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PHILANTHROPY AND LAW IN ASIA

PHILANTHROPY AND LAW IN ASIA

A Comparative Study of the Nonprofit Legal Systems in Ten Asia Pacific Societies

Thomas Silk, Editor

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foreword by

John G. Simon

A Publication of the Asia Pacific Philanthropy Consortium

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FOREWORD

BY ALL RIGHTS, publication of this volume should be an occasion for a celebration, at which this foreword could serve as a longish toast. Both the celebration and the toast would and should be hearty and even joyful, for the project is extremely important and its execution hugely successful.

For one thing, this book deals with a world of organizations—referred to as "nongovernmental," "nonprofit," "voluntary," "Third Sector," or "independent" organizations—that play an increasingly central role on the world scene. In the United States we have recognized for some time that we depend on these organizations to an enormous extent to shoulder a great deal of the nation's business—to teach us, to heal us, to entertain us, to defend our natural resources and our liberties, and ultimately to receive our ashes. Increasingly we have realized as well that the nonprofit sector serves as the laboratory or incubator for major innovations in the public and business sectors, paving the way for new governmental initiatives in education, environmental protection, space exploration, and health and opening up new commercial territory in computer technology, pharmaceuticals, and other science-based industries.

The picture has been somewhat more mixed in most other lands. On the one hand, no other country relies as much as the United States does on the nonprofit sector to provide health care, higher education, and the performing and visual arts. (The Preface, by Barnett Baron, makes this point with respect to the Asian region.) On the other hand, voluntary organizations in other nations have played a vital role in addressing some of the most crucial of human needs. For example, these groups spearheaded the environmental campaigns leading up to and following the Rio conference of 1992. One astute observer of this process, Julie Fisher (1993, p. 4), stated that "the non-governmental organizations founded in the Third World in recent years are already implementing sustainable development and are increasingly challenging and sometimes changing government policy. Confronted by catastrophic changes in their own lives, people in Asia, Africa, and Latin America are organizing their own communities in partnership with committed professionals. In doing so they are inventing alternatives to a dismal human future." These nongovernmental organizations have also wrought huge advances in human rights and have initiated or accelerated the galvanic movements toward democracy and freedom that we have witnessed in Eastern Europe, the former Soviet Union, South Africa, and several countries in Latin America. (There are now many other voluntary groups working, often heroically, for similar breakthroughs in several other countries suffering from persistent oppression.)

Just as the results achieved by nonprofits have been revolutionary, so has the birthrate of these organizations. What Lester Salamon (1994, p. 109) calls "a global 'associational revolution'" is under way, which "may prove to be as significant to the latter twentieth century as the rise of the nation-state was to the latter nineteenth."

It is time to stop talking about these organizations as afterthoughts, as understudies on the world stage—a marginalized role sometimes invoked by negative descriptors such as "nongovernmental" or "nonprofit" or by the last-place connotation of "the Third Sector." Indeed, in purely historical terms we should perhaps refer to it as "the First Sector." Long before there were government agencies, long before there were investor-owned businesses, there were the tribes, the clans, the communal gatherings that lie outside the worlds of formal government or proprietary enterprise, occupying the space we now sometimes refer to as "civil society."

Once upon a time the First Sector appeared to wax and wane in a state of nature, uncomplicated by the constraining or shaping forces of law. For better or for worse, this state of nature has been repealed. Today the shape, size, and direction of the First Sector (the nonprofit sector) is largely (although far from exclusively) a function of law—a function of both regulation and subsidy. (These are often interactive, because the criteria for subsidy, through the tax system or otherwise, are themselves central parts of the regulatory picture.) Both subsidy and regulation influence the size of the nonprofit world. Indeed, one reason why the nonprofit sector plays a greater role in the U.S. economy than it does elsewhere is the comparatively greater degree of subsidization offered through the American tax system, mainly in the form of deductibility of contributions. (I use the word *subsidization* as a shorthand, fully aware of the powerful arguments made by some noted American tax scholars that neither exemption nor deductibility can properly be construed as a subsidy.) Regulation seeks to ensure that the public will benefit from voluntary organizations, new and old, by preventing various forms of neglect and larceny and a variety of intermediate misdeeds, thus (indirectly) affecting the degree of public support for the nonprofit sector.

But there are several other, even more interesting ways in which the nature of subsidy and regulation affect the fiscal and programmatic conduct of voluntary groups—and therefore the role they play in the social order. Here are some examples, each with a set of two opposing views:

- *The availability of tax deductions or other donor subsidies*

  Promotes innovativeness and heterodoxy in the voluntary sector by allowing organizations to look to private individuals as well as government funding for support

  Permits the tastes and priorities of the wealthy to play a disproportionate part in the allocation of otherwise taxable resources

- *Restrictions on the "political" activity of nonprofits (legislative lobbying, political campaigning, litigation, pressure on executive agencies)*

  Constrict the avenues available to a nonprofit organization in the pursuit of its charter purposes

  Prevent private, nonelected groups from wielding nonaccountable power over public policy formation

- *Restrictions on "commercial activity"*

  Prevent nonprofits from expanding the goods and services they make available to the general public

  Discourage nonprofits from imitating the worst behavior of the business world to the detriment of charitable purposes

- *Restrictions on ownership of business enterprises*

  Retard the organizational birthrate within the charitable world and thus the entry of new voices and ideas

  Preclude the distraction of nonprofit trustees from their charitable responsibilities

- *Redistributional requirements (for example, insisting that hospitals serve the poor or that universities offer a certain level of scholarship aid)*

  Make charitable organizations attentive to first principles and to the most troubling aspects of the human condition

Force nonprofit organizations to provide disproportionate attention to only one of many important human values that they are able to serve

- *Advance licensing or registration restrictions, especially those with programmatic or fiduciary criteria*

  Avoid the necessity of an expensive, ex post facto sanctioning process

  Constitute a "prior restraint" that limits the essential pluralism of the nonprofit sector

These and other social impacts of nonprofit law vary, of course, from country to country, as the law itself varies from country to country (often dramatically, as this volume demonstrates) and also as a result of differences in national culture. To capture the legal disparities, with all their complexity, across a wide range of alternative regulation and subsidy regimes is a daunting task. It is also an indispensable task, vital to understanding the structure and health of civil societies around the world. It is, in fact, the kind of enterprise that I, as a teacher and writer in the field of nonprofit law for the past thirty-five years, have eagerly awaited, as have others in this field. My own hunger for such a compendium was abetted, in the case of Asia, by a series of separate meetings in recent years with government servants, academics, foundation officers, and, in one case, a royal family member, from Australia, China, Japan, Taiwan, and Thailand—all of them eager to discuss the nonprofit sector and its possibilities. In the absence of navigational assistance concerning the nonprofit law of these countries, however, I found these exchanges frustrating and my own performance disappointing.

But *Philanthropy and Law in Asia: A Comparative Study of the Nonprofit Legal Systems in Ten Asia Pacific Societies* has landed. Its authors have grasped the nettle—and have done so in the most challenging of all possible settings. Of all continents, Asia presents the starkest contrasts in basic legal structures, nonprofit regulatory and subsidy approaches, and cultural, social, and religious environments. And yet, thanks to the establishment of the Asia Pacific Philanthropy Consortium under Barnett Baron's leadership; the launching of the Comparative Nonprofit Law Project under the direction of Thomas Silk, with Yoshiko Wakayama's assistance; the elegant research methodology they have designed; and the tireless implementation of that methodology by gifted scholars in ten Asian countries, this enterprise has triumphed beyond any early imaginings.

Truth be told, I would have expected no less from Thomas Silk. I have been a Silk-watcher for fifteen years, reading his papers; listening to his presentations at conferences in San Francisco, New York, and Budapest; and watching with admiration as he set out across Eastern Europe and Asia to put his lawyerly and scholarly prowess at the service of civil societies of all stages of maturity and vulnerability.

Nor should I have been surprised to see such excellence in a project that involved Yoshiko Wakayama, who has visited Yale on two occasions for long talks about the condition of the nonprofit sector in Japan and the United States. Never have I had a visitor who came armed with more knowledge or better questions or a cheerier collegial spirit.

The result is a book that will make a great deal of difference to a variety of constituencies in Asia and everywhere else. I include in this group legislators, government officers, other policymakers (including royal family members), academics, nonprofit managers, lawyers—and also social scientists and historians, who can use this splendid knowledge base as a window for comparative studies of culture and belief. As I complete this toast to *Philanthropy and Law in Asia,* I can hear, in my mind's ear, simultaneous cheers from all those readers, present and future, who will benefit from this remarkable achievement.

New Haven, Connecticut
November 1998

John G. Simon
Augustus Lines Professor of Law,
Yale Law School

Founding Director, Yale University
Program on Nonprofit Organizations

REFERENCES

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Salamon, L. "The Rise of the Nonprofit Sector." *Foreign Affairs,* 1994, *75* (4), p. 109.

PREFACE

PHILANTHROPY AND LAW IN ASIA is a significant contribution to improving the enabling environment for nonprofit organizations in East Asia. It is the main product of the Comparative Nonprofit Law Project, launched by the Asia Pacific Philanthropy Consortium in 1995. The Project had two broad objectives. The first was to encourage and support research on the legal and regulatory frameworks affecting the nonprofit sector in the region and to deepen public awareness and academic interest in the sector, particularly with respect to philanthropic grantmaking institutions. Our approach was to establish a baseline of accurate information on existing laws, regulations, and administrative practices in ten East and Southeast Asian countries and territories. The study of nonprofit law is not well established in Asia, however, and few Asian legal scholars or practicing attorneys would describe themselves as expert in this area. Our first task, therefore, was to create teams of legal scholars, attorneys, or social scientists in each participating country to conduct the baseline research and analysis. To assist in this process and to ensure a degree of comparability across countries, a common analytical tool had to be developed to focus the inquiry, guide data collection, and provide a core framework for analysis and recommendations.

These conceptual and organizational tasks were superbly codirected by Thomas Silk and Yoshiko Wakayama. Silk, an American attorney whose firm specializes in nonprofit law, has taught, provided consultancy services, and assisted in the review and formulation of nonprofit legal frameworks in China, Thailand, and Vietnam as well as Eastern Europe, Russia, and the United States. Wakayama was formerly Chief Program Officer of the Toyota Foundation in Japan and is currently Chief Program Officer at the Sasakawa Peace Foundation. Together they identified and assembled a remarkable group of colleagues, with whom they collaborated closely in preparing this book. One of the gratifying results of this study has been the identification of these scholars and, for many of them, their induction into the small but growing international community of nonprofit experts.

The ten countries and territories included in the Project and reported on in this book are Australia, China, Indonesia, Japan, Korea, Philippines, Singapore, Taiwan, Thailand, and Vietnam. (For linguistic simplicity, we refer throughout this work to the ten "countries" participating in the study. We acknowledge, however, that Taiwan's international status is a matter of dispute and that it is not generally recognized as an independent country.) All of the research reported in this volume is original. This is the first time that such detailed and comprehensive information on the enabling environment for the nonprofit sector in East Asia has been assembled in one volume, written by local experts using a common analytical framework and published in English to reach an international audience.

The second objective of the Comparative Nonprofit Law Project, building on the legal analysis reported here, is to help identify obstacles to the further development of the philanthropic sector in each country and territory, to develop action strategies to address these obstacles, and to explore opportunities for supportive legal development. Our plan is to build on the research phase of the Project to engage local interest in legal policy reform as it affects philanthropy in each of the countries involved. The Project therefore identified an appropriate host institution in most of the participating countries to serve two purposes: to provide appropriate professional auspices under which the legal research could be conducted and to serve as the appropriately influential institution to guide subsequent efforts at law reform in that country.

There are significant obstacles to improving the enabling environment for the nonprofit sector in East Asia. The regulatory contexts in which nonprofit organizations currently operate there are only partially explicit and allow broad administrative discretion in the registration, oversight, and dissolution of nonprofit organizations. Moreover, few countries in the region currently provide strong tax incentives for charitable giving. Asian donors and donees alike argue that more transparent and predictable administrative procedures for registration and incorporation, less restrictive government oversight and "administrative guidance," more favorable tax treatment, and fewer restrictions on equity investments and capital formation would help create a more favorable environment for the development of indigenous philanthropy. Each of these is a problem that could be solved through revisions in law and administrative practice, and each is examined in this book within individual-country contexts, with recommendations offered for improvement.

A more profound set of issues that are only partly amenable to improvement through legal reform is related to the current state of civil society in Asia and the limited scope for private actors to engage in and influence public policy. Private foundations and private wealth have traditionally played important catalytic and implementing roles in providing social services and influencing public policies in the United States. In most of East and Southeast Asia, however, popular views of the roles of the "public" and "private" sectors—and the appropriate relationship between them—differ significantly from the view commonly held in the United States. Religious, ethnic, or regional organizations continue to provide specialized educational, medical, or social welfare services to their members, and private schools and hospitals are increasingly common in the region. But the concept of privately funded and privately managed public interest organizations whose scope extends beyond charitable relief is neither well understood nor widely appreciated. The legitimate scope for "private" social action is generally perceived to be rather limited, as the state is expected to provide all basic services. Indeed, "private" nonprofit organizations are often greeted with suspicion concerning their motives and intentions and rarely are perceived as deserving—or made eligible for—the favorable legal status and tax treatment that nonprofit organizations have come to expect as a matter of right in the United States.

There is ample room for improvement in nonprofit law throughout Asia. Such improvements are both necessary and desirable, but law reform by itself will not be sufficient to ensure the sector's rapid growth. To develop, the nonprofit sector requires a favorable legal and regulatory environment, which can only be provided and guaranteed by the state; but to flourish, the nonprofit sector also requires some minimal level of economic development and a society that values pluralism, organizational autonomy, and innovation and that accepts a legitimate role for private actors to participate and sometimes lead the way in developing social policy.

In most countries, developing more supportive nonprofit laws and regulations will be a critical first step. Other necessary steps include supporting public education to cultivate awareness of the positive role of the nonprofit sector, encouraging more corporate engagement in social policy and community welfare, and facilitating increased and more creative efforts to mobilize private and public resources for nonprofit organizations. The Asia Pacific Philanthropy Consortium will continue to support Asian initiatives and activities in each of these areas in the years ahead, building on a firm foundation of local expertise and an informed appreciation of the complex social, economic, and political realities at play within Asia's diversity. In recognition of the fundamental importance of law in shaping and enforcing social policy, *Philanthropy and Law in Asia* is one of the first and most important results of our efforts to date.

San Francisco, California
November 1998

Barnett F. Baron
Chairman, Asia Pacific
Philanthropy Consortium

Executive Vice President,
The Asia Foundation

ACKNOWLEDGMENTS

MANY PEOPLE CONTRIBUTED to the complex undertaking that resulted in the Comparative Nonprofit Law Project and this book. The entire enterprise involved nineteen legal specialists, ten countries, three regional workshops and conferences, and the writing, editing, and publishing of ten country reports.

My nineteen colleagues take first place. I gratefully acknowledge their prodigious effort, careful judgment, and, in some cases, exceptional courage. Due to their efforts, we now have the first comprehensive analytical study of nonprofit legal regimes within a particular region of the world.

I particularly thank Yoshiko Wakayama, the Administrative Director of the Project, for her patient teachings about the peoples, cultures, and nonprofit sector developments in the countries within our study. Next, to Barnett Baron, the dean of comparative philanthropy studies in Asia, I express my debt for his vision, his unflagging support, and the unerring wisdom of his guidance. Then there is the able leadership that made this project possible, from the Executive Committee of the Asia Pacific Philanthropy Consortium, which I also want to thank. In addition to Dr. Baron, the members are Carrillo Gantner, Ku-Hyun Jung, Aurora Tolentino, Paiboon Wattanasiritham, and Tadashi Yamamoto. Particularly influential throughout was the advice of Peter Geithner, Senior Adviser, Asia Center, Harvard University; formerly Director, Asia Programs, The Ford Foundation; and Mark Sidel, Lecturer in Law, University of Iowa College of Law, and former Director of Vietnam programs for the Ford Foundation (1992 to 1995). Thanks also to Jaime Faustino and the staff at the Secretariat of the Asia Pacific Philanthropy Consortium in Manila for all of the unseen but essential work in producing the workshops and final conference.

The Project as well as this book benefited from the generous funding made possible by various foundations in Japan, the United States, and Australia. The Sasakawa Peace Foundation provided more than half of the total Project funding, with the rest provided by, in alphabetical order, The Asia Foundation, The Bankers Trust Foundation, The Ford Foundation, The Hitachi Foundation, The Meyer Foundation, The Mott Foundation, The Rockefeller Brothers Fund, and The Rockefeller Foundation.

I also acknowledge the contribution and support of my partners at Silk, Adler & Colvin. In particular, I want to thank my law partner Betsy Buchalter Adler, a gifted lawyer and a valued friend. Her assistance in reviewing the country reports and her careful editing of my chapter were invaluable. Special thanks are also due to my secretary, Susan Boutté, who managed the complex flow of documents and performed with such skill and care the large and difficult task of preparing this entire manuscript for publication. I am also the grateful beneficiary of helpful editorial advice from my daughter and colleague, Nicole Silk, and of the steadfast support, patience, and good humor of my wife, Suzanne Vinson Silk. Finally, I thank Susan Reed Clark, Executive Director of The Columbia Foundation, particularly for introducing me to international philanthropy; and Madeleine Haas Russell, President and Trustee of The Columbia Foundation and Trustee of The Asia Foundation, for awakening me to philanthropy in Asia.

T. S.

EDITOR AND AUTHORS

THOMAS SILK received his B.A. (1959) and his J.D. (1963) from the University of California at Berkeley. He began his legal career as an appellate attorney with the Tax Division of the U.S. Department of Justice, Washington, D.C. In 1972 he founded a San Francisco law firm now known as Silk, Adler & Colvin, which represents organizations and individuals active in the nonprofit sector in the United States and internationally. He has taught nonprofit law at the School of Law of the University of California at Berkeley and at the Institute for Nonprofit Management at the University of San Francisco, and he has published extensively in the field of nonprofit law. He has consulted on nonprofit law matters in East Asia, Southeast Asia, Central Europe, Eastern Europe, and Latin America. For the last three years he has been the legal director of the Comparative Nonprofit Law Project of the Asia Pacific region. Mr. Silk is president of Silk, Adler & Colvin, where he practices law full-time.

Takako Amemiya graduated from the Law Department of Keio University and received her doctorate in 1973. She is a professor of law at Shoin College and dean of the Department of Business Management. Professor Amemiya is an internationally recognized authority on Japanese nonprofit law.

Satya Arinanto is a lecturer and the secretary of the Department of Constitutional Law at the University of Indonesia. He was recently a Visiting Young Asian Scholar at the University of Melbourne Law School, Australia. Mr. Arinanto has conducted research and edited and published articles in the field of constitutional law.

Jessica Los Baños earned her B.S. (1989) and her LL.B. (1994) at the University of the Philippines. She is an associate with the firm of Raval and Lokin and an assistant professor in the Department of Business Administration, University of the Philippines.

Barnett F. Baron is chairman of the Asia Pacific Philanthropy Consortium and executive vice president of the Asia Foundation, San Francisco.

Chinchai Cheecharoen received his B.W.W. (1980) and his M.S.W. (1984) from Thammasat University, Bangkok. He is the head of the secretariat section of the National Commission on Social Welfare, Ministry of Labor and Social Welfare, Bangkok.

Joyce Yen Feng is a professor of sociology in the Department of Sociology, National Taiwan University. She has been heavily involved with child welfare policy and service delivery in Taiwan. Professor Feng is a board member of several professional organizations and foundations in Taiwan and has published extensively in the field of child welfare.

Dinh Duy Hoa was educated in Vietnam and Germany, receiving his LL.B. (1977) and J.D. (1991) at Leipzig University. He is presently deputy director of the Department of Organization of the Government Committee on Organization and Personnel, which has jurisdiction over domestic nonprofit organizations in Vietnam.

Chang-Soon Hwang received his B.A. (1981) and M.A. (1985) from Yonsei University and his Ph.D. in sociology from the University of Georgia (1991). He is an assistant professor of social welfare at the Soonchunhyang University, Korea. Professor Hwang has published articles on youth welfare issues and nonprofit law.

Ku-Hyun Jung is a graduate of Seoul University and holds an M.B.A. from the State University of New York and a Ph.D. from the University of Michigan. He is professor and dean of business administration at Yonsei University, Seoul. He has also taught at the Chinese University of Hong Kong, the University of Hawaii, the University of Michigan, and the University of Washington. He has published extensively and is an internationally recognized authority on business and philanthropy in Korea. Professor Jung is a consultant to business and government and a member of the boards of directors of several business and nonprofit organizations, including the Hyundai Construction and Engineering Corp.

Carol C. Lerma earned her B.A. (1989) and her LL.B. (1994) at the University of the Philippines. Ms. Lerma practices law, is a certified public accountant, and is an assistant professor in the Department of Finance, Accounting, Business Economics, and Business Law at the University of the Philippines.

Corinna Lim has practiced law in Singapore for eight years. She is currently completing work at Columbia University, New York, for her master of public administration degree. She is actively involved in women's interests in Singapore and was formerly vice president of the Singapore Association of Women Lawyers.

Myles McGregor-Lowndes has undergraduate degrees in law and arts, a master's degree in public administration, and a doctoral degree. He is an associate professor in the Faculty of Business at the Queensland University of Technology, codirector of the Program on Nonprofit Organizations, and a consultant in nonprofit and charity law to Dunhill Madden Butler, Solicitors. He has published extensively in the field of Australian nonprofit law and is an internationally recognized authority in the area.

Tae-Kyu Park earned his B.A. from Yonsei University (1973); his M.A. from Mankato State University, Minnesota (1975); and his Ph.D. in economics at Indiana University (1980). He is professor of economics at Yonsei University. Professor Park has published numerous articles on taxation policy and corporate philanthropy.

Nicole Tan Siew Ping graduated from the Faculty of Law of the University of Singapore with an LL.B. in 1993. She practices law in Singapore, with emphasis on corporate and commercial law, banking, and finance. She is also a member of the executive committee of the Singapore Association of Women Lawyers.

John G. Simon is Augustus Lines Professor of Law, Yale Law School, and the founding director of the Yale University Program on Nonprofit Organizations.

Dipa Swaminathan graduated as a twin gold medalist from the National Law School of India in 1995. She works for an international law firm in Singapore and is associated with nongovernmental organizations in Singapore and India devoted to animal welfare and eco-conservation.

Nguyen Van Thanh was educated at Hanoi University (1960) and the University of Foreign Affairs, Vietnam (1968). He was a researcher at the Academy of Social Sciences in the former USSR (1982) and a Special Fellow at Johns Hopkins University, Baltimore (1995). Mr. Thanh has been a professor of philosophy and a diplomat in Laos and Japan; he is now executive vice president of the Vietnam Union of Friendship

Organizations, which has jurisdiction over foreign nonprofit organizations in Vietnam.

Titawat Udornpim received his LL.B. (1989) from Thammasat University, Bangkok; his LL.M. (1993) from Southern Methodist University, Dallas; and his LL.M. (1994) from Tulane University, New Orleans. He is a judge in the Central Labor Court in Bangkok and a lecturer at the Sukothai Dammadhiraj University, Bangkok.

Yoshiko Wakayama is administrative director of the Comparative Nonprofit Law Project and chief program officer of the Sasakawa Peace Foundation, Tokyo.

Xin Chunying received her law degree from Jilin University (1978) and her LL.M. from the graduate school of the Chinese Academy of Social Sciences (1981). She has been a visiting scholar at the University of California at Berkeley School of Law and a visiting professor of East Asian legal studies at Harvard Law School. Professor Xin is currently deputy director of the Law Institute, Chinese Academy of Social Sciences, Beijing. She has published extensively in the areas of jurisprudence, constitutional law, and human rights law.

Yoshinori Yamaoka graduated from the School of Architecture (1964) and the Graduate School (1969) of Tokyo University. He is the secretary and managing director of the Japan NPO Center. Formerly, Mr. Yamaoka was a program officer, program director, and consultant to the Toyota Foundation. He has published extensively on the role of philanthropy in society.

Zhang Ye is program liaison officer for the China Program of the Asia Foundation. She was assistant to the representative of the Ford Foundation, Beijing, from 1988 to 1994, where she was responsible for women and gender programs as well as personnel management. From 1980 to 1987 Ms. Ye was deputy director and program officer at the Chinese Academy of Social Sciences, where she organized academic activities and was in charge of academic exchanges with the United States, Canada, and Mexico. Ms. Ye is an accomplished writer and translator of academic books and papers.

INTRODUCTION

Yoshiko Wakayama

PHILANTHROPY AND LAW IN ASIA is the product of the first phase of the Comparative Nonprofit Law Project, an effort designed to encourage the development of philanthropy in the Asia Pacific region. International symposia on organized private philanthropy—held in 1989 in Bangkok, in 1993 in Seoul, and in 1994 in Osaka—led to the launching of the Asia Pacific Philanthropy Consortium (APPC), which is composed of grant-making foundations and intermediaries located in East and Southeast Asia, North America, and Australia.

The APPC, in turn, initiated the Comparative Nonprofit Law Project to contribute to the development of an enabling environment for philanthropy in the region by conducting a two-phase effort. In the first phase, baseline studies of the nonprofit legal systems in each country would be produced. In the second phase, efforts would be made to stimulate interest in improving the legal environment for philanthropy.

The first phase was conducted over a three-year period. During the initial stage, Thomas Silk and I visited all ten countries in the study and conducted more than one hundred interviews with foundation officials, academics, legislators, ministry officials, and attorneys. Our main purpose was to gain a greater understanding of how the legal and regulatory systems governing nonprofit organizations (NPOs) operate in practice and to identify suitable candidates for legal specialists in each country.

We then selected legal specialists from throughout the region, who began as early as the fall of 1995 to work on the research and writing of their reports. In October 1996 we held a three-day working conference, at which the legal specialists presented draft country reports, took into account and responded to comments, and offered critiques of reports presented by colleagues. In April 1997, at the urging of the legal specialists, we held a second three-day working conference, at which the country reports were further refined. The first phase of the Project came to a formal close with the presentation of the country reports by the legal specialists at the International Conference on Supporting the Nonprofit Sector in Asia, held in Bangkok in January 1998.

What are the benefits of the Project? Let me emphasize five:

1. The decision to identify and rely on indigenous legal specialists brings an authenticity and legitimacy to the country reports that will aid in their favorable reception within the region.
2. The collaborative nature of the Project has furthered the development of regional expertise in nonprofit law. The Project provided an opportunity for the legal specialists to understand how all ten countries in the region have addressed common nonprofit legal issues.
3. The specific recommendations made in the country reports may influence the development of nonprofit law in those countries.
4. For the first time, comprehensive information is available on how important public policy issues are addressed by the nonprofit laws and practices of ten nations within a particular region. For countries within the region, the availability of detailed information about the nonprofit legal systems of adjacent countries may lead to a new regional influence. That information may also be of benefit to countries outside the region.
5. The Project can be replicated elsewhere. The culturally sensitive project design and its nonprescriptive approach would be welcomed in other regions of the world as well.

Significant expansion in the scale of the nonprofit sector and the accompanying development of modern nonprofit law is everywhere a recent phenomenon. In the Asia Pacific region, attitudes and laws are changing as well. In Japan, for example, the response by individual volunteers and NPOs to the human suffering caused by the great Hanshin-Awaji earthquake of 1995 has had a profound effect on the attitudes of society and the government to the nonprofit sector. That overwhelming response to people in need demonstrated the societal benefit of NPOs as never before. This new sense of the value of NPOs has also led to popular law reform efforts to empower citizens' groups and to stimulate discussions on the need to modernize the civil code, as Takako Amemiya and Yoshinori Yamaoka ably discuss in Chapters Five and Six.

The favorable changes in the attitude toward NPOs and the accompanying law reform efforts are not limited to Japan. Similar changes in attitude are occurring throughout the Asia Pacific region. *Philanthropy and Law in Asia* will serve as a catalyst to needed change and as an encyclopedic guide for the development of legal environments favorable to philanthropy.

PART ONE

COMPARATIVE ANALYSIS

1

A COMPARATIVE STUDY OF NONPROFIT LEGAL SYSTEMS IN TEN ASIA PACIFIC SOCIETIES

Findings and Commentary

Thomas Silk

What we now call the nonprofit sector has always been contested ground—precisely because its nature and extent involve fundamental questions about the nature of human institutions, the possibilities of political, economic, and social organization, and the quality of our values and moral imagination.

—Peter Dobkin Hall, 1994, p. 31

EFFORTS TO IMPROVE the enabling legal environment for nonprofit organizations (NPOs) are under way in almost every country in the Asia Pacific region. In no other region of the world are such endeavors so widespread. These activities are discussed and documented in this chapter and in the country reports in Part Two.

Why are these efforts occurring in the Asia Pacific region? And why now? All of the reasons are not yet well understood. We can, however, identify six major contributing factors: the end of the Cold War and a relaxation of government controls directed against perceived security threats; a trend toward rapid economic growth (despite recent downturns) and increased economic empowerment in the region; the powerful appeal of the notion of a civil society, made possible by the telecommunications revolution and the globalization of nonprofit sector networks; a marked increase in higher education among the current generation of government officials; the continuing transition of the socialist states in the region; and the end of authoritarian rule in many other countries in the region. The possible implications of these factors become more profound when we realize that they are all of extremely recent origin.

