a new organ called a Council (a supervisory body). According to Miyakawa, “[t]he function of a board of councillors is to make decisions on material matters described under this Act. These include changes in the corporate constitution, assignment and transfer of whole the activities, amalgamation, exemption of liabilities, and approval of financial reports.”<sup>132</sup> The Board of Councillors is also charged with the selection and removal of directors/trustees, corporate auditor(s), and the accounting auditor. These requirements apply to foundations that become authorized public benefit foundations in addition to the requirements of the Authorization Law.

## V. ANALYSIS OF ASPECTS OF THE PBC REFORM LEGISLATION

### A. *Freedoms of Association and Religion*

Japan is a state party to the International Covenant on Civil and Political Rights (ICCPR),<sup>133</sup> which in Article 22 guarantees the freedom of association; Article 21 of the Japanese Constitution protects this right as well. This broad guarantee applied only to informal, voluntary groups of citizens prior to the enactment of the SNPC legislation, which did not require formal government permission to set up an NPO. It did not imply that any group of citizens could easily obtain juridical personality if they wanted to conduct public benefit activities until the SNPC legislation was adopted. Thus, the enactment of the PBC System Reforms is an important step in the development of a truly hospitable environment for this internationally protected right.

The continuing requirement of *a priori* approval is, nonetheless, still present for the special PBCs. For certain of these, the approval process amounts to no more than a licensing regime (e.g., for medical service corporations and private schools) for activities for which there would routinely be a requirement to obtain a license prior to operations in any case. And such a license would be required for anyone seeking to conduct the activities, not just the special PBCs. This should not be considered to be problematic.<sup>134</sup> On the other hand, requiring certification to set up a religious association might violate the freedom of religion, also protected by the ICCPR in Article 18<sup>135</sup> and the Japanese Constitution in Article 20.<sup>136</sup>

<sup>132</sup> See MIYAKAWA, *supra* note 18, 69.

<sup>133</sup> Japan deposited its instrument of ratification in 1979.

<sup>134</sup> Cf. State of New York Not-for-Profit Corporation Law, sec.404, Approvals and Consents.

<sup>135</sup> Article 18 (2) specifically addresses the right to freedom of religious assembly, speaking of the “freedom, either individually or in community with others, to manifest [...] religion or belief.”

<sup>136</sup> Akira Matsubara suggests that is not problematic and that the authorities respect the freedom of religion. See A. MATSUBARA, Speech Draft for “Comparative Regulation/ Account-

### B. *Overlap and Complexity*

It seems problematic to require government approval to establish entities classified as Social Welfare Corporations when much of what they actually do is encompassed within the public benefit activities of the new APBCs and the older SNPCs. This needs to be rationalized. Continuing complexity with regard to legal forms makes work for lawyers but does not help the NPO sector. Aspects of complexity with regard to the tax laws affecting SNPCs and APBCs are addressed below.

### C. *Problems with the Authorization Process*

Needless to say, any new system brings with it vocal criticisms from the sector sought to be regulated regardless of the process of reform and adaptation of the new system to the needs of the sector. This is true of Japan's PBCs, which are now complaining vociferously about aspects of the new system.<sup>137</sup> The complaints address the following issues, among others:<sup>138</sup>

- The complexity of the application process – experts Hotta and Ohta describe some of these, including the prospect of filing some 20 documents.<sup>139</sup>
- The income restrictions and payout rules – Hotta and Ohta discuss the extreme difficulty facing an organization that may well be unable to sustain itself because of these rules.
- The fact that the new authorization criteria do not recognize educational loans as proper public benefit expenses (which would suggest that scholarship funds would not qualify as PBCs under the new system).<sup>140</sup>
- The lack of clarity about the requirement for an organization to adopt a suitable accounting system.<sup>141</sup>

One way to consider the complaint about the number of documents to be filed is that this would tend to reduce discretion because, while complex, the criteria to be satisfied would be clear. But that does not seem to move the experts in Japan, who express concerns that despite all the complexity of the authorization process, the “basic require-

---

ability: JAPAN” available at [http://icnl.org/knowledge/pubs/chinaconference/comparative\\_regulation\\_japan.pdf](http://icnl.org/knowledge/pubs/chinaconference/comparative_regulation_japan.pdf).

137 See, generally, SPF Voices interview, *supra* note 69. See also JCIE, Japan's Nonprofits, *supra* note 18, 5, making it clear that the sector is suspicious about how the Commission has developed its policies and suggesting there has been a little too much reliance on the Secretariat, which is staffed by government bureaucrats.

138 These are taken from the SPF Voices interview, *supra* note 69.

139 With regard to an actual application process under the new law, see *supra* note 103,.

140 This seems particularly unjust given that Ohta says that “Philanthropy in Japan originated with scholarship funds established in each region.” SPF Voices interview, *supra* note 69, 4.

141 The relationship between a suitable accounting system and PBC oversight is addressed in Section IX, *infra*.

ments” still remain vague.<sup>142</sup> It must be noted that in viewing all the documents relevant to the reform process (including the Cabinet decisions and the legislation itself), there is a tendency to make the process of application for approval very bureaucratic and not dissimilar from the application process prior to the reforms – minus the discretion in the hands of the authorizing ministries. The extent to which these issues will be addressed once the Commission implements its final rules and applies them to organizations seeking APBC status remains to be seen.

