

Legal and Tax Reforms for Koeki Hojin
Discussion and Comparative Analysis*

by

Karla W. Simon
Professor of Law
Catholic University of America

and

Leon E. Irish
President
International Center for Civil Society Law
Visiting Professor of Law
Central European University

* The authors were invited by Prof. Masayuchi Deguchi, Chair of the International Society for Third Sector Research (ISTR), to visit Japan under the sponsorship of the Institute of Ethnography and ISTR's Japan chapter. The purposes of the visit, in May 2004, were for Prof. Simon and Dr. Irish to consult with government officials, researchers, leaders of the not-for-profit sector, and members of the Fukuhara Commission (the Expert Commission on Reform of the Public Benefit (Koeki Hojin) Corporation System in Japan, to make presentations of their work on the laws affecting civil society organizations around the world, and to write a report containing comparative analysis of the reform process in Japan. The list of meetings held is attached as Appendix A. Prof. Simon and Dr. Irish have prepared this report based on the discussions held during their visit as well as additional analysis and research. They are grateful to the persons with whom they spoke during their visit and for the insights gained. All remaining errors in the analysis in this paper are entirely their own. By way of background, it should be noted that Prof. Simon is co-author with Robert Pekkanen of a book chapter entitled *The Legal Framework for Voluntary and Not-for-Profit Activity in Japan* in THE VOLUNTARY AND NON-PROFIT SECTOR IN JAPAN (Routledge 2003). The authors have also been closely following the developments in Japan since 2002 and have provided coverage of them in the INTERNATIONAL JOURNAL OF CIVIL SOCIETY LAW (IJCSL) and the IJCSL NEWSLETTER. These are available at www.law.cua.edu/students/orgs/IJCSL/.

Part I
Legal Rules for Not-for-Profit Organizations:
Comparative Analysis for Japan

A. Introduction

The terms “NPO” (not-for-profit organization) and “PBO” (public benefit organization) will be used in this Report because they are terms in common usage throughout the world to describe different types of organizations within the not-for-profit or civil society sector. In addition, these terms are utilized so that there is a uniform terminology for discussion and comparative analysis of the structures for and the methods of differentiating between public benefit organizations and all other not-for-profit organizations.¹ This is necessary because organizations whose principal purposes and activities benefit the public are generally accorded greater benefits (e.g., tax benefits, subsidies, etc.) than other not-for-profit organizations. At the outset it should be noted that in many legal systems the terms NPO and PBO do not describe any legal forms² or specify a legal status – they are used as colloquial classifications for different types of organizations, but they have no legal significance. In some countries, however, the terms are used to describe legal forms, and these include Japan.³ Regardless of whether the terms are used colloquially or have legal significance, it is necessary to define them in order to use them for the comparative analysis contained in the Report.

The general understanding in legal systems around the world is that a not-for-profit organization or NPO is (1) a legal person (2) that is not principally organized or operated to make and distribute profits, (3) that is not part of the State, and (4) from

¹ See Leon E. Irish, Robert Kushen, and Karla W. Simon, GUIDELINES FOR LAWS AFFECTING CIVIC ORGANIZATIONS (Open Society Institute, 2004) at 103 (hereafter OSI GUIDELINES).

² In England and much of the common law world NPOs are known as not-for-profit organizations and PBOs are known as charities; in France PBOs are classified for administrative law purposes as “*organisations d’utilite publique*,” and in Germany there are different types of “*gemeinnützige Zwecke*,” for which different levels of tax benefits are provided.

³ The term “NPO” has been used in Japan to describe the “Special Nonprofit Corporation” created in 1998. This report, however, uses the term “SNC” for such organizations in order to avoid any confusion between the generic “NPO” and the special SNCs. .

which no profits, earnings, or assets can be distributed other than for its not-for-profit purposes.⁴ In most civil law countries there are two legal forms for NPOs – associations and foundations – though some civil law countries have several forms (in addition to Japan, Russia is one such country).⁵ In general, though not always, civil law countries permit both forms to be used both by mutual benefit organizations (e.g., private clubs are formed as associations and foundations are permitted to be established for mutual benefit purposes) and by public benefit organizations.⁶ This type of framework permits organizations to choose the type of governance structure they wish to have – associations are ordinarily governed by a board of directors elected by the members, while foundations usually have a self-perpetuating board of directors. It is generally desirable to allow such flexibility within a traditional civil law legal framework having only two legal forms of NPO.⁷

⁴ Distributions in dissolution by mutual benefit organizations may be made to members – for example, if a club dissolves, and it was formed by member contributions that were not tax benefited, it may distribute its assets to members upon dissolution. See *In re Los Angeles County Pioneer Society*, 217 F.2d 190 (9th Cir. 1954). If an organization permits non-dissolution distributions to members but is operated on a not-for-profit basis, it would ordinarily be classified as a cooperative and not an NPO.

⁵ In certain countries in Central and Eastern Europe, e.g., Hungary and the Czech Republic, a third legal form was added to the traditional structure because legal theorists had difficulty imagining that the foundation form could be used to operate a public benefit service providing entity. Thus, each country adopted a form of “public benefit corporation” to overcome this problem. See *Hungary Country Report* and *Czech Republic Country Report* at www.usig.org. In China a similar form has been developed – the *minban fei qiye danwei* – but with the added confusion of allowing private investment in such entities (see Karla W. Simon and Qi Hong, *The Legal Framework for Not-for-Profit Entities in China*, paper delivered at the ISTR Asia Regional Meeting in Beijing China, October 2003 (draft on file with the authors)).

Despite these developments, many countries in Europe (e.g., Germany and Holland) have had no difficulty with allowing foundations to be operating, as opposed to grant-making, entities. See, Andreas Schlüter, Volker Then and Peter Walkenhorst, *FOUNDATIONS IN EUROPE INTERNATIONAL REFERENCE BOOK ON SOCIETY, MANAGEMENT, AND LAW* (Bertelsmann Foundation 2001).

⁶ The most modern law on associations and foundations in Europe – the Belgian law adopted in 2003, permits this type of flexibility, as it recognizes four different types of NPO legal person. See Michel De Wolf, *The New Legal Regime for Not-for-Profit Organizations in Belgium*, 2 INT’L J. CIVIL SOC. L. 155 (April 2004), available at www.law.cua.edu/students/orgs/IJCSL/. Poland, on the other hand, does not permit mutual benefit foundations. See *Poland Country Report* at www.usig.org.

⁷ It is important to note that the Interim Summary of Discussions of the Expert Meeting on Reform of the Public Benefit Corporation System (hereafter Interim Summary) mentions the need

For purposes of this Report, the crucial category of NPOs is that of “public benefit organizations” (PBOs). In general understanding, a PBO is (1) an NPO that (2) has the exclusive purpose of acting for the public good by benefiting (a) all members of the community or (b) some particular group that is disadvantaged or otherwise deserving of special benefits.⁸ It is clear from the developments in Japan at the present time that the manner of determining the difference between PBOs and other NPOs is the critical issue at hand.

B. Basic aspects of the reform of the NPO/PBO system in Japan

Beginning in 2002 the government began to assess the need for “sweeping” (later “drastic” reform) of the legislative framework for “Public Benefit Juristic Persons” (koeki hojin) in Japan⁹. This was seen as part of the administrative reform process, which was already well underway and which was transforming the state and its relationships with Japanese society. In part, the reform effort for koeki hojins relates to the fact that they have until now been regulated by Article 34 of the Civil Code, which has not been updated since it was enacted in 1896. In part, the effort also relates to the growing awareness that NPOs play an enormous role in modern Japanese society and that the legal framework within which they operate needs to be modernized to take that role into account – basically to create rules that will facilitate their operations.¹⁰

for further study of whether to permit foundations to be formed for mutual benefit purposes. *Id.*, at 4. Recent developments in Belgium (supra note 6) and long-term practice in Germany suggest that mutual benefit foundations should be permitted in Japan. Indeed, de-linking form from tax status, as the proposals suggest will be done, removes the potential problems associated with mutual benefit foundations finding their way into tax-preferred status by stealth.

⁸ Thus, an NPO formed to improve the environment or to protect orphans would be a PBO under virtually every legal system in the world. This issue is considered in more detail in the text at note 43, *infra*.

⁹ For the purpose of the “Informal Research Meeting” held with members of the Administrative Reform Promotion Office of the Cabinet Secretariat of the Government of Japan, the participants from the government side prepared a set of Briefing Documents containing all the relevant English language translations of the various steps in the reform process as well as other matters. The basic timeline for the process is attached as Appendix B. Other documents that are referred to in this paper are either available in IJCSL (see citation in note *, *supra*) or are on file with the authors. The documents provided at the meeting will hereafter be referred to as the Briefing Documents

¹⁰ See Interim Summary, *supra* note 7, at 1.

Under the rules of Article 34, two different forms of public benefit organization (koeki hojin) are described – incorporated associations and incorporated foundations. In order to form a koeki hojin under Article 34, a group must receive permission from a competent authority – one of eleven ministries with administrative discretion to grant permission for the organization to exist as a juridical entity. If an organization does receive koeki hojin status under Article 34, it is automatically entitled to certain tax benefits (including tax deductible status for donors). Public benefit corporations can also be formed under special legislation relating to social welfare, private school, religious, and medical corporations introduced during the late 1940's and early 1950's. Each of these special forms has its own rules for tax benefits, and, with the exception of religious corporations, a group must have the approval of the oversight line ministry in order to be formed. Hereafter, when the Report refers generically to koeki hojins, it includes these special legal forms of public benefit corporation as well.

From the 1950's to the end of the last century nothing much happened with regard to this complicated and bureaucratic legal framework for NPOs in Japan. Thus, although Japan's Constitution of 1946 specifically guarantees the freedom of association in Article 21, the legal framework within which that freedom is supposed to be exercised was until quite recently extremely cumbersome. It was not until 1995, when the Kobe Earthquake raised public awareness of the difficulties faced by NPOs operating in the country, that things began to change.¹¹ After the earthquake, the publicity surrounding the difficulty NPOs had had in responding to the crisis led to a political process aimed at transforming the outdated legal regime with which they were encumbered.

In 1998, the so-called “NPO law” was enacted, which created the legal form of “Special Nonprofit Corporation” (hereafter SNC); this was in direct response to the Kobe Earthquake. SNCs created under this law are certified by the Economic Planning Agency; this law has generally made it much easier to establish a public-service-providing NPO in Japan, though research has shown that not all organizations wish to be

¹¹ The historical context for this is discussed by two American scholars in Robert Pekkanen and Karla W. Simon, *The Legal Framework for Voluntary and Not-for-Profit Activity in Japan* in THE VOLUNTARY AND NON-PROFIT SECTOR IN JAPAN (Routledge 2003). Both authors were privileged to be actively involved with the transition process as observers and lecturers.

within the SNC system.¹² In 2001 the Chukan Hojin law was enacted, which provides for juridical person status for not-for-profit associations serving the interests of their members (such as clubs and fraternal associations).¹³ Applying the terms NPO and PBO to the different entities now permitted by Japanese law, it seems clear that koeki hojins and SNCs are PBOs,¹⁴ while Chukan Hojins are regular NPOs. At present it is impossible to establish a private or mutual benefit foundation under Article 34 of the Civil Code,¹⁵ though if such a legal form were permitted it would be an NPO and not a PBO.

When the Cabinet launched the “Drastic Reform of the Public Benefit Corporation System” in June 2003, many people assumed that all PBOs (koeki hojins in the extended sense) and SNCs would be included in the reforms and that the administrative and tax rules developed would apply to all of them.¹⁶ In the reform process a differentiation was expected to be made between koeki hojins and other PBOs, on the one hand, and Chukan Hojins and possible mutual benefit foundations, on the other. As it has evolved, however, the SNCs do not want to be included in the reform process for koeki hojins. The argument has been made (and accepted) that since their legal regime is relatively new, there is no need for modernization at the present time.

¹² They may also be formed as “Approved Community Based Organizations,” formed under the Local Autonomy Law of 1991.

¹³ Prior to 2001 the tax system permitted tax exemption only for koeki hojins and the related public interest organizations set up under the special laws. Tax deductibility was available for donations to them pursuant to Income Tax Law § 78 (2)[2]. Tax reforms in 2002, with amendments in 2003, now permit tax deductible contributions to be made to a sub-class of SNCs, those that meet the tests for qualifying as “Tax-Deductible (“*nintei*”) Specified Nonprofit Activities Legal Persons.” Further discussion of these reforms can be found in Pekkanen and Simon, *supra* note 11. Up until now, however, such organizations have not been tax exempt.