METHODOLOGY

In the field of nonprofit law, the core issues of policy choice are remarkably uniform across cultures. And in every society where NPO activity exists, the policy response to those core issues largely accounts for the overall nonprofit legal structure. For this study, we identified eight such issues and asked each of the legal specialists to address them. We designed a common comparative nonprofit law framework, which all of the legal specialists used, where the eight central issues appear in clusters with subsidiary questions.

The first two core issues focus on the registration—the formation, incorporation, or establishment—of nonprofit organizations. How do they become legally empowered? What are the obstacles and restrictions to registration? The next two issues concern tax policy. What income tax exemption policy applies to NPOs? Are income tax deductions available as incentives to individual and corporate contributors? Finally, the framework considers the issues of capital formation, internal governance, accountability and reporting requirements, and dissolution of NPOs.

THE LEGAL SPECIALISTS

In the country reports that follow (Part Two), the legal specialists, using the common comparative nonprofit law framework, discuss and analyze nonprofit laws, describing how they are administered in their countries, and offer recommendations for change. Ten countries are included in this study: Australia, China, Indonesia, Japan, Korea, the Philippines, Singapore, Taiwan, Thailand, and Vietnam.

All nineteen legal specialists and authors (ten men and nine women) live and work in the countries they have written about. Occupations represented (some authors have more than one job) include professor (nine), lawyer or judge (nine), government official (five), and nonprofit sector employee or consultant (three). A remarkable number of the authors (eleven) have done postgraduate study abroad.

The efforts as well as the achievements of the legal specialists have been extraordinary, and their reports are pioneering. For some of the countries covered, they stand as the first attempt to describe the nonprofit legal structure. In others, the task required a recasting of familiar material to fit an unfamiliar comparative law model. In a few countries, the early stages of legal development presented formidable barriers.

STUDY LIMITATIONS

There are also many limitations to a study of this kind. Three, in particular, bear emphasis:

1. This study covers only a portion of the nonprofit sector. It concentrates on laws governing *charitable* or *public benefit* organizations (privately funded and privately managed organizations devoted to benefiting society) rather than laws regarding labor unions, business associations, social groups, cooperatives, political organizations, and other forms of mutual benefit organizations or religious organizations.

2. This is a study of the *formal* (that is, law-based) structure for NPOs. It excludes consideration, except incidentally, of the informal NPOs that exist without registering with the state and without legal powers. We are unaware of any comprehensive studies of informal NPOs in any country in the region, but if the estimates we discuss here are sound, then the formal NPOs are only a part—and probably the smaller part—of the total number of NPOs in most countries in the region.

3. This study is about the laws governing *institutions* devoted *primarily* to charitable and public benefit activities. But those institutions do not act in a vacuum. Individuals, governments, and mediating institutions may also act in a manner that benefits the public. However, except to the extent that they are involved in charitable and public benefit institutions as, for example, donors, members, or directors, this study is not about those actors.

Finally, it should be noted that the views expressed in this chapter are solely those of the author and do not necessarily represent the views of any institution or any other individual, including the legal specialists.

LEGAL CONTEXT

Every country covered in this study has distinctive legal traditions. In addition, however, the three major worldwide legal traditions—civil law, common law, and socialist law—have had a dominant influence on the modern legal systems of the nations in the region. Usually, the civil law and common law traditions were imposed by Western and regional colonial regimes. It is also important to bear in mind that those legal traditions are relatively recent, less than a century old in most countries in the region. One or more of these three major legal traditions has continuing significance within each country, a point that is discussed throughout this book. These traditions also perform a connective function. The dominant major legal traditions have become a complement to the distinctive legal systems of each country, and the common legal concepts of those traditions link diverse nations within the region and throughout the world.

What follows is a brief, country-by-country précis summarizing the relevant legal traditions, the status of the current nonprofit legal frameworks, and efforts to improve the enabling environment for NPOs. Since 1998 happens to have been the centennial of Japan's adoption of its Civil Code, we begin with Japan.

Japan

Japan joined the civil law tradition exactly a century ago with the adoption of the Japanese Civil Code in 1898. The Japanese had invited Professor Boissonade of Paris and Professor Roessler, a German, to consult on the preparation of a modern civil code. The consultants submitted drafts, which met with opposition from the legislature. A codification debate ensued, and both drafts were shelved. Preparation of a civil code was given instead to a commission, consisting of Professors Hozumi, Masaaki, and Umo. The Civil Code produced by the commission reflects the influence of French law and even common law, but the dominant influence is the German Civil Code, the *Bürgerliches Gesetzbuch* (BGB), which it follows in structure and content (Zweigert and Kotz, 1992, pp. 323–324).

The Civil Code has not been revised in the intervening century, except for family law provisions. Yoshinori Yamaoka observes in Chapter Six that “the time for amending the Civil Code to meet the conditions of our present society is long overdue.”

The current legal framework cannot be characterized as favorable to NPOs. For years, the Japanese nonprofit legal system has been criticized for imposing undue barriers to registration and offering minimal tax incentives for contributors. But two signs may indicate that the legal climate is improving. First, in 1996 the government issued the Standards, a Cabinet Directive that offered a partial response to the complaint that NPO laws took the form of unwritten administrative practices rather than written rules. Second, public attitudes toward NPOs have been favorably influenced by the response of volunteers and NPOs to the human suffering caused by the great Hanshin-Awaji earthquake of 1995, with the result that the Diet is considering legislation that would remove barriers to registration by certain NPOs. (After the Japan country reports were submitted, Japan enacted that legislation, which is discussed in the Conclusion.)

Taiwan

The colonization of Taiwan by Japan resulted in the displacement of Chinese law. Taiwan enacted its Civil Code, patterned on Japan’s, in 1927. Today, the legal climate in Taiwan is favorable to NPOs, despite the fact that features of the nonprofit legal framework in Taiwan and Japan remain similar. Ministry officials in both countries, for example, have broad discretion in determining whether to approve NPOs. The manner in which that discretion is exercised, however, differs dramatically. Registrants have noted that Japanese officials express reluctance to empower private organizations to engage in activities that are traditionally within the province of the state, whereas Taiwanese officials are eager to encourage such efforts.

Since the late 1980s, the combination of dynamic economic growth and the lifting in 1987 of the Emergency Decree, which had been in effect for more than forty years, has resulted in an explosive growth of NPOs. Some 75 percent of Taiwan’s foundations and 60 percent of its associations have been founded since then. As H.H.M. Hsiao (1995, p. 14) has written, “Taiwan’s civil society not only has developed into an autonomous entity, but also has successfully changed the nature of the authoritarian state.”

Korea

Chinese law was the primary influence on Korean law until the modern era. At the turn of the century, however, came Japanese hegemony and along with it Japanese law, which was by then firmly within the civil law tradition. More recently, the influence of American law has introduced common law elements into the Korean system. The dominant feature of Korean law, however, is the Yukbop (the five legal codes—Civil Code, Criminal Code, Commercial Code, Code of Civil Procedure, and Code of Criminal Procedure—and the Constitution).

Since the end of martial law and the opening of democratic procedures in Korea in 1987, there has been a surge of interest in the role of NPOs and an increase in their numbers. From 1990 to 1994, the number of registered NPOs jumped from 9,318 to 11,050. The number of unregistered NPOs is estimated at about 49,000.

The civil law legal framework in Korea is similar to that of Japan and Taiwan. Ministerial control and broad discretion are central. The manner in which official discretion is exercised appears to be less rigid than it is in Japan but also less favorable toward NPOs than it is in Taiwan.

Thailand

Thailand is also a civil law country. The current Thai Civil Code, drafted by a group led by M. Guillon of France and strongly influenced by the Japanese Civil Code, was adopted in 1925 (Muntarbhorn, 1991, p. 142). Until recently, however, authoritarian rule and the fear of communism have been the dominant factors influencing the development of nonprofit laws and the manner in which they have been interpreted (Pongsapich and Kataleeradabhan, 1994, pp. 126–131).

In the 1990s, Thailand's legal climate changed dramatically. In 1991, Prime Minister Anand, advised by his influential Minister Mechai Viravaidya, became a strong advocate for a vigorous nonprofit sector, resulting in numerous proposals for law reform favoring NPOs. In the following spring, public interest NGOs formed the core group that contributed to the current political stability in Thailand by ending the military-led government of General Suchinda, despite the violence that was directed against them (Pongsapich and Kataleeradabhan, 1994, p. 131).

In the intervening years, Thai law has continued to move toward the development of an improved legal framework for NPOs. The Thai

Constitution of 1997 guarantees freedom of association and, specifically, the "freedom to gather in the forms of associations . . . or non-government organizations." In the last few years, influential NPOs have been instrumental in developing coalitions to propose legislation and press for the enactment of laws enabling NGOs to play an increased role in society.

Singapore

Since becoming independent in 1965, Singapore has continued to adhere to the common law tradition. The nonprofit legal framework it inherited from the British is repressive, however. The only legislation specifically directed at NPOs was not an enabling act but a social control measure, the Societies Act, which was enacted by the British in 1889 to control Chinese secret societies, or triads, but is still in effect.

Recently, Goh Chok Tong, the Prime Minister, has called for the development of a strong civil society in which "people participate actively and become involved in community and national issues." The legal specialists suggest that the exceptional economic success of Singapore may carry with it an obligation to provide incentives to encourage Singaporeans to help the less fortunate, wherever they may reside. Efforts are under way to introduce legal reform legislation in Parliament.

Australia

Ever since European settlement began in 1788, Australia's laws have been strongly influenced by English common law. Australian laws are distinctive, however, and today Australian jurisprudence makes an important contribution to the formation of an international body of common law.

The legal environment for philanthropy is generally favorable in Australia. The primary legal concern is not about restrictive controls over registration, limited tax benefits to NPOs, or weak tax incentives for contributors. The major reform issues are the narrow class of donees eligible to receive deductible charitable contributions and the lack of uniformity in the regulation of NPOs because of the Australian federal system. During the mid–1990s, the Industry Commission, a government body, held extensive hearings and proposed reforms generally favorable to philanthropy, but none were adopted. Efforts by professional associations, such as the Australian Association of Philanthropy, continue, however.

China

Three legal traditions form the basis of China's legal system today: a traditional Confucian-legalist influence; a civil law influence, stemming from German law brought to China via Japan at the beginning of the twentieth century; and since 1949, a dominant socialist law influence.

In the country report on China (Chapter Three), the two authors, Xin Chunying and Zhang Ye, point out that "the term *nonprofit* . . . has a different meaning in China [than it does] in the Western societies. Because of China's centralized system from 1949 to 1978 and the government's monopoly over all resources, almost all institutions, both for-profit and not-for-profit, were basically run by the government." Since then, however, a socialist market economy has developed, displacing much of China's traditional centralized planning, with the result that the role of the state has shifted from direct to indirect control. Even though emphasis on social stability has made legislation on NPOs more sensitive than other laws, this transition has created demand and space for a different relationship between the government and NPOs.

Regulations adopted in the late 1980s provide the basic legal framework for NPOs in China, and government policy review has continued since then. Delegations of government officials have made several study visits to the United States and elsewhere in the last decade. Recently, the State Council asked the Ministry of Civil Affairs to revise the existing nonprofit regulations. Xin and Ye conclude that "laws and regulations will be modified many times. . . . Chinese NGOs and NPOs will continue to expand, despite all the difficulties. Given the changing situation in China, the original top-down approach will gradually be supplemented by a bottom-up approach."

Vietnam

As in China, three legal traditions form the basis of today's legal system in Vietnam: a traditional Confucian-legalist influence, a French colonial (civil law) influence, and a socialist law dominance since the August Revolution of 1945. A common element of all three legal traditions is a powerful state. As Mark Sidel (1997, p. 12) observes, "A strong state has been a feature of imperial Vietnam, under French colonial rule, and . . . in the post–1954 socialist period."

A modern legal framework for NPOs is currently under construction in Vietnam. In 1995, Vietnam adopted a civil code that provides a basic

NPO legal framework. Also, a drafting committee has undertaken a policy review to replace restrictive social control regulations on NPOs adopted in 1957. The committee has made study visits to other countries and has consulted with nonprofit law experts. Drafts of the new law maintain and in some cases increase government control over NPOs by requiring registration, but they also reflect a policy to encourage NPOs. If the recommendations contained in the country report (Chapter Twelve, written by two prominent Vietnamese government officials) are any indication, Vietnam may take further steps to promote the development of NPOs, including adoption of legislation offering tax incentives for the first time.

Indonesia

From the arrival of the first colonists in 1511 until independence in 1945, Indonesia was ruled by the Portuguese, the British, the French, the Japanese, and the Dutch. Charles Himawan, Professor of Law and former Dean of the Faculty of Law of the University of Indonesia, has identified twelve distinctive periods of influence by outside legal traditions during those 434 years.

A legal framework favorable to NPOs has not yet begun to develop in Indonesia, however, and the prospects under the current regime are not encouraging. Laws designed to control NPOs are more prevalent than are those intended to encourage NPO development. A recent example is the regulation proposed in 1994 in the form of a Presidential Decree that was widely regarded as a social control measure (Carrothers and Surgatha, 1995, p. 138). In addition, the absence of laws prohibiting improper economic benefit has led to the widespread practice of using foundations to reap personal profits. Despite this situation, NPOs in Indonesia are reluctant to support efforts to improve the legal framework. Many believe that, in the current climate, legislative action is likely to result in increased restrictions and tighter controls, thereby narrowing the considerable space for NPO activity that now exists. As a prominent lawyer has observed, "NGOs generally perceive *UU Ormas* [a law enacted in 1985 to control NGOs] as a kind of sword of Damocles, which could, at any time, be dropped by the government to restrain, suspend, or dissolve NGOs" (Lubis, 1994, p. 214).

The resignation of Suharto occurred after the Indonesia report was submitted for publication. We have been advised subsequently, however, of a growing expectation within the NPO community that Suharto's resignation will lead to the end of an era of autocratic rule and to the development of a modern nonprofit sector and a legal framework favorable to NPOs.

The Philippines

The Philippines is generally regarded as a civil law country, with a blend of Spanish, American, and Philippine law. Since the end of martial law in 1986, the Philippines has developed the most favorable legal framework for NPOs in the Asia Pacific region. It has the largest independent nonprofit sector in the region, with 95,829 domestic and 154 foreign NPOs.

The 1987 Constitution commits the government to supporting the nonprofit sector with the provision that "the State shall encourage nongovernmental . . . organizations." Registration has become less of an obstacle with the introduction of a twenty-four–hour express procedure that satisfies one step in the two-part registration process. Until the enactment of the Tax Reform Act of 1997, tax deductions for charitable contributions were largely unavailable to individuals. Now, however, charitable contribution deductions for individuals and corporations are generous and, under some circumstances, without limit.

Against this background, we now turn to the eight core issues addressed by each country report.

REGISTRATION: REQUIREMENTS, LEGAL FORMS, AND PROCEDURES

The term *registration* is used in this study to refer to the official process by which an NPO comes into legal existence as a distinct entity, with perpetual existence and the ability to own property (including a bank account), to enter into contracts, and to bring legal actions.

Any consideration of NPO registration raises a threshold issue concerning freedom of association: May the state impose conditions on the freedom of individuals to associate for lawful purposes? Often the answer to that question becomes entangled with the response to a related but distinct question: What qualifications may the state legitimately impose on NPOs for them to receive government benefits, such as contracts and tax preferences, and to protect the public from fraud and abuse from fundraising and other activities by NPOs? A growing international consensus in favor of freedom of association is reflected in the modern nonprofit laws being adopted. Nevertheless, each country in the study answers those questions in a distinctive manner, striking a different balance between the competing values of order and freedom.

In many countries, NPOs—particularly small, community-based groups, as well as groups whose purposes and activities may not gain official approval—may prefer to operate without registration. Freedom from government regulation and control may be perceived as a greater benefit than qualification for preferential tax treatment and other benefits available only to registered NPOs.

Registration Requirements

Compulsory registration laws, even in those states where the laws were enacted as social control measures, have not prevented the proliferation of NPOs in recent years. In Thailand, registration of all NPOs is required by the National Cultural Act, enacted in 1942 as a social control measure in response to the threat of communism. But the National Culture Commission, which registers associations and foundations, has neither the personnel nor the budget to monitor unregistered NPOs, and they are no longer perceived as a menace. The number of unregistered NPOs in Thailand is substantial.

In Vietnam, the legal requirement of registration has been relaxed in practice. The current law on associations was enacted in 1957, at the time of the crackdown on the Vietnamese Hundred Flowers Movement, as a control measure to severely limit the formation of associations (social organizations). Nevertheless, during the last decade, as the Vietnamese Communist Party and government began to encourage the activity of associations, hundreds, perhaps thousands, of NPOs have become active, without formal registration (Sidel, 1997, p. 40).

The pattern is similar in China. Even though the law on associations (social organizations) requires all associations to register, as the China report (Chapter Three) notes, a large majority of NPOs do not do so. Thus far, government policy has not generally required enforcement of the registration laws. "Chinese society," as Chapter Three observes, "is indeed increasingly open, and more and more organizations are performing social services outside the government structure."

In Singapore, however, all NPOs are required to register under the 1889 Societies Act, as discussed previously. The Act imposes criminal sanctions on association or society members if their organization fails to register. The definition of a "society" is sweeping. It includes any association of ten or more persons for any purpose other than business. And unlike China and Vietnam, Singapore strictly enforces its registration law; thus in Singapore few, if any, unregistered NPOs exist.

Informal or unregistered NPOs are proportionately significant compared to NPOs in the formal or official nonprofit sector. In some countries, informal NPOs may outnumber their formal counterparts. The Korea report (Chapter Seven), for example, estimates that more than 80 percent of the NPOs in Korea are not registered with the government. In Japan, writes Yoshinori Yamaoka (Chapter Six), numerous unregistered NPOs "have grown and proliferated." In China and Vietnam, it is believed that the number of unregistered NPOs far exceeds the number that have registered. The number of unregistered NPOs is also sizable in Indonesia and the Philippines. In only two countries are the numbers of unregistered NPOs minimal: Singapore, because of compulsory registration and vigorous enforcement; and Australia, because of the ease of registration.

Legal Forms

The choice of legal forms for NPOs is similar in countries within the civil law tradition. The basic civil law forms for nonprofit organizations are the association (an organization of a group of people) and the foundation (an organization of assets, or a fund). Typically, associations and foundations may be, but need not be, incorporated. In Japan, Taiwan, Korea, and Thailand, the dominant nonprofit legal forms are associations and foundations.

The same pattern of legal forms also appears to be emerging in the socialist countries as their legal transitions move in directions similar to those of the nonsocialist states in the region. In China, the major legal forms are social organizations (associations) and foundations. In Vietnam, the Civil Code, which became effective on July 1, 1997, also recognizes two legal forms for nonprofit organizations: social organizations (associations) and foundations. However, Vietnam has not yet issued decrees or regulations interpreting the Civil Code and setting forth implementation procedures.

Registration Procedures

The registration process for NPOs in the region varies widely from country to country. In Indonesia, foundations obtain legal status by filing a brief notarized document. Social organizations, however, must register with the government and are subject to general supervision by the Ministry of Home Affairs, with technical supervision by the relevant line agency. Japan and Korea follow a single-step registration system. The NPO must obtain approval from the ministry or other government agency that has jurisdiction over the proposed purposes and activities of the NPO.

Registration in Australia never requires more than one step. Whether registration is required at all, and with what government agency, depends on the NPO's legal form. The unincorporated association, which is not a legal entity, is not required to register; the charitable trust, an equitable relationship rather than a legal entity, is also not obligated to register; the incorporated association, a legal entity, is required to register under the laws of the state or territory where it is located; and the company limited by guarantee, also a legal entity, is required to register at the national level with the Australian Securities Commission.

Two-step registration procedures are required in Taiwan, the Philippines, Thailand, Singapore, and Vietnam. In Taiwan, foundations and associations are required to obtain authorization from the relevant government agency and must also register with the District Court. In the Philippines, nonprofit corporations are required to obtain accreditation from the relevant government agency as well as to register with the Securities and Exchange Commission. Registration in Thailand must be approved by two central agencies. All NPOs must obtain the approval of the National Culture Commission. In addition, associations must apply for registration with the Bangkok Police Department (or local equivalent), and foundations must apply to the Bangkok Metropolitan Authority (or local equivalent), but the final registration decision is made by the Ministry of the Interior. In Singapore, charitable organizations must follow a two-step registration process. As noted earlier in the chapter, all NPOs must register under the Societies Act. Registration under the Companies Act, although it is legally an alternative to registration under the Societies Act, is strongly discouraged by the government and is not available in practice. All charities must also register with the Commissioner of Charities in Singapore. Vietnam requires an association to obtain a recommendation from the relevant line agency, but the required approval is issued by the Prime Minister's office (or local equivalent).

China requires a two-step or a three-step registration procedure. NPOs (social organizations and foundations) must obtain approval of a government line agency. They must also register with the Ministry of Civil Affairs or a local equivalent. For foundations, yet a third step is required: approval by the People's Bank of China.

Whenever the power to approve and register NPOs is exercised by multiple agencies rather than by a single authority, forum shopping is likely to occur, as applicants learn that the actions of some agencies may be more favorable than those of others. In countries where NPOs must seek the approval of a government agency with jurisdiction over the area in which the NPO intends to operate, the NPO will often have a choice of where to obtain approval based on how the organization characterizes its purposes. For example, an NPO formed to educate the public about environmental health and to promote organic farming and sustainable economic development may come within the jurisdiction of any one of five separate ministries—Education, Health, Environment, Agriculture, or Economics—depending on which purposes are emphasized. In some countries, another registration choice may exist between the national and local office of the ministry. In Chapter Six, Yoshinori Yamaoka refers to a 1994 report showing that of the twenty-five thousand incorporated associations and foundations registered in Japan, 72 percent were registered at the prefectural level.

Instances of forum shopping have been reported in most of the multiple-step-approval states. As the nonprofit sector grows, so too will the number of activists, former government officials, lawyers, and others knowledgeable about how government agencies exercise their discretion to approve NPOs. It is likely that they will act as advisors to NPO applicants, directing them toward the more favorable agencies and jurisdictions and guiding them through the registration process.

REGISTRATION OBSTACLES AND RESTRICTIONS

No country in the Asia Pacific region administers a true registration system—that is, a system that legally empowers an NPO as a result of simply entering the name of the NPO in an official register. Each country uses some form of permission system instead, requiring NPOs to overcome obstacles and restrictions before government approval is granted. By contrast, the registration system for businesses in every country in the region is far less onerous. No policy appears to be served in the modern era by treating foundations and other nonprofit public benefit organizations less favorably than businesses.

This section notes and comments on major obstacles and restrictions to the legal empowerment of NPOs in the region as identified by the country reports. Some of these same factors are also relevant in connection with tax exemptions and are considered in more detail in a later discussion on that topic.

Burdensome Capital Requirements

In many countries in the region, foundations are required to meet a minimum capital requirement. That capital fund may not be invaded and must be retained by the foundation. A specific amount may be expressed in the law. Thus China's Regulation on the Management of Foundations (1988), as modified in 1995, provides that foundations must have capital funds of no less than RMB2,100,000 (approximately U.S.$262,500). In other countries, the amount of assets required of a foundation must meet a general suitability standard: the capital amount must be suitable or appropriate in view of the foundation's proposed purposes and activities. That standard is interpreted independently by each relevant agency, and the level of required funds may be high. In Japan, for example, it is not uncommon for the supervising agency to require a foundation to maintain the equivalent of U.S.$3 million.

The policy goal to be served in the modern era by a substantial capital requirement for foundations is not clear. Businesses are not generally required to satisfy such a rule. In the case of either a business or a foundation, the enterprise may fail if the funds are inadequate. But imposing a substantial capital requirement on foundations may deny opportunity without guaranteeing success. It stands, in any event, as a formidable barrier to entry.

Limitations on Business Activities

An analysis of the written laws in the region reveals seven distinct approaches to the regulation of business activities by NPOs:

1. Prohibit NPOs from engaging in a business purpose or activity as their *primary* purpose or activity (Philippines)
2. Prohibit NPOs from engaging in *any* business purpose or activity unless necessary to the NPO's survival (China, Taiwan; but see number 7)
3. Prohibit business activities only if they are unrelated to the NPO's purpose (Singapore)
4. Permit business activities if the income is used to further the NPO's goals (Australia, Thailand, Vietnam)
5. Permit business activities if the income is used to further the NPO's goals *and* prior approval is obtained from the relevant ministry (Korea)
6. Permit business activities only if they do not compete with a for-profit business enterprise *and* business expenditures are less than 50 percent *and* public benefit expenditures are at least 50 percent of total expenditures (Japan)
7. Permit business activities as legitimate without limits (Indonesia)

The diversity of views and the ambiguity reflected in policies on business activity by NPOs is not surprising. This is one of the most difficult policy issues in nonprofit law. What policies will encourage the development of viable NPOs? What protections should be added to prevent abuse? What balance should be struck between NPOs and for-profit businesses? Do those answers change if the same questions are asked at different points in the process of developing a nonprofit sector?

Prohibition of Excessive Economic Benefits to Individuals

As discussed in the next section, except for Indonesia, every country in the region, by law or by practice, prohibits NPOs from making excessive payments to individuals for services or property.

Specific-Purpose Requirements

A frequent complaint of the legal specialists in their reports is the absence of definitions and standards to control the exercise of official discretion. For example, Korea recognizes five proper purposes or activities for a public benefit NPO: support of education, research, the arts, science, and charity for the benefit of the public. The NPO is required to stay strictly within the limits of those categories. But what are those limits? What is the meaning of each of those five categories?

The difficulties concerning legal interpretation in this field of law were recognized more than a century ago. The definition of the term *charitable purposes* for Singapore and for most common law countries was decided in 1891 in England in *Income Tax Special Purposes Commission* v. *Pemsel,* AC 531. In *Pemsel,* Lord Macnaughten reasoned that charitable purposes fell into four categories: relief of poverty, advancement of education, advancement of religion, and "other purposes beneficial to the community." The decision has been lauded particularly for the inclusion of the last category—public benefit, essentially—which allows a judge the flexibility to interpret the term in accordance with changing circumstances. As a matter of logic, however, the last category takes us back to the beginning of the quest. *Public benefit,* the term used by most civil law countries, is, after all, simply a synonym for *charitable.*

It is difficult to fashion a workable means of controlling abuses of administrative discretion when administrators are charged with interpreting broad concepts. The most effective solution may be procedural, by requiring that decisions be prompt and subject to review by an independent body using a broad standard of review.

Limitations on Legislative Advocacy and Political Participation

Unlike in the United States, few restrictions, apart from generally applicable electoral laws, limit participation by NPOs in the political process.

Multiple Steps for Registration

As the prior section indicates, six of the ten countries in the study require NPOs to obtain government approvals at more than one level.

Necessity Requirement

As a condition of registration, some countries require a finding that the NPO is necessary or is not identical or similar to existing NPOs.

Funding Restrictions

Taiwan prohibits associations from soliciting funds from nonmembers. No other country restricts solicitation by NPOs as a condition of registration.

Absence of Reasonable Time Limits for Government Action

Few countries impose specific time limits on the government approval process. The process of NPO approval in Japan can take as long as two or three years or (with the proper connections) as little as six months, with one year being about average. China and Taiwan, in contrast, specify a thirty–day limit, and Korea holds to a twenty–day limit. In the Philippines, a twenty-four–hour "express lane" is available for swift NPO registration with the Securities and Exchange Commission, one part of a required two-step procedure.

Lack of Adequate Guidance and Training

Except for Australia, few of the nations in the region make information widely available to the public to encourage the formation of NPOs. In all of the countries, the training of government personnel handling NPO matters could be improved. The Taiwan report (Chapter Ten) calls for the formation of a consulting team composed of practical and academic specialists to provide training and consultation to staff at the government offices regulating NPOs.

TAX EXEMPTIONS

The term *tax-exempt organization* is often used as a synonym for *nonprofit organization*. Taxes abound, however, and no country confers immunity on NPOs from every tax imposed by every taxing authority. This study examines the exemption of NPOs in the region from income taxes; all references in this section to tax exemptions are to exemptions from income taxes.

Extent of Exemptions in the Region

Every country in the region has an income tax, and exemptions for NPOs are widespread. The breadth of these nations' tax bases and the efficiency of their tax reporting and collection systems vary widely, however. In every country but China, Indonesia, and Vietnam, laws exempt NPOs from paying income tax.

In China and Vietnam, the transition from a centrally planned economy to a socialist market economy has not yet resulted in laws or regulations that expressly exempt NPOs from paying income tax. Nevertheless, in practice, NPOs are not generally taxed. This result is based not on a specific exemption in the law but on an informal official view that NPOs do not fit into any taxable category. Any business income they receive, however, is subject to tax.

Indonesia is the only country covered by the study where income tax exemptions for NPOs have been narrowed in recent years. In 1983, Indonesia enacted a limited exemption from income tax for foundations engaged in religious, educational, health-related, or cultural activities. The law was repealed in 1994, however, and now only income from gifts and government aid is exempt.

Factors Affecting Exemptions

Tax exemptions for NPOs usually depend on two factors: the type of organization and the type of income received. Australia has what may be the broadest income tax exemption in the region. It exempts from tax all income received by qualified NPOs—including business income—so long as the income is used to further the purposes of the NPO. In most countries, however, tax-exempt status depends on whether the receipts of the qualified NPO consist of gifts and contributions, passive (investment) income, or related or unrelated business income.

Gifts and Contributions

Gifts and contributions to NPOs are generally exempt from tax. With the exception of Singapore, all countries in the region that have considered the issue treat gifts and donations to NPOs as exempt from income tax, either because tax laws expressly exempt them or because gifts are not regarded as fitting within the definition of income.