As to the criticism with regard to the application of the payout rules contained in the law, that does appear to be quite well-founded. Not being able to retain enough of a surplus to conduct future business could well be catastrophic for small APBCs in particular. This is presumably something that could be remedied by legislation amending the overly strict rules found in Article 5 (vi) and Article 16.

#### *D. Addressing Issues of Conflict of Interest/Accountability Within the Organization*

The rules in this regard are very complicated,<sup>143</sup> but they give an organization detailed guidance as to what will be appropriate and what will not. This should suffice to prevent most conflict of interest transactions. Various considerations are missing, however, such as procedural mechanisms for clearing conflicts that benefit the organization as well as a recognition that outside directors of APBCs should serve without remuneration.

#### *E. Addressing Issues of Disclosure/Transparency to the General Public*

The Cabinet Office report from 2004 says:<sup>144</sup>

- Corporations shall disclose information to the general public with the use of the Internet, while giving due consideration to the protection of privacy.
- Matters to be disclosed will include matters relating to operations and financial conditions, matters relating to the requirements for judging public benefit, and matters that should be subject to public inspection such as director remuneration and management costs.
- The entity authorized to judge shall also collect information disclosed by corporations, compile a nationwide database of such information, and make it available to the general public with the use of the Internet.

---

142 OHTA, SPF Voices interview, *supra* note 69, 5.

143 For example, the new legislation (Art. 20) requires that an APBC set and publish standards for remuneration that, according to Art. 5 (xiii), show that the “amount of payment is not unsuitably high in view of the remuneration, etc. for directors and officers of business operators in the private sector, salary of employees, accounting situation of the juridical person in question or other circumstances.”

144 See Document F.



Although not specifically addressed in the Authorization Act itself, these issues are dealt with in the rules adopted by the Commission.

*F. Ministry-related Subcontractor Type NPOs*

As indicated, the reforms contemplate that ministries will review practices with regard to these types of entities. That review has already begun. In a July 2008 press conference the Minister of Defense Ishiba announced as follows:<sup>145</sup>

Concerning the intensive reviews of public interest corporations, the Government has been taking measures to correct the wastefulness and inefficiency associated with the expenditures to those corporations that have close relations with the government administration. In line with these moves, the MOD has launched intensive reviews of public interest corporations under its jurisdiction. The details of the reviews have just been compiled. I would like to mention three major points of the results of the latest MOD reviews. The first point is that MOD will abolish non-competitive, sole-source contracts with any public interest corporation in and after FY2009. The second point is to reduce the amount of MOD subsidies for “*Ji-eitai Engo Kyōkai*,” an association supporting re-employment of retired SDF personnel, which is the sole recipient of MOD subsidies. The third point is to reduce the number of board members posted at some of the public interest corporations. Reference materials will be delivered later. Upon request, officials concerned will give further explanations. I regard these results of the reviews as the beginning. The MOD would like to further eliminate wastefulness from its expenditures associated not only with the corporations targeted in the latest reviews, but also with other ones.

On the other hand, in their interview in *SPF Voices*, both Mr. Ohta and Mr. Hotta urge less complacency about these issues. As Hotta points out,<sup>146</sup>

[f]or public interest corporation reforms to succeed, the corporations that are not serving the public interest and those that exist simply to serve the interests of the bureaucrats must be eliminated, but this won't be accomplished by the reforms themselves. That's why we've asked that serious attention be paid to issues such as subcontracting processes, the lucrative arrangements made by bureaucrats, and *amakudari*.

Clearly rooting out all the problems, including the “parachuted” ex-government officials, will take some time. The seriousness with which each ministry undertakes its task in this regard will be judged by the sector (and the press) as time goes on.

---

145 See press conference report, available at: <http://www.mod.go.jp/e/pressconf/2008/07/080704.html>. Mr. Ishiba was replaced by Yoshimasa Hayashi in the early August 2008 cabinet shake-up.

146 See *SPF Voices* interview, *supra* note 69.

### G. *The New Agency for Certifying Qualification and Dealing with Oversight*

Some in the sector regard the fact that the PBCC is staffed by such a large Secretariat, filled with government officials, as cause for concern.<sup>147</sup> Indeed, the development of the rules and guidelines for authorization suggests that the process has already become too bureaucratized.

### H. *Impact of the Transition*

JCIE points to one dilemma facing PBCs as they begin the transition process to becoming APBCs: should they attempt to qualify under the new regime or be content to pay taxes as general nonprofit organizations? As JCIE points out,<sup>148</sup>

[m]any [PBCs] worry about the administrative burden of re-registering and restructuring their boards in order to meet potential new requirements as well as the additional work posed by heightened requirements for governance and information disclosure.

The extent to which PBCs will find the transition too cumbersome ultimately may rest on the extent to which the sector is successful in lobbying for less burdensome legislation and rules. The availability of the tax benefits (enacted in 2008) that APBC status carries with it ought to allay concerns that some of these entities may have expressed in 2007.