¹⁴ For the purpose of keeping this discussion relatively simple, the special types of social welfare, educational, health, and religious organizations are included as koeki hojins even though each is regulated by its own special law. The paper also assumes that charitable trusts will be treated like other PBOs in the new system of regulation for PBOs that will eventually be adopted in Japan.

¹⁵ Informal conversations with the members of the Koekihojin Kyokai (Association of Nonprofit Organizations) and Prof. Takako Amemiya (Professor of Civil Law at Meiji Gakuin University Graduate Law School) suggest that such groups do exist in Japan at present either informally or under the Public Charitable Trust Law of 1923/1977.

¹⁶ In fact, the chart provided for the Informal Briefing on 18 May 2004 suggests the theoretical connection between SNCs and other PBOs by listing them all as “public benefit corporations (of a wide sense).” Document numbered 6; Briefing Documents, *supra* note 9.

Thus, when this Report discusses PBOs, it will only be referring to the koeki hojins (in the extended sense) that will be directly affected by the reform efforts currently underway. When the Report refers to NPOs, it means to include Chikan Hojins as well as any other non-PBO entities that may be permitted to be formed (e.g., private or mutual benefit foundations).

C. What are the key issues raised by the reform?

In looking at the documents that have been developed by the government in the course of the reform process and in particular the Interim Report from 31 March 2004, the first key issue is **whether the definition of PBO will be part of the Civil Code or whether it will apply for tax purposes only**. The centrality of this issue for the process is recognized not only by the government but also by the Yusikisya Kaigi (Experts' Commission appointed by the Minister of State for Administrative Reform and Regulatory Reform, which is chaired by Mr. Yoshiharu Fukuhara (Fukuhara Commission)). Criticisms of the Interim Report focus on the fact that it treats both possibilities equally despite the fact that the majority of members of the expert Fukuhara Commission favor the option of having the new definition of PBO be used for both civil law and tax law purposes.¹⁷

The second key issue raised by the reform process is **what organization should be the “determining organization?”** In other words, which body will determine whether an NPO is a PBO -- will it be a government ministry or a semi-independent commission? At the present time, eleven different “competent authorities” (line ministries that have jurisdiction over matters relating to the purposes and activities of each koeki hojin) provide permission/approval for national level koeki hojins to operate as legal entities. If the activities of a koeki hojin are confined to one local area, the local to, do, fu, or ken (prefecture or its equivalent) has the authority to grant approval. Since over 70% of all koeki hojins in Japan operate at the local level, deciding how a national level “determining organization” will approve such organizations remains a critical issue.

¹⁷ See Hideko Katsumata, Interim Report on Public Interest Corporation Reforms Stirs Further Debate in CIVIL SOCIETY MONITOR No. 9 for June 2004 (JCIE), available at <http://www.jcie.or.jp/civilnet/monitor/9.html>. Mr. Katsumata is Managing Director of JCIE and a member of the Fukuhara Commission.

The third key issue is **the “determination requirements” for obtaining PBO status**. As stated above, the question of whether an NPO is a PBO depends on its having the exclusive purpose of acting for the public good by benefiting (a) all members of the community or (b) some particular group that is disadvantaged or otherwise deserving of special benefits. In addition, unlike a regular NPO, a PBO must never be allowed to distribute profits, earnings, or assets other than for its public benefit, not-for-profit purposes. This is the “non-distribution constraint,” which is the most important defining characteristic for PBOs and which ensures that they operate only for public benefit.¹⁸

The fourth key issue is **the requirements for maintaining PBO status**. What sorts of internal governance (board oversight) and management structures will need to be established for PBOs by law? In addition, how will they maintain transparency of operations and accountability to the public to ensure that they continue to operate only for public benefit? As the “Outline of Japan’s System of Public Benefit Juristic Persons” suggests, some existing koeki hojins have apparently abused the system by paying “unfairly large amount of remuneration,” and by monopolizing access to certain state contracts.¹⁹

D. Key Issue One – Will the new legal framework exist for both civil law and tax law?

A rational framework for the operations of NPOs and PBOs in Japan can best be achieved by **having the Civil Code provide the general legal framework for these organizations**. The suggested arrangement is consistent with modern practice. In most countries the civil law creates the criteria for the registration of an NPO²⁰ as well as the

¹⁸ See OSI GUIDELINES, supra note 1, at § 4.1.

¹⁹ See Outline of Japan’s System of Public Benefit Juristic Persons, Document numbered 5; Briefing Documents, supra note 9.

²⁰ It may well be that the Civil Code itself contains only the rudimentary definitions of associations and foundations, leaving it to special legislation (e.g., the new law in Belgium, supra note 5) to flesh out the details for their governance, etc. How this result will actually be accomplished in Japan will need to be discussed among legal scholars. It is important to note, however, that ease of access to obtaining legal personality is required not only by Japan’s Constitution but also by the international law guarantee of freedom of association. For a discussion of this issue, see OSI GUIDELINES, supra note 1, at § 2.1.

additional and special qualifications needed for certification as a PBO,²¹ and the tax law provides similar, but distinct criteria for obtaining tax benefits. Although continuity of definition is useful, it is not always possible because of the incremental way in which laws develop. At this stage, however, Japan has the possibility of making the definition of the terms NPO and PBO exactly the same for both civil law and tax law purposes, which would create a desirable simplification not present in many existing legal frameworks for NPOs.

Looking at the situation in several civil law countries, there is considerable support for this recommendation. In France, there is a definition of public benefit (public utility or social utility) for both administrative law and tax law.²² In Italy, ONLUS are defined in the civil law, and a determination of ONLUS status permits the organization to receive tax benefits.²³ In Brazil OSCIPs are certified under civil law and may also receive special tax benefits.²⁴ **The principal reason for making the distinction between NPOs and PBOs in the civil law is that PBOs may receive benefits other than tax benefits.** In each of the named countries PBOs are entitled to subsidies, special rules (and preferences) with respect to public procurement processes, and other non-tax benefits. As a result, these countries have chosen to make the PBO-NPO distinction in the civil law, and Japan should do the same.

²¹ Consistent with the practice in many countries, obtaining PBO status for civil law purposes requires an additional application, after the legal entity has been formed. For example, an organization can apply for the status of being a public utility organization in France, an ONLUS in Italy, and an OSCIP in Brazil. See discussion in the text.

²² See Sylvie Tsyboula, *Not-for-Profit Sector Laws in France*, in GOVERNANCE AND TAXATION OF PUBLIC BENEFIT NON PROFIT ORGANIZATIONS (Ambrosianum Foundation 2002).

²³ See Alceste Santuari, *The Italian Legal System Relating to Not-for-Profit Organizations: A Historical and Evolutionary Overview*, 3 INT'L J NOT-FOR-PROFIT L. 3, available at http://www.icnl.org/journal/vol3iss3/ar_santuari.htm.

²⁴ For a recent discussion of the use of two different forms of "PBO" certification in Brazil, see Eduardo Szazi, *How Are Civil Society Organizations Qualified in Brazil?*, in 2 INT'L J. CIVIL SOC. L. 102 (July 2004), available at <http://law.cua.edu/Students/2.3%20IJCSL%20-%20July%202004.pdf>; an earlier analysis of the various certifications available in Brazil can be found in Laís, Vanessa Carvalho de Figueirêdo Lopes, *Compendium of Third Sector Legislation - Analysis of the Existing Laws and Regulation in Brazil*, in 1 INT'L J. CIVIL SOC.L. 8 (January 2003), available at [http://law.cua.edu/Students/Orgs/IJCSL//Inaugural%20Issue%20\(January%202003\).pdf](http://law.cua.edu/Students/Orgs/IJCSL//Inaugural%20Issue%20(January%202003).pdf).

When the system for distinguishing between NPOs and PBOs in the United States is compared with these civil law systems, it may well seem that the tax law definition of PBO is what really matters and that the NPO-PBO distinction is only made under the tax law. The tax laws are indeed quite important for making the NPO-PBO distinction, but the reality is more complex because the U.S. is a federal country. In fact, all corporate not-for-profit organizations (as opposed to those that exist in the trust form) in the U.S. are incorporated as NPOs under the laws of the fifty states and the District of Columbia. Many of the state laws follow the *Revised Model Nonprofit Corporation Act (RMNCA)* (produced by the American Bar Association in 1987 after a long series of discussions, drafts, etc.) and permit an organization to self-declare as a PBO for state law purposes.²⁵ It is only once an organization is set up as an NPO that it will need to apply to the Internal Revenue Service for tax exempt status. Because of this framework, it is clear that many states follow the system recommended here – the application of PBO status for both civil law and tax law purposes.

One additional advantage to making the distinction between NPOs and PBOs in the civil law as well as in the tax law relates to public fund raising. In many countries only PBOs are permitted to raise funds from the general public through mail and door-to-door solicitation efforts. Although public fund raising does not appear to have been a matter of significant concern in the discussions thus far in Japan, the issue of whether an organization qualifies as a PBO that may raise funds in public campaigns is one that deserves attention. This is, of course, a matter of civil law and not tax law.

E. Key Issue Two – What should be the “Determining Organization?”

In many countries the determination of whether an NPO qualifies as a PBO is made by a Public Benefit Commission (PBC) which is established as an independent administrative body composed of representatives of the government, the PBO community, and the public. **Japan should establish a Public Benefit Commission as**

²⁵ For a longer discussion of the way the system works in the US, see Karla W. Simon, *The Legal and Regulatory Status of Public Benefit Organizations in the United States – the System of Accountability* in GOVERNANCE AND TAXATION OF PUBLIC BENEFIT NON PROFIT ORGANIZATIONS (Ambrosianum Foundation 2002).

the “Determining Organizations” for PBO status.²⁶ The oldest model of PBC is the Charity Commission of England and Wales,²⁷ which has been in operation for many years. Developments in other countries such as Brazil, Italy, Moldova, Russia, and, most recently, in New Zealand²⁸ and Scotland²⁹ indicate the growing acceptance of PBCs around the world.

A PBC acts as the certification, oversight,³⁰ and sanctioning authority for PBOs. A key benefit of unifying these various responsibilities in a specialized commission is the quality as well as the consistency of decision-making that is brought to the process by commissioners who are experts on PBOs. The PBC should receive an annual budget appropriation necessary for the fulfillment of its duties, and it should be able to hire expert staff to carry out its role as PBO regulator.³¹

Other entities that serve as the certification authority for PBOs in various countries include (1) courts, (2) line ministries, each within its area of expertise (e.g., health, education, sport) (as in Japan at the current time), (3) one specific ministry or department (e.g., the Justice Ministry or the tax agency). In theory, either (1) line ministries or (2) one specific ministry or department could exercise the oversight authority of PBOs. However, none of these options provides the efficiency or consistency and quality of decisions provided by a specialized commission. In fact, the

²⁶ The authors have recently submitted comments to the Senate Committee on Finance recommending the adoption of such a Commission for the United States. See <http://finance.senate.gov/sitepages/round.htm>.

²⁷ See the Charity Commission website at www.charity-commission.gov.uk for a description of the Commission’s organizational structure and duties. Recent changes in the structure of the Commission – moving from a “Chief Charity Commissioner” to a “Chair” and a CEO – are supposed to streamline its activities.

²⁸ Recent developments with respect to the creation of a “Charities Commission” for New Zealand are discussed in Patrick Hanley, *New Zealand Charities Legislation: An NGO Perspective* in 2 INT’L J CIVIL SOC. L. 120 (April 2004) *available at* www.law.cua.edu/students/orgs/IJCSL/.

²⁹ Recent developments with respect to the regulatory framework in Scotland are discussed in Christine R. Barker, “Draft Charities Bill for Scotland” in 2 INT’L J. CIVIL SOC. L. 118 (July 2004), *available at* www.law.cua.edu/students/orgs/IJCSL/.

³⁰ The role of the PBC in oversight is discussed in F., *infra*.

³¹ The Interim Summary, *supra* note 7, at page 6 notes the importance of providing budget and staffing for the Determining Organization.

situation in Japan at the present time permits undue discretion within the line ministries, does not provide for consistency of standards across the sector, and encourages PBOs to look for alternative means to become established.

The administrative law of any country will, of course, regulate the establishment and operations of a PBC. The attached “Model Provisions for Laws Affecting Public Benefit Organizations”³² contain many of the essential features of a Commission; but not all requirements for a Commission are included because different solutions will be appropriate for different countries. For example, a specific PBC size needs to be stipulated. In general, the PBC should be of medium size (perhaps between six (6) and twelve (12) Commissioners), allowing for both broad representation of interests and efficiency. Also, the specific composition of the PBC, terms of service of Commissioners, and the process through which they are selected are not specified in the Model Provisions. Again, this is because there are many possible solutions; the one most appropriate for a particular country should be selected and included in that country’s PBO law.

