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ENGLAND & WALES:**

A comparative assessment of common versus civil law

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Defining the nonprofit sectors in Japan and England & Wales: a comparative assessment of common versus civil law

Rosario Laratta, Chris Mason *

Abstract

This paper provides a comparative assessment of the legal frameworks for non-profit organisations (NPOs) in England and Japan, offering fresh insights into the differences in legislative support for NPO development in both countries. Following a review of NPO legal developments in England and Japan, we outline the major contemporary issues affecting NPOs and focus on the key challenges of: legislative reform, systems of regulation, accountability and third/public sector partnerships. The paper contributes to knowledge by exploring the potential of comparative assessments of NPO legislation, and highlights the disparities in support for NPOs that are culturally-bound. Also, we contribute to contemporary debate on the ability for NPOs to manage amidst a global climate of change and the possible return to the so-called 'age of austerity'. Highlighting the differential roles of legal frameworks between cultural contexts shows academics, practitioners and policy makers, the global context of national challenges for NPOs.

Keywords: nonprofit organizations, legal context, partnership, comparative assessment

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1. Introduction

The nonprofit sectors in England and Wales, and Japan have long histories and have significant economic impact. Yet in other respects, especially regarding legal frameworks, the sectors could not be more different. On the one hand, the common law system used in England and Wales is respected for its flexibility and, in the case of charity law, its support for the protection and development of the sector. Recent amendments to the Charities Act indicate the political support for legislative reform, in this case creating a new legal form for social enterprise organisations, i.e. the Community Interest Company (Dunn and Riley 2004). On the other hand, the legislative framework for Japanese nonprofits, based on a civil law code, has differed greatly in its treatment of new and existing nonprofit organisations. These variations cover forms of incorporation, tax exemptions, and systems of legal accountability. The rigidity of the civil law code in Japan, as well as political intractability, has created an environment where control over qualification for NPO status was highly centralised (Kawashima 2000). Therefore, power over NPO incorporation and status resided with ministries using strict qualification criteria. The impact of this process has a direct impact on grassroots NPOs, restricted in their ability to compete with local Government agencies in key areas, or outside of their classified remit. Other factors, such as tax exemption, also made conditions more difficult for some classifications of NPOs where the organisation was not permitted to seek exemption. This has been debilitating rather than supportive of the NPO sector – compared with England and Wales legislation that has typically been more accommodating over tax exemptions and with less bureaucracy related to incorporation, reporting and ministerial involvement. The common law framework in England and Wales has been capable of delivering a more rapid response to amending outdated laws, especially making them more applicable to changing operational conditions for NPOs.

In the last few years, however, Japan has gone through a period of NPO legal transition which partly amended the much-debated 1896 Civil Code that is still providing the nonprofit's legal basis. Interestingly, these changes in NPO legislation show that Japan is emulating parts of the NPO legal framework in England and Wales. One crucial difference between the two sets of legislature concerns the nature of the competent authority that authorise public interest status to nonprofits. Within the English framework, the Charity Commission decides whether a nascent NPO can and will provide services in the public interest, as well as clarify the terms upon which it can do so. The system in England and Wales supports the incorporation of NPOs provided they can prove doing so benefits defined public as stated. This test does offer transparency and accountability to political actors and, importantly, the general public that registered charities operate in ways consistent with their stated objectives. In Japan, on the contrary, government

bureaucrats have historically had the exclusive control in deciding what the public good was and which organizations were allowed to promote it. However, in April 2007, the Japan's Cabinet Office established a Public Interest Corporation Commission (PICC), which is modeled on the Charity Commission for England and Wales (CCEW). Since launching in April, the PICC has been meeting weekly to discuss the various aspects of the new legal system, focusing on how the regulations should be created consistent with the new law, what the requirements should be for public interest status, and how the authorisation process will work. Under the new legal system which started in December 2008 Japanese nonprofit organizations are no longer required to operate on the basis of authorization from the government ministry or agency with jurisdiction over their field of activities. Instead, the previous authorization system was replaced by a system whereby nonprofits seeking incorporation simply register with the Prime Minister's Cabinet Office or their local prefectural government if their activities take place solely within one prefecture.

This paper contributes to contemporary NPO discourse in three areas. Firstly, it will analyse both legal frameworks in order to understand how both systems have developed and the components of each. Secondly, it will look into the challenges Japan is currently facing in adopting a new NPO legal framework modeled on England and Wales NPO legislation system. Finally, it will attempt to predict the type of issues confronting the Japanese new legal framework, based on England and Wales experiences.

2. Nonprofits in England and Wales – the common law perspective

England and Wales are countries subject to common law, which means that "expositions or commentaries upon Statutes are resolutions of judges in courts of justice in judicial courses of proceeding, either related and reported in books or extant in judicial records, or in both, and therefore, being collected together, it is conceived to produce certainty." (Holmes, 1963). Kendall and Knapp (1997: 7) stated that in these two countries "whether or not an organization is deemed charitable in law depends on a huge corpus of accumulated case or judge-made law, and past court decisions". The nonprofit sector is legally defined in terms of its most common functions and, according to Picarda (1977), the most common type of function attributed to the nonprofit sector is the promotion of what is *variously* termed the *public interest*. Kendall and Knapp (1997) pointed out that what is particular about English and Welsh nonprofits is not the organizational form which dominates the legal position, but their pursuit of charitable purposes which earn charitable status.