## VI. TAX LAWS BEFORE THE REFORMS<sup>149</sup>

As in many countries, not-for-profit organizations in Japan must go through a separate application process with the tax authorities and satisfy particular criteria established in the fiscal laws in order to establish their tax exempt and tax deductible status.<sup>150</sup>

<sup>147</sup> See JCIE, *Japan's Nonprofits Prepare*, *supra* note 18, 5.

<sup>148</sup> *Id.*

<sup>149</sup> This section draws heavily on materials provided to the author by the Ministry of Finance's Tax Policy staff and the Outline of Japanese Taxes 2005, published by the Ministry and available at [http://www.mof.go.jp/english/tax/taxes2005e\\_c.pdf](http://www.mof.go.jp/english/tax/taxes2005e_c.pdf) (referred to as "MOF 2005") and on charts describing the tax system and translated legal texts made available to the author and Dr. Leon Irish, the other leader of a delegation of government officials from the Socialist Republic of Vietnam to study the not-for-profit sector in Japan and the Republic of Korea in January 2005. The documents are on file with the author; these are referred to as "MOF special papers 2005."

<sup>150</sup> Tax exempt status is relevant to the entity, while tax deductibility is relevant to the donors to the entity. The Corporation Tax Law generally deals with PBCs as tax exempt entities. See MOF 2005 2/2 (1. c (1)) – "taxable persons" does not include PBCs. As in many countries, tax deductibility in Japan is available only to a smaller subset of NPOs; in Japan, however, it was thought by the sector to be unduly restrictive, as the Tax Commission report discussed below indicates.

Although the Tax Commission dealing with reform of the PBC System issued only one report,<sup>151</sup> that report was very influential and resulted in the reforms described below. It is, however, useful to have a sense of what the system was prior to the reforms in order to judge their efficacy.

#### A. *Tax Exemption*

In general, grants and donations to Japanese NPOs are exempt from corporate income tax; only income from profit-making activities has been subject to taxation.<sup>152</sup>

##### 1. *PBCs*

Prior to the reforms adopted in 2008, PBCs were required to pay corporate income tax on revenue from 33 listed for-profit activities.<sup>153</sup> For the 33 activities, PBCs were taxed at a concessional rate of 22%.<sup>154</sup> In addition, PBCs were allowed to deduct up to 20% of income from profit-making activities if the funds are used to carry out their core public interest activities (the so-called “internal or deemed donation”). Thus, the effective tax rate on such activities carried out by PBCs was 17.6%.

Passive income, such as interest, dividends, and investment income, was not subject to income tax if the income was related to the organization’s not-for-profit activities. PBCs would have been exempt from local taxes only if their main purpose was the establishment of a museum or the pursuit of education.<sup>155</sup>

##### 2. *SNPCs*

SNPCs were required to pay corporate income tax on revenue from the 33 listed for-profit activities. The tax rate on these activities was a concessional rate of 22% on up to total revenue of ¥ 8 million, and 30% on amounts above that threshold. In addition, certain SNPCs were allowed to deduct up to 20% of income from profit-making activities if the funds are used to carry out their core public interest activities (the so-called “internal or deemed donation”). Thus, the effective tax rate on such activities carried out by SNPCs was 17.6%.

---

151 The “Tax Commission” issued only one report, although it is unclear whether it met more than once. *See* subsection V, below.

152 *See* Art. 7 of the Corporations Tax Law and MOF 2005 at 2/3 (tax base does not include gifts and grants); 2/3 (8) donations from individuals constitute nontaxable income.

153 *See* Art. 2 of the Corporations Tax Law. Art. 2 (13) states that profit-making activities “prescribed by Cabinet Order” are subject to tax. The Cabinet Order lists such things as sales of goods, publishing, mining, gaming, etc. *See* MOF Special papers 2005, Scope of Profit-making activities.

154 The same concessional rate applies to the profits of business corporations that are below ¥ 8 million. *See* Taxation in Japan, available at <http://www.hi-ho.ne.jp/yokoyama-a/taxationinjapan.htm#coporate%20status>.

155 *See* MOF 2005, on Local Taxes, Business Enterprise Tax 2.a.

### 3. *Special PBCs*

Social Welfare Corporations, Private School Corporations, and Religious Corporations were generally subject to the tax benefits that applied to PBCs but with several different rules. For example, they could deduct the greater of 50% or ¥ 2 million of income earned from profit-making activities.

Medical Corporations, by contrast, were taxed at the full corporate tax rate except to the extent they received medical fees as reimbursements through the social insurance system.<sup>156</sup> An exception applied to “Special Medical Corporations” (*tokutei iryô hôjin*), which the Ministry of Finance had certified as being especially in the public interest. These organizations were taxed at the 22% rate on their profits and receive other minor tax benefits.