An interesting approach to the size and composition of a PBC is presented in the Moldovan Law on Associations (1996/97).³³ The Moldovan Commission consists of nine (9) persons, of whom three (3) are appointed by the President, three (3) by the Parliament and three (3) by the Government. At least one of each of the three sets of three (3) appointed members must be a representative of a PBO and must not simultaneously be a civil servant, a government official, or a Member of Parliament.

Under other approaches (e.g., in England and Wales) there is no parliamentary representation on the PBC, but instead government and PBOs both have representatives; in some instances there are also representatives of the general public or expert bodies (e.g. the accounting profession). Whatever approach is used, however, there should always be PBO representation, either through an appointive process or by selection through a democratic process administered by the PBO community. The presence of PBO representatives protects against repressive or discriminatory decisions and increases

³² Appendix A.

³³ Law of the Republic of Moldova on Public Associations, No. 837-XIII, ch.5, art. 34-37 (May 1996).

the confidence of the public. It is clear, however, that selection processes for the PBO representatives must be fairly determined so that adequate representation of interests is assured over time.

In addition, the length of terms for the Commissioners serving on the PBC must be specified – they should generally be between two (2) and six (6) years. The terms should be long enough to assure experience on the PBC, but short enough to prevent stagnation or entrenchment of interests. To ensure continuity, terms should be staggered. It may be appropriate to put limits on how many consecutive terms may be served by an individual.

It is also important to note that there is a model of self-regulation being developed in two countries that pairs the PBC idea with delegation by the government of PBO certification to a non-governmental agency. In the Philippines, for example, the Philippines Council for NGO Certification oversees the granting of tax preferences for PBOs. It was established by six NPO networks, and it has an agreement with the Department of Finance to certify and oversee the PBOs.³⁴ A more recent model can be found in Pakistan, where the Pakistan Centre for Philanthropy – an NPO -- has a similar arrangement with the tax authorities in that country.³⁵ The issue of linking regulatory oversight with self-regulatory oversight has also been recently suggested in the United States, though the NPO accreditation bodies discussed in the US would link to the IRS, not to an independent commission.³⁶

One final issue requires consideration, and that is how to make the system described here function in a country like Japan, where over 70% of the PBOs operate locally. In that sense Japan is very much like England and Wales; there the Charity Commission exercises national jurisdiction over all PBOs in those two parts of the United Kingdom.³⁷ The Charity Commission has local offices throughout England and Wales,

³⁴ For more information on the PCNC, see www.pcnc.com.ph.

³⁵ For more information, see www.pcp.org.pk/certification.htm.

³⁶ See Senate Finance Staff Discussion Draft, Part G. 5., *available at* <http://www.finance.senate.gov/sitepages/hearing062204.htm>.

³⁷ Without going into elaborate detail about the constitutional structure of the United Kingdom, suffice it to say that determination of “charity” status is a “devolved” power, which means that each part of the UK (including Scotland and Northern Ireland) must decide this matter for itself.

which de-centralizes its functions somewhat. Policy is, however, made at the national level and carried out locally. Looking more carefully at what the Charity Commission has done to develop its operations to meet local needs might well help to deal with this specific issue mentioned by the Interim Summary.

F. Key Issue Three – What criteria should apply to determination of PBO status?

As indicated in the introduction, in order for an organization to be a PBO, it must be an NPO that has the exclusive purpose of acting for the public good by benefiting (a) all members of the community or (b) some particular group that is disadvantaged or otherwise deserving of special benefits. Thus, a PBO must not only have the exclusive purpose to benefit the public, it must also be (1) a legal person (2) that is not principally organized or operated to make and distribute profits, (3) that is not part of the State, and (4) from which no profits, earnings or assets may be distributed other than for its not-for-profit purposes. These requirements are considered in turn.

1. Obtaining legal person status – an organization seeking to become a PBO should first register as an NPO under the civil law. *The legal persons permitted to be established as NPOs should be associations and foundations.*
2. *Associations and foundations established pursuant to these rules will be private law entities.* It is clearly permissible to set up public law foundations, etc., but those are not considered here.
3. An *association* is a separate legal person founded by seven (7)³⁸ or more natural³⁹ or legal persons⁴⁰ for the principal purpose of engaging in activities⁴¹ that are --

The significant change in this regard is that Scotland, which had long resisted making itself subject to the Charity Commission, is now developing legislation that will create a Charity Commission-like Office of the Charity Regulator, which looks a lot like the Charity Commission. See, the Christine Barker, *op.cit.*, supra at note 29.

³⁸ Requiring a large number of founding members impedes the formation of associations. Modern laws of associations typically require three (3) to seven (7) founding members.

³⁹ This definition does not impose any special restrictions or limitations on the right of foreign citizens or residents to form or participate in associations and foundations. Such persons must, of course, comply with all applicable immigration and visa requirements, and the associations or foundations they create or participate in must obey all applicable laws of the country in which the NPO is being formed, including applicable reporting requirements under that law. It seems both

- (a) either
 - (i) for the mutual benefit of a defined group, or
 - (ii) for public benefit, and
 - (b) not for profit.
4. A *foundation* is a separate legal person that is founded by one (1) or more natural or legal persons by allocating an amount of money for a definite or indefinite period of time for the principal purpose of supporting or engaging in not-for-profit activities either for public benefit or mutual benefit.⁴² A foundation may be established by a living or testamentary act.⁴³
 5. An association is a *membership organization* in which the highest governing organ is the members of the organization gathered at a properly convened at the

discriminatory and unnecessary to impose additional special limitations on foreign citizens with respect to their involvement with NPOs.

⁴⁰ Thus, an association may be formed, not only by individuals, but also by a group of like-minded associations (e.g., an association of farmers' associations), by groups of similar business entities (e.g., a trade association), or a group of similar organs of the state (e.g., an association of police departments). Founders may choose whether and which kinds of associations to form. There is no need for the law to limit the different kinds of associations that can be formed by legal persons.

Although special care needs to be taken to assure that associations or foundations established by governmental organs do not involve a financial or political conflict of interest or improper personal benefit, there is nothing inherently improper in allowing governmental organs to be founders of a foundation or association. In a civil law system, the governmental organs will, of course, continue to be governed by public law, whereas any foundation or association founded by them would be a private law entity.

It should be noted that foreign legal persons, like foreign natural persons, would be entitled to establish an association or foundation under this provision. So long as such an organization fully meets the standards and requirements established under this law, including applicable reporting requirements, there would seem to be no reason to impose discriminatory rules or special limitations on foreign legal persons.

⁴¹ An association or foundation, once formed, may engage in any legal not-for-profit activities. For example, there could be a not-for-profit association of stamp collectors or mountain climbers and there could be a foundation for the benefit of all orphans in a specific community (public benefit) and or to create a retirement fund for the employees of a specific employer (mutual benefit).

⁴² A foundation may make grants to others to perform public benefit activities, it may engage in such activities itself, or it may do both. The amount of money allocated for its purposes may be nominal or large. A foundation may not be utilized for personal or family benefit.

⁴³ Consideration should be given to amending the laws, if necessary, to facilitate the creation of a foundation by will or testamentary act.

- annual general meeting of members (AGM). A membership organization may have a Board⁴⁴ that is elected by, and is accountable to, the membership. For large associations it is virtually impossible to have the AGM be the only internal organ – they will need to elect a Board for proper governance.
6. A foundation is a *non-membership organization* in which the highest governing body is a self-perpetuating Board. In some cases, in particular if the organization is large, there may be a need for a two-tier governance structure. In such cases the law or the rules for PBOs might require a foundation to have an audit committee or a “supervisory” board.
 7. *Not-for-profit does not mean that the NPO cannot engage in economic activities to produce revenues for its support.* Such revenues may be earned from activities that are conducted to carry out the organization’s not-for-profit purposes (museum entrance or school tuition fees, for example), from investments (interest and dividends earned on a foundation’s endowment, for example), or they may be from the active conduct of a trade or business engaged in solely to gain revenue for support of the NPO.⁴⁵ In general, both NPOs and the smaller sub-class of PBOs *should be allowed to engage in income-producing activities as long as those activities further the not-for-profit purposes stated in their governing documents.* A test of whether the business activities further the not-for-profit purposes of the organization is essential to distinguishing proper NPOs from for-profit enterprises. If business activities that are unrelated to the not-for-profit purposes predominate, the “NPO” is really not an NPO and should be required to register as a for-profit entity. Exactly how much business activity is necessary in order to require that an NPO register as a business will need to be decided. This is essentially a civil law matter – it must be determined at the time the entity registers to become a juridical person. Of course, the PBC or the tax authority

⁴⁴ The Board of either a membership or non-membership organization may be called a “Board of Directors,” a “Board of Trustees,” or any other name which would be commonly understood to refer to a governing body.

⁴⁵ This does not include ad hoc or “one-off” activities, such as raffles, charity sales events, etc. “Active conduct of a trade or business” requires the regular, repeated, or continuous conduct of an income-producing activity over a substantial time. Thus, profits from one-off fund raising events are generally not taxed.

may later discover that an entity that was properly registered as an NPO at the outset has begun to engage in too much unrelated business and may require it to terminate its status as an NPO and re-register as a business entity.

8. *The non-distribution constraint must apply to all PBOs and many NPOs.*

Whether it applies or not to an NPO is an issue of what benefits that NPO has received from the State. NPOs may be permitted to return any assets to members upon dissolution – at least to the extent that the members did not receive a tax deduction at the time the assets were contributed to or the entity paid tax when revenues were earned. The way in which assets of such NPOs are distributed on dissolution depends on the terms of their charters.

9. *A PBO must have as its purpose the pursuit of one or more “public benefit activities,”⁴⁶ as defined by law; and it must conduct activities in pursuit of those purposes almost exclusively (de minimus non-public-benefit activities are permitted).*

10. *An NPO can qualify as a PBO if intends to provide significant benefits*

- a. to the public-at-large, or
- b. to a targeted class of beneficiaries, where
 - i. the class is disadvantaged relative to the population as a whole, or
 - ii. there is a significant value to the community in providing special benefits to the targeted class;⁴⁷ and
 - iii. the NPO provides significant goods and services at or below cost; and
- c. it meets all other factors indicating that the NPO is organized and operated principally to engage in Public Benefit Activities.

⁴⁶ The Model Provisions contain a list of public benefit activities that was derived in a specific context. The list for Japan must reflect Japanese needs.

⁴⁷ Note that this factor constitutes a significant limitation on what constitutes a PBO. This factor means that it is not sufficient for an organization to engage in a “public benefit activity” as defined by law. It should also provide significant benefits, either to the public at large or to a targeted group under the conditions specified above. Thus, the Public Benefit Commission should determine that an organization that promotes economic development only in a prosperous area would not qualify as a PBO. One that promoted economic development in a disadvantaged region of a country, however, or even in a whole country if the entire population can be deemed “disadvantaged,” would be eligible for PBO status.

This Report thus takes the position that a few fairly clear and nondiscretionary tests must be met by an NPO that seeks to become certified as a PBO. Certification would require the filing of a set of documents showing that the organization seeking to be so qualified looks like one that will fit the status. These will include the organization's charter and by-laws (the internal governing documents), which state the purposes and proposed activities and describe the organization's governance structure. Also to be included is a prospective budget for three years. The Report does not recommend that numerical strictures be placed on e.g., the proposed level of administrative expenses, because organizations differ markedly in that regard and because start-up organizations typically have a higher level of administrative expenses than mature ones.⁴⁸

G. Key Issue Four – What should be the requirements for maintaining PBO status?

Of the four key issues, this may be the one about which there will be the most contention because it involves a wide range of issues. These are as follows:

- The extent to which an organization has internal rules for management and governance that structure its management and board oversight to ensure that it is operated as a PBO;
- The extent to which external accountability and reporting to the PBC and the general public create an adequate external oversight process;
- The extent to which there are adequate accounting and record retention rules in place to back up the internal and external accountability standards; and
- The extent to which self-regulation can and should play a role in the system for PBO supervision.

Much of this material is already discussed at more length in the Interim Summary document, in the Model PBO Provisions, and in some of the materials already cited in the Report. Some issues to highlight in terms of the choices to be made are as follows:

⁴⁸ The Report does recommend, on the other hand, that there be set limits on management and trustee compensation in order to deter self-dealing. See text at note -- , infra.