Passive Income

The exemption of passive (investment) income varies widely within the region. Passive or investment income includes dividends, interest, rent, royalties, and capital gain on the sale of investment assets. Japan exempts from tax all noncommercial income, and investment income ordinarily falls into that category. In the Philippines and Taiwan, dividends are generally exempt. Interest income is exempt in Taiwan. Interest and royalties are subject to a 20 percent tax in the Philippines. In Korea, dividends and interest are subject to tax, but with a 50 percent exemption for interest income that is set aside and used to further NPO purposes within five years.

Business Income

The tax treatment of NPO business income is not uniform within the region. In Australia, as noted, business income is not taxed at all if it is used to further the purposes of the NPO. Korean tax laws exempt from tax 50 percent of the business income of an NPO if the income is set aside as a reserve and used within five years to further the NPO's purposes. Similarly, Japan exempts 20 percent of the business income of a public interest corporation if it is used to further the corporation's activities, and nonexempt business income is taxed at the preferential rate of 27 percent rather than the usual 37.5 percent. Singapore is the only country in the region with an unrelated business-income tax law—that is, a law that exempts business income only if it is generated by an activity related to the purpose of the NPO. Current tax laws in China, Indonesia, the Philippines, Taiwan, Thailand, and Vietnam contain no exemptions from income taxes for NPO business income.

Registering for Tax-Exempt Status

In some countries in the region, tax exemption is an automatic consequence of registration, but in others a second step is required: application to a tax agency and receipt of a favorable ruling. In Japan and Korea, tax exemption is an automatic consequence of registration. In the Philippines and Thailand, NPOs must apply to the tax agency for an exemption. Singapore combines automatic exemption with a particularly stringent discretionary system. Specific NPOs that are listed in the tax law receive exemptions automatically. Most charitable and mutual benefit NPOs, however, must apply each year for income tax exemption.

The exemption process in Taiwan also follows an annual cycle, but without requiring a yearly application by the NPO. The National Taxation Bureau reviews the annual tax returns of NPOs to determine their continuing qualification for exemption. If the Bureau determines that an NPO does not qualify for exemption in that year, it will assess taxes for that year. The NPO's income in the following year may qualify for exemption, however; failure to qualify in one year does not bar the NPO from future exemption.

Under Australian law, NPOs must self-assess their qualification for income tax exemptions each year. Nevertheless, the benefits of official recognition prompt most NPOs to apply for exemption to the Australian Tax Office at the time of their formation.

Throughout the region, tax exemption categories are generally broad rather than restrictive. The laws of every country with tax exemptions allow exemptions for NPOs organized and operated for charitable, public interest, or other public benefit purposes.

Restrictions on Tax-Exempt Status

Except for Indonesia, all countries in the region impose on NPOs, by law or practice, a nondistribution constraint that prohibits excessive distributions or payments to individuals. No country has attempted to define with precision the meaning of "excessive," however, except for Japan. The Standards provide that benefits to directors, including compensation for services, "shall not be inordinate or excessive in view of the assets of the corporation concerned, its income and expenditures, or when compared to wages standards in the private sector."

NPOs are generally not prohibited from advocating legislative change or from supporting or opposing candidates for election to public office.

The laws of most countries do not restrict political activities of NPOs as a requirement of exemption, except to the extent that they may threaten national security. In Japan, a public interest corporation may further its purpose by engaging in political action with the government sector, but it may not support or oppose the election of specific individuals. In the Philippines, Korea, and Taiwan, no laws prevent NPOs from influencing legislation or engaging in electioneering. In Thailand, by contrast, the rule for tax-exempt foundations differs from the rule for tax-exempt associations. Foundations may not engage in any political activities, whereas associations are not so restricted. Both types of NPOs must refrain from activities that threaten national security.

NPOs seeking tax exemptions are not generally prohibited from engaging in business activities. Singapore's laws are the most restrictive, providing that tax-exempt charitable NPOs may engage in business activities only if those activities are related to the purpose of the organization and if the income derived from them is used exclusively for charitable purposes.

To qualify for tax exemptions, NPOs are often required to make minimum annual expenditures for exempt purposes. Many countries in the region impose a minimum annual expenditure (MAE) requirement. To qualify for income tax exemptions, charitable or public benefit NPOs must each year use or distribute a substantial amount of their receipts in furtherance of their exempt purposes. The highest MAE percentage requirement is in Australia, where the Australian Tax Office requires a charitable trust to pay out a minimum of 85 percent of its income annually. In other countries, the MAE for exempt purposes ranges from at least 80 percent of gifts and income (Singapore and Taiwan) to at least 60 percent of income and 65 percent of expenses (Thailand), more than 50 percent of all expenditures on grants and service delivery (Korea), and a minimum of 50 percent of business revenue (Japan).

All of the country reports call for broadening the scope of income tax exemptions for NPOs. The reports of the countries without NPO tax exemption laws recommend their enactment. Other reports propose expanding the types of income that are tax-exempt to include business income and various categories of investment income.

Two specific recommendations deserve special mention. The Singapore report (Chapter Nine) calls for the repeal of a law restricting charitable expenditures outside Singapore, asserting that the law is inconsistent with modern Singapore's wealth and status in the region. The Australian report (Chapter Two) recommends that the drafters of tax exemption laws move away from functional definitions, which emphasize the purposes of organizations, and toward economic definitions, which would allow any organization with legal objects and a nondistribution constraint to qualify for a tax exemption.

TAX DEDUCTIONS

Before examining the practices within the region with regard to tax deductions for charitable contributions, it may be helpful to consider two characteristics of those deductions that are of fundamental importance from a public policy standpoint yet are neither widely recognized nor well understood.

The first is the concept of *treasury efficiency*. Although economists are divided as to whether tax deductions provide sufficient incentives to prompt charitable contributions, there is no dispute about the *treasury efficiency* aspect of a charitable tax deduction. Charitable deductions can be more efficient than direct subsidies when deductions serve to unlock private funds that would not otherwise have been available to benefit the public. The taxpayer in a 40 percent tax bracket who deducts a contribution of $100 to a public benefit NPO effectively transfers $40 to the NPO that would otherwise have gone to the government in taxes. That much is clear. What is often overlooked is that the taxpayer also had to transfer an additional $60 of the taxpayer's own funds to achieve that tax result. Those private funds would not have been available if the government had acted on its own, providing a direct subsidy to the NPO. Whether the government regards that transaction as producing a loss of $40 or a gain of $60 depends on whether government policy is furthered by strengthening and collaborating with NPOs.

The concept of collaboration between the government and the charitable sector brings us to the second fundamental and overlooked characteristic of a charitable contribution tax deduction: the notion of a *joint venture* between the government and the donor claiming a deduction. To return to our example, a contribution of $100 to a public benefit organization can be thought of as a distinctive type of nonprofit public interest *joint venture,* where the donor invests $60 and the government $40 (the amount that it would otherwise have received in tax revenues) in a public benefit enterprise—selected by the taxpayer—which has no obligation to repay the investment. Within the universe of qualified organizations, it is the donor, not the government, who selects the charities that will received the donor's contributions. As economic growth causes an increase in the number of taxpayers who can benefit from an income tax deduction for charitable contributions, such deductions become an annual national poll reflecting the taxpayers' funding priorities within the charitable sector.

Our study illuminated the treatment throughout the region of three issues that are key to tax deductions for charitable contributions: the nature of the contributor, the status of the donee, and the type of contribution.

Deductions Versus Exemptions

Income tax systems in the rest of the world provide tax exemptions for organizations more readily than they allow tax deductions for contributors. An unexpected finding of this study is that in these ten countries, the reverse is true: more nations in the region permit tax deductions for charitable contributions than allow tax exemptions for NPOs. The reason is that China, which has no tax exemption law, has begun to permit limited tax deductions to contributors to NPOs. Pursuant to an administrative pronouncement at the ministerial level issued in 1997, corporations may now deduct contributions made to support cultural activities up to a ceiling of 3 percent of profits. In addition, corporations are often able to obtain tax deductions for contributions made in response to government fundraising efforts by bargaining with relevant authorities.

Limits on Deductions

Most nations in the region limit the percentage of income that individual and corporate contributors may deduct. For individuals, tax-deductible contribution limits expressed as a percentage of income range from 5 percent (Korea) to 10 percent (Thailand) to 25 percent (Japan). The applicable percentage for corporations usually differs from that available to individuals: 2 percent rather than 10 percent in Thailand, and 7 percent rather than 5 percent in Korea. Australia and Singapore allow unlimited deductions for charitable contributions to NPOs.

Laws in the region restrict charitable contribution deductions beyond the legal norm by requiring eligible donees to meet additional qualifications or by otherwise narrowing the eligible class. Income tax laws typically provide that a contributor may claim a tax deduction for a contribution only if the gift is made to a qualified donee. To qualify as an eligible donee, the NPO must be more than merely tax-exempt. It must also be a charitable, public interest, or public benefit NPO.

The tax laws of the countries in the region follow that pattern; often, however, they impose additional restrictions. Australian law, for example, allows tax deductions only for three subsets of charitable organizations: those organizations individually listed in the tax law, other cultural and environmental organizations listed on the register of supervising government agencies, and human service organizations (but only for aid directly to those in need and not for prevention, education, or advocacy).

In Japan, individuals may deduct contributions to the government, to organizations designated by the Ministry of Finance, and to public interest–promoting organizations. An organization is designated public interest promoting by consultation between the Ministry of Finance and the authorizing agency, and this designation must be reviewed every two years. Of the twenty-six thousand public interest corporations in Japan, less than one thousand qualify as public interest–promoting corporations to which contributions are deductible.

The most dramatic improvement in a nation's tax policy toward NPOs has recently occurred in the Philippines. The Philippines' Tax Reform Act of 1997, which became effective on January 1, 1998, provided new incentives to encourage financial support of the nonprofit sector. Prior to that law, deductions for charitable contributions were largely unavailable to individuals. Only corporations received significant deductions (up to 3 percent for contributions to charity, and unlimited deductions for contributions to private foundations). The act increased the general percentage limits to 10 percent for professionals and the self-employed and 5 percent for corporations.

The act also allowed unlimited deductions to individuals and corporations for contributions to certain organizations. The act recognized a "super donee" category. Individual and corporate donors may deduct donations equal to 100 percent of their income if (1) the NPO donee is a charitable organization that spends or distributes all of its income for exempt purposes within 21/2 months after the end of its tax year and (2) the NPO donee limits its overhead expenditure to 30 percent or less of its total expenses.

CAPITAL FORMATION

The growth of NPOs by means of capital accumulation may be stymied by intensely practical factors, such as an inability to attract support from donors, an absence of other sources of income, or current expenditures' preventing the accumulation of surplus for investment or use in the future. This section considers three *legal* barriers to the formation of capital by NPOs: requirements that an NPO must distribute a minimum annual percentage of its income, investment restrictions that depress total return, and limitations on foreign financial support.

MAE Laws

As noted earlier, minimum annual expenditure (MAE) requirements are widespread throughout the region. In countries with MAE laws, charitable or public benefit NPOs that qualify for an income tax exemption must use or distribute each year a substantial amount of their receipts in furtherance of their exempt purposes.

In practice, however, the MAE requirements may not be quite so formidable. The overall impact of the varying MAE percentage requirements from country to country is difficult to assess. The requirement to spend 50 percent of business income on exempt purposes may not interfere with an endowment campaign, whereas an obligation to spend 80 percent of all receipts is bound to hamper an NPO's efforts. Also, in countries that allow equity investments, a large portion of the total investment return will be unaffected by the MAE rules, because unrealized capital appreciation is not part of the MAE base. To put it another way, the MAE does not interfere with capital formation that results from market appreciation of existing investments.

Restrictive Interpretations of Law

Restrictive interpretations of permissive laws limit the scope of equity investments by NPOs, depressing long-term investment returns. In Japan, the investment rule in the Standards requires NPOs to select investments "[with a] high probability that the principal can be recovered" and "[that] yield as much investment income as is possible." Takako Amemiya points out in Chapter Five that Japanese government agencies give top priority to safety. The informal guidance given at the time of registration often effectively limits the scope of investments to secure time deposits in a bank or postal account.

The pattern in Korea is similar: ministries impose a restrictive interpretation on the statutory standard. Korean laws prescribe a prudent management standard, but government ministries place such heavy emphasis on preservation of capital to the exclusion of other factors that NPOs are often denied the ability to invest in stock.

In other countries, NPOs may invest more freely in equities, but limits still apply. Australia requires investments to satisfy the common law standard of prudence. Singapore places no restrictions on investments by societies and companies, beyond the requirement that prudence be exercised. The Singapore Trustees Act, however, contains extensive investment rules, including detailed limitations on equity investments, such as the requirement that dividends must have been paid for three continuous years prior to investment.

Restrictions on Foreign Funds

Law-based restrictions on the receipt of financial support from abroad are uncommon. No law prohibits outright the receipt of foreign funds by NPOs, but restrictions may exist nonetheless. Indonesia takes the most restrictive approach. Control of foreign financial support of NPOs has been a central regulatory theme in Indonesia. Applied first to religious organizations (1978), then to social welfare organizations (1983), and finally to mass or social organizations (1985), regulations prohibit receipt of financial support from abroad without the consent of the government. The Ministry of Home Affairs makes the strongly contested claim that the 1985 law also applies to foundations.

Even where receipt of foreign funds is not restricted by law, the exercise of official discretion may produce the same result. In China, for example, contributions from overseas Chinese are a significant source of funds for many NPOs. The applicable regulation expressly permits foundations to open foreign currency accounts, whereas the regulation on social organizations is silent. In practice, however, both types of NPOs must obtain approval from their line agencies before receiving foreign funds. The China report (Chapter Three) notes that the agency decision "often reflects the current political climate."

Restrictions on Capital Formation

Restrictions on capital formation are an impediment to the growth of NPOs and should be lessened. Limiting the growth of NPOs is seldom the objective of policies that restrict capital appreciation, however. Restriction occurs as a consequence of other policies aimed at preventing NPO abuse. The goal of the MAE rule, for example, is to compel NPO activity in the current period and to prevent diversion of resources. Other policies are meant to enforce prudent investment choices or prevent foreign control of local organizations. It is doubtful, however, that the same restrictive policies would be followed if the policy goals included the affirmative aim of encouraging and promoting the growth of NPOs. Most of the contributors to this book recommend that laws restricting capital formation of NPOs be relaxed to encourage the growth of NPOs.

INTERNAL GOVERNANCE

The chapters that follow focus on two issues related to internal governance: the rules and procedures of policymaking and management within NPOs, and the legal duties of members of the governing body of those NPOs.

Movement Toward Explicit Standards

In some countries in the region, informal administrative guidance is being supplanted as a primary source of rules and procedures for NPO governance by comprehensive written standards, regulations, and laws. In Taiwan, internal-governance rules are now contained in detailed regulations issued by the relevant ministry, and they may change from ministry to ministry. In Japan, internal-governance rules have traditionally taken the form of unwritten informal guidance, also differing from ministry to ministry. The 1996 Standards, mentioned earlier, provide uniform written guidance on NPO governance for the first time. The Standards address the size of the board, the election of directors, limitation on the payment of excess compensation, and other structural matters.

Two distinctive rules warrant special mention. Contrary to the usual approach, the Standards provide that the board of directors of a public interest corporation without members may not elect its own directors. The directors must be elected, instead, by an advisory council appointed by the board. The advisory council is envisaged as an independent body. Directors may not be members, except under "unavoidable circumstances." Even then, they may not control the advisory council. The Standards also address the issue of family control of public interest corporations, by providing that members of the same family (to the third degree of consanguinity) may not hold more than one-third of the board seats of any public interest corporation.

In Korea, the Civil Code is supplemented by a law, the Nonprofit Corporation Act (1975), and an accompanying Decree. The extensive coverage of rules of governance in the Act provides some sense of the importance given this topic in Korea: of the twenty articles in the Act, six consider issues of internal governance.

Requirements of NPO Governing Bodies

The basic legal duties of the governing bodies of NPOs are expressed in similar terms throughout the region whether the dominant legal tradition is civil law or common law. In common law countries, the basic legal obligations of NPO directors are usually expressed as fiduciary duties. Taken directly from trust law, those duties are imposed on fiduciaries or trustees, who are charged with holding and administering property solely for the benefit of the beneficiaries of the trust. In performing their duties, trustees are obliged to observe a duty of care and a duty of loyalty. The duty of care requires the trustee or director to act in good faith, meaning honestly. It also requires the director to act reasonably, or prudently. The duty of loyalty obligates the director to avoid conflicts of interest, to act in the best interests of the NPO rather than in the interests of the director.

The laws of Australia and Singapore, the two common law jurisdictions in the study, follow that pattern. The nonprofit law in the Philippines, a civil law jurisdiction, also appears to follow that model. That is not as unusual as it may appear. Philippine corporate law blends civil law, common law, and indigenous Philippine legal traditions, and the legal standard for directors in civil law countries is expressed in terms remarkably similar to the common law standard.

A director in a common law country also has a duty to manage. Perhaps because that duty relates more to the fact of performance than to its quality, the duty to manage is not commonly grouped with the twin duties of care and loyalty. In civil law countries, however, the three duties are expressed together.

In Japan, for example, the basic source of legal guidance for NPOs is the Civil Code. The Code sets forth the basic duties and responsibilities of directors of public interest corporations. It provides that directors are obligated to manage and direct the business of the corporation, to exercise due care in the performance of their fiduciary duties, and to avoid conflicts of interest. These provisions have remained unchanged since the adoption of the Civil Code in 1898. The three duties of management, care, and loyalty are also part of the civil law tradition of Taiwan, Korea, and Thailand.

Specific laws on the legal duties of directors of NPOs have not yet developed in China and Vietnam. Only if the transition presently under way in the socialist countries results in greater space between NPOs and the state will there be a need for such laws. As the China report (Chapter Three) observes, due to the close government supervision of NPOs through the two-tiered management structure, "the board of trustees is not as important as it is in other countries, and the leaders of . . . major NGOs are either directly appointed by the government agencies or have strong government connections."

ACCOUNTABILITY AND REPORTING

The subject of NPO accountability is vast. NPOs are controlled by, and thus accountable to, a governing body. NPOs may also be accountable to a membership or to donors. Charitable and public benefit NPOs are accountable to the broad public and also may be accountable to a smaller segment of the public, consisting of the members of a beneficiary class. The staff and directors of NPOs often talk about being accountable to their constituencies, which are often not the same as their beneficiaries.

This section focuses on one aspect of accountability: NPOs' ongoing task of providing information, both to the government and directly to the public. What sort of reporting is required of NPOs? What must they report to the government? What must they report to the public? And how, in the various legal systems, is the line drawn between accountability and state control?

Annual Reports

NPOs in the region are generally required to file annual reports with one or more government agencies. Taiwan, for example, requires all NPOs to file annual reports with the National Taxation Bureau. In China, NPOs file annual reports with their line agencies, and the line agencies in turn make annual reports on behalf of the NPOs to the registration agencies. Japan requires public interest corporations (PICs) to file annual reports with the registering ministry, containing activity reports and audited financial statements for the past year. Japan also requires PICs to file a statement of proposed activities and a budget for the forthcoming year. Every PIC with income of ¥8 million or more must file a tax return.

There is a striking contrast between the filing requirements of the two common law jurisdictions in our study. Singapore has perhaps the most comprehensive NPO filing requirements. It requires a charitable organization to file an annual audit report with the registering agency, the Commissioner of Charities, and with the Comptroller of Income Tax. Australia, by contrast, occupies a distinctive position as the only country that requires no tax returns to be filed by tax-exempt organizations. The obligation to file reports with other government agencies depends on the nature of the NPO. Companies limited by guarantee must file annual reports and audited financial statements with the Australian Securities Commission. Whether incorporated associations must file reports depends on the laws of the state or territory. No general law requires charitable trusts to file reports with any government agency.

Public Inspection and Disclosure of Information

Few states in the region require NPOs to disclose their activities or financial information to the public or allow public inspection of NPOs. The NPO laws in the region require accountability to the government; laws providing for accountability to donors and the general public are generally lacking. Except for Singapore and, to a far lesser extent, Australia, the laws in the region do not provide for public access to or disclosure of NPO reports.

In Singapore, NPO laws permit the public to inspect and copy the lists of participants filed by NPOs under the Companies Act. Public access also extends to documents of a registered society in the possession of the Registrar of Societies. The annual reports of charitable organizations filed with the Commissioner of Charities are open to public inspection. The law also requires a charity to provide a copy of its most recent report to any member of the public within two months of the request and upon payment of a reasonable fee.

Australian law allows no public inspection of tax returns, and there is no general requirement for charitable trusts to publicly disclose information. However, annual reports filed by incorporated associations are available for public inspection in some states and provinces, and the annual reports filed by companies limited by guarantee with the Australian Securities Commission are available for public inspection.

In Japan, the only public disclosure requirement is contained in the recent Standards: "Information concerning matters such as the operations of a public interest corporation or the finances thereof shall be voluntarily disclosed." The Standards are silent on the manner of disclosure, however.

China's Regulation on the Management of Foundations requires a foundation to "make its income and expenditure accounts public on a regular basis." As in Japan, the manner of disclosure is not specified. The same requirement is not imposed on social organizations, however. National NPOs have begun voluntarily to make public disclosure by publishing annual reports and by publishing reports of their activities and finances in journals and magazines.

Accountability and Oversight

The line between simple accountability and strict government supervision and control of NPOs is often blurred in legal systems in the region. In the Philippines, the government follows a hands-off policy toward NPOs. According to the report on the Philippines (Chapter Eight), NPOs are able to operate "with minimal interference from the Philippine government except for broad restrictions concerning public accountability."

By contrast, the laws of Thailand and Vietnam permit extensive government supervision of NPOs by requiring disclosure of their official actions. NPOs must file minutes of all members' meetings with the government. Vietnam requires all NPOs to file such minutes with the government within fifteen days after the annual membership meeting. Thailand requires all such minutes of Bangkok NPOs to be filed with the Royal Thai Police Department, and NPOs outside of Bangkok must file them with the Office of Local Affairs.

In Japan and Korea, the reporting laws give supervisory government agencies access to NPO information at an earlier stage. Those countries require NPOs to file statements of proposed activities and budgets in advance, for the following year, in addition to the customary year-end activity reports and audited financial statements. NGO supervision in Indonesia, as noted previously, requires government consent for an NPO to receive financial support from abroad.

Indirect government control of NPOs may also occur through the use of surrogates. The laws of the civil law jurisdictions and Singapore require NPOs to have auditors. Ordinarily, auditors audit the finances of an NPO and prepare reports based on their inquiry. In Korea, however, auditors are also vested with independent power and authority. Auditors are given the duty of reporting to the board when they discover unlawful or improper activities as a result of their audit. They are empowered to cause a board meeting to be called so that they can make their report. Their authority also extends beyond financial matters. They are charged with the responsibility of signing and sealing the minutes, the record of the official actions of the board. Finally, in Korea, the auditor's role shifts from one of an independent professional to one of a state agent. If auditors discover that the NPO is engaged in unlawful or improper activities, they are required to report it to the relevant ministry "without delay."

In China, nonprofit laws provide that no "institutions or individuals shall illegally interfere in the social organizations' work." This legal directive does not, however, prevent line agencies from exercising day-to-day supervision of NPOs.

DISSOLUTION

Dissolution—"termination" in Thailand, "revocation" in Korea, and "cancellation" in Japan—refers to the formal process by which the legal existence of an NPO is ended. Dissolution laws address three main issues: Who decides to dissolve the NPO? What are the grounds on which an NPO may or must be dissolved? What happens to the assets remaining after payment of all of the NPO's debts?

There is substantial convergence of NPO dissolution laws among the nations in the region, without regard to whether the dominant legal tradition is civil law, common law, or socialist law. Most legal systems, including those in this study, distinguish between voluntary dissolution, where the governing body and the membership of the NPO (or the governing body alone if there is no membership) make the decision to dissolve, and involuntary or compulsory dissolution, where the decision to dissolve is made by a government agency or a court.

Voluntary Dissolution

The grounds for voluntary dissolution are often not specified by law. The emphasis is instead on the dissolution procedure provided by the NPO's internal rules. In most countries in the region, the charter or other governing document of the NPO must set forth the procedure for voluntary dissolution, addressing payment of debts, identification of the transferee of remaining assets, the authorizing vote by the membership or governing body, and the filing of required papers with the appropriate government agency.

Involuntary Dissolution

Involuntary, or compulsory, dissolution laws are also similar throughout the region and generally permit the exercise of broad administrative discretion. Most of the countries in the study grant broad powers to government agencies to dissolve NPOs. The grounds are explicit and include engaging in activities outside the purposes of the NPO, change of organizational purpose, expiration of the initial term of existence, misuse or nonuse of the corporate franchise, inability to pay debts, and violation of the terms and conditions of registration. Many dissolution laws also contain a catchall provision that allows the widest possible latitude for the exercise of discretion by government officials. For example, NPOs may be dissolved for engaging in acts that harm the public interest (Korea); for engaging in activities detrimental to the national interest (China); for operating against the interests of the state (Vietnam); for being managed in a manner contrary to public order, good morals, or the security of the state (Thailand); and for being used for purposes prejudicial to public peace, welfare, or good order (Singapore).

WIDE-RANGING ADMINISTRATIVE DISCRETION. In most of the jurisdictions in the study, the exercise of administrative discretion is not reviewable by a court or an outside administrative tribunal; therefore government agencies have virtually unlimited discretion concerning the dissolution of NPOs. Appeals, if any, are confined to the hierarchy of the same governmental agency that ordered the dissolution.

In common law countries, by contrast, even though some jurisdictions may pay more heed than others to the separation-of-powers doctrine, courts are increasingly willing to tell government officials when their actions are wrong. Even where judicial review is permitted in this region, however, restrictive doctrines often limit the scope of review, severely reducing its effectiveness.

Judicial review of administrative or government decisions is not recognized by the socialist law tradition. Although the same is literally true of the classic civil law tradition, independent review of administrative decisions by outside administrative tribunals is frequently permitted in modern civil law jurisdictions. This notion of outside review has not yet taken hold in the civil law jurisdictions in the Asia Pacific region, however. In Taiwan, however, involuntary dissolution of NPOs does require a judicial procedure.

The infrequent use of compulsory dissolution procedures may indicate relaxation of governmental control of NPOs, but it may also signal the effectiveness of upstream controls. Laws on the books are not always a reliable guide to actual practice. Government agencies may rarely use the extensive powers of dissolution that the laws grant to them, for example. Ironically, infrequent use of the power to compel dissolution of NPOs may simply indicate the presence of stringent government supervision and control over NPO formation and operation. If upstream controls over NPOs, as exemplified by restrictive registration rules and practices, are operating efficiently, then downstream controls, at the point of dissolution, will seldom be needed. Without a tightly controlled registration process in Vietnam, for example, it is unlikely that the authors of the Vietnam report (Chapter Twelve) would have been able to state that from the time the involuntary dissolution law was enacted in 1957, "no associations have been dissolved by the state authorities."

NEED FOR REFORM. NPO dissolution laws should be reformed to limit abuse of official discretion. The ability of government to compel dissolution or termination of an NPO is the most formidable power of the state over the nonprofit sector. Even the power to control the registration and establishment of NPOs is usually less onerous, because NPOs can exist informally, despite the absence of official approval, in most countries.

Limiting abuses of that formidable state power is a concern reflected in the country reports. The form of the proposed limitation varies according to the conditions in each country. Where dissolution standards are absent, detailed regulations are proposed (Vietnam, Korea). Where abuse may occur as a consequence of the exercise of authority by multiple agencies, consolidation of power in a single authority is recommended (China). In the other countries, judicial proceedings for involuntary dissolution of NPOs are either already required (Taiwan, Australia, and the Philippines) or are recommended (Singapore, Japan, Thailand, Indonesia).

CONCLUSION

I began this chapter by emphasizing the recent widespread efforts throughout the Asia Pacific region to improve the nonprofit legal systems in the area. In 1997, those efforts included the enactment of laws in Thailand (the 1997 Constitution, which guarantees "freedom to gather in the forms of associations . . . or other non-government organizations") and in the Philippines (the Tax Reform Act of 1997, which expands the availability of tax deductions for charitable contributions). Those efforts also included the enactment in Japan of a major nonprofit law in 1998. Although that event occurred after the country reports were submitted for this book, we regard it as of sufficient importance to an understanding of Japan and nonprofit law developments in the region to warrant attaching the full text of the law following Yoshinori Yamaoka's report (Chapter Six), and inclusion of the following analysis of the law.

On March 19, 1998, the Japanese Diet enacted the Law to Promote Specified Nonprofit Activities, referred to hereafter as the NAL. The circumstances of the NAL's enactment are notable for three reasons: first, it is the first modern nonprofit law enacted in Japan; second, it is the result of three years of intense and unique collaborative effort by voluntary organizations, with the assistance of many people in local government, business organizations, the media, and other professions; and finally, support for the NAL was so widespread that it was passed unanimously by all of the political parties—an extremely rare event in contemporary Japan ("New NPO Law . . . ," 1998, p. 4).