This legal tradition dates back to the Poor Laws, "a body of legislation for providing relief

for the poor, including care for the aged, the sick, and infants and children, as well as work for the able-bodied through local parishes" (Anheier, 2005: 29). The Poor Laws included also *The 1601 Elizabethan Statute of Charitable Uses*, which provided a clear definition of charity by setting out a variety of purposes for which a charity could have been recognized as an organization involved in promoting the public interest. As noted by Hopkins (1987: 56), the variety of purposes set by the *Elizabethan Statute* included: "the relief of the aged, the disabled and poor people... the maintenance of sick and maimed soldiers and mariners, schools of learning and scholars in universities... the carrying out of public works, such as the repair of bridges, ports, havens, causeways, churches, sea banks, and highways...relief, stock, or maintenance for houses of correction...marriages of poor maids...support aid and help of young tradesmen, handicraftsmen...relief or redemption of prisoners or captives...aid or ease of any poor inhabitant concerning payment of fifteen shillings, setting out of soldiers, and other taxes".

In 1834 the reform of the Poor Laws was enacted, and the status of 'poor' was re-conceptualized as two sub-classes: 'the undeserving poor' (i.e. able-bodied) and 'the deserving poor'. This reform also specified that the State was mainly responsible for the former sub-class, and the charities were mainly responsible for the latter. In 1891, Lord McNaughten in *Commissioners for Special Purposes of the Income Tax v. Pemsel* restated the Preamble to the definition of charitable purposes contained in *The 1601 Elizabethan Statute* by stating that there were four principal types of charitable purposes: the relief of poverty, the advancement of education, the advancement of religion, and other purposes beneficial to the community not coming under any of the first three kinds. This was actually the classification which has been the one most accepted in English law for more than one hundred years.

However in the 1940s and 1950s, and largely in response to the devastating attacks suffered during the Second World War, heavy reliance on private charity was replaced by a comprehensive system of public welfare services. The distinction between the State's responsibility for the undeserving poor and charities' responsibility for the deserving poor no longer applied. "Official concern was aroused, which was linked to the public desire that after the war things should be different and better. Two official enquires were established: *The Beveridge Committee*, whose recommendations led to the establishment of the National Health Services, a universal social security system, and a welfare service for the old and the handicapped; and *The Curtis Committee*, which reviewed child and family welfare services." (Social Services in Practice: A decade of Action, 1982: 3).

This scenario changed throughout the 1970s and 1980s when certain welfare reforms (which led to the well known New Public Management system) promoted the rolling-back of the State in the provision of social services and the transformation of voluntary organizations and charities into alternative services providers. However, throughout the 1990s a series of reports were issued by the State on the relationship between the government and the voluntary sector, culminating in what became known as the Deakin Report. This statement was signed in 1998 by the ruling Labour Party as a Compact to establish the guidelines for the relationship between the two sectors. In 2002, under this new climate of collaboration between the two sectors, the British Cabinet Office conducted a review on the basis of which the four categories of charitable purposes made in the *1891 Pemsel case* were expanded to ten purposes types: the prevention and relief of poverty; the advancement of education; the advancement of religion; the advancement of health (including the prevention and relief of sickness, disease or human suffering); social and community advancement (including the care, support, and protection of the aged, people with a disability, children and young people); the advancement of culture, arts and heritage; the advancement of amateur sport; the promotion of human rights, conflict resolution and reconciliation; the advancement of environment protection and improvement; *and other purposes beneficial to the community*. This classification, although more specific than the previous one, remains open to refinement. The definition of 'other purposes beneficial to the community', as with the four purposes listed in the *Pemsel case*, remains largely unspecified.

This vagueness of what constitutes *public interest* goes hand in hand with an idea of flexibility in common law. The Charity Commission clearly stated that:

"The courts recognize that there is a need for a flexible legal framework by which new charitable purposes can be recognized in the light of changing social and economic circumstances...The courts have stressed that the law is not static and that the law must change as ideas about social values change. This has two implications: first, new objects and purposes not previously considered charitable may be held to be so; secondly, objects and purposes previously regarded as charitable may no longer be held to be charitable"

(RR1a-Needs for a flexible legal framework).

This obviously presents advantages and disadvantages: the common law framework in England and Wales "has a key strength in terms of its adaptability; its case law base means that 'fossilization' can be avoided by the creative use of analogies" (Kendall and Knapp, 1997: 7). At the same time, however, this notion of flexibility in common law justifies the claim that the nonprofit sector in these two countries is "not easy to specify

with any real precision” (Salamon and Anheier, 1997: 17). Of the nonprofit sector in the United Kingdom, these scholars believe that in legal terms “the nonprofit sector is a bewilderingly confused set of institutions with poorly defined boundaries... there is no commonly accepted concept that captures the basic contours of the sector as a whole, and that spells out the defining components of the organizations which in the aggregate constitute the nonprofit sector.”(ibid: 41). The blurring of organizational boundaries within the NPO sector is compounded by the crevice engagement between Third and public sectors, i.e. procurement of public sector service contracts into NPOs in England and Wales (Carmel and Harlock 2008). Thus, the legislative body has a clear mandate to provide a more appropriate legal framework for NPOs in England and Wales that accommodates the challenges facing NPOs engaging in new areas of public life (Dunn and Riley 2004).

Within this legal framework which includes both elements of vagueness and flexibility, a charity to be legally recognized must assume one of these four juridical forms specified by the common law of England and Wales: the company limited by guarantee, unincorporated association, trust, and industrial and provident society. Information about each of these types is given in table 1.

The CCEW is the legally constituted regulator and registrar for charities in England and Wales. The main role of the CCEW is to ensure that all registered charities conform with legal requirements, and are held accountable in the public interest. In so doing, the CCEW is pivotal to the ongoing efficacy of charities in public life, and is influential in promoting benchmarks for NPO accountability. Every charity must register with the CCEW if it has a permanent endowment (i.e. capital which cannot be spent like income), or if it has an annual income over one thousand GBP per year, or if it has ratable occupation of any land or buildings - even if the local authority has agreed not to charge any rates. (Charity Commission 2008c). However, Schedule 2 of the 1993 Act lists some charities, known as ‘exempt charities’, which are not required to register (ibid.).