- Swiss GAAP FER 21, which was adopted in 2002 and went into effect in 2003, should be examined in terms of coming up with a set of accounting standards for NPOs in Japan. It is available at http://www.fer.ch/pdf/FER21_Dez_2002_final_1.pdf.
- Adopting a record retention policy and special sanctions for failure to maintain adequate records and submit required reports is crucial for this regime to work. A sample record retention policy can be found in note 124 in the OSI GUIDELINES.
- Rules setting out clearly the fiduciary standards for board members as well as placing restrictions on conflicts of interest and self-dealing must be adequately spelled out. Recommendations made in recent reports by the authors in other contexts (e.g., China, East Timor) suggest that there be numerical limits on compensation for members of the board of directors (generally no compensation for board members for their board service) and for managers (a set standard for compensation, such as that received in government service or in academia, should be applied).
- There should be rules that set up the manner in which boards must deal with conflict of interest issues, and these should be strictly applied.
- The sanctions that are applicable when conflict of interest and self-dealing problems arise should be imposed on the managers and board members individually but not on the organization.
- Self-regulation should surely play a significant role in any system that will work. In this respect the Report suggests that models created in the Philippines and Pakistan⁴⁹ should be reviewed along with the parts of the Senate Staff Discussion Document that deal with accreditation.⁵⁰

⁴⁹ See notes 34 and 35, supra.

⁵⁰ See note 36, supra.

Part II
Tax Rules for Not-for-Profit Organizations:
A Survey of Practice

A. Introduction.

This part of the Report describes tax rules that are applied to NPOs and their donors in various countries around the world. It is based on primary research and a variety of secondary sources. Access to detailed descriptions of the tax laws affecting NPOs in Germany,⁵¹ the United Kingdom,⁵² and the United States⁵³ is provided in footnotes. As a leading scholar of comparative tax law has stated, “a focus on these three countries (Germany, U.K., and U.S.) will reveal most of the basic contrasts that would arise from including other countries in the study.”⁵⁴ The purpose of this part of the Report is to provide a broad and detailed understanding of how NPOs are taxed in countries around the world. This will enable policy-makers to choose among different alternatives and draft new tax laws appropriate for NPOs in Japan.

There are several taxes from which NPOs (and or PBOs) can be exempt. There are also various ways of providing income tax benefits for donors – whether individuals or companies – to NPOs that are available in various countries. This part of the Report discusses the various taxes from which the entities may be exempt, tax preferences for donations, and issues of tax administration.

B. Substantive Survey of Taxes and Tax Preferences.

⁵¹ See Michael Ernst-Pörksen, Basic Conditions of Corporate Law & Tax Legislation Affecting the Third Sector in Germany, in 1 INT’L J. CIVIL SOC. L. 17 (October 2003), available at [http://law.cua.edu/Students/Orgs/IJCSL//Volume%20I%20Issue%204%20\(October%202003\)%20\(Updated\).pdf](http://law.cua.edu/Students/Orgs/IJCSL//Volume%20I%20Issue%204%20(October%202003)%20(Updated).pdf).

⁵² See Paul Bater, *Tax benefits for civil society organizations in the United Kingdom*, in GOVERNANCE AND TAXATION OF PUBLIC BENEFIT NON PROFIT ORGANIZATIONS (Ambrosianum Foundation 2002).

⁵³ See Leon E. Irish, *Provisions of the United States Tax Laws Affecting Not-for-Profit Organizations*, in GOVERNANCE AND TAXATION OF PUBLIC BENEFIT NON PROFIT ORGANIZATIONS (Ambrosianum Foundation 2002).

⁵⁴ Victor Thuryoni, COMPARATIVE TAX LAW 9 (Kluwer 2004).

1. Income or Profits Tax⁵⁵Exemption in General⁵⁶.

The definition of NPO being used here assumes that an NPO is precluded from providing personal benefits to founders, donors, members, employees, and so forth, or distributing profits to such persons or to anyone else except pursuant to its not-for-profit purposes.⁵⁷ Thus, there is a powerful argument that these organizations are not proper objects of an income tax in any system. Income taxes are imposed on the “profits” of legal entities because they are surrogates for the individuals who own them or who can receive a distribution of profits from them.

NPOs, as defined here, stand on an entirely different footing from business corporations. They are not “owned” by anyone and cannot distribute profits as such. Whatever profits they may earn from their economic and investment activities must be reinvested or spent on appropriate purpose-related activities (i.e., activities related to their not-for-profit purposes). NPOs are not surrogates for shareholders who own them, and thus it can be strongly argued that they should not be subject to income taxation at all.⁵⁸ In fact, however, most countries around the world assume that NPOs, like for-profit entities, are potential subjects of taxation, and that not applying tax to them is a matter of

⁵⁵ Some countries have one tax law governing the taxation of the income of physical persons and another tax law governing the taxation of the profits of legal persons. In most countries these income and profits taxes are included in one law, often called the income tax law.

⁵⁶ Although NPOs are referred to as being exempt from taxes throughout this Report, it is important to note that such exemption is not a matter of course – NPOs must apply to be tax exempt. The process of applying for tax exemption may be lengthy, and it may well be that different applications are required for different taxes (e.g., for income or profits tax, on the one hand, and VAT, on the other). Criteria for exemption may differ as well.

⁵⁷ One important issue in China at present is the extent to which private persons may “invest” in an organization set up as a *minban fei qiye danwei*. Such an “investment” would violate the principle that profits cannot be distributed and would make these organizations similar enough to for-profit business organizations that they should be characterized as such.

⁵⁸ The situation in Sri Lanka illustrates that there may be positions between treating NPOs as full taxpayers and exempting them on all their income. In that country the corporate income tax is levied on charities at a concessional rate of 10 percent on income in excess of Rs. 42,000 per annum, and the tax can be waived for charities providing institutional care. The theory behind this rule apparently is that better accountability will be assured if sizable charities are required to file tax returns, even though the tax rate is quite low. See ESCAP, FISCAL INCENTIVES FOR NONGOVERNMENTAL ORGANIZATIONS IN ASIA-PACIFIC (1994) (hereinafter FISCAL INCENTIVES).

grace and exemption.⁵⁹ Nevertheless, most countries do grant broad tax exemptions and other tax benefits to NPOs, especially PBOs.

Apart from receipts from economic or business activities, which are considered below in Section 3, typical sources of revenue for NPOs include donations, grants, subsidies, membership dues, interest and dividends on investments, and gains from sales of investment assets. The first two groups of revenue sources – donations (gifts, grants, subsidies, etc.) and membership dues – are generally not taxed to NPOs in countries in the world because the tax laws do not include such items in the general definition of income.⁶⁰ For example, Section 102 of the Internal Revenue Code in the United States excludes gifts from income in general terms. The theory is that the donor has already been taxed on the item and to include it in the income of the donee would subject it to double taxation. Prominent scholars in the U.S. believe that this exclusion warrants non-inclusion of such items in the income of NPOs.⁶¹ It is clear, of course, that if the donation to a PBO is also given a tax preference the tax benefit is enhanced. But since

⁵⁹ A typical example of how difficult it is for NPOs to obtain tax exemption in some countries is provided by Thailand: in that country an NPO registered as a foundation or an association may seek tax exemption if its purpose is charitable, which means that it is related to religion, education, health, or social welfare. No NPO can qualify for tax exemption until it has operated for three years, although this rule may be waived by the Ministry of Finance. During the prior three years, the NPO must have spent 60% of its income or 75% of its total expenditures on charitable purposes. The result of these rules is that only about 200 NPOs have tax exempt status in Thailand. See ESCAP, *FISCAL INCENTIVES*, supra note 58.

⁶⁰ Like other gifts, grants, donations, and subsidies received by religious, charitable, or educational institutions are ordinarily not treated as being subject to tax. Some grants may look like contracts or even be in the form of a contract, but the proceeds of such a “contract” will generally not be taxed so long as the NPO is receiving funds to provide goods or services to third parties. If the contract is one to render goods or services to the contractor, however, the proceeds of that contract may properly be treated as income from an economic activity.

Membership dues are not taxed in large part because they are expended in connection with the performance of services for members. If the dues were included in income when received and the costs of member services were deducted when paid, the probable increase in tax revenues would be minor and the costs of collecting taxes would undoubtedly outweigh the gains. It therefore makes good sense not to tax revenues from membership dues. Those who pay membership dues will generally not be allowed to deduct them for income tax purposes, nor will they generally be treated as receiving income as a result of receiving the benefits of membership.

⁶¹ See Boris I. Bittker and George Rahdert, “The Exemption of Nonprofit Organizations from Federal Income Taxation,” 85 *YALE LAW JOURNAL* 299 (1976).

the tax preference generally does not equal 100% of the donation,⁶² the non-inclusion of the gift in income is usually seen as an appropriate subsidy to the PBO sector.

An example of recently enacted legislation (applicable as of July 1, 2004) that includes grants and donations in the income of NPOs can be found, however, in Tanzania, where all receipts by NPOs constitute income, but an NPO is permitted a deduction for all expenditures on its not-for-profit purposes.⁶³ Interestingly, new section 64 of the Income Tax Act says that “charitable” organizations are treated as conducting “charitable businesses” and that all receipts from those businesses as well as any non-charitable businesses are included in their income. If the organization retains more than 25% of the receipts, it will be subject to tax.⁶⁴ This is a novel approach and one that will warrant further research as it begins to be applied.

With respect to membership dues, the theory behind the rule for exclusion from income is somewhat different. Membership dues may not be considered to be income of an NPO in part because the organization owes the member services in return for the receipt of the dues. In addition, unlike charitable gifts, membership dues are never deductible to the donor. There may, of course, be a timing problem in that the member services may not be expected to be received in the taxable year in which the dues are paid, but that is ordinarily thought to be an insignificant problem and one that would not warrant the additional complexity of proper accounting over several taxable periods.

2. Income Earned on Investments (Endowments and Reserves).

Unlike the rules applicable to gifts, grants, etc., “passive” investment income is correctly thought to be subject to tax. Generally accepted tax theory defines income as any receipt during a defined period of time that is either expended or that increases net

⁶² As described in the chart attached as Appendix C, the value of the charitable contribution deduction in a progressive rate system depends on the taxpayer’s highest marginal rate. If a person is taxed at a 40% rate and contributes \$100 to a charity, she reduces her taxes by only \$40, not \$100.

⁶³ This also includes set-asides for future charitable activities, but how these rules are to be applied by the Commissioner of Income Tax has yet to be decided.

⁶⁴ See Tanzania Report in the August issue of IJCSL-N, where the effects of this legislation are explained further.

worth.⁶⁵ Under this approach, and in common understanding, it is clear that all items of “passive income” – interest, dividends, rents, royalties, and gains from the sale of assets - - are generally considered income for tax purposes.⁶⁶ Many countries exempt NPOs, especially PBOs, from taxation on passive income. France and countries that follow the French system of tax rules for NPOs, tend to tax passive investment income of all taxpayers, with a variety of exemptions available for different kinds of NPOs. The dividend and interest income of NPOs is subject to tax in the U.K., but an exemption for interest income can be sought in Ireland.⁶⁷ In the United States passive investment income is not subject to tax.⁶⁸

In the countries of Central and Eastern Europe as well as in some countries of Africa, the question has arisen whether interest and dividends earned on invested assets that constitute an organization’s endowment or reserves should be taxed.⁶⁹ In Madagascar, for example, the investment income of a public benefit foundation is taxed, consistent with the practice in Francophone countries of taxing the passive income of all taxpayers. France, on the other hand, grants a set of special tax exemptions for the investment income of public benefit foundations, which do not seem to have found their

⁶⁵ See R.M. Haig, “The Concept of Income,” in *THE FEDERAL INCOME TAX* 1, 27 (1921); Henry Simons, *PERSONAL INCOME TAXATION* 50 (1938).

⁶⁶ In Romania, however, interest is deemed to be “without economic character” and therefore not subject to the profits tax. See Ministry of Finance Methodological Rules No. 5910 of 1991. Obviously, if interest income is not generally taxed, as in the case of Romania, NPOs should not be taxed on their interest income.

⁶⁷ See Joe Ryan, *Reliefs from Tax on Income and Property of Charities in Ireland* (1995).

⁶⁸ See Appendix A.

⁶⁹ It is often relevant to focus on the kinds of activities conducted by NPOs in deciding whether to exempt income from investments. For example, an excellent report that focuses on issues in the Asia-Pacific region, states that “It is particularly important that NPOs carrying out “watchdog” functions through policy research, lobbying and public awareness-raising be financially independent of both their own governments and foreign donors. To encourage such independence, dividend income on NPOs’ financial endowments could be made tax-free. NPOs providing services to other NPOs (e.g., as “umbrella” organizations, as federations, or as subcontractors) or those playing a catalyst role on behalf of the NPO community could also be given that concession on income from all funds held in trust.” See ESCAP, *FISCAL INCENTIVES*, supra note 5 at 48 (1994).