The NAL opens up the nonprofit registration process by removing major barriers. It recognizes a new legal entity, the specified nonprofit corporation (SNPC), so-called because its main activity must be one of twelve broadly described activities ("promotion of community development," "conservation of the environment," and so on) specified in a schedule included in the NAL. Alongside the existing discretionary approval process for NPOs, administered by the ministries, the NAL introduces an objective authentication procedure, administered locally by the governor of the prefecture where the corporation is located or by the Economic Planning Agency if the SNPC operates in more than one prefecture. The government agency must authenticate the SNPC if the documentation it submits satisfies specified formal criteria, and the agency must act to authenticate or deny the SNPC within four months from the date the agency accepts the application for authentication. The NAL eliminates any minimum asset requirement.

The NAL is not without limitations. Its application to foundations, for example, is ambiguous. Grant making and other financial assistance fit literally within the last of the specified activities in the twelve–item schedule, which recognizes the "provision of . . . advice or assistance in connection with the above activities." But the NAL plainly limits SNPC qualification to organizations with ten or more members, and foundations do not ordinarily have members. Tax benefits are omitted from the

NAL. The absence of the incentives of tax benefits to SNPCs and their contributors may limit the appeal of the new law to existing unregistered NPOs.

Nevertheless, the significance of the law extends far beyond the positive changes introduced by its text; it represents a dramatic shift in the official attitude toward the nonprofit sector in Japan. The law received the unanimous support of all political parties. Accompanying resolutions promise a review of the taxation system for SNPCs within two years and direct the government to interpret liberally the twelve listed activities "so as to include a wide array" of nonprofit activities and to make every effort "to ensure that the independence of specified nonprofit corporations is fully respected." In his report (Chapter Six), Yoshinori Yamaoka predicts that the enactment of the NAL will usher in a new age for the Japanese nonprofit incorporation system.

The introduction of new laws and regulations for NPOs is also under way in China, Vietnam, and Thailand, and such efforts are under consideration in Taiwan, Singapore, and, since Suharto's resignation, Indonesia. Within the next few years, we will know the direction of modern nonprofit law reform in the Asia Pacific region: whether new measures will continue the traditional use of law as an instrument of social control or whether they will reflect the emergence of new public policies that accept and encourage the participation of private actors, including NPOs, in activities that benefit society.

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PART TWO

NONPROFIT LAW REPORTS

2

AUSTRALIA

Myles McGregor-Lowndes

NONPROFIT ORGANIZATIONS have a visible role in Australian society. Although they may be known popularly by a number of terms, such as "not-for-profits," "charities," "trusts," "nongovernmental organizations," "associations," "clubs," "societies," or "foundations," most Australians generally acknowledge that such organizations are different from the government and for-profit sectors. This chapter begins by placing Australian nonprofit organizations in their historical, legal, and social context and outlining the strategies used for describing their legal attributes and regulation.

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CONTEXT AND HISTORY

Nonprofit organizations participate in many areas of Australian life and play a distinct role in the Australian economy. The exact scale of the Australian nonprofit sector is unknown. There have been studies of the size of parts of the sector in the last decade, but most have drawn on dubious data sources.

Religious organizations and their hospitals, paramedical services, schools, and welfare organizations are all nonprofit organizations. A significant number of nonprofit organizations play a role in health care, social welfare, and education at all levels, with nonprofit organizations supplying one-eighth of all hospital beds, one-third of all nursing home beds, and one-quarter of all school education facilities in Australia. These proportions may well change in the near future. Governments at all levels are withdrawing from direct welfare service provision and contracting these services to either for-profit or nonprofit organizations. Examples of such changes can already be perceived in the child care and employment training sectors.

A government-commissioned inquiry performed by the Australian Industry Commission found that social welfare organizations' annual expenditures in 1993–1994 were $A4.8 billion, of which state and federal governments directly funded $A2.7 billion, with $A400 million in the form of tax concessions. The Commission estimated that the Australian community contributed over $A580 million, with 1.9 million volunteers contributing ninety-five million hours. It further reported that the community social welfare sector employed approximately one hundred thousand people. The Australian Bureau of Statistics estimated in 1990 that 21,300 nonprofit organizations were employers. The Australian Industry Commission estimated that there were some ten thousand to eleven thousand organizations receiving government funding to deliver such services, with an unknown number of organizations relying on other funding sources.

In its review the Commission stated that there were 120 overseas aid organizations, with a combined income of $A285 million, receiving $A71 million from government sources. It is estimated that one-fifth of consumer and personal finance is provided by nonprofit building societies, credit unions, and life insurance societies, but demutualization of such organizations is rapidly gaining pace in a deregulated financial environment.

Sporting organizations at the community level are nonprofit, and only recently, in some high-profile sporting codes (such as rugby league football and basketball), have commercial interests moved into a position of dominance. Hobby, arts, cultural, political, and advocacy organizations are usually nonprofit, as are trade associations and community service associations.

Nonprofit organizations that make grants available to the Australian community (foundations) also exist; most are located in the state of Victoria. A mix of social factors such as concentrations of family wealth, cultures predisposed to philanthropy, and the accessibility of professional trustee companies assisted the establishment of early Australian foundations. New foundations outside Victoria are gradually being established, as well as local, community-based foundations. The most comprehensive study of Australian philanthropy, conducted for the Australian Association of Philanthropy in 1991, estimated that donations (excluding commercial sponsorships) were about $A1.7 billion a year across the nonprofit sector.

Another distinctive feature of Australia's nonprofit sector is that there are a small number of very large organizations (often religious and old) and a large number of small, new organizations. For example, the Catholic Church and its establishments have annual expenditures in excess of $A5 billion in Australia, but there are thousands of small organizations that have just a couple of hundred dollars in reserve and rely on volunteers and in-kind donations.

European settlement of Australia began in 1788 with a British penal colony. During the next century the churches, with their social welfare institutions, were the leading nonprofit organizations in Australia. Gradually, secular nonprofit organizations appeared, taking the form of mutual benefit associations that provided relief for sickness, unemployment, and homelessness.

The nineteenth century saw the origins and growth of secular nonprofit organizations in the form of community service clubs, orphanages, disability services, business associations, and hobby and sporting associations. It was also the period in which philanthropic foundations began to emerge in Victoria.

The early 1970s witnessed an explosion of small, community-based associations involved with delivering such assistance as child care, citizen's advisory services, and general social welfare services. This occurred in the context of an expanding welfare state. In the last half decade Australia's welfare state has been changing and receding, which has had an impact on many nonprofit social welfare organizations.

GENERAL LEGAL FRAMEWORK

Australia's laws have been strongly influenced by English common law. In the last two decades Australian law has been increasingly influenced by American law, particularly in the area of antitrust law, commercial law, consumer legislation, and administrative law.

Australia is a federation of states and territories. There is a division of constitutional powers between the states and the federal, or commonwealth, government. The federal government can at times impose its will on the states, either directly through its assigned powers or indirectly using its taxing powers. In the last decade there has been significant reform of governmental structures and economic institutions by agreement between the states and the commonwealth. Legislative reform from this source has largely been confined to commercial legislation (governing corporations and trade practices, for example) and governmental agencies (such as electricity authorities) and has not yet flowed to the nonprofit sector's legal environment. In addition to the commonwealth's system of federal courts, there is a separate judicial system in each state. Appeals proceed from the state courts to the High Court of Australia.

Another level of government, consisting of local or municipal councils, is responsible for such services as water and sewer provision, waste disposal, local transportation, building code development and enforcement, and some community welfare services. In recent years many of these services have been privatized or contracted out to commercial enterprises. The councils are supervised by the state governments. The councils' involvement with nonprofit organizations and their regulation varies greatly from region to region. Local government regulatory provisions affect nonprofit organizations through concessions on property rates and services, building and site use proposals, and health and hygiene regulations.

SPECIFIC LEGAL FORMS FOR NONPROFITS

Australia has a significant number of legal forms available for nonprofit enterprises. This is partly because responsibility for the legal framework of nonprofit organizations is shared between the states and the commonwealth. There has been no formal attempt to rationalize the legal forms that have gradually accumulated.

The most informal legal form is the unincorporated association, which owes its existence to the common law. Unincorporated associations can be formed at will and range from small informal common-interest groups to some of the largest Australian religious and political organizations. In recent years, the issue of personal liability of committee members of unincorporated associations and the problems associated with a lack of a legal persona, such as ability to acquire, hold, and dispose of property and to sue and be sued, have led many to migrate to corporate nonprofit forms.

The charitable trust form, which was received through the common law of England into Australia, is not used in Australia to the same extent as it is in England. A charitable trust is an obligation, enforceable in equity, that rests on a person (the trustee), as the owner of some specific property (the trust property), to manage that property for the advancement of charitable purposes. In some cases the trustee may take on a corporate form. Foundations often take the form of a charitable trust. Trusts are also subject to select provisions in each state's general trust legislation, but they are generally not required to register, merely because of their legal form.

The most numerous nonprofit incorporated legal form is the incorporated association. Each state of Australia has different statutory laws covering the incorporation of nonprofit organizations. Although two states have a long history of incorporated associations, reform and introduction of such statutes during the 1980s spurred the popularity of this form with a wide range of previously unincorporated nonprofit organizations. The limited liability, other benefits offered by a corporate persona, and perceived simplicity compared to other alternatives appear to be the main reasons for this legal form's popularity.

There are also nonprofit organizations created by specific acts of the various parliaments. These are usually quite old organizations or church property–holding statutory trusts. Before modern nonprofit incorporation statutes, the inherent powers of the Queen of England and her representatives in Australia were used to establish nonprofit organizations. These organizations were established by royal charters or letters patent, and it is now rare for such power to be exercised.

The commonwealth also permits the incorporation of nonprofit organizations in its general code of business corporations (the Corporations Law), usually in the form of a company limited by guarantee. This form is inherited from the English corporate law, and the members guarantee to contribute a certain sum of money (usually nominal) toward satisfying the debts of the company upon its dissolution. Commonwealth legislation also provides for a small number of specialist nonprofit associations (for example, aboriginal councils and associations).

Australian law also provides for the creation of cooperatives, mutual associations that in many cases can distribute profits in various forms to their members. Cooperatives legislation is state-based, and recently the states have agreed to harmonize these individual statutes through an agreed core set of legislative provisions. Cooperatives are not discussed further here, because of space limitations and their borderline nonprofit classification. However, the harmonization of state cooperative-organization statutes does provide a practical model of statutory reform that might be applied to state-based nonprofit legislative provisions.

This chapter deals separately with each of the significant legal nonprofit forms: unincorporated associations, incorporated associations, companies limited by guarantee, and charitable trusts. Each is described and analyzed in terms of the registration process, prohibited or limited purposes or activities, capital formation, internal governance, accountability, and termination or dissolution. The majority of states and territories have some form of fundraising or solicitation regulations, and this is dealt with as a discrete topic. Taxation is also dealt with as a distinct topic, as all nonprofit forms are subject to such regulations. The final section reflects on the dominant themes flowing from the analysis.

Unincorporated Associations

An unincorporated association is formed when a group of individuals associate for a common purpose without conducting a business with a view to profit. It is theoretically possible for such an association to be created by an unexpressed consensus, without formal documents. The ease of formation and lack of any significant external regulation or gov-

Table 2.1.

Legal Form	***Separate Legal Persona***	***Main Source of Law***	***Number***
Charitable trust	No	Common law and State Trusts Act	Unknown
Unincorporated association	No	Common law	Unknown
Incorporated association	Yes	State incorporation of associations acts	105,000
Company limited by guarantee	Yes	National Corporations Law	9,000

Table 2.2.

Legal Form	*Liability of Members*[1]	*Liability of Controllers*[2]	*Limitation of Activities or Purposes*[3]	*Privacy of Operations*[4]
Charitable trust	Not applicable, as usually no members	Yes	Yes, must be charitable	Private
Unincorporated association	Only for unpaid subscriptions	Yes	No	Private
Incorporated association	Only for unpaid subscriptions	No	Yes, by statute	Public
Company limited by guarantee	To amount of stated guarantee	No	No	Public

[1]*Refers to basic liability of members.*
[2]*Refers to basic liability of controllers such as Trustees, Directors, and so on. Such persons usually face other liabilities as well, such as insolvent trading or provisions in particular statutes.*
[3]*It is assumed that all of the legal forms are nonprofit.*
[4]*Refers to whether any documents must be filed for public inspection.*

ernment registration has meant that this legal form has flourished across Australia. Unincorporated associations cover a range of activities and organizational types, from informal leisure clubs to large religious and political bodies. The problems associated with a lack of legal persona for such organizations, such as the inability to acquire, hold, and dispose of property and to sue and be sued in the association's name, as well as unlimited personal liability for committee members, has led many to migrate to corporate nonprofit forms. Many nonprofit associations are initially constituted as unincorporated associations but then quickly acquire an incorporated status once it is apparent that the benefits of a corporate persona are desirable. The change from small, informal, unincorporated association to incorporated status has caused problems among organizations unable to bear the costs of incorporation, such as auditing and accounting fees, the costs of increased government reporting, and the costs associated with more formal internal procedures.

REGISTRATION. Because of its unincorporated status, an unincorporated association is not required to register with any state authority. Unincorporated associations are regulated by the common law, and a fair amount of reliance is placed on English case precedents. Many small nonprofit organizations are unincorporated and are not affected by any special regulations. The unincorporated legal form is inexpensive to form and operate, private, and flexible in nature. The ability of citizens to form an association without applying to the state is taken for granted as an important civic freedom, but it is not overtly recorded in any formal document such as a constitution or bill of rights.

ACTIVITIES. An unincorporated association may not be formed for illegal purposes and must have a distribution-constraint clause to be considered nonprofit. It may conduct commercial business, but if it distributes dividends to its members, it is likely to become a business partnership and treated accordingly. Unincorporated associations may take part in influencing legislation and elections, subject to the provisions of their constitutions. There are electoral acts that regulate the conduct of elections and persons running for office that do apply. Many Australian political parties are unincorporated associations, with associated trusts and corporate vehicles holding the property of the political association.

The Corporations Law may restrict the formation of some unincorporated associations, forcing them into a corporate form. Section 112 of the Corporations Law prohibits

- Unincorporated associations consisting of more than twenty persons that have as their object the acquisition of gain by the association or its members
- Unincorporated associations that are not formed under some other state or federal provision or by letters patent
- Unincorporated professional associations that have been permitted by regulation to consist of more than twenty persons by ministerial regulation

Earlier corporate legislation used the phrase "formed for the purpose of *carrying on business* which has for its object the acquisition of gain." The English and Australian judicial interpretation of this phrase included mutual insurance associations and building and loan societies but exempted clubs and nontrading trade associations. It is yet to be judicially determined in Australia whether the removal of the words *carrying on business* has altered the application of the section to include a wider range of associations.

A majority of states regulate fundraising activities and may require adherence to certain conditions and the auditing of tax returns. It should be noted that "carrying on business," which was omitted from the new definition in Section 112 of the Corporations Law, is now defined to include "carrying on business otherwise than for profit" in Section 18.

An unincorporated association with more than twenty members is required under the Corporations Law to register as an "Australian Registerable Body" if it "carries on business" in more than one state. This requires the unincorporated body to file its constitution with the regulator of the Corporations Law and with the Australian Securities Commission (ASC) and to use a unique identifying number on its public documentation.

Specific changes could be made to Section 112 of the Corporations Law to clarify what is meant by "acquisition of gain by the association or its members." If it is the intention to catch nonprofit associations of substance, then a clearer test may be to specify factors such as size of assets, annual income, or employees. An ASC policy statement on the issue could also be of assistance to the nonprofit community.

CAPITAL FORMATION. There are no direct external regulations that prevent unincorporated associations from accumulating capital or that require a certain percentage of their income or assets to be distributed for their purposes. There are no substantial laws with respect to receiving foreign funding, apart from currency regulations and law prohibiting activity with enemies of Australia and with countries under United Nations sanctions.

INTERNAL GOVERNANCE. Unincorporated associations' internal governance is a matter for association members and founders. It is possible to have multiple governing bodies, although this is not common.

Selection of the members of the governing body of an unincorporated association is usually by election among the general members, in meeting or by ballot. The term of office is usually one year; sometimes rotating three-year terms are used in larger organizations. In some instances there is a self-perpetuating board.

The duties of an unincorporated association's governing body can be ascertained by reference to the association's constitution and to common law. Members of a governing committee are in the position of a fiduciary and are required to act in the best interest of the members. Committee members who fail to carry out their fiduciary responsibilities could be sanctioned under the unincorporated association's rules or, with greater difficulty, through the civil courts.

The committee members of an unincorporated association can be held personally liable for any contracts made on behalf of the members. This can also extend to tortious liability. Such a situation is of concern generally in the nonprofit sector.

Removal of officers is generally governed by the organization's constitution, for circumstances such as bankruptcy, unsoundness of mind, conviction of a serious crime, or dismissal by the members in a general meeting. Review of such matters is often provided for in the constitution of the organization, and the courts are reluctant to intervene except where serious property rights are involved.

ACCOUNTABILITY. The lack of a registration process for unincorporated associations means that there is little direct external regulation of them. The extent of accountability that stems from internal processes (such as auditing and presentation to members of annual reports and election of officers) depends on the rules of each unincorporated association and the vigilance of its own members.

Some legislation may incidentally require various degrees of accountability from unincorporated associations. Unincorporated associations that carry on particular activities may require registration and have certain accountability measures imposed on them by virtue of those activities. One common circumstance occurs when an unincorporated association seeks to raise donations from the public for certain purposes. Income tax returns are generally not required from such bodies, and in any case they are not available for public inspection.

Despite this lack of overt external regulation, there are few public concerns about this situation. The potential personal liability of committee members for the debts of the association may be one factor contributing to this situation. Internal accountability issues are often at the root of many internal disputes in unincorporated associations, such as lack of accountability of a perpetual board.

TERMINATION OR DISSOLUTION. The procedure for voluntary dissolution of an unincorporated association is usually found in its constitution. If the members of an unincorporated association unanimously agree to dissolve it, then they may prescribe the procedure to be followed. If the decision to dissolve is by a majority vote, however, then the situation is less clear and the dissolutions procedures specified in the constitution, if there are any, must be followed.

POSSIBLE REFORMS. The unincorporated association provides a flexible, inexpensive method for citizens to associate for legal purposes and does not require drastic reform given the numerous other alternatives available in Australia. Consideration might be given to clarifying the new provisions in the Corporations Law, which appear to unwittingly catch within their ambit certain unincorporated associations having over twenty members. A policy statement on the matter by the Australian Securities Commission would probably rectify the matter for all concerned.

Consideration could also be given to dealing with the problems, mentioned previously, flowing from the lack of a corporate persona for unincorporated associations, such as unlimited personal liability, in contract and tort, of committee members and legal difficulties in acquiring, holding, and disposing of property and in suing and being sued in the association's name. There have been limited attempts in some states to mitigate some of these problems by altering the rules of court procedures to accommodate unincorporated associations. The approach taken by some American states in adopting the Model Uniform Unincorporated Nonprofit Association Act of 1992 may provide a basis for Australian states to provide limited recognition of the persona of unincorporated entities.

The model statute, which has been adopted in some six American jurisdictions, allows unincorporated nonprofit associations to hold property in their own name and to sue and be sued as an entity and stipulates that such entities are separate from their members and committee for the purposes of contractual and tortious liability. The members and committee may still be liable in contract and tort for their own actions, but not for those of the entity. The only registration requirement is to file with an appropriate state official an address for service of legal documents on the entity.

This reform is worth considering in Australia, given that it would help many unincorporated associations clarify their legal standing and prevent inappropriate migration to higher, incorporated forms when it is clearly inappropriate given the informality of the organization.

Charitable Trusts

As noted previously, a charitable trust is an obligation, enforceable in equity, that rests on a person (the trustee) as the owner of some specific property (the trust property) to manage that property for the advancement of charitable purposes. A trust is not an incorporated body but an equitable obligation; however, a trustee can take the form of a corporate entity.

The Australian law of charitable trusts is heavily based on English law and practice. Unlike in England, however, the charitable trust is not commonly used for a broad range of community purposes in Australia. Nonprofit companies and incorporated associations are the more common Australian legal structures. Charitable trusts are often created by wills and can last indefinitely. Persons or bodies wishing to create a public fund or foundation—donations to which are tax deductible—will usually create a charitable trust to comply with the requirements of the taxation authorities. Compliance with the taxation requirements for donor deductibility usually places restrictions on the administration and activities of such trusts.

REGISTRATION. Charitable trusts are not required to register with any state authority as a consequence of their legal attributes. They may be required to register with various authorities for other reasons, however, such as their tax status or collection of public donations.

The formation of a charitable trust is legally more exacting than the formation of an unincorporated association. A charitable trust may not be enforceable in the eyes of the law unless it is properly formed. Most charitable trusts involving some form of real property are required to be in written form. The most troublesome part of creating a valid charitable trust is ensuring that its activities satisfy the definition of "charitable purposes." This is discussed in the following section.

ACTIVITIES. A charitable trust must, through the actions of the trustees, abide by its charitable objectives. For a trust to be charitable, it must both fall within the spirit and intendment of the preamble to the English Statute of Charitable Uses, 1601 (43 Eliz. 1, c. 4), and be beneficial to the community. It is commonly accepted that there are four goals or activities that fit the definition of charity: the relief of poverty, the advancement of education, the advancement of religion, and other purposes beneficial to the community. Although this appears to cover a wide scope of activities, there are some fuzzy definitional boundaries. For example, sport and recreation are not necessarily fully included, and statutory amendments have been used to widen the common law. Political advocacy, campaigns to alter or repeal a particular law, patriotic purposes, and mutual self-assistance can theoretically cause problems. There is also the issue of combining both charitable and noncharitable objectives in one trust. These problems are often minimized in practice, however, by statutory intervention, skilled legal drafting, and lack of state supervision.

These boundary issues are dealt with practically in England by the Charity Commission, which is responsible for registering and supervising charitable trusts. The Commission, which has quasi-judicial powers, is able to clarify the contemporary meaning of charity by issuing guidelines and actual rulings. As there is no equivalent to the Charity Commission in Australia, the courts must pronounce on the contemporary boundaries of charity. The judiciary is given limited opportunities to do this, however, as parties are reluctant to bear the expense of bringing such matters to court. It is unclear where many of the boundaries are, exactly, in contemporary Australian society, and this ambiguity encourages a conservative approach on the part of trustees. This attitude is starting to materially disadvantage otherwise worthwhile community projects.

Charitable trusts may carry on commercial activities that have a connection with their objectives. For example, a trust for a school may charge fees for education, and a trust to preserve a historic building may charge admission fees. Charitable trusts may not carry on activities that provide a personal benefit to their trustees. Trustees owe fiduciary duties to the trust, which prohibits their obtaining personal gain. The trustees are usually indemnified from the trust for legitimate expenses incurred on behalf of the trust.

Qualification requirements for various tax exemptions for trusts and for deductibility of donations to them also restrict the activities of trusts or the choice of their beneficiaries. This is more fully developed in the following section, but it is appropriate here to refer to repealed state inheritance tax legislation. Older charitable trusts that sought exemption from inheritance taxes were required to place restrictions in their deeds to limit their activities, often to the geographical area of the particular state. Although the taxes have been repealed, the trusts still face expense and difficulties in removing such restrictions, which they must do by applying to the court through the Attorney General.

CAPITAL FORMATION. Distribution of capital or income depends on the terms of the trust deed, reflecting the wishes of the settlor of the trust. However, a charitable trust exempted from paying income tax under Section 23(j)(ii) of the Income Tax Assessment Act (ITAA) of 1936 is required, pursuant to an Australian Taxation Office (ATO) administrative fiat, to distribute a certain amount of its income each year. The ATO suggests a figure of 85 percent but is willing to allow variances on good grounds, such as maintaining the real value of trust investments or accumulating funds for a large distribution to a particular cause or activity. The Industry Commission, which conducted an extensive inquiry into Australian charitable organizations, recommended that no restrictions be placed on such accumulations.

State and territory trust legislation controls the range of investments in which trust funds may be placed. In some jurisdictions there is a list of approved investments, and a contrary intention in a trust's deed may partly or entirely exclude the trust's list of investments. The recent trend is to allow charitable trusts a much wider range of investments while placing a positive duty on trustees to monitor a balanced portfolio of investments to benefit the trust.

INTERNAL GOVERNANCE. The trustees make up the governing body of a charitable trust. The initial trustees are usually named in the trust deed. Successors are decided according to the terms of the trust deed and may be appointed by the settlor, an outside party, or the remaining or retiring trustees. Trustees may serve for a term of life and may be removed from office by a specified event detailed in the trust deed or upon a breach of fiduciary duties declared by a court.

The trustees of a charitable trust are primarily accountable to the courts for their administration of the trust. Trustees are personally responsible for the liabilities of the trust and for any damage suffered by the trust through a breach of their duties as trustees. Trustees have a right of indemnity from the trust funds for legitimate expenses in the performance of their duties. Trustees are able to approach the courts to receive instructions on problems that may arise from the interpretation of the trust deed or other matters, but this is often not contemplated by small trusts because of the expense involved. Trustees who follow such court orders cannot be found legally wanting.

ACCOUNTABILITY. Although it is possible for an individual to challenge the actions of a trustee of a charitable trust, it must be done with the approval of the Attorney General. This is known as a relator action, and it is rare. The Attorney General of each state and territory acts as a general supervisor, through common law and their inherent jurisdiction. Few cases are brought by Attorneys General to enforce charitable trusts; their judicial appearances in this area mostly revolve around charitable trusts that are for impossible purposes or have fallen inactive.

Unless required by the trust deed or specific legislation, trustees are not required to disclose or place on public record the trust's activities or financial records. Trustees are usually not obliged to file tax returns for the trust, and in any case such returns are not available to the public. Trusts that claim tax exemptions or donation deductibility may be audited by the Australian Taxation Office (ATO) for compliance with the tax laws.

Charitable trusts provide one of the most private forms of nonprofit legal structures in Australia, with accountability resting almost solely on the trustees. This privacy has perhaps encouraged contributions to charitable trusts from "publicity-adverse" wealthy donors, and there have been few reported instances of fraud, maladministration, or abuse. The government is presently proposing taxation law amendments to curb abuse of the charitable trust as a tax-avoidance mechanism by some high-wealth individuals.

TERMINATION OR DISSOLUTION. Unlike common trusts, charitable trusts may exist in perpetuity. Charitable trusts may themselves provide that they are to have a fixed term of existence, with any surplus assets at dissolution to be transferred to another charitable body. Charitable trusts that fail because their intended purposes are impractical or impossible or that have excess assets for their purposes may apply to the court to authorize a scheme for the redirection of their funds. This is known as a *cy pres* scheme. Funds are usually redirected to a similar purpose in a similar geographic area. In some jurisdictions, statutory provisions permit the Attorney General to deal with small *cy pres* applications, which prevents funds from being exhausted through legal costs and hearing delays. In other jurisdictions, Attorneys General charge substantial amounts to deal with such applications.

POSSIBLE REFORMS. The definition of what constitutes "charitable purposes" in contemporary society has been an issue in both England and Australia. In Australia, the contemporary relevance of the definition relies solely on judicial pronouncements in contested cases. As such cases are rare, there is a risk that the definition will not keep pace with Australian society's needs. The cases that do reach the courts are most often brought by the taxation authorities or by relatives contesting a charitable bequest—cases that focus on narrowing the definition rather than expanding it.

As mentioned previously, the English Charity Commission has a quasi-judicial function to address these problems. Some alternatives for advancing the definition of charity are to provide a contemporary statutory definition or to authorize the courts or Attorney General to make public rulings on the definition. The Charity Commission model holds an advantage over these approaches in that the Commission can not only consistently and regularly reform the definition of charity within the existing legal supervision of the judicial system but also perform other functions, such as regulating nonprofit organizations and facilitating and encouraging philanthropy and voluntary action in a strategic and consistent fashion.

Many submissions to the Industry Commission inquiry into charitable organizations called for the establishment of a charity commission. The creation of an Australian charity commission has been generally resisted, however, because of the potential cost and doubts about its effectiveness. Amendments to the various states' trust legislation could require the Attorneys General to provide free opinions to settlors, upon request, as to the validity of their trust instruments or how to achieve the settlor's intention. The opinion, if followed by the settlor, would provide immunity from an adverse judicial finding that the trust objects were not charitable. The Attorney General would reserve the power to refer matters to the judiciary in appropriate situations, with all costs being borne by the government. This is similar to the operation of the English Charity Commission, but it would not require a new government infrastructure to be established and funded.

Similar arrangements exist to streamline small *cy pres* applications, which would otherwise have had to go before a court, and have worked well. Alteration of trust deeds for such purposes as removing undated taxation restrictions should also be handled through administrative processes supervised by the Attorney General, to minimize legal costs. Appeal to the courts from such administrative decisions should remain.

Practical and formal accountabilities of charitable Trustees are not as great as those of the officers of other nonprofit legal forms, nor are they as closely supervised in Australia as they are in England by the Charity Commission. There is a risk that Australian trustees may find themselves inappropriately regulated by a hasty government response to an instance of trustee fraud or default. The voluntarily adoption of sustained accountability practices as the norm by all charitable trustees may well prevent such a hasty government response. Such practices might include the distribution of meaningful reports and financial statements to the public, the development of trustee training, trustee codes of conduct, and accreditation by a strong trade association. Philanthropy Australia, Inc., an association of charitable trusts and foundations, is already moving in this direction.