Charities must not distribute profits as dividends or otherwise. Under charity law, all expenditure must further the organization’s charitable purposes. This principle applies to salaries as well as other types of expenditure. The law does not specify a particular limit, but excessive salaries could lead to sanctions. All charities must report the number of employees whose salaries fall between particular ranges, 50-60,000 and 60-70,000 GBP, and so on. Trustees ordinarily cannot receive any benefit from the charity - including payment, services, and other benefits of measurable value - unless the charity’s governing documents permit it. If the governing documents do not contain such a provision, the charity must seek authorization from the CCEW or the High Court of

England and Wales to make such a transfer. Furthermore, trustees generally cannot either sell goods to or buy assets from the charity (Charity Commission 2008b).

Table 1 - Types of non-governmental organizations with descriptions.

Type of non-governmental entity	Description
Company limited by guarantee	A company limited by guarantee is a membership organization in which the members' liability is limited to some nominal amount such as £1. The membership can be quite large, or it can be limited to the trustees. A company limited by guarantee can be nonprofit in nature. It is a legal person. Companies House registers companies limited by guarantee.
Unincorporated association	An unincorporated association is a membership organization. (Usually, Charities and other NGOs commonly fall in this category, including most community associations, sports clubs, and social clubs). An unincorporated association is not a legal person. Members of the management committee are jointly and severally liable for the organisation's debts; officers or members may also be liable. Unincorporated associations are governed by a body of case law and not by statutes.
Trust	A trust is an entity created to hold and manage assets for the benefit of others. The trust must pursue a charitable purpose and is governed by trustees. A trust ordinarily is not a legal person. Under the Charities Act of 1992, however, the body of trustees can apply to the Charity Commission for a certificate of incorporation (Charities Act 1992, Art. 14 (1)). An incorporated body of trustees is a legal person, but without the usual corporate limitation on liability. Incorporation lets the trust perform particular functions - hold property, enter into contracts, and sue and be sued - in its own name rather than in the names of trustees.
Industrial and provident society	An industrial and provident society is a nonprofit corporate entity. It is a legal person. The structure is widely used for housing associations and cooperatives, as well as for some charitable organisations. Its principal advantage is that its governing law, the Industrial and Provident Act of 1965, is simpler than the law governing companies. Charitable Industrial and Provident societies are called exempt charities and cannot register as a charity with the Charity Commission.

Source: developed from the Charitable Commission's Official Website

One of the biggest advantages which a charity gets from registration is exemption from most forms of direct taxation. In England and Wales, charities do not pay tax on grants, donations, and similar sources of income. Charities are exempt from taxation on donations they receive from both corporations and individuals, including grants from foreign sources. Donations of cash by corporations or individuals to charities qualify for tax relief under the so-called "Gift Aid" scheme. Under this scheme, the charity can claim back the basic rate tax that the donor has paid on the income from which the gift was made. For example, if the charity receives five hundred GBP, this is treated as having been made out of six hundred GBP income from which the donor has already paid hundred GBP in tax. The charity can claim the hundred GBP from the Inland Revenue. In addition, a donor who pays a higher-rate of tax can claim back higher-rate relief from the Inland Revenue, reducing the net cost of making the gift. Each donor must complete a simple Gift Aid Certificate. A single certificate can cover a series of donations. The charity is then able to reclaim the basic tax rate from the relevant Inland Revenue office. Donations of shares and land and buildings also benefit from tax relief. Charities pay no more than twenty percent of normal business rates on the buildings which they use and occupy to further their charitable purposes. In addition, some charitable outlay by businesses (for example, sponsorship payments) can be treated as allowable expenses of the business (if made wholly and exclusively for the purposes of the trade) and deducted when assessing the profits of the business for tax purposes (Charity Commission 2008a).

We can see that there is a well-established legal framework for NPOs in place in England and Wales, developed over a long time period and enhancing the effectiveness of NPOs due in large part to the flexibility of the common law legal system in place in these countries. Despite some of the noted difficulties inherent in this system, we now contrast this case with the systems in place for NPOs in Japan. In particular, we focus on two major discourses: firstly, how concerns raised by academics and NPO practitioners over the intractability of Japanese NPO law highlight developmental issues for the Japanese NPO sector. Secondly we explain how Japanese legislative changes are being enacted through close transference of the benefits of the approach used in England and Wales.

3. Nonprofits in Japan – a civil law perspective

In contrast to countries subject to common law, Japan has a system of civil law and this changes the way in which the nonprofit sector is legally defined. Generally, civil law comprises two kinds of law: private and public law. The former regulates the rights and responsibilities of individuals and private legal persons, while the latter regulates the relations between individuals and the state, public agencies, and public law corporations

(Anheier, 2005). This distinction is based on the basic assumption that “the state is a legal actor *sui generis* and in possession of its own legal subjectivity that requires laws and regulations qualitatively different from those addressing private individuals” (ibid: 42).

Under Japanese civil law two types of organizations are recognized: *public interest corporations* and *private law associations*. In order to acquire one of those two legal forms, an organization needs to register under certain conditions described by the code. Lack of registration implies that the organization has no legal personality and can only be addressed as a matter of private law (Anheier, 2005). More importantly, as Pekkanen and Simon (2003: 78 emphasis added) clarify, the lack of legal personality means that unregistered organizations “cannot sign contracts or open bank accounts. This means, for example, that as a group they cannot hire staff, own property, sign lease agreements for office space, undertake joint projects with domestic government bodies, or even, on a mundane level, lease a photocopy machine”.

The Japanese nonprofit sector was first institutionalized with the enactment of the Civil Code of 1898. Its Article 34 defines the ‘legal persons acting in the public interest’ or *koeki hojin* as: “An association or foundation relating to rites, religion, charity, academic activities, arts and crafts, or otherwise relating to the public interest and not having for its object acquisition of profit may be made a legal person subject to the permission of the competent authorities” (Civil Code, art.34). The two classifications in this category are: incorporated foundations or *zaidan hojin*, and incorporated associations or *shadan hojin*. What differentiates these two types of *koeki hojin* is that the latter is formed around a group of members, while the former type is formed around an amount of money and usually does not have members.