For a discussion of these issues in the context of the Hungarian legislation, see Nilda Bullain, *The Legal Environment for Endowments in Hungary*, 4 *INT’L J. OF NOT-FOR-PROFIT L* 4, http://www.icnl.org/journal/vol4iss4/cr_ee.htm#Hungary (June 2002).

way into the Malagasy legislation.⁷⁰ Exemption of the income from investments by public benefit foundations is undoubtedly a good rule, since taxing investment income inhibits the creation and continuation of endowments, which are crucial to the support of the not-for-profit sector.

With respect to endowments other issues arise as well – these include the ways in which endowment funds are invested and how to guard against unreasonable accumulations. In some cases the tax laws address these issues. For example, in both the Czech Republic and Serbia special rules exist with respect to the investments that may be made by public benefit foundations, and in the Czech Republic the rules are very restrictive.⁷¹ Limitations with respect to the types of investments that may be made by foundations or other NPOs are intended to limit the risk involved in certain types of investments. On the other hand, imposing restrictions that are too severe may unnecessarily impede the growth of an endowment – for example, when the law only allows investment in government bonds, the growth rate of the endowment may well not keep pace with inflation. The more common approach to investment limitations is to require application of a “prudent investor” standard.⁷²

It is also important to have rules that require foundations to spend their income (and, perhaps, their assets) for programmatic purposes. In order to avoid unreasonable accumulations by endowed organizations, a good approach is to adopt a rule in the tax law that requires minimum distributions or spending of the earnings, as in the United States, Canada, or Germany.⁷³ Such rules generally impose a penalty tax if the earnings are not spent within a specified amount of time.⁷⁴

⁷⁰ Under the Code Général des Impôts [General Tax Code] of Madagascar, the 25 % tax on revenues from movable property is imposed on all organizations with their seat in Madagascar. Exemptions for public benefit organizations were repealed in 1998 and have not been reinstated. See Madagascar File, in the ICCSL library.

⁷¹ See “Survey of Tax Laws Affecting NGOs in Central and Eastern Europe, Second Edition,” (hereinafter CEE Tax Survey) <http://www.icnl.org/programs/cee/pubs/taxsurvey/Default>.

⁷² See Marion Fremont-Smith, *GOVERNING NON-PROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION* (Harvard University Press 2004), at 454.

⁷³ See 26 U.S.C. § 4942, a provision of the U.S. Internal Revenue Code that imposes a tax on a private foundations that fail to distribute a minimum amount of their investment income (approximately 5%) for public benefit purposes. For a discussion of the rules in Germany, see Appendix C. The rules in Canada and possible amendments to them are discussed in the April

3. Income or Profits Taxation of Economic or Business Activities.

Unlike the general rules exempting NPOs from taxation on income from donations and membership fees, the income of NPOs from the active conduct of a trade or business may or may not be treated as tax exempt, depending on the rules applied in a given country. Like income from passive investments discussed in paragraph 2, business income is clearly income in the normal understanding of the term.

Such income may come from the revenues earned from activities that are conducted to carry out the organization's not-for-profit purposes (museum entrance or school tuition fees, for example), or it may be from the active conduct of a trade or business engaged in solely to gain revenue for support of the NPO.⁷⁵ In general, both NPOs and the smaller sub-class of PBOs are allowed to engage in income-producing activities as long as those activities further the not-for-profit purposes stated in their governing documents. As to NPOs that are not PBOs, a test of whether the business activities further the not-for-profit purposes of the organization is essential to distinguishing proper NPOs from for-profit enterprises. If business activities that are unrelated to the not-for-profit purposes predominate, the "NPO" is really not an NPO and should be required to re-register as a for-profit entity.

This can be seen clearly with regard to rules applicable to PBOs in most countries. Generally an NPO may qualify as a PBO *only* if it does not engage more than insubstantially in activities, including economic or business activities, that are not in furtherance of its public benefit purposes – this is known as the "*exclusive purpose*" test.⁷⁶ What this means is that a PBO is permitted to engage in activities unrelated to its

2004 issue of the International Journal of Civil Society Law, available at www.law.cua.edu/students/orgs/IJCSL/.

⁷⁴ The approach adopted in 2004 in Tanzania is similar to the rule in Germany; it permits an organization to retain up to 25% of its receipts in any year. In addition, section 64 of the Income Tax law also permits an organization to seek a ruling from the Income Tax Commissioner that retained set-asides for future projects may be considered to be current expenditures for tax purposes.

⁷⁵ This does not include ad hoc or "one-off" activities, such as raffles, charity sales events, etc. "Active conduct of a trade or business" requires the regular, repeated, or continuous conduct of an income-producing activity over a substantial time. Thus, profits from one-off fund raising events are generally not taxed.

⁷⁶ E.g., § 501(c) (3) of the U.S. Internal Revenue Code.

public benefit purposes only to a very limited extent.⁷⁷ Further, the “exclusive purpose” test requires that if a PBO is going to conduct substantial income-producing or economic activities, those activities must be in furtherance of the not-for-profit, public benefit purposes of the organization.

The “*exclusive purpose*” test is essentially a mechanical test.⁷⁸ It takes a mechanical approach to determining eligibility for classification as an NPO as opposed to treatment as a business entity. Thus, if more than 50 percent of the activities and expenditures of an NPO constitute non-purpose-related activities for a significant period of time (e.g., 3 years) the organization should be required to be reclassified as a business entity. As long as any “related” economic activities are permitted for an NPO, tax can properly be imposed on all unrelated economic activities. Under this test a rule could be developed that unrelated business activities may not be more than 50% or more of all activities (measured by revenue, not by time) and no profits may be distributed. With rules like these in place, NPOs can not be regarded as “tax dodges” set up to disguise for-profit businesses nor would they be engaging in unfair competition with commercial enterprises.

Within these broad parameters, research shows that the taxation rules for economic or business activities vary considerably from country to country. There are essentially five different possibilities for taxing such income that are in use around the world:

any net profit or surplus earned by an NPO from the active conduct of income-producing trade or business activities may be --

- a. exempted from income taxation;
- b. subjected to income taxation;
- c. subjected to income taxation only if the activity constitutes a trade or business that is not related to or is not in furtherance of the not-for-profit purposes of the organization;

⁷⁷ What is small enough to not violate the requirement of the not-for-profit purpose being “exclusive” varies from country to country. In general, however, exclusive does not mean 100%.

⁷⁸ See *infra* text at notes 91-92 for a discussion of other forms of mechanical tests.

- d. subjected to income taxation under a mechanical test that allows a modest amount of profits (e.g., 10% of overall revenues) from economic or business activities to escape taxation, but tax is imposed on all revenues from such activities in excess of the limit; or
- e. subjected to income taxation under a complex rule that combines some aspects of more than one of the preceding rules.⁷⁹

The issues involved in selecting among these possible tax rules are complex and technical. Alternative (a) is a “*destination of income*” test. Under such a test, all income from all economic or business activities would be exempt from tax, but only so long as all of the profits earned from the income-producing activities are used or set aside to carry out the principal not-for-profit purpose for which the NPO was formed. In such a case, a tax exempt NPO would not pay tax on any income from any business activities so long as it dedicated all of its profits to its not-for-profit purposes.⁸⁰

In a country with a developing market economy, it may be appropriate to strike the balance in favor of a “*destination of income*” test for *all* profits used or set aside by a PBO to carry out its purpose-related activities.⁸¹ Countries in which the market economy is still young are generally also countries where civil society is just beginning to flourish. PBOs in such countries are often desperate for money simply to survive, and the profits

⁷⁹ Some countries also look to the aspect of the “commerciality” of the economic activities – is the income derived from an activity that is conducted in competition with the business sector and in a commercial manner. For example, France has developed a set of complex tests that provide for such a rule. See Caroline L. Newman, Recent Ministerial Instructions Regarding the Tax Treatment of NPOs, 2 INT’L J. NOT-FOR-PROFIT L. 2 (March 2000), *available at* www.incl.org/journal/vol2iss2/cr_weurope.htm#FRANCE. Recent legislation in South Africa also looks to the commerciality issue in some cases. See discussion in Appendix B.

⁸⁰ If the active trade or business is carried out indirectly, through a subsidiary, the legal system might regard the subsidiary as a for-profit business entity, but simply exempt it from income taxation if it gave all its profits to the NPO. The result is the same: the activity is permitted and the profits are not taxed. Although both associations and foundations in Poland receive the benefit of a destination of income rule, associations must engage in economic activities through a wholly owned subsidiary, whereas foundations are exempt from tax on activities that they carry out directly. See *Country Report – Poland*, available at www.usig.org.

⁸¹ In practice such a test has only been applied to PBOs and not to NPOs in general. For example, the destination of income test was used in the U.S. for “charitable organizations” up to the changes made by the Revenue Act of 1950, which introduced the “unrelated business income tax.” In Poland, where such a test continues to apply, it is only applicable to public benefit foundations. See *Country Report -- Poland*, available at www.usig.org.

from economic or business activities may make the difference between their continued existence and termination. In such countries it is also possible to argue that there is such a strong need to develop economic activities independent of the state that all entities, whether NPOs or business entities, ought to be encouraged to engage in them. In such a context the destination of income does not involve any tax abuse, provided there is a firm and effective ban on any direct or indirect distribution of profits.

In countries with a more fully developed market economy, the problem of unfair competition can become a serious issue, particularly when the scale and number of economic activities by NPOs begins to pose a threat to private enterprises. Obviously, if a large and wealthy NPO can engage in a particular activity (e.g., book publishing) without paying taxes, it has an economic advantage over its for-profit competitors. When this issue becomes significant for the fiscal policy of a country, the obvious solution is to tax such profits.⁸² Some countries (e.g., France) do so if the NPO is operated on a commercial basis and in fact competes with for-profit companies.⁸³ Other countries (e.g., the United States⁸⁴) tax income from such economic or business activities only if they do not further the public benefit purposes of the NPO (“unrelated trade or business income”).

A rule (see c. above) taxing “*unrelated business income*,” as in the United States, and exempting the profits from “related” activities, makes a great deal of theoretical sense. Often the most effective way for a PBO to achieve its purpose is to pursue it through economic means. For example, the most effective way to disseminate information about a particular kind of art, culture, or scientific knowledge that a PBO wants to promote may be to publish and sell a high-quality magazine devoted to the

⁸² For a useful analysis of the issues related to taxation of profits from economic activities, see Industry Commission, CHARITABLE ORGANIZATIONS IN AUSTRALIA, 311-312 and Appendix J (1995).

⁸³ See Appendix B for a discussion of the “commerciality” test as it applies in France and South Africa.

⁸⁴ This is the rule used in the United States, under sections 511-514 of the Internal Revenue Code, 26 U.S.C. § 511-514. Both the law itself and the regulations issued thereunder are very detailed and complex. See Leon Irish article, cited *supra* at note 57.

topic.⁸⁵ If the “exclusive” purpose of the organization is to promote the particular kind of art, culture, or scientific knowledge, and if no profits are distributed directly or indirectly,⁸⁶ then exempting from taxation the profits from publication and sale of the PBO’s magazine may make good tax policy sense.

Unfortunately, it is extremely difficult to distinguish “related” economic activities from “unrelated” economic activities, and hence the related/unrelated rule is very difficult to administer in practice. For example, if a museum sets up a shop on its premises to sell prints, postcards, or books that replicate the outstanding works of art in its collection, this can easily be argued to be “related” to the museum’s purpose.⁸⁷ But what should happen if the museum opens a chain of retail stores that sell books related to art and culture, most of which are not in its collection? Is it engaging in an “unrelated” activity, or has it simply broadened its purpose and chosen to pursue the broader purpose using economic means? What if the museum operates a café or restaurant on its premises for the convenience of its patrons and in order to encourage greater attendance. Would profits from such an activity be “related” or “unrelated”? Designing administrable rules for making the related/unrelated distinction, which adequately respond to all these relevant considerations is not easy. The amount of revenue raised by the U.S. tax on “unrelated” business activities probably indicates either that the distinction is, indeed, difficult to draw, or that it is applied with great care with the result that taxation is avoided wherever possible.⁸⁸ On the other hand, from the amount of revenue raised it is clear that some

⁸⁵ E.g., National Geographic, which generates hundreds of millions of dollars of income for the National Geographic Society, a U.S. public charity that is exempt from taxation on this income.

⁸⁶ One indirect way to distribute profits is to pay excessively high salaries. Thus, one of the criteria used in France for distinguishing between taxable and nontaxable income from economic activities is whether the managers receive more than a minimal salary. See Caroline L. Newman article cited in note 79, *supra*.

⁸⁷ An extensive discussion of this example and the ways in which the tax laws of France and South Africa might apply to it is found in Appendix B.