Incorporated Associations

Each state and territory of Australia has a statute allowing the creation of incorporated associations. An incorporated association is a nonprofit organization that has a corporate persona. That is, it is an artificial distinct legal "person." Although these statutes all spring from the same basic desire to provide a simplified corporate form to accommodate nonprofit organizations, the details of each jurisdiction's statute are different. The incorporated association is a popular legal structure for nonprofit organizations, especially with formerly unincorporated associations that wish to take advantage of a corporate persona. A corporate persona has the advantages of perpetual succession, the ability to sue and be sued in the corporate name, and the ability to own, acquire, and dispose of property. Incorporation is often pursued as a way of minimizing the potential liability of committee members, and it is often helpful in securing government grants and licenses.

REGISTRATION. Each state and territory has a registering authority, often located in the Department of Consumer Affairs or Department of Justice. The majority of the statutes require a minimum number of members, a registration fee, a constitution conforming to set guidelines, and a completed application form. Nonprofit organizations that already have specialized statutes permitting their incorporation are required to incorporate under that regime rather than under the more general incorporation statutes for associations (for example, for trade unions and employer associations). A minister of the crown is usually responsible for the actions of the department, may determine administrative appeals, and can have discretion to refuse incorporation, although this is rarely exercised.

Some state registration processes could be administratively streamlined, and consideration could be given to the development of client-friendly application forms, more appropriate model rules, and less paternalistic scrutiny of constitutions. If, as suggested later, the states and territories could agree to nationalize the regulation of incorporated associations or to enact similar core legislation in each jurisdiction, benefits could flow to incorporated nonprofit associations throughout Australia (provided the common provisions are appropriate).

ACTIVITIES. No incorporated association may be established for an illegal purpose. All statutes exclude associations that are established for purposes of making profits for members, and distribution of profits to members in the form of dividends is prohibited. All profits are required to be employed in furthering the charitable objectives of the association.

Some jurisdictions' statutes further require that an incorporated association's proposed objectives and activities fall within specified categories. Although the listed purposes are broad (usually including religious, charitable, and benevolent purposes; the provision of medical treatment; the encouragement of literature, science, or art; and community, recreational, and sporting purposes), there is the occasional nonprofit organization that is excluded. Other jurisdictions focus on the economic relationship between the association and its members; an association can be formed for any (legal) purpose, so long as that purpose is not primarily to make a pecuniary gain to be distributed among its members. The listing of specified permitted objects and activities for associations inhibits voluntary action without providing any commensurate public policy advantage. The economic definition should be adopted by all jurisdictions, as it provides a simple and comprehensive definition.

There is considerable variation in other limitations and prohibitions placed on incorporated associations. In Tasmania and the Northern Territory, incorporated associations are prohibited from engaging in activities that generate income from trading business. Other jurisdictions stipulate that if an incorporated association engages in substantial trading activities to support its objectives, it may (at the discretion of the registrar) be moved to the Corporations Law regime. It is common for most associations to engage in a small amount of trading with the public from time to time, and there is a good deal of noncompliance with the restriction in those jurisdictions that prohibit trading. The better policy approach may be to permit trading but to have facilities in place to migrate associations that begin to engage in substantial commercial activity, since the simplified association incorporation acts are not designed to facilitate or regulate such activity.

In a small number of jurisdictions, incorporated associations may not be formed for political purposes unless the relevant government minister has consented. All associations, of course, must comply with the general electoral acts regulating the conduct of public elections and persons standing for public office.

CAPITAL FORMATION. Incorporated associations are not compelled by their establishing acts to spend or distribute a minimum percentage of their income or assets. There are few restrictions on the investments incorporated associations may make, apart from those contained in their rules. The management committee of an incorporated association has a general duty to appropriately invest any monies of the association. Most jurisdictions require an association to open and maintain a bank account.

INTERNAL GOVERNANCE. It is usual for an incorporated association to have a single governing body, often referred to as the management committee. The selection process is usually by election at an annual general meeting of members, but some jurisdictions permit appointment by an external body or class of members. Committee members usually serve a term of one year. Most jurisdictions permit rotating terms of multiple years, but this is not as common for incorporated associations as it is for companies limited by guarantee. Committee members may be removed from office by a majority vote of the general meeting. There is usually no appeal to a higher authority, unless due process has been breached. The office of a committee member may be vacated under certain conditions, such as unsoundness of mind or bankruptcy, and by a vote of the members in general meeting. This may be stipulated in the legislation or in an association's rules.

The management committee is accountable for the activities of the association. It may delegate tasks to others (usually paid employees), but it is still obliged to supervise their activities. Committees are obliged by fiduciary principles to act in the best interests of the association and to avoid personal conflicts of interest. This is either by express provision in the relevant act, by common law principles pertaining to fiduciary duties, or by express provision in the association's constitution. There is a trend for jurisdictions to enact legislation that specifically defines the duties of committee members, often mirroring the provisions of the Corporations Law.

There is some concern that the Corporations Law's insolvent trading provisions might be applied to incorporated associations through an adverse interpretation of some redrafting of the law. This does not appear to have been the intention of the drafters of the amendments, and it would be beneficial to nonprofit organizations if this matter were clarified.

Although the corporate persona of the incorporated association brings limited liability to members and the management committee, some jurisdictions make committee members personally responsible for insolvent trading. In all jurisdictions, statutory provisions beyond the associations incorporation acts will pierce the corporate veil in certain situations (for example, pollution, workers' health and safety, and discrimination), and committee members may face criminal sanctions as well as civil damages. There is no express American-style business judgment rule.

There is less flexibility in this structure in many jurisdictions, and it is an unsuitable vehicle for flat management structures or small organizations that wish to collectively make decisions in open meetings. It does, however, provide a template for an orthodox governance of most associations.

ACCOUNTABILITY. The various jurisdictions have different reporting requirements for incorporated associations. Some jurisdictions require incorporated associations to present audited accounts to their annual general meeting and then file them with a government department for public inspection, whereas other jurisdictions do not require them to keep proper accounting records or to have their records audited. There is discretion to exempt incorporated associations from filing financial accounts in some jurisdictions, but this is rarely granted. Most associations are exempt from taxation and are not required to file a tax return (and in any case a filed tax return is not a public document).

The ability of an incorporated association's members to make the association and its management committee accountable varies depending on the jurisdiction and the association's rules. A member's ability to access the financial records of the association (rather than the annual accounts) is permitted by the rules of the association law in most, but not all, jurisdictions. Members who are dissatisfied with the management of the association may seek to replace the management committee at the next annual general meeting, or earlier in some instances. Incorporated associations in all jurisdictions are characterized by internal disputes among members. In some states, members' rights are enforceable through the courts, but this is a very expensive procedure. In other states, associations are encouraged to provide provisions in their constitutions for appropriate alternative dispute resolution. It would be beneficial for all jurisdictions to provide for members' rights to be enforceable in the lower courts and to provide a mechanism for alternative dispute resolution.

It would be beneficial to develop accounting and auditing standards that provide appropriate and useful information about a nonprofit organization, sensitive to the purpose, size, and complexity of the organization. For example, small organizations should not be required to undergo a full professional audit of their accounts, because of the expense and because of the ability of a small number of members to regulate their own affairs. Accountability of such organizations would be enhanced by a common core of agreed financial and auditing standards for such organizations.

TERMINATION OR DISSOLUTION. The termination or dissolution of an incorporated association may be voluntarily conducted by the members or handled by the courts or government officials. The association incorporation acts do not have a uniform approach to voluntary dissolution. In Tasmania and the Northern Territory, there is no statutory procedure for voluntarily dissolving an association; an association may be so dissolved only if there is a provision for it in its rules. In these jurisdictions, an association wishing to dissolve may request that the relevant department cancel their incorporation. In each other jurisdiction, an incorporated association has the power to decide by a special resolution to dissolve voluntarily. The Corporations Law's dissolution provisions are incorporated by statutory reference to provide the framework for voluntary dissolution.

Each jurisdiction gives government officials the power to terminate the existence of an incorporated association for ceasing business or for gross breach of regulatory requirements. This power is often used to executively dissolve associations that have ceased trading and have no debts and little surplus assets. In all jurisdictions, the legislation incorporates by reference the parts of the Corporations Law pertaining to dissolution by the courts. The courts have the power to wind up the affairs of an incorporated association on several specified grounds, such as the association's being unable to pay its debts, the association's ceasing to carry on business, or its being just and equitable to so do.

A recent innovation for commercial companies under the Corporations Law has been the introduction of an "administration process." A company in financial difficulties may appoint an administrator during a debt moratorium to restore the viability of the company. A similar provision for incorporated associations could be beneficial. Each act regulates the disposition of surplus assets in very different ways. In Queensland and Victoria, surplus assets may be disposed of according to the rules of the association or by a special resolution passed by its members. In the other jurisdictions, any disposition requires the approval of the courts, and in some cases strict government controls are imposed. To qualify for tax exemptions, most incorporated associations' rules have clauses requiring a distribution of surplus assets to like organizations with similar exemptions.

POSSIBLE REFORMS. The incorporated association form could benefit from an appropriate common scheme of legislation. This might be a national regulatory scheme or an agreement among all jurisdictions to enact similar core legislation. Such a solution would require less complex books and materials for volunteer committee members and officers, would simplify the tasks of national associations and of associations with affiliates in several jurisdictions, would permit comparisons of different associations' financial information through common accounting standards, and would reduce multistate compliance costs. Coordinated state legislation seems more politically feasible than does a national scheme administered by the commonwealth government.

Following are some beneficial reforms worth considering:

- Some state registration processes could be streamlined, with more appropriate model rules and less paternalistic scrutiny of constitutions.
- Eligibility requirements for registration as an incorporated association could be made consistent across jurisdictions with an economic definition of this legal form rather than one tied to organizational purpose. Purpose-based definitions may exclude otherwise worthy organizations.
- Ministerial discretion as to eligibility for incorporation should be clearly confined to exceptional circumstances.
- Many incorporated associations suffer from being unable to satisfactorily resolve internal disputes among their members. Consideration should be given to strategies to ease this problem, such as alterative dispute resolution methods and mediation.
- Part 5.7 of the Corporations Law may catch incorporated associations within the definition of "company," which in turn may impose personal liability on committee members for insolvent trading. This should be clarified.
- Administrative procedures could be developed for government offices to allow them to dissolve small nonprofit organizations that have few debts and little in the way of surplus assets.
- A scheme should be developed for administering the affairs of financially troubled incorporated associations.

Companies Limited by Guarantee

A company limited by guarantee is a public company registered under the Corporations Law, which is a national statute regulating corporations. This national regulatory scheme was recently arrived at after two decades of negotiations and trial schemes among the states and territories. The members of this type of company guarantee to pay a specified sum of money if the company is dissolved and unable to pay its debts. The guarantee is usually for a nominal sum, between $A2 and $A100. Many older nonprofit organizations take the form of a company limited by guarantee because the option of an incorporated association did not exist in many jurisdictions prior to 1980. Nonprofit organizations that are national in focus or that carry on substantial trading activity often decide that it is advantageous to be a company limited by guarantee.

REGISTRATION. A company limited by guarantee is created by applying to the Australian Securities Commission (ASC), which administers the Corporations Law. The ASC serves as a national registry for corporations. A company limited by guarantee requires five subscribers, three directors (two of whom are ordinarily resident in Australia), a unique name, a constitution, and a registered office. An incorporation fee must be paid and completed forms submitted to register. Once these matters have been completed there, is no formal or practical discretion to prohibit registering the company. It is possible for a company limited by guarantee to be formed as a for-profit body, but this is very rarely the case.

The ASC could improve its service by making available a public information brochure on the company limited by guarantee form, with model constitutions. The Corporations Law could be altered to provide a plain-English guide to nonprofit companies, as has been recently done under the Corporate Law Simplification Program for small business incorporated as proprietary companies.

ACTIVITIES. A company limited by guarantee is made a nonprofit body by the inclusion of a nondistribution constraint clause in its constitution. It usually has all the powers of a natural person and can carry on a commercial business. It may take part in influencing legislation and elections, provided it complies with the relevant electoral acts and its own constitution.

CAPITAL FORMATION. Companies limited by guarantee are not compelled to spend or distribute a minimum percentage of their income or assets. Any restrictions on investments are contained in company constitutions. The board of directors of a company limited by guarantee has a general duty to appropriately invest any monies of the company. The public raising of capital by corporations is closely regulated by the Corporations Law through registration of a prospectus document. The seeking of loan funds from the public by nonprofit corporations can be exempted from many of the more onerous provisions of the Corporations Law.

INTERNAL GOVERNANCE. A company limited by guarantee is governed by a board of directors. The appointment process for such boards is more flexible than that provided by many incorporated association acts. Usually directors are nominated by members and elected by ballot at the annual general meeting. It is common for directors to be elected for a three-year term that rotates among members of the board. Under the Corporations Law, directors may only be removed from office on a majority vote of the members, and there is an avenue for judicial redress if due process has not been followed. The office may be vacated pursuant to events specified in company articles of association or the Corporations Law, such as unsoundness of mind or bankruptcy.

Usually a company's memorandum and articles of association give to its board of directors the power to operate the business of the company. The board may delegate responsibilities to others, usually paid employees, but the board members are still accountable for the activities of the corporation. Directors are obliged to act in the best interests of the corporation by force of their common law fiduciary duties and specific duties listed in the Corporations Law. The standard of their duties is largely influenced by judicial pronouncement, and a number of recent cases have steadily raised the standard of such duties. Directors can be made personally liable for the liabilities of the corporation by the Corporations Law (for insolvent trading, for example) and by other statutes such as pollution, workplace health and safety, and discrimination laws. Civil and criminal penalties may be imposed on directors. There is no express American-style business judgment rule, but one has recently been proposed.

ACCOUNTABILITY. Companies limited by guarantee must file annual reports and audited financial documents with the ASC, and this information is available for public scrutiny. Many companies limited by guarantee are exempt from income tax and are not required to file tax returns. Returns that are filed are not available for public inspection.

The accountability of boards of directors to their members depends on the constitution of the particular company. In most instances, the board is charged with the day-to-day management of the corporation, and members' only option for influencing the organization's management is to exercise their right to vote at annual elections. If members are oppressed or unjustly discriminated against, there are provisions for a court to make remedial orders against the company and its board.

TERMINATION OR DISSOLUTION. The Corporations Law provides a detailed procedure for voluntary dissolution by the members of a company limited by guarantee. Voluntary dissolution is initiated by special resolution of the members, and a liquidator is appointed to wind up the affairs of the company.

The courts have the power under the Corporations Law to dissolve companies upon application following certain specified events, such as the company's being unable to pay its debts, the company's ceasing to carry on business, or its being just and equitable to so do.

Surplus assets are distributed according to the company's constitution; usually there is a clause requiring that any surplus be distributed to a like organization in the local area. Such a clause has usually been inserted as a result of tax exemption or as a condition of receiving a license or grant. If the constitution is silent on the distribution of surplus assets, then the remaining members would share them.

POSSIBLE REFORMS. The ASC could produce informational materials especially for nonprofit companies limited by guarantee, as it has successfully done for small business, to help volunteer officeholders comply with the Corporations Law. The courts have confirmed in recent cases that the standard of a director's duty of care is not to be judged according to whether the position is remunerated and in a for-profit company or voluntary and in a community nonprofit organization. Given the increasing liability exposure directors face, this is perceived as unfair to voluntary directors. It is becoming difficult to recruit capable nonprofit directors to such positions. Unlike the situation in the United States, there is no precedent in Australia for providing volunteers immunity from civil action, and it may be politically difficult to achieve a similar legislative framework of immunity.

FUNDRAISING

All states and territories, with the exception of Tasmania and the Northern Territory, have legislation controlling fundraising or solicitation. Local government statutes and traffic and policing acts often contain provisions regulating, as a potential public nuisance, street and door-to-door solicitation of funds. Fundraising by way of charity auctions, raffles, and games of chance are regulated by state governments under separate legislation.

There is wide diversity in the form of state regulation of fundraising, with all such legislation in Australia (except in New South Wales and Victoria) being over several decades old. The legislation generally does not take account of current forms of fundraising, such as national and international television appeals, telemarketing, the Internet, or cause-related marketing. There are no reliable indications of fraudulent collections; however, these do appear to occur from time to time. Of greater public concern is the proper use of charitable funds and the cost of funds raised. There are no reliable national indicators of the cost of raising funds, and there will not be until there are accepted accounting standards related to fundraising. The Fundraising Institute of Australia, the nation's premier professional body of fundraisers, has begun professional education and accreditation programs based on American models, but there is scant other relevant education.

The form and thrust of fundraising legislation varies greatly among the states, as does its coverage (that is, which organizations it does or does not apply to). The multistate registrations and filings that must accompany a national appeal for funds can be onerous for nonprofit organizations. Government and quasi-government organizations entering the fundraising market are usually exempt from the restrictions of the fundraising provisions, which gives them an unfair advantage in securing limited donation dollars.

The efficiency and effectiveness of government regulation and policy in this area is very dubious. The rate of filed returns, their inspection, and operative staff of oversight agencies are all low, and prosecutions and proactive enforcement are rare. Government officers are hampered by inappropriate legislation and lack of resources.

The Industry Commission examined the state of fundraising regulation in Australia and recommended that some uniform scheme of regulation be agreed upon among the states. The state Attorneys General decided in 1996 to form a national working group to formulate a national response to the present situation, but progress to date has been slow. Reform of fundraising legislation will be an important step forward for philanthropy in the next few years.

TAX EXEMPTIONS

Taxes are imposed by federal, state, and municipal authorities in Australia. The federal government imposes an income tax, a capital gains tax, a fringe benefits tax, a wholesale sales tax, and excise taxes. The state governments receive a share of the taxes collected by the federal government and impose state taxes, such as land taxes, payroll taxes, and stamp duties, as well. Municipal authorities levy property taxes and service charges.

Many nonprofit organizations are exempt from the taxes, charges, levies, and other imposts of government, but there is no consistent policy on the definition or extent of such exemptions. In August 1997 the federal government announced a review of the taxation system that will look at the introduction of a broad-based indirect tax such as a "value-added tax" and at the states' taxing powers. This proposed major reconstruction of the taxation regime may well affect the tax exemptions of nonprofit organizations, especially as the usual policy stance during the introduction of a consumption tax is hostility toward any exemptions.

Federal Income Tax

The Income Tax Assessment Act (ITAA) of 1936 exempts certain classes of nonprofit organizations from income tax. It is administered by the Australian Taxation Office (ATO), which is the responsibility of the federal treasurer. The ATO has moved to a self-assessment regime, and nonprofit organizations are required to annually self-assess whether they fall within the exemption categories. However, most nonprofit organizations still apply for an "exempt status" determination by the ATO on their formation. This provides some comfort that their self-assessment is correct, as well as tangible evidence of tax exemption for other authorities that may require such evidence. There is no fee for this determination. The cost of administering the exemption for both the government and nonprofit organizations is minimized through self-assessment compared to other jurisdictions.

There is no form prescribed for income tax exemption, and application is usually made to the closest regional office of the ATO. The Industry Commission noted that the ATO regional offices appeared to arrive at contradictory decisions in some applications, and there is a certain amount of "forum shopping" among nonprofits. An application for exemption usually consists of a letter of request, a copy of the organization's constitution, details about its officeholders, annual financial information and reports, the organization's brochures and leaflets, and possibly other information requested by the ATO. The processing time of such application varies greatly, from a couple of weeks to several months depending on the regional office and the complexity of the application.

The ATO can review and audit a nonprofit body's status to ensure that the self-assessment is correct. It appears that only minor audit and review of nonprofit organizations is currently carried out. The most recent ATO audit activity has been in relation to sporting clubs that have substantial ancillary entertainment facilities, usually including gaming machines. Administrative and judicial review is available, but in the higher courts this is expensive.

The category of exemptions is fairly wide, and the exemption of all income, however derived, is generous in comparison with other taxation regimes. The categories of exempt organizations include

- Religious, scientific, charitable, or public education institutions
- Public and nonprofit hospitals
- Hospital and medical benefits organizations
- Trade unions and associations of employers
- Friendly societies
- Associations for musical, artistic, scientific, or literary purposes
- Associations for the encouragement and promotion of games or sport, including animal races
- Community service associations
- Associations for the development of Australian aviation, agriculture, pasturage, horticulture, viticulture, manufacturing, or industry
- Funds established by a will or trust for public charitable purposes or scientific research through a public university or hospital

The income tax exemption categories are somewhat artificial and difficult to reconcile. For example, an association promoting the development of mining or industry would be exempt, but a service profession association, such as an organization of surveying or insurance professionals, would not be; an association devoted to competitive fishing or ballroom dancing probably would be exempt, but a general pastime fishing club or social ballroom dancing club would not be; an organization centered on tossing a caber in a competition would probably be exempt, but one centered on tossing a gum boot or boomerang would not be. There may be an argument to follow an economic-relationship definition rather than an activity-specific definition. This would largely overcome arbitrary classifications, but it may have minor implications for the tax base.

As noted previously, the ATO has interpreted exemption of charitable trusts from income tax as being contingent on such trusts' distributing 85 percent of their income annually. This is aimed at reducing the risk of such trusts' being used for tax minimization purposes, but it has the result of preventing trusts from accumulating capital. The Industry Commission report on charitable organizations recommended that this restriction not be imposed.

Charitable trusts are further disadvantaged if they invest in shares. Recently, the government allowed companies to institute a system of tax credits on shares, eliminating double taxation for ordinary shareholders. However, the alteration discriminates against charitable trusts, which are exempt from income tax and so have no way to recoup the taxation credits.

All income is exempt, provided it is for the furtherance of the purposes of the nonprofit organization. For example, a lawn bowling club received income of $A100,000 from its lawn bowlers and $A4 million from visitors generated by entertainment and gambling facilities. So long as such income is used to further the purposes of the organization, it is tax exempt, regardless of whether the activity that generated the income is related or unrelated to the nonprofit organization's purpose. There are issues of fairness in permitting "unrelated" commercial income to be tax exempt, pertaining to both competition with for-profit enterprises and the narrowing of the tax base. This has to be considered in light of the costs of collecting the tax revenue and the effect on services delivered by such nonprofit organizations.

Australian taxation law also has a common law component that imports the doctrine of mutuality for membership associations, which states that persons cannot make a profit from themselves. Only income derived from trading with nonmembers will be subject to taxation. This is available to those organizations that do not fall within the above statutory tax exemption classifications and qualify for mutual status.

The taxation requirements are minimal in comparison with other regimes, particularly with the introduction of the self-assessment regime. No annual return is required if the organization is income tax–exempt. Several government reviews have recommended that the ATO police the tax exemption of nonprofit organizations more rigorously. The federal parliament is presently considering legislation to dissolve a tax evasion scheme involving nonprofit organizations that remit funds overseas. The extent of abuse has not been quantified.

Possible Reforms

The nonprofit sector has varied views of taxation reform. Many powerful nonprofit organizations benefit from the present situation. Some wish to keep their competitive taxation advantage. Some believe that raising such issues will prompt a legislative response that will only result in further adverse restrictions rather than the improvements sought. Others place the encouragement of philanthropy and voluntary action above competing policy issues and justify complete tax exemption on that basis. This situation does not encourage proactive lobbying on a sector-wide basis for tax exemption reform.

The Industry Commission report on charities recommended a number of reforms that have yet to be acted on by the federal government. Although the report affirmed the current policy of exempting certain nonprofit welfare organizations from income tax, it suggested a review of indirect taxes and a gradual removal of fringe benefits tax exemptions. The pending government review of Australian taxation mentioned earlier may revisit these issues.

Government financial policy officers and trade associations whose members directly compete with nonprofit organizations (such as associations of for-profit hotels, hospitals, medical services, sporting teams, and education and research services) are in consistent and increasingly vocal opposition to the retention, let alone expansion, of nonprofit taxation exemptions. This more unified and consistent source of criticism of nonprofit taxation exemption poses a threat to the presently dislocated policy stance of the nonprofit sector.

The following suggestions for reform are offered as starting points:

- *Create a standard definition of a tax exemption.* The multiple definitions of exemption from state and municipal taxes and charges create uncertainty and high compliance and administrative costs, both for the various governments and for nonprofit organizations. A common contemporary definition would be beneficial to all concerned.
- *Reform the tax exemption eligibility criteria.* The basis for income tax exemption could be improved by providing an internally consistent definition of organizations or activities that qualify for tax-exempt status. Eligibility for an income tax exemption could be extended to all nonprofit organizations, as defined by reference to an economic definition (such as a nondistribution constraint) rather than to an activity-based definition. Any organization with a general nondistribution constraint and legal purposes should be tax-exempt. The implications for the tax base would not be significant, as most nonprofit organizations outside the present definitions have small, if any, taxable incomes and generally do not comply at present anyway. (The cost of rigorous enforcement, both for the nonprofit organizations and for the ATO, would be substantial.)
- *Increase pressures on unlimited unrelated income.* The complete exemption of all of a nonprofit organization's unrelated commercial in-

come from income tax is a generous provision. This position may not be politically sustainable in the future as the nonprofit and for-profit sectors increasingly compete in a competitive market. Nonprofit organizations that are perceived by the public to be mere fronts for commercial businesses may adversely reduce the stock of goodwill that nonprofit organizations generally enjoy in the community. For these reasons, as well as the possible erosion of the tax base, it may be prudent to restrict the complete exemption of unrelated commercial income.

If the reform mentioned earlier of moving to a wider definition of tax exemption were enacted, then reduction of the tax base would be more than compensated for by the introduction of a limited unrelated business income tax. Given the complicated nature of any unrelated business income tax and the costs of administration and compliance, a substantial income threshold for the operation of the tax may be warranted. Small nonprofit organizations should still be exempted because of the regulatory and other costs involved, lack of any meaningful erosion of the tax base, and probable lack of any substantial effect on competitive markets. The threshold could be based on gross income, ratio of unrelated income to related income, or a combination of these.

- *Allow appropriate accumulation of capital.* The ATO restrictions on charitable trusts' ability to accumulate income should be amended to allow foundations to accumulate capital for charitable purposes under appropriate circumstances. Trustees who accumulate income should be required to substantiate their decision to do so according to a test of reasonable prudence.

The system of dividend imputation for fully franked shares and tax credits should be amended to allow charitable trusts to receive the full before-tax dividend. There is currently proposed legislation before the federal parliament to impose new conditions on the income tax exemption of philanthropic trusts. These conditions may adversely affect the administrative costs of such trusts and impose unnecessarily stringent distribution restrictions.

TAX DEDUCTIONS

The Income Tax Assessment Act (ITAA) provides uncapped deductibility for donations to certain specified nonprofit organizations, and donations and sponsorships may be a general business deduction for some taxpayers. Although the absence of limits on the size of donations is generous in international terms, the range of organizations and purposes for which a deduction may be claimed by a donor taxpayer is limited. As more nonprofit organizations seek to replace shrinking government community welfare grants with philanthropic gifts, the ability to give donors a tax deduction for their gift will become increasingly important.

There are two broad categories of deductions: expenses incurred by the taxpayer in producing assessable income and donations to an organization prescribed in Section 78 of the ITAA. The donation deduction is available to both individuals and corporations, on the same basis.

Business Expense

Eligibility for the business expense deduction centers on the nature of the expense rather than on the attributes of the nonprofit organization. For example, a businessperson or corporation may sponsor a sporting team in return for the team's displaying a logo. The deduction for the business would be available whether the team was organized on a nonprofit or a for-profit basis. This deduction is fairly straightforward; the main issue is whether it is an allowable deduction in the production of assessable income. The gift may be claimed even if it had the effect of placing the taxpayer in a loss situation.

Philanthropic Donations

The structure of philanthropic donations requires greater attention because of its implications for nonprofit organizations. Section 78 of the ITAA permits certain specifically named nonprofit organizations, defined types of nonprofit organizations, funds established to support specific and defined nonprofit organizations, and nonprofit organizations registered with certain governmental authorities to receive donations that will be deductible by the donors in the year of donation.

Generally, the gift must be more than $A2 and must be in the form of actual money, property, or trading stock. The vast majority of gifts are not capped at any level, although donations to political parties are capped at $A100, and cultural testamentary bequests may be capped via ministerial discretion. There are limited provisions for testamentary gifts. There are special provisions for valuing noncash gifts, which involve valuation by two independent valuers under certain conditions and are subject to the discretion of the Commissioner of Taxation. There are appeal mechanisms for disputed valuations. It is usual for written receipts to be given, although it may be possible for the taxpayer to substantiate the transaction using other means.

A testamentary bequest (donation of assets of a deceased person) to an organization can result in a capital gains tax liability for the other beneficiaries or for the philanthropic organization itself. This appears to result from inappropriate legislative drafting rather than any contemplated policy. It should be altered.

The tax deductions for Australian contributors are generous in comparison to those allowed by other regimes, as they are not generally capped and the minimum is very low ($A2). Unless there is a gift of property or trading stock involved, the administrative and compliance costs for the donor are slight. Administrative costs for the recipient (receipting and posting) can be a burden on some organizations, however, particularly for small amounts. It has been argued that the minimum threshold should be raised to an administratively feasible level.

There are substantial antiavoidance provisions under Section 78A of the ITAA that seek to prohibit any fraudulent taxation activity that may occur. In the 1996 budget speech, the federal treasurer indicated that further refinement of these antiavoidance provisions would be enacted to counter a tax scheme involving deductible donations to offshore nonprofit organizations that in various ways refund part of the donation to the donor. These proposals are presently before the federal parliament and have serious side effects for the effective administration and flexibility of such organizations.

Donee Exemption Categories

First, donation-deductibility status is available to certain organizations individually listed in the ITAA. This list has grown to several hundred over the years, the result of direct lobbying of the government to amend the ITAA. In some cases, only certain special funds of nonprofit organizations are specified, such as the building funds of schools or the research funds of a medical institute or health organization. It is very difficult to persuade the government to individually list an organization, and the list has been developed largely as a product of political expediency rather than on any rational policy basis.