Article 34 of the Civil Code concerning *koeki hojin* was the norm for defining nonprofit organizations in Japan until 1946 (following the aftermath of the Second World War). Subsequently, Japan was in need of social assistance. New organizations started to flourish around the country, and some others, older ones which were yet to be regulated, began to be very useful. Within this context, the national government was forced to introduce laws which allowed these new, or relatively new, forms of organization to acquire a legal status as *zaidan hojin*. The first two groups that needed to be regulated were ‘religious organisations’ (*shukyo hojin*) and ‘educational corporations’ (*gakko hojin*). These were followed by ‘health care organisations’ (*iryō hojin*) and ‘social welfare corporations’ (*shai fukushi hojin*). They were regulated respectively by the following laws: the Religious Corporation Law, 1946; the Private School Law, 1949; the Medical Law, 1950; and the Social Welfare Services Law, 1951. Each of these prescribes

conditions for approval or certification by the competent authorities for setting up a juridical person (see Pekkanen and Simon, 2003).

In 1923, Tokyo experienced the *Great Kanto Earthquake*, which “killed a hundred thousand people and destroyed 60 percent of the buildings in the city” (Hastings, 1995: 46). This precipitated the creation of public charitable trusts which were a kind of intermediate organization in that they had a membership, like *shadan hojin* but were formed around an amount of money (patrimony or endowment), like *zaidan hojin*. These organizations were regulated by the 1923 Trust Law which was expanded in 1977 with the addition of Article 66 allowing public charitable trusts to have a wide variety of public interest purposes and be regulated in the same way that *koeki hojin* were regulated by Article 34 of the Civil Code.

All these forms of organizations comprised what were legally understood as the ‘Legal Persons Acting in the Public Interest’ in Japan. However, according to Pekkanen and Simon (2003), there are certain difficulties with the way in which these organizations are regulated. The first problem encountered in Article 34 of the Civil Code, as well as in the special laws introduced in the post-war period, concerns the definition of *public interest* (a problem encountered also in the English and Welsh legal system). Apart from the brief reference in Article 34 of the Civil Code to ‘organizations relating to rites, religion, charity, academic activities, arts and crafts, or otherwise relating to the public interest’ there is no definition of what ‘public interest’ is.

The state in Japan has been traditionally conceived not only as a legal actor *sui generis* (Anheier, 2005), but, as Knight (1996) said, it is historically understood to be a *moral entity*. This general understanding gives to the statutory bodies “a key role as the legitimator and regulator” of public interest activities (Osborne, 2003: 10). This leads to another problem with the Japanese public interest law, which Pekkanen and Simon (2003) named *administrative discretion*. According to them, the Civil Code “make challenges against denial of approval of an application quite difficult” and it “does not require that the reasons for rejection of the application be specified”. Furthermore, it “sets no limits within which an application must be considered” (81). In addition, for these public interest organizations to become legal entities, they must apply to and receive the approval of the competent minister, so if an organization intends to involve itself in a variety of activities which are related to the public interest, that organization is likely to receive the approval from more than one minister. The final problem associated with Civil Law regarding public interest organizations concerns capital requirement, referred to in the Civil Code as a ‘sound financial base’, which is again at the discretion of the minister(s) who give the approval (Pekkanen and Simon, 2003).

The legal framework described so far was the only one that regulated Japanese nonprofit organizations up to December 1998 when a very significant shift in political attitude resulting from the *Great Hanshin-Awaji Earthquake* of 1995, made possible the enactment of the 'Special Nonprofit Activities Promotion Law' otherwise known simply as the 'NPO Law'. As it states in Article 10, the main purpose of the new NPO Law was to alleviate the legal difficulties which were encountered by the *koeki hojin* in the process of obtaining legal status under the previous law and free the registration process from administrative discretion in order to ensure the registration of all qualified organizations. Regarding the latter, according to Amenomori (1997), there were more than a million associations in Japan which, until the implementation of this new law, were not allowed to attain legal status. Most notable among them were: civic groups (*shimin dantai*) which represent all forms of informal civic activity organizations, including those relating to environmental matters, civil and women's rights, peace initiatives, consumer rights, international exchanges of people, hobbies, mutual help and so on; neighborhood associations (*Chonaikai*); children's associations (*kodomo-kai*); and seniors' clubs (*rojin-kai*). The new NPO Law shed light precisely on this segment of the nonprofit sector, known as special nonprofit corporations (SNC) or *tokutei hieiri hojin* as opposed to the *koeki hojin* regulated by Article 34 of the Civil Code. In order to make clear the distinction between these, we reproduce below a table taken from Pekkanen (2003) but with alterations designed to clarify the dates of the 'Governing Laws', which were unclear in the original because it did not differentiate between dates of enactment and dates of promulgation.

Table 2: Categories of legal entities which can be characterized as nonprofit organizations in Japan

Legal entity	Governing law	Purpose of the entity	Permitting body & standard
<i>Incorporated associations</i>	Civil Code, Article 34 (1898);	Associations with the objective of worship, religion, charity, education, arts and crafts, and other activities in the public interest, and not for profit;	<i>Competent Minister (by permission)</i>
<i>Incorporated corporations</i>	Civil Code, Article 34 (1898);	Foundations with the objective of worship, religion, charity, education, arts and crafts, and other activities in the public interest, and not for profit;	<i>Competent Minister (by permission)</i>

(continue)