### 4. *Chûkan Hôjin*

Unlike their counterparts in the public benefit world, *chûkan hôjin* were taxed on all their income, including income from membership fees and donations or other gifts.<sup>157</sup> This treatment is not generally consistent with tax rules regarding not-for-profit membership organizations in other countries. For example, in the United States, gifts are not income to any organization under Section 102 of the Internal Revenue Code. With respect to business corporations, gifts may well be contributions to capital and thus also not taxable. As to membership fees, tax theory suggests that they should also not count as income, given that they represent fees for member services.<sup>158</sup>

#### B. *Tax Deductions for Contributions to Japanese NPOs by Individuals and Corporations*

Donors were allowed to deduct contributions to Japanese NPOs only if the recipient organization had received a specific designation from the appropriate tax authorities. Thus, no broad categories of PBCs were entitled to receive tax-deductible donations. Contributions were deductible only if they are made to: (i) “Specific Accredited PBCs” (*tokutei kôeki sôshin hôjin*) (ii) Organizations Eligible for “Designated Donations” (*shitei kifukin*), or (iii) SNPCs with National Tax Administration Accreditation (Accredited SNPCs).<sup>159</sup>

---

156 These may also be exempt from local taxes; see MOF 2005, *supra* note 147.

157 See MOF Special papers 2005, Annex 1.

158 See, e.g., B.I. BITTKER / G.K. RAHDERT, The Exemption of Nonprofit Organizations from Federal Income Tax, in: Yale Journal of Law 85 (1976) 307.

159 See MOF 2005 2/4 (7) describing the types of organizations to which deductible contributions can be made.

### 1. “Specific Accredited PBCs”

The largest group of NPOs that were qualified to receive tax-deductible donations were the “Specific Accredited PBCs.” They numbered about 20,000 in 2005, according to the Ministry of Finance, and Japan Red Cross Society is an example of such an organization.<sup>160</sup> They were required to satisfy special requirements, including (i) having appropriate management and accounting systems, (ii) internal provisions prohibiting the allocation of special benefits to directors or employees, and (iii) allocation of resources primarily to one of the activities in a list.<sup>161</sup>

Only PBCs and certain Special PBCs were eligible for this status (Religious and Medical (other than “special” Medical) Corporations were not).

Contributions of individuals were deductible up to 25% of their annual income above a floor of ¥ 10,000. The contributions of corporations were deductible up to a ceiling (1.25% of income plus 0.125% of paid-in capital). In addition, bequests to such organizations were deductible from inheritance taxes.<sup>162</sup>

### 2. Organizations Eligible for “Designated Donations” (*Shitei Kifukin*)

PBCs, as well as certain Special PBCs were eligible to seek this certification. It was conferred by the Ministry of Finance, and the qualification was based on several requirements as to how funds were to be raised and how they would be used. The contributions were required to be (1) raised from the public at large, and (2) used to meet urgent needs in the promotion of public benefit, such as furthering education, science, culture, and welfare services.<sup>163</sup> Before designating contributions as eligible for this treatment, the Ministry of Finance examined the activities to be supported, the target amount to be raised, from whom the funds would be collected, and the period during which the contributions would be raised. If the Ministry’s requirements were met, it declared that the contributions would qualify as “designated donations,” eligible for deduction. These designations are made pursuant to the Corporate Tax Law Enforcement Ordinance<sup>164</sup> and Individual Tax Law Enforcement Ordinance;<sup>165</sup> they were reviewed every two years.

---

160 See MOF, Special papers 2005, Annex 2.

161 See Article 217 (7) of the Income Tax Law Enforcement Ordinance.

162 See MOF 2005.

163 See Article 78 (2)-[2] of the Income Tax Law. According to the Council for Better Corporate Citizenship (CBCC), there were essentially seven different types of projects for which PBCs could receive this designation. CBCC was authorized to receive corporate donations that were then sent overseas to assist Japanese corporations working outside Japan with their efforts at corporate social responsibility. See CBCC website at <http://www.keidanren.or.jp/CBCC/english/profile/activity.html>.

164 See Article 77 (Part 1, Item 3-q) of the Corporate Tax Law Enforcement Ordinance.

165 See Article 217 (7) of the Income Tax Law Enforcement Ordinance.

Individual contributions to organizations eligible to receive “designated donations” were deductible up to 30% of annual income above a floor of ¥ 5,000.<sup>166</sup> The contributions of corporations were deductible without limitation.

### 3. *Accredited SNPCs*

Provisions in the FY 2001 tax reform legislation allowed SNPCs to acquire tax-deductible status if they met certain conditions. In order for contributions to SNPCs to be tax deductible, they were required to apply to the National Tax Administration and satisfy a list of requirements.<sup>167</sup> Most importantly they were required to demonstrate that they received at least one-fifth of all revenues from qualifying contributions, with various limits on the amounts and sources necessary for contributions to be deemed as qualifying ones.<sup>168</sup>

Contributions of individuals to accredited SNPCs were deductible up to 30%<sup>169</sup> of their annual income above a floor of ¥ 10,000. The contributions of corporations are deductible up to a ceiling (1.25% of income plus 0.125% of paid-in capital).

### 4. *Treatment of Donations of Appreciated Property*

Donors to appropriately designated PBOs do not pay tax on the appreciation in value of the contributed assets.<sup>170</sup>

---

166 This limitation was increased from 25% in the 2005 tax reforms. It applies to all the contributions made by an individual.