⁸⁸ See James R. Hines, Jr., *Nonprofit Business Activity and the Unrelated Business Income Tax*, NBER Working Paper No. w6820, issued November 2000, published in *TAX POLICY AND THE ECONOMY* (Poterba, ed.) (Cambridge: MIT Press, 1999), vol. 13, pp 57-84. In 2001 the Internal Revenue Service collected over \$650,000,000 in revenue from the unrelated business activities of tax exempt organizations. See <http://www.irs.gov/pub/irs-soi/02db01co.xls>. For an earlier discussion of the same issues, see Henry B. Hansmann, *Unfair Competition and the Unrelated Business Income Tax*, 75 VA. L. REV. 605 (1989).

PBOs in the U.S. are willing to engage in unrelated economic activities to support their public benefit purposes even at the cost of paying regular corporate income taxes on the profits from those activities.

To the extent that economic activities (e.g., publication of magazines or of books) are simply the chosen means by which most effectively to pursue a given end (e.g., promotion of art or culture), one could be said to have come back to a “*destination of income*” test, under which related economic or business activities can constitute the entire active work of a PBO as long as all profits go to a proper public purpose.⁸⁹ But the distinction is a subtle one between the related/unrelated test and the destination of income test – as applied in most countries that use it, the “*destination of income*” test applies to all income-producing activities, not merely to those that are in furtherance of the organization’s not-for-profit purposes.

One possible alternative, used in Poland until the mid-1990’s, would permit a PBO to be exempt from tax on profit from any economic or business activities (both purpose-related and regular business activities) as long as that profit was spent for carrying out the public benefit purposes within the year of receipt or the next succeeding tax year. By preventing undue accumulations of profits, this rule may be a useful modification of the “pure” destination of income test, but it nevertheless suffers from the necessity of distinguishing between money that was earned this year or last rather than in an earlier year.⁹⁰

⁸⁹ A strong argument can be made that such a test in fact applies to health, cultural, and educational organizations that cover their costs from the fees they charge. When such an organization earns a profit or surplus, it is plowed back into the organization and used for its not-for-profit purposes. Such an organization is different from a commercial organization that engages in similar activities but distributes profits to shareholders because it cannot distribute or accumulate for distribution any profits it earns. Further, most such health, educational, and cultural not-for-profit entities usually render substantial services free of charge or at a reduced rate to some poor individuals, which provides another basis for treating them as deserving of tax exemption on any profits they may occasionally earn. On the other hand, the question of whether private schools that charge high tuition fees qualify as public benefit organizations has been raised in the context of the current discussions in Great Britain under the new “Charities Bill.” See <http://society.guardian.co.uk/charityreform/story/0,11494,1256061,00.html>.

Of course, if the fees paid to a PBO never exceeded its costs, there would be no profits to tax, and it would be irrelevant whether the organization was regarded as tax exempt or not.

⁹⁰ Poland has now gone to a pure destination of income test. See Corporate Income Tax Act, CIT Article 17(1),(4),(5)]. Germany also has a rule similar to the former rule in Poland, and it was

A *mechanical test* for determining the difference between taxable economic activities and nontaxable economic activities may create a simpler system for taxing NPOs. It might be possible, for example, to tax profits from all economic activities but only if and to the extent that they exceed a certain figure or a percentage of all revenue. In Hungary, which has adopted this approach, NPOs are exempt on the net profits from all economic activities – whether related or unrelated -- if the annual profit from such activities does not exceed the lesser of 10 million forint or 10% of total revenue. This works fine as a tax rule, for the only consequence of exceeding the minimum in any year is that taxes must be paid on actual profits, but in Hungary taxes are levied on all income from economic activities if the threshold is exceeded, whether the activities are related or not, and not just on the excess over the threshold. This is presumably on the theory that if the organization has a lot of economic activity income it is more like a business than an NPO.⁹¹

One aspect of the rules applicable to business income in South Africa is similar to the mechanical test used in Hungary – South African PBOs may engage in “trading” activities tax free so long as the income generated from those activities does not exceed the greater of 15% of gross receipts or ZAR 25,000.⁹² But if the threshold is exceeded and the other qualifying tests are not met, public benefit status is entirely lost; this is a much harsher outcome than that in Hungary.⁹³

As this discussion makes clear, allowing NPOs to engage in related business activities to any extent and in unrelated business activities to a limited extent is the pervasive custom around the world. The rules applicable to taxing income from business activities of NPOs, however, vary considerably from country to country.

4. Political Activities of Tax Exempt NPOs.

The issue of whether tax or other laws restrict the political activities of NPOs has not been well-researched in recent years. There has been a tendency, as exemplified by a

retained and amplified during the last round of tax changes in summer 2000. See Michael Ernst-Pörksen article, *supra* note 55.

⁹¹ For further discussion of this and other mechanical tests, see *CEE Tax Survey*, *supra* note 71.

⁹² Detailed discussion of the South African test can be found in Appendix B.

⁹³ For further discussion of the tax rules applicable to commercial activities of NPOs in South Africa, see Appendix B.

paper that ICNL published in 1996 entitled “*Public Policy Activities of Not-for-Profit Organizations*,”⁹⁴ to note differences between common law countries and civil law countries with respect to political activity restrictions. Common law countries are said by the paper to have more limits on political activities of NPOs than do civil law countries. As the paper notes, common law jurisdictions classify organizations not by the type of legal person they are but by what they do. In common law jurisdictions, “charities” are not generally permitted to engage in political activities, and the tax laws in those countries tend to reflect this approach principally by limiting political activities of charities or public benefit organizations.⁹⁵

Contrary to the assertion of difference in the paper, however, when one looks carefully at the tax rules applicable to political activities of NPOs in many civil law jurisdictions, there is a great deal of similarity between the common law and the civil law. In France, for example, the tax law and the administrative law both define organizations that are entitled to specific benefits (organizations of “general interest” in the tax law and organizations of “public benefit” (*utilité publique*) in the administrative law). Neither type of organization may engage primarily in political activities.⁹⁶

In Germany the restrictions on the political activities of “public benefit organizations” can be found in the regulations under the general tax law. These regulations state quite clearly that political purposes “are fundamentally not” public benefit purposes. On the other hand, “political” is fairly narrowly defined by the regulations. Although it specifically includes trying to influence public opinion and supporting political parties, the regulations go on to say that a certain amount of “influencing public opinion” is permissible for “public benefit” organizations. In fact, it is permissible so long as the accomplishment of a public benefit purpose is linked with setting a political goal, and the actual attempts to influence the political parties and the

⁹⁴ “Public Policy Activities of Not-for-Profit Organizations,” prepared for the Conference Regulating Civil Society 3, held in Budapest Hungary in 1996. See <http://www.icnl.org/library/cee/docs/pubpol.html>.

⁹⁵ See *id.*, for a discussion of the rules in various common law jurisdictions.

⁹⁶ See *Country Note: France – the Status of Political Activities of Associations and Foundations*, 3 INT’L J. NOT-FOR-PROFIT L. 3, available at http://www.icnl.org/journal/vol3iss3/cr_weurope.htm#FRANCE (March 2001).

state are not foremost in what the organization does. The regulations cite a specific case, which held that an organization could take a specific political position, consistent with its public benefit purposes, so long as that was not its primary activity.⁹⁷ In contrast, an organization that has a political goal as its only or its primary purpose would not qualify as a public benefit organization.

As this brief discussion makes clear, tax laws in both common law and civil law jurisdictions frequently restrict political activities of organizations that receive special tax preferences. In general, however, such restrictions are tied to the level of tax benefits received. The theory for imposing such restrictions is one of subsidy (e.g., the public treasury should not subsidize the political activities of anyone, no matter what individual or type of entity is conducting them).⁹⁸ According to this theory, organizations that receive no actual subsidy should have no restrictions imposed by the tax laws on their political activities. In the United States, for example, both social welfare organizations and political parties⁹⁹ – NPOs that are not treated as “public charities”¹⁰⁰ -- are exempt

⁹⁷ The Bundesfinanzhof (Federal Financial or Tax Court) decision that is quoted in the AEAO is the decision from 23 November 1988. The decision can be found in the Bundessteuerblatt 1989, Part II, page 391. It concerned an organization whose purpose was the promotion of "peace" and the question of whether that purpose could be a public benefit purpose. Generally the court decided that it is, despite not being specifically named in the AO, for promoting peace is close enough to general purposes of education and human development (p. 392).

More specifically, with respect to the question of whether the organization could take positions on matters that are of a political nature, the court noted that an organization may need to take "political" positions in pursuance of public benefit aims (such as the promotion of peace). What this organization did in that context was nonpartisan and it engaged in such activities only for the purpose of achieving its goals. Entering into day-to-day political discussions was not the major focus of the ways in which the organization carried out its purposes. In addition, it made statements in an objective and well-grounded way (even though the language used was at times hyperbolic) (p. 392).

⁹⁸ See *Regan v. Taxation with Representation of Washington*, 461 U.S. 540 (1983). It is recognized, however, that even public charities are entitled to freedom of speech. The U.S. Supreme Court has ruled that making the deductibility of contributions to public charity conditional on their not engaging in electioneering or undue lobbying is valid so long as such organizations are entitled to create and control related tax exempt organizations to which contributions are not deductible but which can engage in electioneering and lobbying activities. See *League of Women Voters v. Commissioner*, 468 U.S. 364, 400 (1984).

⁹⁹ See Internal Revenue Code §§ 501(c) (4) & 527.

¹⁰⁰ PBOs in the U.S. include both public charities and private foundations. For a discussion of the distinction between the two types of PBOs, see Leon Irish article, cited at note 55, supra. The rationale for making the distinction is a purely regulatory one.

from income tax on their membership dues, but not on other sources of income, such as investment income and income from commercial activities. Public charities under Section 501(c)(3), however, which are permitted to receive tax deductible contributions, may not engage in electioneering (i.e., supporting or opposing candidates for public office) at all nor, except to an insubstantial extent, in lobbying activities. This is similar to the tax rules in Germany and France, as discussed above.

It is also important to note that distinctions can and probably should be made among different types of political activities. Public policy activities that tend to be more like educational or “issue advocacy” activities should not interfere with or threaten the tax exempt status of a PBO. Grass roots lobbying activities are more “political” in nature and thus might be required to be limited when a tax subsidy is available. Electioneering activities (promoting or opposing candidates for public office), though permitted for NPOs in some civil law jurisdictions,¹⁰¹ tend to be prohibited for tax exempt NPOs in most countries.

5. Income Tax Rules for Donations to PBOs.

Tax rules that provide preferences for donations to PBOs are important and useful tools for encouraging the sustainability of NPOs that act in the interests of the public and promote social and economic development, culture, health, education, science, etc.¹⁰² In most countries with a developed civil society, individuals and business entities are entitled to an income or profits *tax deduction* or a *tax credit* with respect to donations made to PBOs.¹⁰³ Under either a credit or a deduction scheme, the amount of revenue

¹⁰¹ In Brazil and Poland, for example, associations may field candidates for public office without registering as political parties. In most countries, however, such activities are confined to registered political parties. The tax laws tend to treat registered political parties differently from public benefit NPOs – donors are not permitted to deduct as charitable contributions donations to a political party.

¹⁰² For a longer discussion of the design of tax rules for donations, see Paul Bater, *Evaluating Incentives for Donations to Public Benefit Organizations*, 2 INT’L J. NOT-FOR-PROFIT L. 3 (Dec. 2000), available at www.icnl.org/journal/vol3iss2/ar_bater.htm. See also, Karla W. Simon, *Creating an Enabling Environment for Development Partnerships* (Inter-American Development Bank, 1997.)

¹⁰³ Although almost every country surveyed grants at least some tax benefit for donations, some countries, e.g., the Nordic countries, grant very few. Of course these countries provide rather substantial grants in aid from government to NPOs, which may be seen as making up for the relative lack of tax benefits to private donors. But some experts question the validity of the

lost is a small fraction of the amount that is donated to PBOs for purposes regarded by the State as important. Thus, although they decrease the amount of revenue flowing directly to the State in tax revenues, the tax preferences increase the revenue going to State-sanctioned “public benefit” purposes.

Other approaches to preferences for donations result in greater amounts going to PBOs without reducing the revenues initially flowing into the State treasury. For instance, the U.K. has a *tax reclaim scheme*, which costs less revenue than a deduction for donations and eliminates fraud, but at the cost of additional complexity. Increasingly, countries in Central Europe are adopting an extra “tax benefit” (in addition to a deduction or a credit) by allowing for *tax designation schemes* (as in Hungary, Slovakia, Lithuania, Poland, and Romania).¹⁰⁴ Under such a scheme, the taxpayer pays all of his/her/its taxes to the government, but also sends along a designation form requiring that the government pay over 1% or 2% of the taxes collected to a specified PBO.