<i>Social welfare corporations</i>	Social Welfare Business Law, Article 22 (1951);	Corporations established under the law with the objective of becoming social welfare businesses;	<i>Minister of Health and Welfare (by approval)</i>
<i>Educational corporations</i>	Private school Law, Article 3 (1949);	Corporations established under the law for the purpose of establishing a private school;	<i>Minister of education (by approval)</i>
<i>Religious corporations</i>	Religious Corporation Law, Article 4 (1946);	Corporations having the purpose of evangelizing, conducting religious rites, and educating and nurturing believers;	<i>Minister of education (by certification)</i>
<i>Medical corporations</i>	Medical Law, Article 39 (1950);	Associations or foundations whose objectives are to establish a hospital or clinic where doctors and dentists are regularly in attendance, or a facility for the health and welfare for the elderly;	<i>Minister of Health and welfare (by approval)</i>
<i>Public charitable trust</i>	Trust Law, Article 66 (1923- applied 1977);	Trusts with the objectives of worship, religion, charity, education, arts and crafts, and other purposes in the public interest;	<i>Competent minister (by permission)</i>
<i>Approved community based organizations</i>	Local Autonomy Law 260 (2) (1991);	Organizations formed by residents of a community;	<i>Mayor or town headperson (by notification)</i>
<i>Special nonprofit activities legal person</i>	Special Nonprofit Activities Promotion Law (1998); (commonly known as NPO Law)	Nonprofit entities whose activities include those in promotion of health, welfare, education, community development, arts, culture, sports, disaster relief, international cooperation, administration of organizations engaging in these activities, etc.	<i>Mayor or town headperson or Economic Planning Agency. (by certification)</i>

Source: Pekkanen, 2000 (reported again in Pekkanen, 2003)

Under the new legislation, power to approve incorporation status for nonprofits, previously reserved for central government ministries, was transferred to local authorities, thereby considerably accelerating the process. Indeed, local governments were now obligated to publicly announce the opening date of applications for nonprofit

incorporation at least two months in advance, and to reach a decision with regard to every applicant within two months of the closing date for submissions. Furthermore, there was no requirement in the incorporation process concerning the holding of assets.

However, under the new law a *tokutei hieiri hojin* is also subject to numerous requirements. First of all, when applying for incorporation, the group must provide to the competent agency: 1) its articles of incorporation, 2) a list of officers, 3) a list of ten or more members, 4) a document to verify the purposes of the organization and non-affiliation with criminal organizations, 5) a prospectus, 6) a list of founders, and 7) minutes of a meeting that decided on incorporation, a list of assets, a document indicating the organisation's fiscal year, operating plans and budget estimates for the year of incorporation and the following year. (NPO Law, article 2, 10, 28). The new NPO law specifies the activities in which the *tokutei hieiri hojin* can engage, but it also specifies that the nonprofit's main purpose of activities should be neither religious nor political and that the organization can not make a profit for a certain individual, corporation, or other organization, even though it can engage in profit making projects as long as the profit is reinvested in its nonprofit activities (NPO Law, article 2). Every year, the incorporated nonprofit corporation is required to prepare, keep, and submit to the competent agency the following documents: an activities report, an inventory of assets, a balance sheet, a statement of revenue and expenditure, a list of officers, a document stating the names of all officers on the list that received remuneration, and a document stating the names and addresses of ten or more members.

However, there was one point that the NPO law did not address and that was the matter of tax exemption which had constituted a major obstacle for Japanese NPOs. In Japan the NPO process of acquiring legal entity status has always been different from that required to be exempt from tax. The latter requires specific authorization from the National Tax Administration/Ministry of Finance. Aware of such a gap, a little over two years after enactment of the NPO Law, the Japanese Diet passed a second landmark legislation affecting *tokutei hieiri hojin*. March 2001 saw the approval of the law amending in part the *Special Tax Measures Law*, becoming the first legislation to address the eligibility of incorporated nonprofits to receive tax-deductible donations. This brought about a dramatic increase in the number of organizations incorporated as *tokutei hieiri hojin*. In fact, at the end of April 2008 the nonprofits established under the 1998 Law numbered over thirty four-thousand.

Table 3: the main differences in tax treatment among nonprofit legal entities in Japan.

Legal entity	Tax law	Income Tax on revenue	Deduction of contributions
<p><i>Incorporated associations</i></p> <p><i>Incorporated corporations</i></p>	<p>Corporation Tax Law, Article 4 and 7</p>	<p>The Law specifies 33 for-profit activities. For these activities, incorporated associations and incorporated foundations are taxed at a concessional rate of 27 percent. In addition, they are allowed to deduct up to 20 percent of income from profit-making activities if the funds are used to expand their core public interest activities. Passive income, such as interest, dividends, and investment income, is not subject to income tax if the income is related to the organization's nonprofit activities. They may be exempt from local taxes only if their main purpose is the establishment of a museum or the pursuit of studies.</p>	<p>They can qualify as a 'special public interest promoting corporation'(hereafter SPIPC) and under this status they can deduct: individual donations up to 25% of the annual income, corporation donations up to a ceiling (1,25% of income plus 0.125% of paid -in capital), inheritance taxes are totally deductible.</p>
<p><i>Social welfare corporations</i></p> <p><i>Educational corporations</i></p> <p><i>Religious corporations</i></p>	<p>Corporation Tax Law, Article 4 and 7, but with some exceptions</p>	<p>They are generally subject to the tax benefits that apply to Incorporated Associations and Foundations but with a few different rules. For example, they can deduct the greater of 50 percent or 2 million yen of income earned from profit-making activities.</p>	<p>Social welfare corporations and Educational corporations are eligible for SPIPC so they can have deduction as the Incorporated Associations and foundations. On the other hand, religious and medical corporations are not eligible for SPIPC.</p>