167 As of January 2005, only 29 SNPCs had achieved this accreditation. See MOF Special papers 2005, Annex 1.

168 See SNPC Law, article 46-2. SNPCs also received some relief in the 2008 tax reforms, as discussed below.

169 The increase in the individual income tax limit from 25% to 30% came in the 2005 tax reforms. See MOF, FY2005 Tax Reform (Main Points), available at <http://www.mof.go.jp/english/tax/tax2005/tax2005a.htm>.

170 See MOF 2005 2/3 (6 m), Special tax treatment of Capital Gains.

## VII. TAX REFORMS FOR PBCs AND THEIR DONORS <sup>171</sup>

Although the Ministry of Finance had indicated as early as 2003 that it thought the taxation of the business activities of “Public Interest Corporations” should be examined,<sup>172</sup> it was not until two years later that the government involved the private sector in discussions about these issues. In June 2005 Prime Minister Koizumi appointed a Tax Commission to study reforms in the tax legislation affecting PBCs. The Tax Commission was comprised of tax officials, experts, and sector representatives. It met once, in summer 2005, and its announcement that it would propose substantial reforms in the current system warranted considerable attention.<sup>173</sup> The Commission’s report stated:<sup>174</sup>

that the fundamental direction of the reform is to establish a tax system to support public interests served by private action, including overhauling the system of taxation on donations, in redesigning the new non-profit corporation legal system, and its related tax system consistently.

The summary of the points is described as follows:

- Basically, all the income of “public interest non-profit corporations” should be exempt from taxation because of public nature of their activities, as it is under the current system. However, tax should be imposed only on the income from their business activities in competition with for-profit corporations, considering the balance with taxation on profit-making businesses.
- Taxation on general non-profit corporations other than “public interest non-profit corporations” should be imposed on an equal footing with that on for-profit corporations (in principle). However, taxation on membership fees of the non-profit corporations, which engage in business activities exclusively for the mutual benefit of their members, should be exempt.
- Further studies are needed on the scope of business activities, the reduced tax rate and the deemed donation system, and also appropriate taxation of the investment income such as interest and dividends.
- It is reasonable to employ preferential tax measures on donations for “public interest non-profit corporations” in the form of deductions from taxable income. In addition, the treatment of donations from inherited assets as well as donations in kind should be reviewed in accordance with preferential tax measures on donation for “public interest nonprofit corporations.”

---

171 In 2005 and again in 2008, the tax laws were amended to make it easier for SNPCs to receive deductible donations.

172 Like the approach to the PBC reforms generally, the Ministry of Finance discussion is couched in terms of the social problems facing Japan. The issue came up in the “Mid-term Report” entitled “A Sustainable Tax System for Japan’s Aging Society,” available at <http://www.mof.go.jp/english/tax/e20030617.htm>.

173 JCIE describes the Japanese media as “jumping” to cover the announcement. See *Civil Society Monitor* 11 (2005) 4. available at <http://www.jcie.or.jp/civilnet/monitor/11.pdf>.

174 OHTA, *supra* note 6, 86.

After the initial meeting, the Tax Commission decided to break off its deliberations until the PBC reform legislation was adopted, and it does not appear to have reconvened.

Two of the proposals made by the Commission in its initial report would permit tax deductible contributions to *all* organizations determined to be APBCs under the new rules affecting PBCs. In addition, there would be major reforms to the practice of “listing” certain activities as automatically being for profit. For example, it was the case until the new rules took effect, that all publishing by PBCs and SNPCs was considered to be for profit in Japan, which has not been the case in, for example, either the United States<sup>175</sup> or Canada.<sup>176</sup>

The Government’s Budget and Tax Reforms for Fiscal Year 2008 accepted at least parts of the Tax Commission’s proposals and addressed some of its concerns.<sup>177</sup> Under the reforms submitted to the Diet and adopted in April 2008 were the following:<sup>178</sup>

1. Reform of public interest corporations, tax on donations:

For public interest incorporated associations and foundations, exclude from taxation income from their business activities for public interest, and treat all of them as Qualified Public Interest Corporations, donations to which are eligible for preferential treatment.

2. Regarding the maximum deductible amount of donations to Qualified Public Interest Corporations:

Raise such amount based on income to the amount corresponding to 5/100 of income (from 2.5/100).

Thus, once these reforms and the PBS System reforms are effective, all APBCs will be nontaxable on their income from public benefit activities. In addition, they will all be eligible to receive tax deductible contributions. This means that the tax authorities have made a major concession – they will no longer be involved with accrediting PBCs or designating any of their projects for donations. Decisions as to APBC status are located in the Commission, and the tax authorities are not involved.

It is important to note that there was also a reform for SNPCs in 2008, which would relax the requirements for authorization, and alleviate burdens of the application pro-

---

175 See, *Presbyterian and Reformed Pub. Co. v. Commissioner*, 743 F. 2nd 148 (3rd Cir. 1984).

176 See, Canada Revenue Agency, CPS-019 (2003), describing related businesses.

177 One of the concerns that was not addressed is the taxability of general NPOs, which presumably will remain taxable as the *chûkan hôjin* were under the old tax regime; they will thus be taxable on member dues and on gifts. This should receive more attention as the process of adapting to the tax reforms proceeds.