In the discussion of income tax exemptions, it was suggested that no NPO should be taxed on donations it receives. If, in addition, the donor is entitled to a tax credit or a deduction against his/her personal or its business income tax, if the NPO is permitted to reclaim the tax benefit the donor would have received, or if the donor can participate in a tax designation scheme, the same donation receives a double tax preference.¹⁰⁵ This generous tax treatment is deemed justified when the activities of the NPO in question are for public benefit.¹⁰⁶ Of course, if there is a tax preference for contributions to such

current situation. See, e.g., Ole Gejms-Onstad, *Tax Benefits for Public Benefit Civil Society Organizations in the Nordic Countries* in Ambrosianeum Foundation, GOVERNANCE AND TAXATION OF PUBLIC BENEFIT NON-PROFIT ORGANIZATIONS (Milan, 2002).

¹⁰⁴ A good description of the various tax designation schemes in countries of Central Europe can be found on www.onepercent.hu.

¹⁰⁵ A tax designation scheme is a little different from a deduction or a credit in that it does not involve a reduction in the taxes paid by the donor but rather involves a direct requirement by the donor that the State treasury must pay a portion of the donor’s taxes to the designated PBO. Of course, the economic effect for the State and PBO is similar in that, like a tax deduction or tax credit, a tax designation scheme reduces the net revenues of the State and results in more money flowing into the PBO.

¹⁰⁶ India provides an example of a relatively generous tax deduction scheme. In India cash donations to charitable organizations by companies are 50 percent tax deductible, up to 10 percent of gross income. A regional study concluded that in India, “The scheme of deductions for charitable contributions increased the quantum of such contributions substantially. In the absence

organizations, there will be great pressure on the tax authorities to classify NPOs as PBOs. This distinction is often difficult to draw, and in actual practice the tax authorities tend to proceed on a case-by-case basis, looking at the purposes and activities of each NPO.¹⁰⁷

As described above, there are essentially four different types of tax rules for donations, *deductions*, *credits*, *tax benefit reclaim schemes*, and *tax designation schemes*.¹⁰⁸ Tax credits are applied against, and reduce the amount of, tax owed by a taxpayer, while deductions reduce the amount of income that is subject to tax. Tax benefit reclaim schemes and tax designation schemes, on the other hand, involve a payment of the part of the donor's actual tax liability to the designated public benefit organization. In developing the tax rules for donations that a country uses, it is important to weigh considerations of tax equity and to design a system that will encourage contributions in a fair and administrable manner.

The distinction between credits and deductions is of great importance in a tax system with a progressive rate structure. Where rates are progressive, deductions favor higher income taxpayers, who are paying higher rates of tax on larger amounts of income. A system giving a tax credit for contributions allows a contributor to reduce his/her tax by the amount, or a percentage of the amount, of the donation. Because a tax credit has the same absolute value for all taxpayers, as a matter of tax policy it involves is regarded as providing greater horizontal equity – that is, it results in the same tax effect for all taxpayers. Although the absolute value of a credit is the same for all taxpayers, a credit will reduce the taxes of a lower bracket taxpayer by a larger percentage.¹⁰⁹

of incentive provisions, the contributions of companies would have been lower by about 64 percent of the actual contributions.” ESCAP, *FISCAL INCENTIVES*, supra note 58, at 23-24.

¹⁰⁷ See the discussion in Part I. For a longer discussion of the issues that arise in making a determination whether an organization is a public benefit organization, see the Model PBO Provisions, included here at Appendix A.

¹⁰⁸ A chart comparing the effects of deductions, credits, and tax benefit reclaim schemes can be found in Appendix C.

¹⁰⁹ See Appendix C.

Most countries with progressive rate structures, however, allow deductions rather than credits.¹¹⁰ This approach is supported by data showing that lower income individuals generally tend to make charitable contributions without regard to their tax impact, and, indeed, other tax rules may preclude them from receiving any tax benefit at all from a charitable contribution.¹¹¹ On the other hand, there are substantial empirical data showing that high income taxpayers are quite sensitive to tax rates and that allowing deductions rather than credits tends to attract more and larger gifts from wealthy donors.¹¹²

If the tax system permits tax *deductions*, it is important to set the limits, if any, on the amount of tax deductions allowable. For example, in Russia individuals can claim deductions only up to 3% of their income, and business entities are limited to 1%. In the United States, by contrast, individuals can claim deductions for up to 50% of their

¹¹⁰ Under somewhat complex rules, Canada and Hungary allow either a credit or a deduction to individuals, depending on circumstance. See *CEE Tax Survey*, supra note 71. The United States, on the other hand, has always allowed a deduction rather than a credit, and its practice is consistent with that of most other countries.

¹¹¹ In the United States, for example, individual taxpayers must choose between claiming the “standard deduction” or itemizing all deductible expenses. For lower bracket taxpayers the standard deduction tends to be more valuable, but by choosing it a taxpayer is precluded from listing, and hence from deducting, actual gifts made to charity. As a result, nearly 70% of individual taxpayers receive no direct tax benefit for donations to charities. At present, however, tax reform proposals contain provisions that would allow non-itemizers to claim a charitable contribution deduction within fairly narrow limits.

In other countries individuals who earn wages or salaries do not file tax returns because taxes are simply subtracted from their wages. In such situations it is difficult to claim a deduction or a credit if a charitable contribution is made. The “Give As You Earn” scheme in the UK deals with this problem by a rebate to a designated charitable organization rather than a deduction or credit for the donor. That is also true of tax designation schemes – anyone can participate even if they pay taxes entirely through withholding on wages. See text at notes 118 ff, *infra*.

¹¹² See, e.g., Charles Clotfelter, *Tax Incentives and Charitable Giving: Evidence from a Panel of Taxpayers*, 30 JOURNAL OF PUBLIC ECONOMICS, 319 (1980); Richard Steinberg, *Taxes and Giving*, 1 VOLUNTAS 61 (1990); Kevin S. Barrett, Anya M. McGuirk and Richard Steinberg, *Further Evidence of the Dynamic Impact of Taxes on Charitable Giving* (1996). Indeed, this assumption is borne out by recent statistics in the U.K., which indicate that there was a rise in charitable giving by wealthy donors after new legislation allowing tax deductions was instituted (see discussion of this issue in IJCSL-N for July 2004). It is also borne out by recent statistics published with regard to a 2002 change in the tax benefits accorded to donations. In many instances a donor may deduct double the amount contributed, which has led to a one-third rise in the amount of money given to charity. See discussion of this legal change in text at note 114, *infra*.

income,¹¹³ and in Australia there is no limit at all. Although empirical studies show that few business entities contribute more than 1-2% of their income in any given year to PBOs, it is important to have a higher allowable limit to accommodate those businesses that regularly or occasionally give substantially more. To provide encouragement for the minority of companies that do give more, it would be reasonable to allow business entities to deduct up to 10% of income.

Individuals, however, do not have the same constraint to maximize value to shareholders that business entities have. Where there is no limit on allowable deductions to PBOs, it is possible for wealthy individuals would be able to avoid paying any taxes at all by contributing to charity an amount equal to their taxable income each year. In a democracy, however, it is appropriate that each citizen who is financially able to should bear a fair share of the costs of government if he/she is able to, and it is therefore not generally thought appropriate to allow unlimited deductions. At the same time, if deductions are limited to contributions to PBOs -- i.e., organizations contributing to the public good and often relieving the burdens of the State -- generous deduction limits (e.g., 50%) are appropriate.

One recent change in the tax laws in Singapore is worth noting here. Effective on January 1, 2002, Singaporean taxpayers were permitted to double the amount of money contributed to approved charitable organizations, called Institutions of Public Character (IPCs), and deduct that amount from their taxes in the next succeeding year. Not all donations receive the double tax benefit (those that provide naming opportunities, for example, do not), but statistics released by the Internal Revenue Authority of Singapore for the 2002 tax year show that the double deduction resulted in a one-third increase in charitable giving!¹¹⁴

With respect to *tax credit* schemes, the situation in Canada is an interesting one. Canada offers a two-tier tax credit system, which gives high marginal rate taxpayers a credit equal to a deduction while offering to those in lower brackets a credit worth more

¹¹³ The limitations in the United States are considerably more complicated than can be addressed here.

¹¹⁴ For further discussion of this change, see August 2004 issue of IJCSL and authorities cited there.

than a deduction. This scheme, which is not nearly as complex as it sounds, has not led to any significant decrease in tax revenues since it began being implemented in 1988.¹¹⁵

The use of *tax benefit reclaim schemes* seems to be limited to the UK. In general this type of preference does not provide a direct incentive for donors because it does not reduce their taxes, but it is valuable to individual taxpayers who plan their donations carefully. A donor can ensure that the charities will receive the amount he/she wants them to receive by making a contribution directly to the charity in an amount net of the tax that would otherwise have been payable on the gross amount of the intended transfer. The charity then collects the amount of tax paid by the donor on the gift from the Inland Revenue Service.¹¹⁶ The United Kingdom amended its legislation in 2000 to make the prior rules simpler to apply and to remove monetary limits on Gift Aid and payroll giving. The “Give As You Earn” scheme, which permits individual wage-earning taxpayers to set up a tax reclaim account, is very popular and seems to be administered in a fairly straightforward and easily understandable fashion. Other countries have not chosen to adopt the U.K. tax benefit reclaim system, perhaps because of its complexity, but it has the double advantage of costing the government less revenue than a deduction scheme and greatly reducing the risk of tax abuse.¹¹⁷

In addition to these tax rules, Hungary, Slovakia, Lithuania, and Romania, and possibly Poland¹¹⁸ have created “*tax designation*” laws, which permit taxpayers to direct that a small percentage of the taxes they pay in a given year be paid over to NPOs designated by them.¹¹⁹ By providing a simple mechanism for directing tax funds to

¹¹⁵ See Carl Juneau, *Charity and Taxes in Canada* (1996), on file with ICCSL.

¹¹⁶ See Paul Bater article cited at note --, *supra*, where the mechanics of such a scheme are explained.

¹¹⁷ See Paul Bater article, *supra* note --, for further discussion.

¹¹⁸ Although the new Polish law is called a “one percent” law, the available, unofficial, and incomplete translation reads as if it were a tax credit scheme.

¹¹⁹ For further discussion of the different countries, see *CEE Tax Survey*, *supra* note 31. For a discussion of recent developments with respect to Slovakia, Lithuania, Romania, and Poland see N. Bullain, *Percentage Philanthropy and Law*,” http://www.onepercent.hu/Dokumentumok/Chapter_2_ECNL.doc. (2004). Although the Polish law is called a “One Percent Law,” it actually seems to involve a tax credit rather than a true tax designation. See Igor Golinski, “Poland’s One Percent System,” http://www.onepercent.hu/Dokumentumok/Chapter_4_Golinski_PL.doc (2003). Accordingly,

NPOs, the “1 % Law”¹²⁰ in Hungary, which has been in operation since 1996, enabled nearly 45% of taxpayers to designate nearly 10 billion forint (about € 39 million)¹²¹ to support socially beneficial activities.

6. VAT or GST Rules.

Many activities of NPOs can be given preferential treatment under a value added tax (VAT) or a goods and services tax (GST),¹²² although the precise range of preferred activities varies from country to country. For example, in Germany the rules were traditionally quite broad, but now, with VAT harmonization underway in the European Union, the range of preferred activities is smaller.¹²³

The design of VAT rules is important for NPOs. If an organization is excluded from a VAT system by not being defined as a “taxable person” or by being exempt (which would be true of most NPOs), it pays VAT on goods and services it buys from others, for the tax is built into the price it must pay (input VAT). However, since it is not in the VAT system, as an excluded organization it cannot apply for a rebate of the input

less money has been collected under the Polish scheme than in Hungary, for example. See IJCSL-N for September 2004, where more information on collections by PBOs in Poland can be found.

¹²⁰ See Istvan Csoka, *Hungarian Tax Designation Scheme – the “One-Percent Rule*, 1 INT’L J. NOT-FOR-PROFIT L. 1 (Sept. 1998), available at http://www.icnl.org/journal/vol4iss4/cr_cee.htm; G. Posch, *How Hungary’s One Percent Law is Applied*, http://www.onepercent.hu/Dokumentumok/Chapter_4_Posch_Hu.doc (2003).

¹²¹ See T. Bauer, *Hungary’s One Percent Law – Why?*, http://www.onepercent.hu/Dokumentumok/Chapter_1_Bauer_Hu.doc. (2003): “In 2003, close to 1.5 million out of the 4.5 million taxpayers in Hungary (nearly one third of income tax payers) decided to use the 1% option and allocated over 6 billion forints (over 23 million euros) to organisations such as associations and foundations, and also to cultural institutions this way. More than 600,000 people did likewise to support the running costs of their church with just under 3 billion forints (over 12 million euros). A further 140,000 people who did not wish to support a church chose instead to designate over 800 million forints (over 3 million euros) to special purposes earmarked in the national budget (this year, anti-ragweed and health-care programmes). In sum, over 2 million designations were made to almost 22,000 beneficiaries totalling nearly 10 billion forints (about 39 million euros).”