<p><i>Medical corporations</i></p>	<p>Corporation Tax Law</p>	<p>Medical Corporations, by contrast, are taxed at the full corporate tax rate, except to the extent they receive medical fees as reimbursements from the social insurance system. An exception applies to "Special Medical Corporations" (<i>tokutei iryo hojin</i>), which the Ministry of Finance has certified as being especially in the public interest. They are taxed at 27 percent on profits and receive other minor tax benefits.</p>	
<p><i>Public charitable trust Approved community based organizations Special nonprofit activities legal person</i></p>	<p>They are not exempt</p>	<p>They must pay corporate income tax on revenue from 33 specified for-profit activities. The tax rate on these activities is a concessional one of 27 percent up to a total revenue of 8 million yen, and 30 percent above that threshold (See Articles 4 and 7 of the Corporation Tax Law). In addition, some of them are allowed to deduct up to 20 percent of income from profit-making activities if the funds are used to expand their core public interest activities.</p>	<p>They used to be ineligible for SPIPC. The 2001 Tax Reforms allowed these organizations to obtain the same status. They must apply to the National Tax Administration Office and satisfy a list of requirements, including demonstrating that they receive at least one-fifth of all revenues from qualifying contributions, with various limits on the amounts and sources necessary for contributions to be deemed as qualifying (NPO Law, art. 46:2).</p>

Source: developed from: Pekkanen and Simon (2003), Yoshida (1999), Yamamoto (1998), Amenomori (1997), and Japan Civil Society Monitor issues 5- 6.

The new NPO Law turned out to be exclusively focused on facilitating the incorporation status for the millions of nonprofits which had sprung up since World War II (i.e. *tokutei hieiri hojin*), without concretely addressing the issue of how to reform the current public interest corporation system (*koeki hojin*) which covered roughly 25,000 of Japan's largest and most established nonprofits. Indeed, according to the White Paper on *koeki hojins* issued by the Ministry of Home Office and the Ministry of Internal Affairs and Communications (MIC), the median of income by *koeki hojins* is 59.27 million yen, 15 times bigger than that of the *tokutei hieiri hojins*, and the mean is 718.48 million yen, 32 times bigger than that of the *tokutei hieiri hojins*.

However, in June 2006 three new laws aimed to reforming the *koeki hojin* passed the Diet and from December 2008 a new legal framework for NPOs was enacted in Japan.

Despite their long history, *koeki hojins* have been often subject to two major criticisms by the general public: first, those organizations are often directed by retired bureaucrats who used to be responsible for supervision and oversight of the same organizations while they were public officials; second, those agencies are the ones who receive most consistent subsidies from the government not to conduct their missions but to pay high salaries to those retired bureaucrats as directors of *koeki hojins*.

Well-publicised reports and enquiries into fraudulent practices of some of these organizations at the turn of the century revealed that the public opinion on *koeki hojins* was partly right. It was found that in some *koeki hojins* resource expenditure on the public good were not commensurate with the tax benefits they were receiving. The arrest in 2000 of a former ruling Liberal Democratic Party (LDP) lawmaker in a bribery scandal by one of these foundations named KSD caused the loss of public trust in *koeki hojins*.

In March 2002 the Cabinet released the decision on the reform of the public interest corporation system. The real problem was to identify a new "competent authority" that would have authorize public interest status to *koeki hojins*. In 2004, a private sector advisory council convened by the minister of administrative reform recommended the creation of a new, independent entity to play this role, but the law eventually submitted by the government instead mandated the creation of a PICC or *koeki nintei touiinkai* under the jurisdiction of the Cabinet Office to serve as the competent authority.

After years of consultation with experts, practitioners and researchers from the private sector, three new law acts passed the Diet on June 2, 2006 and they were enforced in December 2008. In April 2007, before the new laws were enforced, the Cabinet Office

established the PICC, which was modeled on the United Kingdom's Charity Commission. Seven members were appointed by the Prime Minister, upon obtaining the consent of both houses of the Diet, to serve on it, mostly on a part-time basis, and they are experts in diverse fields: law, accounting, business, health and welfare, arts and culture, and the nonprofit sector. The PICC has the following roles: a) judging whether an organization should be granted the status of public interest corporation; b) conducting follow-up checks and supervisions; c) dealing with complaints from public interest corporations; d) providing a detailed list of requirements to which organizations should attain to obtain the status as public interest corporation; e) giving advises and counseling to public interest corporations about their management. In addition to these functions, if the PICC authorize an organization, it can enjoy full exemption from both corporate and deductible taxes.

The three acts which were enforced in December 2008 are: a) Act on General Incorporated Associations and General Incorporated Foundations; b) Act on Authorization of Public Interest Incorporated Associations and Public Interest Incorporated Foundations; c) Act concerning Special Measures for enforcement of General Incorporated Associations/Foundations Act and Public Interest Incorporated Associations/Foundations.

Under these three acts, the status of all *koeki hojins* was revoked and they were forced to re-register as new entities. The new law allows these organizations to be re-registered in the form of incorporated associations (*Ippan Shadan Hojins*) or incorporated foundations (*Ippan Zaidan Hojins*). The former type can be established if there are at least two members and without any requirement for its financial base - this was a big improvement compared to the previous legislation which required to *shadan hojins* at least 300,000 yen as annual membership fees. The latter type to be established under the new law needs only a net asset of at least three million yen compared to the 500 million yen required under the previous law.

In addition to existing *koeki hojins* re-registered as *Ippan Shadan* or *Ippan Zaidan Hojins*, any organization as long as it can claim not to operate in the pursuit of profit, regardless of whether it has a charitable purpose, is allowed to file for this legal designation and they will be recognized as "public interest incorporated associations" (*koeki shadan hojin*) or "public interest incorporated foundations" (*koeki zaidan hojin*). The government also set out a scheme in which the PICC can determine and judge general *Ippan Shadan* or *Ippan Zaidan Hojins* which satisfy definite requirements to become "public interest association corporations" (PIACs) or "public interest foundation corporations" (PIFCs) and become eligible to receive tax-deductible contributions from

corporations and individuals just as some of the current public interest corporations already do.