178 See Ministry of Finance, FY 2008 Tax Reform Main Points, available at <http://www.mof.go.jp/english/tax/tax2008/tax2008a.pdf>.



cess.<sup>179</sup> While the tax regimes affecting SNPCs and PBCs are drawing closer together, they are not yet the same, which adds to the complexity burden for persons desiring to form NPOs. For example, should an NPO decide that it wants to come under the fairly loosely defined payout requirement for APBCs having to do with retention of assets not needed for programs<sup>180</sup> or the fairly precise requirements for SNPCs that one-fifth of their support must be from the public? While complexities are always present in tax systems of major economic powers such as Japan, one wonders whether they are strictly necessary with regard to the universe of public benefit organizations.

#### VIII. ACCOUNTING STANDARDS FOR PBCs AND HOW THEY AFFECT THE LEGAL AND FISCAL REFORMS<sup>181</sup>

Accounting Standards are an important aspect of the way in which the not-for-profit sector is regulated.<sup>182</sup> By setting norms for the way in which books are kept, items of income and expense are recorded, etc., such standards help to regulate the sector and ensure transparency and accountability. In many countries the setting of accounting standards for the sector has gained significance in recent years, as scandals have been discovered and as problems have arisen. In Japan, for example, issues have been raised with respect to government subsidies to certain PBCs.<sup>183</sup>

##### A. *Process of Adopting the New Standards*

New Accounting Standards for Japanese PBCs were discussed as the legal reform process was going on; they went into effect for fiscal years beginning after April 1, 2006.

---

179 The Government's budget for Fiscal Year 2005 had also implemented the following reforms to "promote the activities of NPOs:" (meaning SNPCs)

- Relaxing the scope for qualified NPOs by
  - Applying the public support test (one-fifth of all revenues) by averaging donations/subsidies received in the past two years (the prior law required that the test be met for every year); and
  - Simplifying the documentation for applying for the status and the reporting requirements; and
- Increasing the deduction limitation to 30% of income.

180 See language in text at *supra* note 124.

181 This section draws on materials from MHAC and JACO. The MHAC report available at [http://www.soumu.go.jp/daijinkanbou/kanri/pdf/040730\\_1\\_g1\\_e1.pdf](http://www.soumu.go.jp/daijinkanbou/kanri/pdf/040730_1_g1_e1.pdf) discusses some aspects of the reform process, while JACO has provided details on other aspects.

182 See L.E. IRISH / K.W. SIMON, Comparative Civil Society Law Teaching Materials, available at <http://www.iccs.org/pubs/CEUNGOLawReader.doc>.

183 See OHTA, *supra* note 6, SPF Voices interview, *supra* note 69, and MHAC FY 2004 report, *supra* note 21.

The Accounting Standards for PBCs had not been changed for 19 years after an amendment in the late 1980's, despite changes in the circumstances surrounding the organizations to which they applied. In view of this, a Study Group on Accounting Standards for Public Interest Corporations, set up in the former Prime Minister's Office in April 2000 (switched to the Ministry of Home Affairs and Communications after the ministerial reorganization in January 2001), began to study ways in which these standards could be changed to bring them more in line with reality. As a result, an "Enumeration of arguments concerning a review of accounting standards for public interest corporations (Interim Report)" was published in December 2001.

Based on the results of this study, and the fact that, in the "Outline of Administrative Reform" decided by the Cabinet in December 2000, measures to improve accounting standards for PBCs were also to be studied, a "Study Group on Accounting Standards for Public Interest Corporations" was set up in March 2002. Consisting of experts from the sector under the Managerial Board of Meetings of Cabinet Ministers Related to Supervisory Guidance of Public Interest Corporations, and others, the Group conducted studies over a term of about one year.

In March 2003, the "Report by the Study Group on Accounting Standards for Public Interest Corporations," consisting primarily of "Draft Accounting Standards for Public Interest Corporations," was compiled and published. The Report focused on

- greater transparency of fiscal information,
- clarification of the trustee responsibilities of public interest corporations, and
- simplification of financial statements.

A "Research Committee on the Draft Accounting Standards for Public Interest Corporations" met in the Ministry of Home Affairs and Communications from June 2003 to discuss the Draft. The Committee consisted of experts from the sector and the Ministry, and studied directions for the application of the Standards, the timing of their application, and other issues, based on trends in the "radical reform of the public benefit corporation system that were then being considered."<sup>184</sup>

In October 2004, it was officially decided and announced that there would be a revision of the Standards in accordance with the review by the Research Group of the Ministry of Home Affairs and Communications. In March 2005, the official guidance on the introduction and application of the newly revised Standards was published. In that guidance it was stated that PBCs should apply the new Standards as soon as possible for accounting years beginning from April 1, 2006.

The new "Accounting Standards for Public Interest Corporations" address issues such as accounting for restricted funds and the duty to disclose any transactions with the people closely related to the organization. As the Standards are quite new, it remains to

---

184 See, FY 2004 MHAC report, *supra* note 21.

be seen to what extent the standards will be effectively applied. As the following statistics indicate, not all public interest corporations were able to apply the former Standards.