Second, donation-deductibility status is also accorded to certain organizations approved by government departments. The main types of organizations are cultural and environmental. The responsible departments maintain a register of organizations that are given donation-deductibility status, subject to that department's supervision. The departments require six monthly (for cultural organizations) or yearly (for environmental organizations) statistical returns reporting gifts from registered organizations. There are also similar schemes for testamentary cultural bequests (for example, of art) to certain museums, art galleries, and similar institutions. Also, individual approvals supervised by government departments can be arranged for such bequests. Gifts of heritage properties (for example, historic buildings) to certain heritage trusts are deductible. These approvals are on a case-by-case basis and are not common for the bulk of donations under Section 78 of the ITAA.

The third major class of donation-deductible nonprofit organization is the public benevolent institution (PBI). The definition of a PBI has developed through judicial precedent. This has been, in turn, the subject of formal policy directions by the ATO. The definition of a PBI is restricted to nonprofit organizations

- That have as their main or principal object and activity the relief of poverty, sickness, distress, misfortune, destitution, or helplessness
- That are established for the benefit of a section or class of the public
- That provide relief without discrimination to every member of the section of the public that the organization aims to benefit
- That give aid *directly* to those in need

Thus the normally wide meaning of the word *benevolent* (wider than the legal definition of *charity*) is restricted by its combination with *public* and *institution* and the judicial interpretation of this phrase. "Preventative" organizations, organizations that concentrate on "advocacy," support or self-help groups, and referral agencies (those that do not provide direct aid) usually do not qualify for PBI status. In many cases the activity-based test is satisfied by establishing that PBI activities are the dominant activity of the organization. Non-PBI activities can be conducted so long as they are only minor, inconsequential activity, or related to PBI activities. Thus it is possible for a large organization that has dominant PBI purposes to also conduct minor, non-PBI activities. However, a specialized organization that only conducts those non-PBI activities would not receive PBI status. Large multifunction bodies with non-PBI secondary activities may have an edge in fundraising over nonprofit organizations that are solely devoted to a non-PBI activity due to income tax–deductibility status.

There are complex issues arising from the limitation of PBI status through its definition. PBI status is used not only for the purposes of tax deductibility but also as the gateway definition to a host of other tax and charges exemptions, which in many cases outweigh the financial benefits to the organization of received donations. The definition of PBI can be characterized as being out of step with contemporary notions of nonprofit organizations that are worthy of support through tax-deductibility status. For example, the definition as it currently stands has a bias against organizations that focus on prevention, education, and advocacy rather than "charity" in the nineteenth-century sense of remediation and alleviation.

Fourth, public funds can be established to distribute funds to organizations mentioned above pursuant to Section 78(5) of the ITAA. Such funds are unduly hampered by a requirement limiting the range of investments that they are permitted to make, and testamentary gifts are not tax deductible. Proposals for the reform of public funds presently before the federal parliament will also unnecessarily restrict the geographic location of their activities and the bodies that they may fund without losing their tax-exempt status (refer to the previous section). Although self-assessment principles would apply to the adoption of PBI status, it is common practice to seek a written opinion from the ATO to confirm PBI status. This is done to avoid a situation in which donors have relied on a nonprofit organization's erroneous self-classification.

The ATO's administration of these provisions has been criticized by a number of government and Industry Commission reports for lack of supervision. They have all recommended that greater supervision of such organizations be exercised by the ATO. The extent of this abuse does not appear to have been quantified. Reforms before the federal parliament at present focus not on ATO proactive enforcement but on placing blanket, indiscriminate restrictions on all philanthropic trusts.

Possible Reforms

The definitions of eligibility for donation deductibility status, particularly for PBIs, require clarification to make them more comprehensible to the public, more just, and more in accord with contemporary notions of social policy. The use of the term *public benevolent institution* for exemption purposes by state and municipal governments and by the federal government for sales tax and fringe benefits tax exemptions replicates these inequities throughout the whole nonprofit sector in Australia.

At the very least, an ad hoc broadening of the definition of PBIs should be considered to include preventive, research, policy development, information coordination, and welfare advocacy bodies that provide clear social benefits to the Australian community. This would redress the unsustainable and artificial divisions now being perpetrated between PBI and non-PBI institutions.

A more radical reform would be to take an entirely fresh approach to the definition of tax deductibility. The question to be asked is, "What organizations should the state favor with an indirect taxation transfer, and how this should be achieved?" Some suggestions to begin such a debate are canvassed below.

Assuming that tax deductions amount to forgone state revenue (and even this is seriously contested), who should receive this money? Does the state address the issue in terms of the costs saved by encouraging nonprofit organizations to engage in certain activities? Some contemporary examples may be donations to organizations that replace or supplement goods and services usually supplied by the state (for example, education and health care organizations) or to organizations that help the state meet articulated national goals (such as improved Australian exports, a more competitive labor market). Other suggestions include a rebate scheme to promote greater tax equity among taxpayers; a more functional definition, linked to the current needs of the contemporary Australian community, to foster better value for the government's taxation transfer; and a scheme linking donation deductibility status to approval and supervision by a relevant government department, to improve accountability. Should the state concede that donors are in the best position to make a judgment about what are worthy activities? Statutory tinkering with the definition may produce unintended consequences that could adversely affect philanthropy; any revisions require careful consideration.

Does the state take a wider view, that a healthy "civil society" is important to the social well-being of Australia, and thus it should encourage philanthropic behavior? If so, where are the boundary lines of civil society, or how does one prioritize what is more "civil" in a distribution of scarce forgone tax revenues? Can the state be left to administratively determine who it should favor, or should that be left to donors or determined through a broad definition interpreted by independent institutions?

A detailed discussion of the alternatives goes well beyond the scope of this chapter, but a process should be devised for the community and politicians to engage in an informed debate about this issue. This needs to be supported by accurate statistical analyses of philanthropic behavior in Australia and by ensuring that technical legal drafting issues do not confound important social policy issues.

CONCLUSION

Australia's heritage of English precedent and laws provided a sophisticated and substantial basis for the development of the law and regulation of nonprofit organizations. Australian jurisdictions adopted from this tradition the legal form of the charitable trust, the definition of charity, the unincorporated association, the company limited by guarantee, various special act and charter forms, and fundraising regulations. The judicial precedent that accompanied these forms was at the time large and sophisticated. For various reasons, the regulatory structure of the Charity Commission of England and Wales was not adopted on a federal basis, and only very pale imitations exist in the states and territories.

Having this treasure trove of laws has meant that some of the English provisions have been copied without much scrutiny of their appropriateness for the Australian legal environment or social condition. The large amount of English precedent (although now persuasive, rather than binding in effect) has not been built on by Australian courts vigorously enough in the last two decades to keep pace with changing social conditions. The costs of altering a precedent through the Australian judicial system are prohibitive for most nonprofit organizations. Even if legal assistance is available, most charities are reluctant to risk tarnishing their image by becoming involved in judicial proceedings unless absolutely necessary. In England, despite some contemporary judicial precedents, the Charity Commission is able to advance precedents quasi-judicially, especially in relation to the definition of charity. This is achieved through policy statements and determinations. There is no similar body that performs such a function in Australia. Australia has, however, pioneered the establishment of a corporation statute specifically for nonprofit organizations, known as the "incorporated association," which is only now being considered in the English jurisdiction. The mix of law sources or influences does not need a radical revision but may benefit from some fine-tuning and will inevitably become more distinctively Australian over time.

The federal nature of the Australia system of government creates a number of diverse jurisdictions. The lack of coordination of the laws in the differing states is starting to lead to a number of problems for nonprofit organizations. Nonprofit organizations that operate in more than one state face multiple and sometimes conflicting regulations and duplication of costs. It is also structurally inefficient for a nation of just nineteen million people to have eight state or territory jurisdictions, a commonwealth jurisdiction, and a layer of local government. The politics of achieving reform of nonprofit statutes is made difficult by the lack of priority it receives from all levels of government. The Industry Commission report, which reviewed many aspects of charity regulation in 1995, still has not been formally responded to by governments in any meaningful way. Significant law reform usually occurs as a reaction to a public fraud involving nonprofit organizations or alleged taxation abuses.

It is likely that the regulation of nonprofit organizations, which is largely fragmented between states and territories, will be harmonized if not centralized in the coming decade. This might be achieved through a nationalization of legislation through commonwealth laws or by agreement between the states to adopt almost identical legislative provisions. This is already happening in high-priority microeconomic reform areas, such as commercial statutes and regulation.

The announced review of the taxation system by the federal government may pose a challenge to the exemption of many nonprofit bodies from income tax and particularly from any broad-based indirect tax. Nonprofit organizations are receiving increased opposition from their marketplace competitors about their tax exemptions. The multiplicity of exemption definitions present in all levels of legislation require rationalization to reduce administrative costs and promote a rational public policy environment. It is important that the harmonization of such definitions advance, rather than restrict, philanthropy and voluntary action.

Many organizations are seeking to obtain philanthropic gifts to replace other dwindling income sources. Tax deductibility of donations is an important incentive. The restrictive definitions of eligible organizations—which are often based on quaint, outdated notions of social benefit—should be reformed to suit contemporary values. This process should be concerned with unlocking the positive virtues of philanthropy and voluntary action for the Australian community rather than with recovering "foregone tax revenue."

In comparison with some countries, Australia has a fairly stable legal and regulatory infrastructure for nonprofit organizations. This is due in part to the inheritance of English laws and the stable social and political environment enjoyed to date in Australia. Australia's challenge is to refashion its laws and regulations so that they facilitate philanthropy and voluntary action in a manner consistent with Australia's changing culture.

3

CHINA

Xin Chunying
Zhang Ye

THE PEOPLE'S REPUBLIC OF CHINA (PRC) was founded in 1949 as a socialist country with a civil law system. The civil law system was first introduced to China in the late nineteenth century, when China learned the German civil law model from Japan. To explain the legal context of the PRC today, however, we must review the events that actually laid the foundation for China's current legal system.

The victory of the Chinese People's Liberation War in 1949 marked the end of the old era. Before the founding of the PRC, the Communist Party of China announced that all the laws made by the Kuomintang government should be abolished because they were oppressing the people. New laws and regulations would be enacted, and a people's legal system would be established to protect people's rights and interests. Thus the legal system of the PRC was formulated on the basis of an absolute rejection of the old legal framework. During its early legal construction, China took the former Soviet Union as its model, stressing strict social control and a highly centralized planned economy as the foundation of its socialist system.

Although Western references were excluded in the formation of the post–1949 Chinese legal system, Chinese nonprofit organizations (NPOs) first developed amid an inflow of Western civilization. Early in the twentieth century, the Self-Strengthening Movement provided a great impetus to the development of Chinese industry. At the same time, it enhanced the spread of democracy and gave rise to social pluralization. Organizing social groups became a major activity of political advocacy forces, through which progressive intellectuals disseminated Western democratic ideas and sought ways to bring about social transformation. The Interim Constitution of the Republic of China, issued after the 1911 Revolution, granted citizens the rights of association, expression, and publication, thus providing legal protection for the development of NPOs. This favorable situation led to the flourishing of Chinese NPOs in the early decades of the twentieth century.

Of all the NPOs, the chambers of commerce played the most active role. In 1914, the National United Chamber of Commerce was established. In 1931, the Chinese National United Chamber of Commerce joined the International Chamber of Commerce. Women's groups, such as the Free Bound Feet Association, Women's Studies Charity Federation, and Society for Women's Independence, were also active. They expanded their focus from women's issues to China's national destiny.

After the founding of the People's Republic of China, the Interim Provision on the Registration of the Social Organizations was adopted, on October 19, 1950, to regulate existing NPOs and put them on a socialist course. This laid the foundation for future legislation governing NPOs. The Interim Provision turned for guidance to the Common Program of the Chinese People's Political Consultative Conference, which emphasized citizens' rights as well as punishment of counterrevolutionaries. For example, it stated in its fifth article that "Chinese citizens have the right to enjoy freedom of association," but its seventh article indicated that "the People's Republic of China must suppress all counterrevolutionary activities . . . . For all the reactionaries, feudal landlords, and bureaucratic capitalists, after being disarmed and deprived of former privileges, should be deprived of their political rights when necessary. But they should be allowed to make a living and to be rehabilitated through forced labor. If they continue the counterrevolutionary activities, they must be severely punished." Under this principle, the Interim Provision promulgated clearly in its fourth article that "all counterrevolutionary organizations that threaten the state security and the interests of the people should not be allowed to incorporate. Those already incorporated and found engaged in counterrevolutionary activities should be discontinued and dissolved."

The process of registration was thus also a screening process to help the government eliminate those organizations that ran counter to its socialist values. In the name of "multiparty cooperation under the leadership of the Chinese Communist Party," nonmainstream political organizations were not allowed to exist. Some NPOs were labeled "feudalistic" or "reactionary" and were banned altogether. Some NPOs with a stronger political orientation were transformed into "democratic parties," separated from other nonpolitical social organizations and absorbed into the existing political system, losing their independent political identity. The same thing happened to some nonpolitical organizations. The once-prevailing notion that socialism represents the ultimate interests of the working class made a separate representative group for workers unnecessary. The Trade Union, for example, eventually became a government organization that received funds from the state and helped the government take care of workers' social welfare. The Peasants' Union became even less useful after the land reform initiated in the early 1950s. It simply stopped functioning after the People's Commune System formed in 1958.

The registration and management of NPOs in the People's Republic of China became the legal responsibility of the Ministry of Internal Affairs. Registered social organizations were divided into the following categories:

1. Mass organizations engaged in social activities, including the Trade Union, the Peasants' Union, the Federation of Industry and Commerce, the Women's Federation, and the Youth League
2. Organizations for public services, such as the China Welfare Association and the Red Cross
3. Art and literature groups, such as the Art and Literature Association and the Theater and Drama Association
4. Academic research organizations, including such professional organizations as the Medicine Association and the Social Sciences Workers' Association
5. Religious organizations, such as Christian and Buddhist groups
6. All other social organizations recognized by law

In the thirty years from the 1950s to the end of the 1970s, the Trade Union, the Youth League, and the Women's Federation were further centralized and politicized under the Communist Party's leadership. They expanded more quickly than did other kinds of NPOs and became in reality peripheral organizations of the Party. The Trade Union and Women's Federation became "assistants of the Party," and the Youth Federation became both "the assistant and the reserve of the Party." During this same period, other NPOs faced a more difficult situation. In fact, authentic NPOs in China stopped functioning after 1958. The implementation of regulations concerning NPOs was brought to a halt as well. The Cultural Revolution in the 1960s and 1970s led to enormous chaos in China. As a result, no new social organizations were established during these years, and most of the existing ones were closed down, accused of being counterrevolutionary. To serve the government's needs in international relations at that time, the Chinese Medical Association, the Women's Federation, and other, similar organizations played an important role in maintaining relations with the United States, Japan, and other Western countries in the Cold War era, providing an open channel for people-to-people contacts.

Constitutionally, China's political system is unitary and highly centralized. In such a centralized society, public and private spheres are never clearly distinct. This state of affairs provides little room for nongovernmental organizations (NGOs) to exist. Especially in the prereform era, public ownership of organizations—with the government monopolizing all resources—did not allow NPOs independent access to financial and other resources. Thus independent NGOs were impossible. The rigid vertical administrative structure of the government grew into a comprehensive social order. Citizens' identities were based on their work assignments, and the government supervised citizens' behavior and provided a social safety net. This situation left little opportunity or incentive for citizens to create social organizations outside the government structure. In that context, the NGOs and NPOs that existed were not pure citizens' groups, independent of the government. Indeed, they were given the responsibility of carrying out some of the Party's and the government's policies. Chinese NGOs and NPOs served as intermediaries between the political system and civil society or as supplements to government bodies.

The reforms and opening-up policy initiated toward the end of the 1970s have brought about great changes in Chinese society. In the economic arena, the traditional centralized planned economy has gradually been replaced by a socialist market economy. In the early 1980s, for example, the policy of separating the government from enterprises transformed centralized, direct control over enterprises to indirect control. As the state's direct role in the economy has declined, so has the state's share of GNP. Today, the state accounts for less than 40 percent of GNP. Conversely, nonstate enterprises have grown rapidly. This economic transformation has been mirrored in the reform of the social welfare system, which has restructured the role of enterprises and government institutions. China's decentralization process during the reform period has eroded the central government's ability to meet societal needs. The central government's share of fiscal revenue has declined from 31.2 percent of national income in 1978 to about 10 percent in the 1990s.

Given this diminished financial capacity, the central government must now rely on other sources of funds to respond to all kinds of needs, thus changing the relationship between the state and society. Social responsibilities have to be shared by the government and the social groups. Economic and social changes have led to the pluralization of interests and encouraged the formation of different interest groups. These changes have created demand and space for the development of a different form of NPO sector than what existed between 1949 and 1978. Today NPOs are seeking legal status and ways to protect their own activities. Hundreds of thousands of NPOs have been set up in recent years, both to take advantage of the opening up of society and to respond to society's increasing demands.

Legal reforms resulting from this economic development have also contributed to decentralization. In the past, legislative power had been kept in the hands of the central government. Since 1979, China has developed a multitiered legislative structure to cope with the increasing demand for legal guidance and the lack of legal principles undergirding China's transition from a planned economy to a market economy. Under the overall legal framework provided by the Chinese Constitution, basic laws are approved and passed by the National People's Congress and its Standing Committee. At the same time, the State Council has the power to issue administrative regulations that provide guidance for the implementation of laws and for regulating state administrative procedures. The people's congresses at the provincial and autonomous-region levels also have the power to enact regulations for their jurisdictions. Usually after a new law is enacted by the National People's Congress, each province drafts its own implementing regulations. Finally, the ministries, provinces, capital cities, and major cities have the power to issue certain rules. The rules issued by the ministries guide the work and activities of certain sectors. Local rules provide guidelines for particular geographical areas.

In the last twenty years, more than three hundred laws have been passed by the National People's Congress, about three thousand administrative regulations have been issued by the State Council and by ministries, and more than four thousand local regulations have been adopted by local authorities. Of all Chinese laws and regulations, the local regulations play the greatest role in day-to-day life. They tend to be more practical and less ideological. Even though regulations governing

NPOs and NGOs cannot be issued by local authorities, the implementation of these regulations at the local level is indeed more flexible. For example, of 180,538 registered NPOs and NGOs at the end of 1995, 102,215 were registered at the county level, accounting for 57 percent of the total number.

China is slowly moving from a society of rule by men to one of rule of law, and more work is needed both in lawmaking and law enforcement. Even though the amount of legislation in China keeps growing, many aspects of Chinese society operate without a legal framework. Moreover, the existing laws and regulations sometimes contradict one another. Law enforcement remains the biggest problem, often because of officials' intervention and the lack of legal literacy among the people. It is against this background that Chinese NPO laws and regulations evolve. Finally, China's lack of a civil society tradition and the government's emphasis on social stability make legislation on NPOs more difficult and sensitive than other laws. The government's attitude toward and management of NPOs is often circumscribed by the Chinese domestic situation, the government's interactions with other countries, and its leadership's decisions at any particular moment.

On top of this complex background, Chinese NPOs or NGOs also have some distinctive "Chinese characteristics" that can be confusing even for Chinese. The character of Chinese NPOs is the result of both the changing functions of the government and the development of market forces.

THE NATURE OF CHINESE NGOS AND NPOS

The concept of NGOs or NPOs is new in China. However, China has a long tradition of charity. Charitable activities existed for centuries within communities, clans, and kingships, and the same activities persist today. The 80 percent of the population living in China's rural areas have never been reached by China's social safety net. Apart from the government's special relief funds for the poor and handicapped, community mutual assistance has always helped people survive temporary economic difficulties. Throughout Chinese history, there have always been local charitable schools, farmland, and temples managed by communities, village heads, or religious groups.

However, the word *charity* in Chinese does not imply a distinct philanthropic sector with legal protection and a well-established social infrastructure to guarantee the delivery of social services to needy people. In Chinese, *charity* means "mercy" and "benevolence," emphasizing goodwill and generosity rather than entitlements. Traditional Chinese charity emphasizes mutual help and personal relationships. These concepts reflect Confucian and Buddhist beliefs in benevolence, righteousness, ritual, order, and loyalty and a rigid social hierarchy that defines love and loyalty according to personal relationships. Chinese people are not used to giving money to strangers, and giving money to an intermediary organization to manage and use on their behalf is even less familiar. These traditional Chinese concepts of charity help to account for the absence of an independent NGO sector in China.

In China, NGOs are usually defined as "social organizations," meaning organizations that are not directly part of the government. According to current Chinese laws and regulations, social organizations can be divided into two categories. The first category includes mass organizations engaged in economic activities that seek commercial profit. Those social organizations must register with the Bureau of Industry and Commerce. The second category, according to the Regulations on the Registration and Management of Social Organizations (promulgated by the State Council in 1989), includes those "associations, societies, federations, research societies, foundations, leagues, progress organizations, business associations, and other social organizations organized within the territory of the People's Republic of China." According to the Regulations, "social organizations may not engage in business activities undertaken with the purpose of making a profit." These organizations, according to the Regulations, must register at the Ministry of Civil Affairs or its local offices.

The term *nonprofit* is also confusing in the Chinese context, as it has a different meaning in China from that in Western societies. Because of China's centralized system from 1949 to 1978 and the government's monopoly over all resources, almost all institutions, both for-profit and not-for-profit, were basically run by the government. In Chinese terms, "NPOs" include schools, research institutions, hospitals, and social welfare organizations run and funded by the government. However, since 1979, with the progress of China's reforms, organizations with different kinds of ownership, management, and funding structures operating outside the main government structure have rapidly multiplied. Nonetheless, Chinese NGOs and NPOs should not be understood as the equivalent of those in Western countries.

Currently, the distinction between for-profit and not-for-profit, governmental and nongovernmental, remains blurred. This situation is due to three factors. First, the laws and regulations are far from complete—there are no clear guidelines governing NGOs. Second, what limited laws and regulations there are have not been enforced effectively. They are not regarded by the public as authoritative, legal, or binding. Third, the rapid speed and dynamic energy of China's social and economic transition creates space and opportunities for events and activities to take place without having legal protection or a regulatory framework.

As of the end of 1995, a total of 180,538 official NPOs and NGOs were registered with the Ministry of Civil Affairs or with local civil affairs departments. These NGOs and NPOs represent different types of organizations, ranging from quasi-governmental to distant governmental to relatively independent entities. As noted earlier, some NPOs and NGOs are registered with the Departments of Industry and Commerce as commercial entities. These are usually organizations initiated by individuals that cannot find parent institutions or that have been rejected or revoked by the civil affairs departments. They end up registering with the Bureau of Industry and Commerce and pay a certain amount of taxes. But these organizations would qualify as NPOs by any world standard. They are independent, in terms of both finance and management, of any government institution. Their social service activities rely primarily on foreign and domestic donations. They have no commercial activities. Currently, there are many of these organizations at the national and the grassroots levels.

A large majority of NGOs or NPOs are not registered or are not allowed to register but are nonetheless active in their communities. Those organizations are usually engaged in community-based, educational, cultural, and social welfare activities. In South China, for example, there is a revival of the traditional charitable practices based on clans, kingships, and dialects. In Guangdong Province, people from Taishan counties and the Kejia clan often organize their own county folks associations. Since many overseas Chinese are of Taishan and Kejia origin, their network has spread to almost every corner of the world. People donate millions of dollars through their county folks associations for the development, social welfare, and education of their hometowns. These associations usually have boards of trustees, secretariats, and accountants. In the same counties, some distinguished personages also run family-based foundations to support the education, for example, of the Wang family or the Li family. These organizations play a very important role in education and social services in the localities and usually have good relations with the local government. Nonetheless, at the current stage many of them are unrecognized by the government and could even be regarded as illegal.

Chinese society is indeed increasingly open, and more and more organizations are performing social services outside the government structure. Hence, there is a need to accord legal recognition to these organizations as well as to expect an accurate accounting of their activities.

In this chapter, "Chinese NGOs or NPOs" refers to those societies, associations, foundations, centers, and groups that are working outside the main government structure, though some may be affiliated with government line agencies. They are financially independent, although their staff salaries may be paid by government agencies. They are doing not-for-profit work such as social services, poverty alleviation, scientific research, art and cultural activities, education and training, environmental protection, and protection of women's and children's rights. Despite all the differences between these organizations and NGOs in other parts of the world, their activities are similar. Therefore, for comparative purposes, this chapter uses the terms "NPO" and "NGO" in referring to "social organizations" in China.

Currently, three administrative regulations directly govern the practices of Chinese NPOs. There may be as many as fifty other decrees, circulars, and regulations that have some bearing on NPOs. The three sets of administrative regulations are the Regulations on the Registration and Management of Social Organizations, the Regulations on the Management of Foundations, and the Interim Provisions for the Administration of Foreign Chambers of Commerce in China. Thus far, the existing legal documents governing NPOs and NGOs are all at the level of administrative regulations drafted by different government departments. These regulations provide only broad guidelines for the activities of social organizations. They are far from being sufficient, in that they do not provide concrete legal definitions to Chinese NGOs and NPOs. Also, different regulations give different directions.

The three sets of regulations were adopted in response to the development of social organizations since the beginning of the reform process. The Ministry of Civil Affairs was set up in 1978 to take charge of, among other things, the management of the social organizations. However, the Ministry's work on NGOs did not really start until the 1980s. In 1984, the Central Committee of the Communist Party and the State Council issued Document No. 25, which states that every NGO shall be affiliated with a government line agency in its professional field and shall be reviewed and supervised by the State Commission for the Restructuring of the Economic System. This policy failed to give clear guidelines. As a result, every Party or government department had the power to set up NGOs. Some NGOs even set up subbranches or separate NGOs as well. Some government organizations that were threatened by the government's streamlining turned themselves into NGOs. Other government agencies simply juggled two names, operating as both a government body and an NGO. Some local NGOs were set up to absorb the surplus labor dismissed from government units or to provide retired cadres with a base for unofficial activities. The lack of clear legal guidelines caused tremendous chaos, both for NGOs and for the normal functions of government agencies.

To improve the situation, the State Council in 1988 made it clear that the Ministry of Civil Affairs would be the responsible organization for the management of NGOs. In the same year, the Department of Social Organizations was set up in the Ministry of Civil Affairs specifically for the purpose of managing NGOs. The Regulations on the Management of Foundations, enacted on September 27, 1988; the Regulations on the Registration and Management of Social Organizations, promulgated on October 25, 1989; and the Interim Provisions for the Administration of Foreign Chambers of Commerce in China, adopted by the State Council on April 28, 1989, provide at least basic guidelines for the management of the NGO registration procedure and NGO activities.

REGISTRATION

In China, as in most countries, the establishment of social organizations is based on the prerequisite of legal registration. According to Chinese laws, a social organization must register to gain tax and other benefits. NGO management in China is based on two tiers: affiliation and registration. To be registered, a social organization must first be affiliated with a government line agency. Such linkage can occur when a government agency takes the initiative to set up an association or foundation to supplement its role. Or a group of people, interested in a particular task and with funds to do the work, can approach a government organization whose work is similar to their interests and seek support and protection. With the support and approval of a line agency, a social organization can then apply for legal registration. National social organizations must register with the Ministry of Civil Affairs. Local social organizations should register with their local departments of civil affairs. Cross-regional social organizations should also register with the appropriate department of civil affairs.

China's registration system provides for three types of registrations: registration of association, registration for alteration, and registration for termination.

• *Registration of Association.* A social organization must meet certain standards to be registered. First, the establishment of a social organization must be in conformity with the Chinese constitution and other relevant laws; it must not harm the sovereignty and public security of the country; it must not endanger the public order, social morality, or the legal rights of others; and it must not damage the unity among China's various nationalities or harm friendly relations with people of other countries. Second, a social organization should be necessary for the advancement of work in a particular field. Its members should be real experts in the particular field and should be able to represent China in international nongovernmental exchanges. Third, the staff of a national social organization should reach a certain size and should have professional skills. A national organization's members should come from all over the country, not from a single region or department. They should be able to cooperate with staff of all walks of life and organizations of all kinds. The scope of the organization's activities should not be limited by the geographical location or the host institution's responsibilities. Fourth, a social organization should be an independent legal entity, with its own civil rights and legal liability.

Registration as an association is usually the first step for a social organization before it can carry out its activities. The registration procedure starts with the application and submission of the following documents and information:

1. The application to register, signed by the responsible person of the social organization. The reasons for setting up the organization should be stated.
2. The examination documents issued by the responsible professional authority.
3. The organization's charter, listing the name of the organization, its purpose and objectives, the qualifications required of its members, its organizational structure, the selection procedure for its leaders, the terms and responsibilities of its leaders, its funding resources and financial management plans, and its procedures for amending its charter and terminating its activities.
4. The address of the office or contact address, together with a rental agreement from the landowner.
5. The name, age, address, and resume of the head of the organization.
6. The number of staff and financial sources, with a relevant statement of financial credibility.

Within thirty days of receiving the application, the registration agency is expected to respond to the applicant in writing. The process can be extended if the required documents are incomplete. When the registration process is completed, a social organization that meets the requirements for becoming a legal person (legal entity) must be granted a certificate of legal person registration. Those not qualified to be legal persons are given a certificate of registration only. Registered social organizations are announced by the registration agencies in the newspapers.