4. Major Challenges in NPOs

4.1. NPOs in Japan

Under new legislation, Japanese NPOs (especially that segment which was known in this country as the traditional partners of the state, i.e. *koeki hojins*) will face three major challenges:

1) The new legislation is giving *koeki hojins* a temporary special status as “special civil code corporations” or *tokurei minpo hojins* until 2013. During the five-year transition period, 2008-2013, *tokurei minpo hojins* have two options: a) to receive authorization under the new system as either PIACs or PIFCs skipping the process of registering first as “general incorporated associations” or “general incorporated foundations”. They can do this in their current form or after a merger with a similar organisation. b) to forego preferential tax treatment by simply registering as general incorporated associations or foundations; however, they will then be required to pay out their endowments to other public interest corporations that manage to receive authorization. Organizations whose applications are rejected or that fail to apply will be forced to dissolve and terminate their operations at the end of the transition period.

2) The new legal framework specifies the types of activities for which organizations are entitled to receive public interest incorporation status. The list put together charitable and not charitable activities. Under these circumstances, the main question is whether or not nonprofit organizations will face a crisis of legitimacy resulting in the public beginning to question whether they can maintain their historical image of delivering services in a trustworthy and reliable manner. To prevent such a criticism, the law imposes on those organizations new requirements, including those for governance and information disclosure. These new requirements provoked high worry among organizations who are scared of the administrative burden of re-registering and restructuring their boards in order to meet those new requirements.

3) The members of the PICC have been carefully selected and include professionals from the business world, academia, and the nonprofit sector, but the secretariat that supports the commission is made up of 30 bureaucrats from different government ministries and agencies and their numbers will eventually rise to 70. Because the secretariat plays a critical role in directing the activities of the commission, compiling and translating the

various opinions of the commission members into policy, and, most importantly, reporting to the government, the way that the secretariat is structured troubles some civil society experts. In comparison, the Charity Commission for Charities in England and Wales (CCEW) has a different structure and composition. The Commission comprises eight main commissioners, one chair, and four directors drawn from legal, business, development and third sector backgrounds. The key, stated focus of the CCEW is to ensure legal efficacy and accountability, as well as supporting the public interest in charitable activities. The Commission's composition, rather like the new Japanese regulator, helps to direct the accomplishment of these aims, in that it seeks to provide a level of cross-sector expertise to support the regulation of the sector and monitor the effectiveness of policy. However, the main difference with the Japanese PICC is the smaller size of the executive and advisory components of the committee. This is advantageous because it allows for quicker regulatory enforcement and more effective channels of accountability. In principle, the larger PICC will compound some of the main challenges highlighted in this section: the reduction of bureaucracy and more supportive NPO regulation will be counter-acted by an unwieldy Commission, slower decision-making and problems ensuring accountability.

4.2. NPOs in England and Wales

Amid the background of economic recession, there are several significant challenges that NPOs in England and Wales face. The Cabinet Office, the department housing the Office of the Third Sector, recognises the difficult environment for all NPOs in the current climate. As the current Minister for the Third Sector, Angela Smith noted: "It is clear to me that our priority at this time has to be to support the third sector during the recession. The decision does not alter the fact that the Government is committed to enabling campaigning in the third sector." (Plummer 2009). As such, the importance of effective and supportive regulatory bodies and sector-orientated Government policies is clear. Two dominant issues for NPOs comprise funding and financial viability, and accountability in the public interest.

Funding and financial viability

The problem facing all types of NPOs is how to meet the financial needs of the organization within their legally-constituted boundaries. Many NPOs are strictly precluded from raising revenues through the primary purposes of trade, as the amended Charities Act (2006:ch.50 p75) states:

"... 'primary purpose trading', in relation to a charitable institution, means any trade carried on by the institution or a company connected with it where — (a) the trade is

carried on in the course of the actual carrying out of a primary purpose of the institution; or (b) the work in connection with the trade is mainly carried out by beneficiaries of the institution.”

The CCEW ensures this stipulation is upheld for all of the registered charities in England and Wales, with the exception of social enterprises (SEs). SEs are types of NPO that have the ability to trade in goods and services for the purposes of creating social benefit for a defined community. These organizations have become a popular vehicle for individuals, or as spin-offs from existing organizations, to engage in trading activities to create economic as well as social benefit. SEs also side-step the traditional ‘non-distribution’ constraint placed on charities and non-trading nonprofits: SEs can distribute a proportion of accrued financial surplus to key stakeholders as a dividend. Legal forms for SE include industrial and provident society, companies limited by guarantee, mutual cooperative and CIC. Charities and non-trading NPOs can use SEs as trading-arms to pursue trading activity, which further ‘blurs’ the boundaries between types of NPO. Importantly, this means that legislation over the trading activities of charities *per se* is more difficult for the CCEW to enforce. Consequently, there are legal compliance and accountability issues at play for sector regulators and policy makers alike. This create a legislative vacuum where *governance* of NPOs is inadequate given divergences between current legislation and emergent public policy. Public policy needs to address the need for organizations with non-profit distribution constraints to pursue trading opportunities.

Accountability in the public interest

The viability of the sector, especially as NPOs become embedded in public sector service delivery, hinges on how well the current interventionist legislative regime resolves conflicts arising from contemporary events (Dunn 2008). Indeed, as third sector organizations are integrated (via procurement) into public sector service delivery, regulation and policy should accommodate the two main of issues arising from this environment. Firstly the embeddedness of NPOs into public policy (especially via the Department of Health) presents regulatory problems, where there is crossover between law governing NPO activities, and legislation governing public sector contractor arrangements. In other words, how are NPOs working in the public sector to be recognised within the law: as third sector organisations, as public service contractors or both? The implications are notable for the contracting NPO because they must know *how* to comply with legislation, and be held accountable in the public interest. This is naturally complicated by the adjudications of the CCEW. As Dunn (2008) noted, greater clarity is required over the legal identities of organisations that straddling the third and public sectors.