*B. Application of the Prior Standards (as of 2004)*

According to MHAC's 2004 report, accounting standards for public interest corporations were first issued in March 1977. They were subsequently reviewed, and the former accounting standards for public interest corporations were issued in September 1985 (and applied from April 1, 1987). These accounting standards were, in principle, applicable to all public interest corporations established under Article 34 of the Civil Code.

The statistics indicate, however, that the actual state of application of these accounting standards was as follows (as of 2004).

- Accounting standards for public interest corporations completely applied: 19,132 corporations (74.1%);
- Accounting standards for public interest corporations partly applied: 4,373 corporations (16.9%);
- Corporate accounting standards applied: 753 corporations (2.9%);
- Others applied (i.e. other accounting standards, such as ministerial accounting): 1,567 corporations (6.1%).<sup>185</sup>

The 2006 accounting standards apply in connection with the new rules applicable to APBCs, and they should make the system more transparent. For example, Miyakawa says that the law requires that “[i]n case of a large PBC, an accounting auditor must be appointed and retained for auditing service every year.”<sup>186</sup> Nevertheless, there are strong objections to the new standards because of their complexity.<sup>187</sup>

Special aspects of accounting with regard to APBCs are addressed in the 2006 legislation. For example, profit-making business must be separately accounted for under Article 19, and there are detailed rules with regard to the standards for payment of remuneration, keeping of business plans and asset inventories, etc. in other parts of the Authorization Act. These detailed rules, taken together with the non-legislative accounting standards, suggest that the Commission will be quite rigorous in its attention to accounting for APBCs in the future.

---

185 See [http://www.soumu.go.jp/daijinkanbou/kanri/pdf/040730\\_1\\_g1\\_e1.pdf](http://www.soumu.go.jp/daijinkanbou/kanri/pdf/040730_1_g1_e1.pdf).

186 MIYAKAWA, *supra* note 18, 66.

187 See email from M. MIYAKAWA, July 22, 2008, on file with the author.

## IX. CONCLUSION

Coming on the heels of the legislation adopted for SNPCs in 1998 and subsequently modified, the reform process for PBCs and *chûkan hôjin* has been an interesting and important one. In addition, it is clear that certain issues about the determination of public benefit status have not yet been fully resolved and that the sector will need to continue to lobby to achieve outcomes with which it is comfortable. The reforms do promise more flexibility for Japan's civil society, and one can hope that they will also provide a model for reforms in other countries that still require a permission system for establishing NPOs.<sup>188</sup> The key to the reforms is a recognition that freedom of association requires that people must be allowed to form legal entities if they so wish. It is only when a group of citizens asks to receive recognition as a public benefit entity – which carries with it tax benefits—that there should be a determination of whether the public interest is actually served by the organization.

That said, the achievements of the reforms cannot be fully realized as long as the requirements for approval as an APBC remain as rigorous as they are. Comparing and contrasting the new rules in Japan with two countries that have commission systems for determining charity status make that clear.

For example, the New Zealand Charities Commission estimates that it will take a charity approximately 20 minutes to fill out an online application.<sup>189</sup> One interesting aspect of the process of applying in New Zealand should be noted – the Charities Commission indicates that if the proposed charity has a formal binding ruling from Inland Revenue as to its charitable purposes, it would be helpful for the Commission.<sup>190</sup> The information required to be submitted with the online application form is less extensive than the information required by Article 7 of Japan's Authorization Act, and it does not include a formal written business plan and budget.<sup>191</sup> The Commission, which began receiving applications in 2007, says that easier cases will be processed quickly, but “if there are any complex issues involved, or the application requires additional work by a senior analyst to confirm an analyst's initial view, it will take longer to complete the process - currently several additional months.”<sup>192</sup>

---

188 For example, China and Vietnam.

189 See Charities Commission, Apply for Registration Online, available at <http://www.register.charities.govt.nz/applyOnline.aspx>.

190 By reversing the process – with the tax authorities accepting the Commission's determination of APBC status – Japan may well have moved the site of most delays in achieving charitable status to the non-fiscal authorities. According to the Australia Inspector General – Taxation, New Zealand's experience with issuing formal binding rulings (not associated with charitable status, as this is a new procedure) is, however, fairly good, with most having been issued in no more than 90 days.

See [http://www.igt.gov.au/content/reports/potential\\_revenue\\_bias/IGT\\_PBR-09.asp](http://www.igt.gov.au/content/reports/potential_revenue_bias/IGT_PBR-09.asp).

191 The application form, including instruction pages, is 16 pages long.

192 See Charities Commission, available at <http://www.charities.govt.nz/>.

As to the Charity Commission for England and Wales (on which the PBCC in Japan is modeled), the application procedure can be accomplished online only if the proposed charity uses “approved governing documents” that have been developed by large national charities with which the proposed charity may be affiliated.<sup>193</sup> Other applications, including those using the Commission’s model documents, must be submitted in writing. Again, there is no requirement for a formal written business plan or budget as there is in Japan.<sup>194</sup> It is worth noting that the Charity Commission asserts that it can act on most applications within 40 days.<sup>195</sup> A separate application to Her Majesty’s Revenue and Customs Service must also be made so that the tax authorities can make a determination of charitable status for tax purposes.<sup>196</sup>

Thus, there are both plusses and minuses for the new PBC System in Japan when it is compared with two similar processes for achieving charitable or public benefit status.<sup>197</sup> By eliminating entirely the separate step of obtaining a tax ruling, the process is simplified. But some of the other rules will probably prove to be unduly restrictive, as Messrs Hotta and Ohta have predicted. It is perhaps for that reason that the SNPC legal form remains as one that will have continuing attraction for smaller, more volunteer-driven NPOs. That may, in the end, not be the worst outcome, as Japan strives to create a set of mature and independent civil society organizations that can meet the needs of its society in the 21<sup>st</sup> Century.