Social organizations whose applications are refused can go to a higher level of the registration agency for review. At the local level, social organizations can appeal to the Department of Civil Affairs within ten days after receiving the rejection. The Department of Civil Affairs must respond to the appeal in writing within thirty days and file the appeal with the local government of the same level. At the national level, the applicants can go to the Ministry of Civil Affairs for review within ten days after being rejected, and the Ministry of Civil Affairs shall respond in thirty days and file the case at the State Council.

- *Registration for Alteration.* A social organization may wish to change its name, legal representative, leaders, or address and contact address. When such changes occur, the social organization applies for registration for alteration at the same registration agency within ten days after the change is made. The Department of Civil Affairs provides forms for alteration and registration of legal representatives.
- *Registration for Termination.* This procedure is discussed later in the chapter, under the heading of dissolution and termination.

These provisions apply to all NGOs and NPOs. Certain types of NGOs and NPOs must also meet other specific requirements.

Foundations, in addition to having a line agency as its host institution, must also have the approval of the People's Bank of China before registering with the Ministry of Civil Affairs. Local foundations must go through the same procedure at the local People's Bank branches and civil affairs departments. In addition, foundations must meet the following requirements:

1. They must be nonprofit social organizations with funds from voluntary donations from Chinese and foreign social organizations and other institutions.
2. They must have an endowment of no less than RMB2,100,000, equivalent to U.S.$262,500.

3. They must have their own charter, management board, and accountants.
4. They must have permanent office space.

A foreign chamber of commerce must first get the approval of the China International Chamber of Commerce, which submits an application on behalf of the foreign chamber of commerce to the Ministry of Foreign Trade and Economic Cooperation (formerly the Ministry of Foreign Economic Relations and Trade) for examination. After these clearances are granted, a foreign chamber of commerce can apply for registration at the Ministry of Civil Affairs. A foreign chamber of commerce must meet the following conditions:

1. It must be a legally incorporated nonprofit organization, set up within Chinese territory by foreign commercial establishments and with personnel in the Chinese territory.
2. It must not engage in any business transactions.
3. It must have a charter reflecting the common interests of its members, a certain number of founding members and a governing body, a permanent office space, and a legal and stable source of funding.

The management of religious groups is also different from that of other organizations. Chinese religious social organizations are under the leadership of the State Council Bureau of Religious Affairs. A national religious social organization, after getting approval from the State Council Bureau of Religious Affairs, applies to the Ministry of Civil Affairs for registration. A local religious social organization correspondingly first gets approval from the local department of religious affairs before registering at the local department of civil affairs. At the same time, the local department of religious affairs refers the case to the next-higher religious affairs department. A religious social organization must provide the following information for registration:

1. The name of the organization and the name and address of the person responsible for it
2. A charter that conforms to the Constitution, laws, and regulations of the People's Republic of China

3. The organization's regular sources of funding
4. The organization's religious doctrine, scriptures, and historical background (provided in writing to the religious affairs office)

Finally, a religious social organization must have broad representation among the people.

The Bureau of Industry and Commerce, in addition to being responsible for the registration and management of commercial enterprises, also manages service-oriented organizations. The Regulations on the Registration of Enterprises state that privately funded organizations "engaged in public work, health, sports, social welfare, education, art and literature, TV and broadcasting, scientific research, or technical services can register at the Bureau of Industry and Commerce as enterprises." As commercial entities, these social organizations do not require parent institutions. The registration process is also much easier. Those registered at the Bureau of Industry and Commerce are considered enterprises or business entities, even though they are engaged in NGO and NPO work. They must register with the Tax Bureau as well to get a business license. Organizations with a registration deposit smaller than RMB300,000 (U.S.$36,000) are considered small businesses and are required to pay a business tax of 5 percent of their total business turnover receipts per month.

Under existing laws and administrative regulations, some social organizations do not need to register. These organizations include officially recognized political parties, trade unions, federations of industry and commerce, and foundations set up by the government to support scientific research.

Analysis

The registration procedure in China is not only a formality but also a management process. In theory, registration is widely available to the public. However, the implementation of registration regulations fluctuates with the political climate. The process may be tightened or loosened as the government seeks to balance protection of citizens' freedom of association with maintenance of social stability.

The current registration regulations emphasize control. All NGOs must be affiliated with government line agencies and meet other conditions. This makes it difficult to establish and operate independent, autonomous organizations. Social service–oriented organizations without strong government backing are unlikely to be registered.

The two-tiered management structure is confusing and inconsistent. Since the regulations are drafted by different departments of the government, which may have conflicting interests, some regulations contradict or overlap with others. The fact that so many government agencies are designated to take charge of different types of social organizations creates loopholes and confusion. Since many national NGOs organize subsidiaries and branch organizations, it is difficult for both line agencies and the Ministry of Civil Affairs to keep track of all the NGOs.

Enforcement of these regulations is also a problem. This is not only because China is not yet a law-based society but also because the laws and regulations are ambivalent. For example, on the one hand, the regulations require all NGOs to be associated with government line agencies. On the other hand, the regulations prohibit incumbent government officials from being leaders of NGOs. Because of these ambiguous conditions, and despite the regulations' prohibition, the leaders of major NGOs or NPOs in China are either incumbent government officials or retired government leaders. This causes confusion for NGO management and operation.

Recommendations

China needs consistent laws governing NGO registration. NGOs should be allowed to register as independent legal persons that bear legal liability independently. The current two-tiered management system should be changed. Either a single agency should be responsible for registration, or the rules and regulations should be made uniform throughout all government departments.

Laws should be designed to facilitate rather than inhibit registration. At the same time, China's monitoring system should be strengthened to regularize the work and activities of registered NGOs. Laws and regulations should provide clear, specific guidelines for the management of NGOs.

REQUIRED, PROHIBITED, AND LIMITED PURPOSES AND ACTIVITIES

The third article of the Regulations on the Registration and Management of Social Organizations specifies that "social organizations must obey the Chinese Constitution, laws, and regulations; should uphold national reunification and national unity; and should not conduct any activities that are detrimental to the national, social, and collective interests or in violation of other citizens' legal freedom and rights." The fourth article indicates further that social organizations should not conduct any for-profit activities. Relevant laws also prohibit social organizations from conducting activities that are not clearly defined in their charters.

The Regulations on the Management of Foundations stipulates that foundations "through the use of funds are to promote the development of scientific research, culture and education, social welfare, and services in the public interest." It also states in the fifth article that "currently serving government personnel may not concurrently hold leading positions in foundations." Foreign chambers of commerce, according to the Interim Provision for the Administration of Foreign Chambers of Commerce in China, should "promote trade and economic and technological exchanges between their members and Chinese counterparts and facilitate their research in and discussions about the development of international trade and economic and technological exchanges."

Analysis

There is great demand for social services in China, and the current regulations do allow citizens' groups to take part in providing them. Although the regulations discourage political advocacy, they do not specifically prohibit issue-oriented advocacy. In fact, NGOs engaged in environmental protection and women's and children's rights are playing an active role in Chinese society today. Chinese laws and regulations are so abstract that there is always room to get around them. Current regulations governing NGOs do not conform to China's reality, making them difficult to implement. For example, existing regulations do not allow NGOs and NPOs to engage in commercial business. But since most NGOs cannot survive without conducting some kind of for-profit activity, most registered social organizations do engage in business. Many NGOs and NPOs set up subsidiaries to run enterprises, hotels, restaurants, and entertainment facilities and use the proceeds for their non-profit activities. These subsidiaries sometimes register with the Bureau of Industry and Commerce and pay business tax. However, there is no clear guideline governing the commercial entities run by NGOs. Current regulations do not include any prohibition against deriving personal economic benefit from NGO and NPO activities. However, the supervising agencies monitor NGO and NPO activities closely, and penalties can be imposed through administrative means. Without clear, consistent regulations governing NGOs, NGO staff do not have sufficient legal guidance, and supervisory agencies have considerable leeway in exercising their powers.

Recommendations

It is crucial to give NGOs and NPOs a consistent legal status, with clear definitions of for-profit and nonprofit organizations. Laws and regulations must provide clear rules regarding commercial activities and personal benefit. NGOs and NPOs should be authorized to engage in for-profit activities when the purpose is for public benefit.

TAX EXEMPTIONS

China does not yet have a separate law governing taxation of NGOs. Nor do the relevant tax laws give special tax status to NGOs per se. In the tax law framework, there are six taxable categories. Since NPOs do not fit into any of them, in practice not-for-profit activities are not subject to paying taxes. The Bureau of Industry and Commerce also gives not-for-profit organizations registered at the Bureau of Industry and Commerce the legal status of social service organizations, which enjoy some preferential tax treatment.

The National Tax Bureau is in charge of taxation. Whether or not an organization is subject to paying taxes depends on where it is registered. Organizations registered at the Ministry of Civil Affairs usually do not pay tax. Those registered at the Bureau of Industry and Commerce, depending on the nature of the organization and its registration fees and size of profit, may pay different kinds and amounts of taxes. Social service–oriented organizations may also be exempt from value-added taxes.

The commercial subsidiaries of NGOs are in principle subject to paying taxes. However, the actual taxation of these NPO-run undertakings varies depending on local policies and specific cases.

According to the Customs Law, donations from foreign organizations can also be exempt from tax. For example, the law specifies that "the gifts given to foundations by foreign organizations can be exempt from tax. The donations shall belong to the foundations and can be used for social welfare purposes, but shall not be used for commercial benefit."

Analysis

China's taxation system is both incomplete and complicated. The existence of different forms of ownership makes a unified taxation system impossible. For example, there are state-owned enterprises, collectively owned enterprises, joint ventures, and private-owned enterprises. They are all subject to different types of taxes. And at the same time, the central government and local governments collect different types of taxes.

China's tax laws primarily cover the commercial sector. There is very little legal guidance on how NPOs can be exempted from paying tax. The tax laws give little incentive for corporate and individual donations to NGOs and NPOs. The blurred boundaries between nongovernmental and governmental organizations and between nonprofit and for-profit organizations also make tax enforcement difficult. The absence of appropriate tax incentives is a major obstacle to NPO development, as it prevents NPOs from getting contributions, both from within China and from abroad.

Recommendations

Enabling tax laws are essential to the healthy development of NPOs. Chinese tax law should provide tax-exempt status to NGOs and NPOs and guide their commercial activities. To encourage corporate giving, tax exemptions deductions for corporate and individual contributions should be provided by law.

TAX DEDUCTIONS OR CREDITS FOR CONTRIBUTORS

Before 1997, there were no written rules in China on tax deductions or credits for contributors to NPOs. In March 1997, the Ministry of Finance and the National Tax Bureau jointly issued a document stating that corporate charitable giving to cultural affairs may be deducted against taxes, up to a ceiling of 3 percent of total profits.

In practice, major corporate donations mobilized by the government often receive some sort of tax deduction. Some programs, like natural disaster relief or Project Hope (a program supporting poor children's education, conducted by the China Youth Development Foundation), are usually launched by the major foundations in collaboration with government agencies. These efforts are often supported by the local governments as well as by the departments of industry and commerce and tax bureaus. They are widely publicized. Donors receive certificates and are praised by the media. Companies and enterprises can receive a certain amount of tax deductions for their donations. These practices depend on the discretion of the relevant government agencies, however, and on how successfully the donor institutions bargain with the relevant authorities.

Analysis

The Chinese tradition of state and Party intervention and the early stage of NGO development in China make government intervention in fundraising for social needs both unavoidable and necessary. However, due to the lack of legal structure, tax exemptions and deductions are rather discretionary. This situation does not provide much incentive to support charitable activities, and compelling people or companies to make donations hinders development of the concept of philanthropy. As many state-owned enterprises are already running at a loss, government-directed fundraising for social organizations is regarded as nothing more than an excessive levy of fees and thus meets with resistance from enterprises.

Recommendations

The current 3-percent-of-profits cap on tax deductions for donations to social organizations provides little incentive for corporate giving. The percentage should be raised and guaranteed by law. As NGO activities grow both in scale and speed, laws and regulations establishing tax deductions and credits for charitable contribution should be at the top of the agenda for legal reform.

CAPITAL FORMATION

Chinese NGOs and NPOs depend mainly on donations, from within China and overseas. None of the NGOs or NPOs have a big enough endowment to be self-sustaining. However, those NGOs initiated by or close to the government may get government funds to cover staff salaries and other administrative costs.

According to the Regulations on the Management of Foundations, "foundations can raise funds from . . . corporations and institutions, social organizations, and individuals . . . interested in the foundations' causes. But the donations shall be voluntary." Also "a foundation can put its funds in a financial organization to earn interest. It can also purchase stocks, bonds, and other securities. But the stocks purchased from any particular enterprise should not exceed 20 percent of the total shares of the enterprise."

According to a regulation issued by the People's Bank of China, donations received by foundations should be used exclusively for programs;

staff salaries should be paid out of interest from the foundation's savings. And foundations should not conduct commercial business.

Usually NPOs or foundations have to obtain approval from their supervising line agency to receive foreign funds. Implementation of this policy is at the discretion of the line agencies and often reflects the current political climate.

Analysis

China is increasingly open to the outside world. Although Chinese laws and regulations do not impose restrictions on obtaining foreign funding, the government sometimes uses its discretion to impose restrictions.

Capital formation remains one of the major obstacles to NPO development in China. One reason is that, as China is a developing country, societal wealth is not yet great enough to support NPO activities. A second reason is that China still lacks an understanding of the concept and value of philanthropy. People are used to looking to the government for solutions. Third, the regulations do not provide much incentive for capital growth. Without legal protection, NPOs cannot accumulate self-perpetuating endowments; thus they cannot grow. Restrictions on allowable NPO expenses mean they must raise funds without increasing their costs, which prevents them from reaching out to potential donors. Because of restrictions on overhead expenses, NGOs and NPOs are left with little funding for administrative costs. This also makes NGOs and NPOs less appealing to capable staff, who look elsewhere for employment. As a result, many NGOs have to engage in business to cover their overhead and salary costs.

Recommendations

Laws and regulations on capital formation should reflect China's current situation. Legal authority should be granted NGOs to determine the ultimate disposition of their financial resources. NGOs and foundations should be allowed to use a larger percentage of their income for operational expenses. At the same time, China needs to develop a banking and financial system conducive to capital formation.

INTERNAL GOVERNANCE

The Regulations on the Registration and Management of Social Organizations state that an NGO's charter should specify the name of the

NGO, its missions, its funding sources, its organizational structure, its procedure for electing its leadership, its procedure for revising the charter, and its procedure for dissolution. Current laws and regulations do not provide specific rules on the internal governance of NGOs. In practice, however, two basic types of internal governance are common. The first type is found in the major NGOs affiliated with government agencies and registered with the Ministry of Civil Affairs. These usually have a board of trustees, consisting of either incumbent or retired officials or well-regarded social activists. This kind of NGO usually has a president, who is often the legal representative of the NGO, and several vice presidents. Day-to-day administration is usually managed by the secretary general, who also manages the NGO's programs and serves as its spokesperson. NGOs are supposed to have accountants. Because of the two-tiered management structure, the board of trustees is not as important as it is in other countries, and the leaders of these major NGOs are either directly appointed by government agencies or have strong government connections.

The second type is found in the small NGOs, those that are initiated by individuals and are sometimes community-based. They rely for internal governance on their founders' ability, personal charisma, and connections with Chinese and foreign organizations. They may or may not have full-time accountants. For these NGOs, decision making may not follow prescribed procedures, even though their charters may state such a requirement.

Analysis

Unregulated operations may hinder the development of the nonprofit sector. NPOs and NGOs may be vulnerable to changes in government policy, financial mismanagement can threaten their survival, and ad hoc internal management can cause setbacks in their development. These factors can in turn prevent them from attracting funds from China and abroad.

Recommendations

Chinese laws and regulations should provide clear requirements for internal governance practices. The requirements should specify the governing structure, decision-making procedures, and role of the leadership, as well as the accounting system.

ACCOUNTABILITY

According to relevant laws, the state protects legally registered social organizations' activities, and no institutions or individuals may illegally interfere in social organizations' work. Registered NPOs and NGOs are legally entitled to conduct independent activities. However, the line agencies and registration offices both oversee NGOs' work and activities. The line agencies supervise the day-to-day administrative work of social organizations. They review the registrations of association, alteration, and termination of social organizations. They are supposed to provide documents for these purposes. Social organizations are obliged to report to the line agencies annually about their activities, and the line agencies file annual reports on the social organizations' behalf with the civil affairs departments or the People's Bank of China. The reports include descriptions of the social organizations' activities, finances, and accounting practices.

To guarantee that registered NGOs are working within the scope of their objectives and missions, the agencies in charge of registering them, namely the Ministry of Civil Affairs and its local departments, are supposed to examine their activities annually. NGOs are required to submit their annual report and other relevant documents to the departments of civil affairs in the first quarter of each year.

NGOs that are unable to pass the annual audit of the Ministry of Civil Affairs will have their registration withdrawn and must discontinue their activities. NGOs registered at the Ministry of Industry and Commerce also receive an annual audit. In this case, the audit is conducted by the Bureau of Industry and Commerce and the Tax Bureau, as in the case of commercial entities. Table 3.1 shows the number of NGO applications, registrations, and dissolutions for the years 1991 to 1994. In 1992, a total of 6.6 percent of NGOs were dissolved; in 1993 the figure was 7.3 percent, and in 1994 it was 4.7 percent.

According to China's Auditing Law, donated funds are subject to audit, but the law does not give clear guidelines on how audits should be conducted. In practice, the auditing department may examine an NPO's accounts at any time. Without clear rules, however, it is difficult for the auditing department and the NPOs to cooperate with each other.

Chinese laws and regulations do not require direct accountability of social organizations to the general public. However, some NPOs have established their own self-monitoring system by inviting independent accounting offices to check on their use of funds. They announce the re-

Table 3.1. NGO Applications, Registrations, and Dissolutions, 1991 to 1994.

Year	*Applications*	*Registrations*	*Dissolutions*	*Organizations at Year's End*
1991	118,691	89,969	9,974	115,738
1992	62,891	54,852	7,654	154,502
1993	29,773	25,958	11,331	167,506
1994	18,826	15,235	8,298	174,060

sults of these audits to the public in their journals and yearbooks. The national NGOs usually publish journals describing their activities and openly acknowledging donors and the amount of donations. These publications are helpful for NGO accountability.

Analysis

China's NPO sector is still at an early stage of development. Accountability has thus far been provided by government supervision. Lacking are specific rules governing NGO accountability to the general public and to donors. There is little transparency in NGO revenues and expenditures. Because of this lack of accountability, the general public's awareness of public services and philanthropy is lacking, and NGOs and NPOs in turn get little support from the public. For these same reasons, donors hesitate to make contributions to NGOs.

Recommendations

Accountability should be an important component of NGO laws and regulations. Without regulations to ensure accountability, Chinese NGOs will never develop into a well-established sector.

TERMINATION OR DISSOLUTION

An NPO can voluntarily discontinue operations or dissolve because of financial or other problems. In such cases, the NPO completes a cancellation process at the appropriate registration office. Cancellation is also called for when a social organization changes its objective or its agenda no longer fits the jurisdiction of its registering agency. Under such circumstances, the social organization must complete a cancellation procedure at the appropriate registration agency by filling out the necessary form and returning its certificate and stamp. A social organization may dissolve itself for other reasons as well, in which case it must submit to the appropriate registration agency a cancellation application signed by the organization's legal representative or leaders, together with its line agency's approval and financial clearance. If the social organization is a legal person, its cancellation will be announced in the newspapers. A social organization can also be dissolved by either its registration agency or its affiliated government line agency.

The Regulations on the Registration and Management of Social Organizations state that NGOs shall not engage in the following activities: giving wrong or faulty information at registration, altering a registration certificate or transferring possession of one, conducting for-profit activities, or engaging in activities detrimental to the national interests. Social organizations may be penalized for these actions, ranging from a warning to termination depending on the gravity of the misconduct. Penalties imposed on social organizations are announced by the registering office. The Departments of Civil Affairs, for example, have the authority to dissolve NGOs or NPOs that are conducting activities without having registered. The Regulations on the Registration and Management of Social Organizations also state that registration agencies shall exercise their powers as authorized by law. Penalties imposed on an NGO shall be based on full investigation of the evidence and shall be issued in writing to the legal representative or leaders of the NGO. The legal representative or leaders have ten days to appeal to the next-higher level of the Department of Civil Affairs, which shall review the penalty and make a decision within thirty days after receiving the appeal. NGOs can appeal to the Ministry of Civil Affairs for final review under the same administrative procedure.

Since government line agencies are responsible for supervising the activities of NGOs, they can dissolve NGOs through administrative means. If a line agency severs its relationship with an NGO, the NGO may lose its status as a legal person.

Analysis

China's regulations on dissolution and termination emphasize the government's control and management of NGOs. Without clear laws and regulations governing their legal status, NGOs are vulnerable to the discretionary decisions of the line agencies and registration agencies.

At the same time, since China's legal system is not fully developed, these regulations have not been well enforced. Many NGOs either conduct for-profit activities or operate without registering.

Recommendations

Discretionary decisions regarding termination and dissolution should be avoided. NGOs should be allowed to register as independent legal entities, and termination or dissolution should be handled by a single organization, preferably the registering agency, such as the Ministry of Civil Affairs.

TRENDS IN THE DEVELOPMENT OF CHINESE NGOS AND NPOS

The laws and regulations discussed in this chapter may soon be outdated. The State Council has asked the Ministry of Civil Affairs to revise the Regulations on the Registration and Management of Social Organizations issued by the State Council in 1989. The proposed new regulations will be more specific in defining procedures, rights and obligations of NGOs, financial requirements, staffing requirements, and so on. The Ministry of Civil Affairs or the local civil affairs departments will continue to be responsible for the registration and management of NGOs in China.

Another draft that is well under way is the Regulations on the Registration and Management of Nongovernmental and Non-Enterprise Organizations. These regulations are meant to regulate the activities of all nongovernmental, privately funded organizations, such as schools, hospitals, and research institutions. All private not-for-profit entities will have to reregister with the Ministry of Civil Affairs after the new regulations are issued.

A third new set of regulations will be Regulations for the Association of Foreign Social Organizations in China, which will stipulate the registration procedure for foreign social organizations and requirements they must satisfy to employ Chinese staff.

It is expected that in the years to come there will be other changes in China's NGO and NPO development. Laws and regulations will be modified many times. The nongovernmental and nonprofit sector remains very much a moving target and an area much more unpredictable than many other fields. However, Chinese NGOs and NPOs will still have to work within the scope established by the government. Two-tier management may still be the practice for many years.

Chinese NGOs and NPOs will continue to expand, despite all the difficulties. Given the changing situation in China, the original top-down approach will gradually be supplemented by a bottom-up approach. A major task faced by the government is the development of a new management system to cope with the rapid change. NGOs and NPOs will also have to further improve their accountability and credibility to survive and grow.

The overall development of China's NGO sector depends on a well-established legal framework to protect the existence and operation of NGOs. At this point, not only domestic initiatives are needed, information from abroad is also important. Since the 1980s, China's coastal areas have adopted some of the commercial laws of Hong Kong and have adapted some international market rules to local conditions. However, the rules and laws of other countries governing NGOs or NPOs have not yet been directly included into Chinese law. Second, the development of NGOs and NPOs depends on the growth of societal wealth outside the government sector and a supporting system of banking, accounting, and investment. Third, social awareness of philanthropic values, concepts, and practices is important to the development of the NGO sector. The concepts of "volunteerism" and "good citizenship" need to be developed in China. Finally, NGOs will have a vital place in Chinese society if they play an effective intermediary role linking the government, corporations, and citizens. Reform of the social security system provides NGOs with a good opportunity to grow. The community-based social security system will bring local government agencies, business entities, and citizens together. It is at the community level that those three parties' interests merge. The intermediary role of NGOs can therefore positively reinforce the interaction of the three parties.

APPENDIX A: REGULATIONS ON THE REGISTRATION AND MANAGEMENT OF SOCIAL ORGANIZATIONS

Following is an unofficial translation (by Yu Hui and Mark Sidel for the Asia Pacific Philanthropy Consortium) of the Regulations on the Registration and Management of Social Organizations, adopted by the State Council on October 13, 1989, and promulgated by Premier Li Peng on October 25, 1989.

Chapter 1: General Provisions

ARTICLE 1. These Regulations are promulgated to protect citizens' freedom of association, ensure the lawful rights of social organizations, strengthen management of social organizations, and foster the active role of social organizations in socialist construction.

ARTICLE 2. All associations, societies, federations, research societies, foundations, leagues, progress organizations, business associations, and other social organizations organized within the territory of the People's Republic of China shall make application for registration pursuant to these Regulations. Only after examination, approval, and registration may social organizations conduct activities, subject to the provisions of other laws and administrative regulations.

ARTICLE 3. Social organizations must obey the Constitution, laws, and Regulations and safeguard national integrity and the unity of the nationalities; they may not harm the interests of the state, society, or collectives or the lawful freedoms and rights of other citizens.

ARTICLE 4. Social organizations may not engage in business activities undertaken with the purpose of making a profit.

ARTICLE 5. The state protects social organizations in undertaking activities under registered charters, and other groups and individuals may not illegally interfere.

ARTICLE 6. The registration and management agency for social organizations is the Ministry of Civil Affairs of the People's Republic of China and civil affairs authorities at and above the county level. Professional activities undertaken by social organizations are subject to the guidance of relevant professional responsible authorities.

Chapter 2: Jurisdiction

ARTICLE 7. To form national social organizations, applications for registration are directed to the Ministry of Civil Affairs; to form local social organizations, applications for registration are directed to corresponding civil affairs authorities in the locality. To form social organizations across several administrative areas, applications for registration are directed to the common higher-level civil affairs authority.

ARTICLE 8. The relevant professional responsible authorities and the registration and management agency shall be responsible for the day-to-day management of the social organizations they have examined, approved, and registered. Where the registration and management agency is not in the same administrative area as a social organization it has examined, approved, and registered, the registration and management agency may entrust the registration and management agency located in the administrative area in which the social organization conducts its affairs with the day-to-day management of that social organization.

Chapter 3: Formation and Registration

ARTICLE 9. An application to form a social organization shall, after being examined and agreed to by the relevant professional responsible authority, be directed to the registration and management agency for application to register.

ARTICLE 10. In applying to form a social organization, the following materials and information shall be submitted to the registration and management agency:

1. The application to register, signed by the responsible person (of the social organization)
2. The examination documents issued by the relevant professional responsible authority
3. The charter of the social organization
4. The address of the organization's place of business or liaison address
5. The name, age, home address, occupation, and resume of the responsible person
6. The number of members

ARTICLE 11. The charter of a social organization shall specify the following matters:

1. Name (of the social organization)
2. Purposes
3. Sources of funds
4. Organizational structure
5. Procedure to elect the responsible person and his or her scope of duties
6. Procedures to amend the charter
7. Termination procedure of the social organization
8. Other necessary matters

ARTICLE 12. Social organizations that meet the conditions for legal-person status obtain the status of a legal person after examination, approval, and registration. National social organizations must meet the conditions for legal-person status.

ARTICLE 13. The registration and management agency shall reply in written form within thirty days after receiving an application as to examination, approval, and registration or denial of registration.

ARTICLE 14. Social organizations that have been examined, approved, and registered are issued social organization registration certificates; those that meet the conditions for legal-person status are issued a social organization legal-person registration certificate; those not meeting the conditions for legal-person status are issued social organization certificates. Registration and management agencies shall announce in the newspapers social organization legal persons that have been examined, approved, and registered.

ARTICLE 15. An applicant that does not agree with a denial of registration by a local civil affairs authority may, within ten days of receipt of the written reply, request reconsideration from the next-higher civil affairs authority. The next-higher civil affairs authority shall respond in writing within thirty days after receipt of the reconsideration request and report for the record to the people's government at the same level. An applicant who does not agree with the denial of registration by the Ministry of Civil Affairs may, within ten days of receipt of the written reply (from the ministry), request reconsideration from the Ministry of Civil Affairs. The Ministry of Civil Affairs shall respond in writing within thirty days after receipt of the reconsideration request and report for the record to the State Council.

ARTICLE 16. The name of a social organization shall be consistent with the professional scope, distribution of members, and area of activities of the social organization. The names of non-national social organizations may not use terms such as "China (Zhongguo)," "National (Quanguo)," or "Chinese (Zhonghua)." Within an administrative area there may not be more than one social organization with the same or a similar name.

ARTICLE 17. In accordance with the relevant Regulations, a social organization may secure seals and open bank accounts with its social organization registration certificate. Social organizations shall submit copies of their seals in use and membership certificates issued and distributed to the registration and management agency for the record.

ARTICLE 18. Social organization registration certificates may not be altered, transferred, or loaned. In the event a social organization's certificate is lost, it shall be declared invalid in a timely manner, and the organization must apply to the registration and management agency for replacement.

Chapter 4: Amendment of Registration and Cancellation of Registration

ARTICLE 19. In the event of a modification or cancellation of a social organization, the social organization shall, after examination and approval by the relevant professional responsible authority, apply for registration with the registration and management agency.

ARTICLE 20. In the event a social organization changes its name, legal representative, responsible person, address of place of business, or liaison address, it shall effect a change of registration with the original registration and management agency within ten days after the change.

ARTICLE 21. In the event a social organization changes its purpose or in the event of other changes that bring the social organization outside the jurisdictional scope of the original registration and management agency, it shall cancel its registration with the original registration and management agency, return the social organization registration certificate and seal, and reregister with the relevant registration and management agency pursuant to the provisions of Chapter 3 of these Regulations.