Secondly there is the issue of public interest, specifically whether NPOs continue to provide services which are “public in character” and provide a form of public benefit (Harding 2008:159). When NPO mission and objectives become aligned with those of public sector partners (e.g. the NHS), the same test of public benefit applies but under different circumstances (i.e. the public sector providing a new market environment for a NPO). Accordingly, the NPO in question could be subjected to regulatory review to ensure they continue to adhere to guiding principles, such as those set down by the charities or CIC regulators in England and Wales. The consequence of this is an added administrative burden both on NPOs and the regulator. In order to enhance NPO effectiveness, regulators need to provide a way of working within existing law (especially the Charities Act) that enables NPOs to meet their expected levels of accountability. Yet, NPOs face compliance, competitive pressures pulling and internal pressures pushing them into new market opportunities (i.e. public sector service delivery).

The regulation of CICs

Community Interest Companies (CICs) are a legal form for NPOs created by virtue of the Companies (Audit, Investigations and Community Enterprise) Act 2004 and the Community Interest Companies Regulations 2005 in the England and Wales. The rationale for their creation was the long-held feeling by practitioners and policy makers alike, that the existing options for incorporation were outmoded and out-dated (Cornelius, Todres, Janjuha-Jivraj, Woods and Wallace 2008). Consequently, the UK government developed the CIC through consultation with sector professionals. CICs are formed in the same way as other private companies, but they differ along four key components. First, CICs must prove that their work will have a community interest, i.e. the rationale for existence will be to work in communities and create social benefit. Second, the CIC must provide an annual statement or report indicating its success regarding the first proviso – i.e. The level of community involvement and social benefit accrued during the past twelve months. Thirdly, the CIC is covered by an ‘asset lock’, effectively protecting the interests of the community from illegal or otherwise detrimental activities taken on behalf of the CIC, where the longevity of the CIC is threatened. Finally, there is a (now relaxed) dividend and interest ‘cap’, which allows those running the CIC to apply for and acquire financing, but limits the scale of dividend and interest payments made following the company’s success. So, the CIC is a potentially useful legal form, because it intends to give social entrepreneurs the freedom associated with private companies, while applying a light-touch regulatory approach to ensure community interests are upheld. The uptake of the CIC form to date has been relatively underwhelming, and following consultations with the sector, the UK government has enacted changes (such as the relaxing of the dividend cap) to encourage

those running CICs to make better use of enterprising opportunities, and attract finance through the promise of a better return (Regulator of Community Interest Companies 2009).

Conclusions

The legislative environments for NPOs present a number of commonly shared challenges. These common challenges comprise a number of areas related to both legislative frameworks, specifically financial sustainability, the evolving nature of third and public sector relationships and tests of public benefit combined with administrative burdens on sector regulators.

NPOs experience on-going pressure to prove their financial stability amid changing market conditions, especially the restrictive conditions imposed on NPO legal forms that disbar them from trading to raise revenue. Organisations thus restricted from pursuing new methods for increasing revenues are at a significant disadvantage compared with other forms of NPO, particularly social enterprises. These organisations are constitutionally permitted to use entrepreneurship to directly benefit their defined social cause, eliminating the need to rely on voluntary donations. Legislative and regulative clarity is required to guide NPOs to better adopt appropriate legal structures to enhance their sustainability, rather than prove to be restrictive. Issues such as public benefit are also raised here, simply because many NPOs must fit the "public in character" test to ensure their regulative legitimacy. Indeed in both contexts, it remains vague quite what is meant by NPOs complying with public benefit and how this can be proven. This situation is not aided by legal frameworks that largely deal with matters such as incorporation, operations and issues like taxation in relation to nonprofits are devised to ensure better governance, rather than prescribing clear enough guidance on public benefit. The structure, mechanism of purpose compliance and monitoring of adherence to legal provisions are overseen by state machinery. But then, the question arises as to whether legislations can ensure good governance? Do the nonprofits follow the legal provisions both in letter and spirit? Much of the emphasis is on upward accountability (i.e. towards the State, proving public interest), rather than focusing on downward accountability (i.e. to the general public). As Lavoie and Wright made clear (2000, p.20) "A legal system cannot provide the rule of law if there is no generally accepted attitude about justice...The presence of a written Constitution will be of little help if the underlying cultural norms which maintain its legitimacy are dead". The legislations create a formal framework and creates a "bureaucracy, the predominant organizational model of 20th century, (that) favoured highly uniform and routine process to deliver public value". However, for the present complex problems and organizations a shift is

needed from governing by hierarchy to governing by network. This should enable a better down flow of accountability to the general public because the act of implementing legislation is brought closer to recipients of NPO activity. Furthermore, forging closer involvement between the general public and NPOs creates a source a legitimating accountability upwards to political actors and regulators. Increasing transparency between sector participants and regulatory level actors is critical in both countries to make clearer the practice of public benefit.

The capability of NPO regulators to foster a culture of steady, progressive change for NPO is central to the reforms in both England & Wales and Japan. However, we can expect the administrative burden for both the CC and PICC to increase as they try to keep pace with the dynamic interactions between third and public sectors in both countries. Considering the current social (and political) prerogative to decrease reliance of State provision in public health and social care, while spinning-out opportunities for third sector collaboration presents new opportunities for NPOs. However, it is unclear how legislation will apply to NPOs engaging in such opportunities, whether they remain a distinctive part of the third sector (hence covered by charity and public interest corporation law), or a *de facto* aspect of the public sector. This grey area between sector boundaries requires greater clarification if the interests of TSOs are to be properly served by legislature: legal conformity and stakeholder legitimacy must converge in NPOs in cross-sector collaboration. In countries such as Japan, the degree of public credibility for NPOs can be raised if they are encouraged to engage more closely with the public sector. Indeed, the state in Japan has been traditionally conceived as moral entity and it is exactly this aspect that gives to the statutory bodies "a key role as the legitimator and regulator" of public interest activities (Osborne, 2003: 10).

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