Taking the PBC System Reforms together with the earlier and ongoing SNPC reforms, we can see that the Japanese government and Diet are truly convinced that there must be a transformation of the enabling environment for civil society in the country. Although it will take some tinkering to make the legal and fiscal framework more flexible and responsive, what now exists is a huge improvement over what existed in the past.

---

193 See Charity Commission for England and Wales, Approved Governing Documents, available at <http://www.charity-commission.gov.uk/registration/govdoclist.asp>.

194 The application form is 20 pages long.

195 See Charity Commission, FAQs, available at <http://www.charity-commission.gov.uk/registration/faqpage.asp#17>.

196 See HMRC, Charities, Detailed Guidance Notes, Chapter 2, available at [http://www.hmrc.gov.uk/charities/guidance-notes/chapter2/chapter\\_2.htm](http://www.hmrc.gov.uk/charities/guidance-notes/chapter2/chapter_2.htm).

197 No comparison’s are made to *e.g.*, the United States or Australia, because in each of those countries it is the revenue authorities who principally control the determination of charitable status. See generally, K. O’HALLORAN / M. MCGREGOR-LOWNDES / K.W. SIMON, *Charity Law and Social Policy* (Berlin 2008).

APPENDED TABLE (RELATING TO ARTICLE 2 IN AUTHORIZATION ACT) <sup>198</sup>

- (i) Business to promote academism and scientific technology
- (ii) Business to promote culture and art
- (iii) Business to support persons with disability or needy persons or victims of accident, disaster or crime
- (iv) Business to promote welfare of senior citizens
- (v) Business to support persons having will to work for seeking the opportunity of employment
- (vi) Business to enhance public health
- (vii) Business to seek sound nurturing of children and youths
- (viii) Business to enhance welfare of workers
- (ix) Business to contribute to sound development of mind and body of the citizen or to cultivate abundant human nature through education and sports, etc.
- (x) Business to prevent crimes or to maintain security
- (xi) Business to prevent accident or disaster
- (xii) Business to prevent and eliminate unreasonable discrimination and prejudice by reason of race, gender or others
- (xiii) Business to pay respect or protect the freedom of ideology and conscience, the freedom of religion or of expression
- (xiv) Business to promote the creation of gender-equal society or other better society
- (xv) Business to promote international mutual understanding and for economic cooperation to overseas developing regions
- (xvi) Business to preserve global environment or protect and maintain natural environment
- (xvii) Business to utilize, maintain or preserve the national land
- (xviii) Business to contribute to sound operation of the national politics
- (xix) Business to develop sound local community
- (xx) Business to secure and promote fair and free opportunity for economic activity and to stabilize and enhance the lives of the citizenry by way of activating the economy
- (xxi) Business to secure stable supply of goods and energy indispensable for the lives of the citizenry
- (xxii) Business to protect and promote the interest of general consumers
- (xxiii) In addition to each of the foregoing items, business provided for in Cabinet Order as one relating to the public interest

---

198 This listing is taken from the unofficial government translation of Law No. 49/2006. It is interesting to note that Miyakawa translates the term “business” used here as “activities.” See MIYAKAWA, *supra* note 18, 66. The latter is clearly more consistent with the usage of the not-for-profit sector world-wide.

## ZUSAMMENFASSUNG

*Seit dem letzten Jahrzehnt des vergangenen Jahrhunderts haben sich die rechtlichen und steuerlichen Rahmenbedingungen für die Entstehung einer Zivilgesellschaft in Japan grundlegend gewandelt. Zu beobachten ist der Übergang von einem diese Entwicklung hemmenden, in das 19. Jahrhundert zurückreichenden Paradigma zu einem wesentlich moderneren. Das neue Modell erkennt die Bedeutung einer Zivilgesellschaft für das Binnenwachstum der Wirtschaft, den Umgang mit sozialen Problemen und für eine Zusammenarbeit mit der Regierung bei der Bewältigung der gesellschaftlichen Aufgaben an, die sich infolge des demographischen Wandels und der Überalterung der Bevölkerung stellen.*

*Der Beitrag knüpft an die Erfahrungen mit der ersten Reformwelle auf diesem Gebiet (der Einführung der sogenannten gemeinnützigen Körperschaften für besondere Zwecke als neuer Rechtsform) an, er stellt jedoch die neueren Reformen in den Mittelpunkt. Diese haben nicht nur das über 100 Jahre alte Zivilgesetz geändert, sondern Japans non-profit Sektor rechtliche und steuerliche Rahmenbedingungen gebracht, denen auch international eine Vorbildfunktion zukommt.*

*(deutsche Zusammenfassung durch die Red.)*