¹²² GST is the terms used for VAT in some countries, e.g., Canada and Australia.

¹²³ See Sixth Council Directive of the European Community 77/388/EEC of 17 May 1977 on “The harmonization of the laws of the Member States relating to turnover taxes; a common system of value added tax and a uniform basis of assessment.”

VAT when it sells its good or services, and is treated like a final consumer.¹²⁴ Although exclusion from the VAT system is thus not usually desirable from a tax point of view, NPOs may rationally prefer it in order to be relieved of compliance burdens. But, this will mean paying the VAT or GST on all goods and services that are purchased by the NPO.

For PBOs that are willing to deal with the compliance burdens, a better economic solution would be to elect to be included in the VAT system¹²⁵ and for the system to permit them to be zero-rated with respect to the goods and services they provide and that are related to their public benefit purposes. This would mean that, although the PBOs would pay input VAT on the goods and services they buy, they would not have to collect output VAT because they would be zero-rated on their outputs.¹²⁶ They could then receive a rebate of, or offset for, the input VAT paid. This would constitute a rather significant tax subsidy, and the approach is therefore not adopted in most countries.¹²⁷ The more general approach, and the only approach allowed in the European Union and countries seeking accession to it, is to reduce the potential revenue loss by allowing certain goods and services produced by public benefit organizations a favorable VAT rate, but no lower than 5%.impose a lower rate of VAT (but not lower than 5%) on certain socially desirable goods and services, such as medicines and health services, which are often provided by public benefit organizations. For example, if the general rate of VAT is 20%, the special rate for listed goods and services might be 5 -10%.¹²⁸ The lower rate of VAT makes the preferred goods and services cheaper for the ultimate

¹²⁴ For further discussion of this problem, see Gejms-Onstad, op.cit., supra note 52.

¹²⁵ Some NPOs would necessarily be included in the system because their economic activities are substantial. Most countries have a threshold amount of turnover that must be met before a legal entity is included in the VAT system, but most countries allow entities that have outputs below the threshold to opt into the VAT system if they wish to. See David Williams, *Value-Added Tax*, in Victor Thuronyi (ed.), *TAX LAW DESIGN AND DRAFTING* (IMF 96).

¹²⁶ Of course if the NPO were engaged in unrelated income-producing activities, it would need to treat that aspect of its activities separately from the zero-rated activities.

¹²⁷ In Bangladesh, Indonesia, the Philippines, and Thailand, NPOs receive no exemption from the VAT, but in some cases they benefit from lower rates levied on primary, unprocessed agricultural products. See Derek Allen, *VAT in the European Community* (1994).

¹²⁸ For a fuller discussion of VAT issues, IMF, *THE MODERN VAT* (2002); see also, Williams, op. cit., supra note 125.

consumer, and it also allows the provider of them to claim a rebate or credit for some of not all of the input VAT it paid in connection with them, up to the amount of the output VAT on the preferred items.

7. Customs Duty Rules and VAT on Imports.

Customs duties and import VAT are among the most contentious and difficult tax issues faced by NPOs in practice, in particular in developing countries that rely on the VAT and customs duties as their principal revenue sources. Even if the law of a particular country provides for exemption for PBOs from both customs duties and VAT on imports related to the organizations' public benefit purposes, customs officials often disregard the law, and PBOs must often spend a disproportionate amount of time dealing with customs officers to actually receive the benefit of their exemptions.¹²⁹ At the same time, it is understandable that tax officials are cautious, for allowing customs and import VAT exemptions for PBOs sometimes attracts charlatans and crooks into the NPO sector with the prime motive of using a fake NPO¹³⁰ to obtain exemptions on the import of certain goods.

If customs duties and import VAT are imposed on legitimate PBOs, however, they can dramatically increase the costs of operations. This difficulty faces both foreign and domestic PBOs. It can be particularly severe for humanitarian relief organizations that typically must import all of their goods and services in order to meet emergency relief needs. It is an added problem in developing countries that most bilateral and multilateral funders of humanitarian relief and development projects forbid any of their funds to be used to pay host country taxes, making a special tax agreement with that country necessary. Customs duties and import VAT are problems, though, for even the smallest PBO, which might want to import a fax machine or a computer to make its work more productive.¹³¹

¹²⁹ In Rwanda the only tax benefits for NPOs are exemption from customs duties and exemption for expatriate NPO employees from the entrance fee. Malawi, Kenya, and Uganda, on the other hand, grant a range of customs duty exemptions to NPOs in addition to other tax rules. See *Africa Tax Survey* (1997), on file with ICCSL.

¹³⁰ Called "suitcase NPOs" in East Africa.

¹³¹ Often the problem is not the absence of an exemption for NPOs, but the red tape involved in claiming it. In India NPOs wishing to obtain concession from duties imposed on equipment imports donated by foreigners have to apply for central government approval six months in

Most countries therefore provide customs duty and import VAT exemptions only to PBOs. But if such exemptions are available, there must also be a fair but thorough process for assuring that only genuine PBOs qualify for the exemption. Countries have generally provided for a certification, licensing, or similar process to ensure that an organization's exemption will be honored at the border.¹³² Even certified PBOs, however, may be required to seek specific exemptions for particular goods they want to import.¹³³ To protect against the improper use of the exemption, it is also appropriate to provide that imports will be exempt only if they are going to be used by the PBO in its operations. To avoid abuses, if an item is sold by a PBO (e.g., a computer, a truck, or an automobile) within a short period (e.g., 2-3 years) after its import, it should be subject to customs duties and import VAT at the time of sale.

8. Other tax rules.

Depending upon the extent to which a government wishes to encourage NPOs, exemption from, or preferential treatment under, other tax laws (e.g., taxes on real or personal property, sales taxes, estate or inheritance taxes) should be considered. Practices in this respect vary widely around the globe. As one example, Indonesia, Thailand, and the Philippines exempt religious organizations from land taxes, while Australia provides no similar rules for religious organizations.¹³⁴ Most countries of Central and Eastern Europe give different types of real estate tax benefits to NPOs.¹³⁵

advance, and strict rules and procedures are invoked under the Foreign Contributions Regulation Act (FCRA). In Sri Lanka and the Philippines exemption from customs duties and the VAT on donations from foreign sources can be obtained only if the donations are consigned to the relevant government agency. These kinds of procedures generally involve numerous bureaucratic obstacles, conditionality provisions, and opportunities for rent-seeking. See, ESCAP, FISCAL INCENTIVES, *supra*, note 58.

¹³² Exemption at the border, however, offers serious possibilities for corruption. See Williams, *op.cit.*, *supra* note 125.

¹³³ In Timor-Leste a certified PBO must file detailed financial and tax information each time it wants exemption for goods to be imported, and the East Timor Revenue Service (ETRS) may do a site visit to determine whether there is a need for the item in the programs of the PBO. Tax rules for Timor-Leste, on file with ICCSL.

¹³⁴ See ESCAP, FISCAL INCENTIVES, *supra* note 58.

¹³⁵ See *CEE Tax Survey*, *supra* note 71.

Most countries have a variety of additional tax or rate rules for NPOs, generally limiting them to PBOs and/or to the public benefit activities of other NPOs.¹³⁶

9. Employment tax rules.

Despite the fact that NPO and, particularly, PBO employees typically expect and receive a lower level of compensation than that which is paid for comparable work in the for-profit sector, there is little justification for exempting them from the usual social security and related employment taxes that are exacted from workers in the government or for-profit sectors. Social security and similar taxes are exacted on the basis of actuarial estimates of what is required in order to meet the State's obligations to retired workers over the long term. Those who are employed in the not-for-profit sector should not be excluded from the benefits that are provided for those who participate in these State schemes.¹³⁷

Arguments have been advanced that NPO workers are paid less than workers in the for-profit sector, and that they should therefore be exempt from social security taxes or pay them at a reduced rate. Although it is a valuable tax preference to provide exemptions for NPOs from most forms of regular taxation, to exempt NPO employees from social security taxes while including them in the benefits of such systems (e.g., pension and health benefits) would create an appearance of unfairness and may cause resentment among workers in the for-profit sector. On the other hand, employees of NPOs should not suffer the double disability of working for a lower wage and being excluded from basic employee benefit programs provided for other employees in the society.

C. Tax Administration

¹³⁶ For example, donations of up to € 3999 are exempt from gift taxes in the Netherlands and donations in excess of that amount are subject to tax at a preferential 11% rate. See Ineke Koele, *Tax Benefits for Public Benefit Civil Society Organizations in the Netherlands*, in Ambrosianum Foundation, GOVERNANCE AND TAXATION OF PUBLIC BENEFIT NON-PROFIT ORGANIZATIONS (Milan, 2002). For a discussion of similar, but by no means uniform, transfer tax exemption practices in Central and Eastern Europe, see *CEE Tax Survey*, supra note 71.

¹³⁷ In Australia, however, NPOs involved in social welfare work pay reduced sales taxes and, if their payroll is over A\$10,000 a month, a reduced payroll tax as well, depending on which State they are in.

In countries around the tax rules and preferences that apply to NPOs and their donors are generally applied by the tax authorities. There may be different authorities to handle different taxes, such as the income tax, VAT, customs duties, and real property taxes. In many countries, each tax authority develops its own rules and procedures and may define basic terms, such as “public benefit organization,” differently.¹³⁸

In many developed countries with sophisticated tax systems and large NPO sectors, there may be separate forms, rules, and procedures for NPOs, tailored to the unique characteristics of various kinds of NPOs.¹³⁹ For example, there may be special rules for PBOs, which are treated more favorably than other NPOs. Some countries have developed separate accounting rules and standards for NPOs,¹⁴⁰ and some tax authorities have separate units to deal with NPOs.¹⁴¹ In many countries, however, NPOs must file and report using the forms and procedures designed for business entities, and tax officials with little understanding of, or sympathy with, NPOs often apply the tax rules to them.¹⁴²

Like other laws, tax laws are no better than the way they are administered, and in most countries much work needs to be done to make the rules, procedures, and forms that

¹³⁸ It is also common to have special rules that apply to public fund-raising by PBOs. These tend not to be tax rules but rather are administered by authorities that deal with public protection, such as the office of the State Attorney. In some countries, e.g., the Netherlands, these rules are administered by a self-regulatory body and not by the government. See the website of the Central Bureau of Fundraising at www.cbf.nl/

¹³⁹ This is true in the three countries discussed as major reference points -- the U.S., the U.K., and Germany.

¹⁴⁰ E.g., Switzerland and the United States. A description of the newly developed accounting rules for NPOs in Switzerland can be found in the October 2003 issue of the INTERNATIONAL JOURNAL OF CIVIL SOCIETY LAW, available at www.law.cua.edu/students/orgs/IJCSL/.

¹⁴¹ One of the reasons that the tax laws affecting NPOs in the United States have been designed and applied in a way that is supportive of NPOs is that they are administered by a separate unit of the Internal Revenue Service that is dedicated to tax exempt organizations and whose employees devote their careers to handling the tax affairs of NPOs, giving them both great expertise and a supportive rather than a revenue collector’s attitude towards the sector.

¹⁴² For example, the Polish tax authorities recently sought to tax the Polish Science Foundation on its entire endowment on the ground that a Polish foundation is exempt only if it spends its money on good works not if it uses the money to buy stocks and bonds. The Foundation had to take the case to the Supreme Court of Poland to get this position, which was based on a fundamental failure to understand the nature of a grant-making foundation, overturned. See discussion of the Polish Foundation of Science case in the April 2003 of the INTERNATIONAL JOURNAL OF CIVIL SOCIETY LAW, available at www.law.cua.edu/students/orgs/IJCSL/.

apply to NPOs suitable to their special characteristics and to ensure that the rules and procedures are applied effectively and fairly.

Conclusion

This Report is necessarily not detailed enough to provide more than an overview of the issues presented with regard to the “Reform of the Public Benefit (Koeki Hojin) Corporation System” in Japan as well as some suggested comparative examples of solutions developed by various other countries. References to supporting materials are contained in footnotes; the authors will also make available or provide information about access to various hard copy sources that cannot be accessed through the Internet. The authors are happy to continue to correspond with Japanese experts and interested individuals to provide substantive comparative input into the ongoing reforms being considered at present by the Fukuhara Commission and the Administrative Reform Promotion Office of the Cabinet Secretariat. They also look forward to continuing discussions with the Tax Commission, of which Mr. Deguchi is a member. The recipients of this Report should feel free to have it translated into Japanese if they so wish.