ARTICLE 22. In the event a social organization effects a voluntary dissolution, it shall apply to the original registration and management agency to cancel the registration. Cancellation of registration requires submitting an application to cancel registration signed by the legal representative or responsible person of the social organization, the examination documents executed by relevant professional authorities responsible, and proof that all debts have been cleared. After examination and approval by the registration and management agency, the social organization registration certificate and seal shall be retrieved. After cancellation of the registration of the social organization's legal person, the registration and management agency shall announce that in the newspapers.

Chapter 5: Supervision and Management

ARTICLE 23. The registration and management agency exercises the following functions in supervising and managing social organizations:

1. Supervising social organizations in observing the Constitution and laws
2. Supervising social organizations in effecting registration procedures pursuant to the provisions of these Regulations
3. Supervising social organizations in conducting their activities in accordance with the registered charter

ARTICLE 24. The registration and management agencies shall conduct annual inspections of social organizations. Social organizations shall submit the previous year's annual inspection report and relevant materials to the registration and management agency in the first quarter of each year.

ARTICLE 25. In the event that a social organization violates the provisions of these Regulations in any of the following forms, the registration and management agency may, depending on the seriousness of the violation, impose such penalties as a warning, suspension of activities, cancellation of registration, and banning pursuant to the law:

1. Omissions or false statements at registration
2. Altering, transferring, or loaning the social organization's registration certificate
3. Conducting business activities with the purpose of making a profit
4. Conducting activities in violation of the purposes stipulated in the charter
5. Conducting activities that harm the national interest

The registration and management agency shall announce in the newspapers when the penalties of cancellation of registration and banning pursuant to law are imposed.

ARTICLE 26. The Ministry of Civil Affairs may order dissolution with respect to those groups that, without examination, approval, and registration, conduct activities under the name of a social organization and do not respond to guidance.

ARTICLE 27. In handling violations of law by social organizations, registration and management agencies must ascertain the facts, proceed pursuant to the law, and notify the legal representative or responsible person of the social organization of decisions in writing.

ARTICLE 28. If a social organization does not agree with a penalty decision by a local civil affairs agency, its legal representative or responsible person may, within ten days of receipt of the notice of the penalty decision, apply for reconsideration to the civil affairs agency at the next-higher level; the next-higher civil affairs agency shall issue a decision on the reconsideration within thirty days after receipt of the application for reconsideration.

If a social organization does not agree with a penalty decision by the Ministry of Civil Affairs, reconsideration may be had at the Ministry of Civil Affairs within the time periods provided in the preceding paragraph.

Chapter 6: Supplemental Provisions

ARTICLE 29. Social organizations formed before the date of entrance into force of these Regulations and that have not registered shall apply for registration pursuant to these Regulations within one year after the date of entrance into force of these Regulations; those that have already registered shall effect procedures to change their certificates.

ARTICLE 30. The registration and management measures for social organizations formed within the territory of the People's Republic of China by non-Chinese citizens or by Chinese citizens residing abroad are governed by other regulations.

ARTICLE 31. The Ministry of Civil Affairs is responsible for interpreting these Regulations.

ARTICLE 32. These Regulations enter into force from the date of their promulgation. The Interim Measures on the Registration of Social Organizations promulgated by the Government Affairs Council of the

Central People's Government on October 19, 1950, are repealed at the same time.

APPENDIX B: REGULATIONS ON THE MANAGEMENT OF FOUNDATIONS

Following is an unofficial translation (by Yu Hui and Mark Sidel for the Asia Pacific Philanthropy Consortium) of the Regulation on the Management of Foundations, adopted by the State Council on September 9, 1988, and promulgated by Premier Li Peng on September 27, 1988.

Article 1

These Regulations are enacted to strengthen the management of foundations and to facilitate the healthy development of foundations.

Article 2

The term *foundations* in these Regulations refers to nonprofit and nongovernmental organizations, which are managed through the use of funds voluntarily donated by foreign and domestic social organizations and other groups, as well as individuals; they are social organizations with legal-person status. The purposes of the activities of foundations are to promote the development of scientific research, culture and education, social welfare, and services in the public interest. The Regulations do not apply to foundations supported and established by the government that are supporting scientific research, and various other special-funding management organizations.

Article 3

The following conditions must be met to establish a foundation:

1. Its nature, purposes, and sources of funds must conform to the stipulations of Article 2 of these Regulations.
2. Its registered funds must be more than RMB100,000 (or foreign currency of equivalent value).
3. There must be a foundation charter, a management structure, and necessary finance personnel.
3. There must be a fixed place of business.

Article 4

A foundation may raise funds through donations from enterprises or public institutes, social organizations, and other groups and individuals that are enthusiastic about its activities and purposes, but the donations must be voluntary, and compulsory donations are prohibited.

Article 5

Currently serving government personnel may not concurrently hold leading positions in foundations. Foundations should practice democratic management; establish stringent rules for raising, managing, and utilizing funds; and make their income and expenditure accounts public on a regular basis.

Article 6

Foundations' funds should be used for financial support of activities and causes that conform to their purposes and may not be diverted to other uses. Foundations may not operate or manage enterprises.

Article 7

Foundations may deposit funds in financial institutions and receive interest and may also purchase bonds and stocks and other securities of value. However, the amount of any stock in an enterprise that a foundation purchases may not exceed 20 percent of the total stock of that enterprise.

Article 8

Foundations have the right to supervise use of funds by the recipients of funds. If it is found that funds are being utilized contrary to the original agreement, foundations have the right to reduce, terminate, or retrieve the assistance funds.

Article 9

Salaries of foundation employees and office expenses are to be paid out of income from interest on funds and other income.

Article 10

Foreign currency donated to foundations from foreign sources belongs to such foundations, and foundations are permitted to establish foreign currency accounts. Goods donated to foundations from foreign sources are duty free and belong to such foundations; foundations have the right to transfer such goods as support to other organizations or individuals related to its purposes on a gratis basis, but the goods may not be sold.

Article 11

To form a foundation, the responsible institution to which it reports submits an application to the People's Bank for examination and approval, and after registration with the civil affairs authorities, a license is issued. Only after obtaining qualifications as a legal person may it conduct professional activities. National foundations submit applications to the People's Bank of China for examination and approval, apply for registration to the Ministry of Civil Affairs, and report for the record to the State Council. Local foundations submit applications to provincial, autonomous region, or directly administered municipal branches of the People's Bank of China for examination and approval; apply for registration to the civil affairs authority at the provincial, autonomous region, or directly administered municipal level; and report for the record to the people's government of the province, autonomous region, or directly administered municipality. The change of name, merger, or revocation of foundations shall be conducted in accordance with the procedures for application and establishment.

Article 12

Foundations should report their financial income and expenditures and activities on an annual basis to the People's Bank and to civil affairs authorities and accept supervision by the People's Bank and the civil affairs authorities. When the activities of foundations violate these Regulations, the People's Bank has the authority to halt payments, freeze funds, and order reorganization, and civil affairs authorities have the authority to impose such penalties as disciplinary warnings and revocation of license.

Article 13

The People's Bank of China and the Ministry of Civil Affairs are responsible for implementing these Regulations and may enact corresponding detailed implementing rules.

Article 14

These Regulations shall be effective on the date of promulgation.

APPENDIX C: INTERIM PROVISIONS FOR THE ADMINISTRATION OF FOREIGN CHAMBERS OF COMMERCE IN CHINA

Following is an unofficial translation (by Yu Hui and Mark Sidel for the Asia Pacific Philanthropy Consortium) of the Interim Provisions for the Administration of Foreign Chambers of Commerce in China, adopted by the State Council at the Thirty-Ninth Executive Meeting on April 28, 1989; promulgated by Decree No. 36 of the State Council of the People's Republic of China on June 14, 1989; and effective as of July 1, 1989.

Article 1

These provisions are formulated with a view to promoting international trade and economic and technological exchanges, strengthening the administration of foreign chambers of commerce, and protecting their legitimate rights and interests.

Article 2

A foreign chamber of commerce in China refers to a non-profit-making organization that is set up in accordance with these provisions within the Chinese territory by foreign commercial establishments and personnel and does not engage in any business transaction. The activities of foreign chambers of commerce in China shall be aimed at promoting trade and economic and technological exchanges between their members and Chinese counterparts and facilitating their research in and discussions about the development of international trade and economic and technological exchanges.

Article 3

Foreign chambers of commerce in China must abide by the laws and regulations of the People's Republic of China and shall not jeopardize the state security and social and public interests of China.

Article 4

The following must be established before setting up a foreign chamber of commerce in China:

1. Articles of association reflecting the common will of the chamber's members
2. A certain number of sponsoring members and responsible persons
3. Premises for a permanent office
4. Lawful sources of funds

Article 5

Foreign chambers of commerce in China shall be formed according to their respective country of origin and may have both group members and individual members. Group members mean those that join the chambers in the name of commercial establishments. Commercial establishments refer to representative offices or branches set up in the Chinese territory according to law by foreign companies, enterprises, and other economic organizations. Individual members mean those staff members of non-Chinese nationality working in commercial establishments or enterprises with foreign investment who join the chamber in their own names.

Article 6

The name of a foreign chamber of commerce in China shall be preceded by the name of its own country plus the word *China*.

Article 7

For the setting up of a foreign chamber of commerce in China, a written application shall be submitted to the China International Chamber of Commerce for further transmission to the Ministry of Foreign Economic

Relations and Trade of the People's Republic of China (hereinafter referred to as the examining authorities) for examination. The examining authorities shall complete the examination within sixty days after the date of receiving the written application and all the attached papers. It shall issue an approval certificate if the conditions laid down in Article 4 are satisfied or reject the application if the abovementioned conditions are not satisfied. The examining authorities shall give explanations if they cannot complete the examination within the prescribed time limit on account of special circumstances.

Article 8

The written application for the setting up of a foreign chamber of commerce in China shall be duly signed by the chief sponsor and accompanied by the following papers:

1. Articles of association of the chamber, in quintuplicate, in which the following items shall be included:

   Name and address

   Organizational structure

   Names and status of the Chairman, Vice Chairman, and Managing Director

   Procedure for the admission of members and their rights and obligations

   Scope of activities

   Financial information
2. A list of the sponsoring members of the chamber, in quintuplicate, with the group members and individual members listed separately. For each of the group members, the name, address, business scope, and names of the responsible persons shall be indicated. For each of the individual members, the name of the commercial establishment or enterprise with foreign investment for which the individual member works, as well as his position and personal resume or a brief account of his commercial activities in China shall be indicated.
3. Name and resume of the Chairman, Vice Chairman, and Managing Director of the chamber, in quintuplicate.

Article 9

After the application for setting up a foreign chamber of commerce in China has been examined and approved by the examining authorities, the chief sponsor shall, in accordance with the stipulations of these provisions and other relevant laws and regulations, submit the approval certificate to the Ministry of Civil Affairs of the People's Republic of China (hereinafter referred to as the registration authorities) for registration. A foreign chamber of commerce in China is established at the time its registration is accepted and a registration certificate is issued.

Article 10

A foreign chamber of commerce in China shall set up account books in its office. Its membership fees and other funds obtained in accordance with the stipulations of its Articles of Association shall be used to cover the expenditures specified in its articles of association and shall not, under any name, be used as payments to its members or remitted out of the Chinese territory.

Article 11

A foreign chamber of commerce in China shall submit in January of every year a report on its activities in the previous year to the examining authorities and the registration authorities through the China International Chamber of Commerce. The China Chamber of International Commerce shall provide foreign chambers of commerce in China with consultative and other services for their activities and contacts with relevant Chinese authorities.

Article 12

When a foreign chamber of commerce in China needs to amend its articles of association; replace its Chairman, Vice Chairman, or Managing Director; or change the address of its premises, it shall apply for examination and approval and register such changes in accordance with the procedures laid down in Articles 7, 8, and 9.

Article 13

A foreign chamber of commerce in China shall subject itself to the supervision of relevant Chinese authorities. Should a foreign chamber of commerce in China violate these provisions, the registration authorities have the power to apply sanctions by imposing a warning or fine on it, suspending its activities for a specific period, revoking its registration, or ordering to ban it.

Article 14

When a foreign chamber of commerce in China is to be dissolved, it shall submit an application duly signed by its Chairman, together with a certificate proving the completion of its liquidation, to the registration authorities for canceling its registration and report to the examining authorities for the record. A foreign chamber of commerce in China shall stop all of its activities as of the date when it returns its registration certificate to the registration authorities.

Article 15

These provisions shall go into effect as of July 1, 1989.

4

INDONESIA

Satya Arinanto

LIKE MANY NATIONS IN ASIA, Indonesia belongs primarily to the civil law tradition. Indonesia's legal tradition is distinctive, however, because of the influence of many nations, which have contributed common law as well as civil law elements. Dr. Charles Himawan, professor of law and the former Dean of the Faculty of Law at the University of Indonesia, has identified twelve distinctive periods of legal influence since Portuguese penetration in 1511. The following 435 years saw rule by the Portuguese, the British, the French, the Japanese, and, of course, the Dutch.

In the past, law was used by the Japanese and by European colonial powers in Indonesia to suppress rather than promote development. During the colonial era, law was regarded by the native inhabitants of what is now Indonesia as an instrument of social control rather than a means of empowerment. Often the lawmakers and law enforcers stood above the law. The popular view, even today, is that law is something to be avoided. It is fair to say that the notion that law can be used in a positive and beneficial manner as a vehicle of change and development is not yet generally accepted in Indonesia. This colonial legacy of law as a negative force has been a dominant factor stunting the development of Indonesia's nonprofit legal framework.

Although the struggle for independence (1945–1949) was a period of violence in which thousands of Indonesian patriots lost their lives, the following change in legal regimes was designed to occur smoothly. Dutch laws and institutions were to continue until they were replaced by those of the newly independent nation of Indonesia. Article 2 of the Transitional Provision of the 1945 Constitution provides, "All existing institutions and regulations of the state shall continue to function as long as new ones have not been set up in conformity with this constitution."

In some ways the transition has yet to be completed. Scholars have identified more than four hundred laws from the colonial era that continue to apply, such as the Code of Business Law, the Civil Code, and the Criminal Code. Indonesian law continued the Dutch Civil Code that was in force in Indonesia in 1945.

Article 1653 of Chapter 9 of the Third Book of the Civil Code, the provision of the Indonesian Civil Code that is generally regarded as the source of Indonesia's nonprofit legal forms—foundations (*yayasan* or *stichting*) and associations *(perkumpulan)*—has been virtually unchanged since that time. Although laws on the establishment and operation of foundations were promulgated in the Netherlands in 1956 (*Staatsblad* [Government Official Gazette] 327, Article 1, May 31, 1956), Indonesia did not adopt similar laws, nor has it since promulgated its own comprehensive law setting forth rules for the establishment, operation, and dissolution of foundations.

The present nonprofit legal framework is characterized by a marked contrast between an extensive network of laws and regulations designed to prohibit and control nongovernmental organization (NGO) activity and the paucity of laws designed to encourage the development of a legal environment favorable to philanthropy or NGO activity.

ESTABLISHMENT

Social Welfare Organizations

Social welfare organizations are required to register with the Ministry of Social Affairs. They must obtain written authorization from the Ministry to receive foreign funds (Decrees No. 77 of 1983 and No. 54 of 1984). The Ministry may evaluate activities financed with foreign funds, and a recipient social welfare organization must file quarterly reports accounting for its expenditures of such funds.

Social Organizations

The Law on Social (or Mass) Organizations, promulgated in 1985, purports to reach all organizations established voluntarily on the basis of similarity of activity, profession, function, or religion.

A newly established social organization must register with the government within two months of its establishment by filing a copy of its statutes or bylaws and detailing the composition of its board. Such organizations are supervised, generally, by the Minister of Home Affairs or a local equivalent. Technical supervision is by the Ministry (or local equivalent) with jurisdiction over the area of activity.

The Law on Social Organizations (Law No. 8/1985) empowers the government to dissolve a social organization if it conducts any activities that interfere with security and order, receives donations from foreign institutions without the government's consent, or gives assistance to foreign institutions that may harm the nation.

Foundations

The legal rules pertaining to the establishment of foundations (*yayasang)* in Indonesia are minimal: a foundation is established by filing a brief notarized document. The organizers of the foundation must complete a document providing the foundation's name and domicile, the amount of assets owned separately by the foundation, the name of its organizers, the composition and structure of its board, its procedures for removal and replacement of board members, and its procedures for distribution of assets on dissolution. The document may be signed by one person, and it must be notarized.

Many legal issues with regard to foundations are unresolved. For example, it is generally understood that the minimum fund to establish a foundation is twenty-five thousand rupiahs (Rp25,000). But there is also support for the view that no specific minimum is required; rather, the requirement is that the fund be owned by and within the exclusive dominion and control of the foundation. Exactly how a foundation fits within the nonprofit regulatory system has recently become an issue. As discussed later in the chapter, the government appears to have taken the controversial position that foundations are subject to the Law on Social Organizations and must register and submit to regulation as social organizations.

LIMITATIONS ON PURPOSES OR ACTIVITIES

Indonesian law contains none of the usual laws or regulations to prevent abuse by foundations, such as limits on personal economic benefit, restrictions on commercial activities, and constraints on political activities. Thus no limits are placed on the ability of a foundation to distribute its income or assets to insiders for their personal economic benefit. Foundations are permitted to engage in commercial as well as political activities.

The most comprehensive nonprofit laws are those designed to ensure order and security. Control of the receipt by nonprofit organizations (NPOs) of foreign support has been a central regulatory theme. In 1978, religious organizations became subject to regulation by the Ministry of Religious Affairs of their receipt of contributions from abroad. In 1983, the Ministry of Social Affairs issued regulations requiring written permission from the Minister for social welfare organizations to receive foreign aid. In 1985, a similar restriction was extended to mass organizations. Law No. 8/1985 prohibits mass organizations from receiving donations from foreign organizations without the government's agreement and from giving assistance to foreign institutions that may harm state interests.

According to the Ministry of Home Affairs, all NGOs are subject to the 1985 Law on Social Organizations until such time as Indonesia passes a new law on foundations. Not everyone agrees. A prominent attorney has pointed out publicly that a literal reading of Law No. 8/1985 would include all organizations outside political parties, including limited-liability companies, state-owned companies, and cooperatives. A sounder interpretation, he suggests, is to exclude all of those entities from coverage, since they are subject to their own legal regimes.

TAX EXEMPTIONS AND DEDUCTIONS

In the recent past, Indonesian law provided for an exemption from income tax for foundations. This was short-lived, however. Former law required foundations to pay income tax but also allowed an exemption so long as the foundation's activities were limited to religion, education, health, or culture; the purpose of the activities was to promote social welfare; and the activities were not profit seeking or profit oriented (Law No. 6/1983, Article 1[b], and Law No. 7/1983, Article 4[i], [j]). Those laws were superseded (Law No. 9/1994 and Law No. 10/1994), and the new laws leave foundations subject to income tax and offer exemptions only for specific types of income. Income to a foundation in the form of contributions, aid, grants, inheritance, or subsidy from the government, for example, is exempt from income tax. Tax deductions or credits are not available to contributors to foundations or associations.

Indonesian tax policy took a wrong turn in 1994. Income tax exemptions and deductions are important incentives to encourage the development of a vigorous nonprofit sector. The 1983 laws took the proper approach, allowing tax exemptions for organizations engaged in public benefit activities. There is no reason, however, to limit the class of beneficiary organizations to foundations. Exemptions should be available to any organization engaged in public benefit activities—foundation or association—so long as the income and assets of the organization are used or distributed for public benefit rather than for the personal economic benefit of insiders.

CAPITAL FORMATION

No laws restrict the investment choices available to an NPO, and none require expenditure of any particular amount of income or property received by an NPO.

INTERNAL GOVERNANCE

Indonesia has enacted no laws pertaining specifically to the internal governance of foundations or associations.

ACCOUNTABILITY

Accountability of foundations and associations is not a major emphasis of Indonesian law. Limited accountability to the state is required of NPOs in connection with income tax returns and reports on receipt and expenditure of foreign aid. No law requires NPOs to make any documents or reports available to the public.

TERMINATION OR DISSOLUTION

Indonesian law does not address the termination or dissolution of NPOs in a comprehensive manner. Voluntary dissolution of a foundation usually occurs in accordance with the provisions of the notarial document establishing the foundation. Typically that document provides for the disposition of assets on dissolution. In the case of most associations, voluntary dissolution is informal, since few assets usually remain to be distributed. Involuntary dissolution of a social welfare organization may result from failure to comply with Regulation No. 40 of 1980. Similarly, involuntary dissolution of a social organization may occur if the social organization violates the provisions of Law No. 8/1985.

Completely missing is any procedure for independent review of a government decision to terminate or dissolve an NPO. That decision should be made in a judicial proceeding.

CONCLUSION

In 1991, Onny S. Prijono observed that "Government policy tends to focus on ways to regulate and control private nonprofit organizations through guidance and supervision, reducing their independence" (p. 137). The situation has not improved in the intervening years. In several ways—the retrenchment on tax incentives for foundations, the use of the Law on Social Organizations to tighten control of foundations—it has gotten worse. As a consequence, many prominent and distinguished nonprofit leaders in Indonesia have discouraged any efforts toward law reform. They are concerned that those efforts may lead to a more tightly controlled regulatory system, unless they are preceded by a profound change in government policy toward NGOs, philanthropy, and the nonprofit sector.

My recommendation is that the present government should reconsider its overall policy toward the nonprofit sector. It should reassess its security concerns and seek to address them by developing a strengthened civil society through encouraging NGOs and other institutions that mediate between the family and the state. As part of that process, the government should appoint a Citizens Advisory Commission to propose a comprehensive nonprofit legal structure, one that will provide a favorable, enabling environment for the development of responsible institutions for public benefit through private effort.

REFERENCE

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5

JAPAN

Takako Amemiya

JAPAN IS NOW in a period of major change regarding the legal system for citizens' activities. The impetus for the change was the great Hanshin-Awaji earthquake of January 17, 1995. The devastating earthquake left in its wake more than 6,200 victims, and the city of Kobe and its residents are still struggling to recover. For various reasons, neither the local nor the national government was able to respond quickly by calling out the emergency units. The one bright spot in the midst of all the suffering after the earthquake was the fact, reported in the media, that about 60,000 people a day, or a total of more than 1.3 million people, voluntarily participated in rescue and recovery efforts and ¥173 billion in unsolicited donations were received. Although the majority of the volunteers in Kobe were individuals, many were nonprofit organizations (NPOs) already active in the medical, social welfare, international aid, and other fields. Groups of NPOs instantly formed associations that either worked directly with victims or coordinated the activities of volunteers. The quick, effective, and flexible efforts of NPOs to help victims get back on their feet contrasted with the government's approach and generated much public admiration.

Most of the NPOs active in Kobe were not incorporated. Thus they lacked social status, and funds donated to them were not considered charitable contributions. People from many quarters pointed out that the current system and legal framework do not support NPOs and indeed hinder their effectiveness.

It was in this context that the government announced its intention to consider legislation to support volunteer groups. This announcement led to efforts to formulate an NPO law (known as the Law to Advance Citizens' Activities) that would make it easier for grassroots groups to carry out their activities and receive incorporated status. The factors preventing Japanese NPOs from incorporating easily are discussed later in the chapter. Here it is enough to explain that although Article 21 of the Japanese Constitution recognizes the freedom to assemble and form organizations, the issue of what type of organizations may incorporate is a matter of national policy. Profit-making organizations easily and automatically receive permission to incorporate as long as they meet certain objective legal requirements, but incorporation is more difficult for public interest organizations, because the process contains a subjective element. For these organizations, permission rests not on objective criteria alone but also on the authorizing agency's assessment of the public interest character of their activities. In other words, approval is given at the discretion of the authorizing agency.

Corporate status is regulated by both the Civil Code and the Special Law. The Civil Code, which is the body of law regulating incorporation, applies only to nonprofit public interest corporations—incorporated foundations and incorporated associations recognized by an authorizing agency. The Special Law regulates the incorporation of nonprofit organizations whose primary activities are not necessarily for the public interest. The Special Law was made to give legal-person status to those special-purpose organizations. But unless a particular law applies to specific objectives of such organizations, and unless they meet Civil Code requirements concerning size and other matters, they have no way to become incorporated and must operate without any recognized legal status.

To complicate matters, there is no comprehensive legal system for the nonprofit sector. The Special Law designates the legislation governing establishment and the authorizing agency, taking into account individual organizational objectives. For example, educational corporations are regulated under the Private School Law, social welfare corporations are regulated under the Social Welfare Services Law, and religious corporations are regulated under the Religious Corporations Law. To try to explain the legal incorporation system for NPOs in its entirety would be impractical; here I will deal only with public interest corporations under the Civil Code.

Table 5.1 shows that in 1996 there were over 250,000 incorporated NPOs in Japan. Special laws regulating those NPOs number more than

Table 5.1. Types and Number of Incorporated NPOs.

Types	*Number*
Public Interest Corporations	26,312
Religious Corporations	183,996
Social Welfare Corporations	14,832
Educational Corporations	7,566
Others	21,422
Total	254,128

Source: *Weekly Taxation News, Zeimuken-kyukai, No. 2434, July 8, 1996, p. 7. The Material of the Government Tax Commission. Used by permission.*

one hundred. According to a survey conducted by the Economic Planning Agency, the estimated number of NPOs without legal status is about eighty-five thousand.

THE REGISTRATION PROCESS

Definitions

Public interest corporations, as defined by Article 34 of the Civil Code, have the public interest as a corporate objective, do not operate for the sake of economic gain, are either an association or a foundation, and are approved by the respective government agency.

THE PUBLIC INTEREST. Operating for the public interest means operating for the benefit of society in general or for the benefit of many unspecified persons. Article 34 names "worship, religion, charity, academic activities, and arts and crafts" as examples of activities that are in the public interest. There are many other activities undertaken for the public good, including environmental preservation, international exchange, and community building.

The public interest is not specifically defined in the law, however. The Cabinet Directive of September 20, 1996, titled Approval and Supervision of Public Interest Corporations ("the Standards") states that public interest corporations must have as their objective the carrying out of activities for the public good. Organizations not recognized as operating in the public interest were defined as groups that gather for the sake of maintaining personal ties, such as reunion and alumni groups; groups that offer welfare services to people who formed a group with a specific purpose or to members of specific occupations; and support organizations that provide economic or spiritual support to individuals.

NONPROFIT ORGANIZATIONS. Being nonprofit means that economic benefit to members is not among the aims of the organization and that organizational income is not shared with members. Being nonprofit does not mean that an organization cannot engage in profit-making activities; it means that the organization must use its income for the public good. According to the directives of the authorizing agency, it is only reasonable that public interest organizations should undertake activities for the public good, and profit-making activities should make up less than one-half of such an organization's activities. Furthermore, the Standards specify that more than one-half of the income from profit-making activities must be used for public interest activities.

ASSOCIATIONS AND FOUNDATIONS. An incorporated association is defined as an organization of people who assemble for the sake of a certain public interest objective. An incorporated foundation is defined as an organization that manages and uses its endowments according to the aims of its contributors.

Approval from the Authorizing Agency

The authorizing agency is the central government agency that presides over the area in which the prospective public interest corporation intends to operate. For example, if the main organizational objective is international exchange, then the Ministry of Foreign Affairs has jurisdiction; if it is in the areas of culture, the arts, or education, then the Ministry of Education, Science, Sports, and Culture has jurisdiction. If two government agencies are involved, such as would be the case for a prospective public interest organization planning to operate in both the area of public welfare (Ministry of Health and Welfare) and the area of environmental protection (Environmental Agency), then approval from both agencies is necessary. This is called joint supervision. Further, if the activity of the prospective public interest organization will be limited to operating within one prefecture, then the appropriate body in that prefecture becomes the authorizing agency. For example, a group carrying out social welfare activities for the elderly in Osaka Prefecture would be under the jurisdiction of the Osaka prefectural governor, and a group giving scholarships to students attending universities in the Tokyo metropolitan area would fall under the jurisdiction of the Tokyo Metropolitan Government Board of Education (Civil Code, Article 83[2]). Nationwide, there are more than 120 authorizing agencies.

Article 34 of the Civil Code requires that approval be obtained from an authorizing agency for the establishment of a public interest corporation. This type of approval system allows the supervising agency to determine, at its discretion, whether or not to confer corporate status on an organization. In addition are the legal requirements under the Civil Code and the regulations concerning the establishment and supervision of public interest corporations promulgated by each respective government entity. Thus the authorizing agency has the freedom to decide whether it should grant an organization status as a public interest corporation, within the scope specified by law. No time limit is specified for granting or refusing authorization. Because there are no clear standards stating under what conditions authorization is to be granted or when an agency must approve or deny an application, the application process can take many years.

Normally, outright denial is rare; agencies usually indicate revisions that must be made or attach various conditions to their approval. If approval is denied, an applicant may contest the denial under an administrative suit on the grounds that the denial was improper. Nevertheless, a denial cannot be ruled to be unlawful unless the authorizing agency has clearly violated proper application or interpretation of the law. There are few case precedents in this area, with judgments essentially restricted to the *Adachi Ward Physicians Association* case, which involved a denial of an application to establish a second incorporated association of physicians within the same ward as an existing one (Supreme Court decision of July 13, 1988, Hanrei Jiho no. 1297, at 29). In this case the court determined that "administrative agencies are granted broad discretion in approving the establishment of a public interest corporation. A disposition which refuses to grant authorization is not unlawful, unless one can deny that a certain level of reason existed in the determination process through the conclusion that it would be proper to deny approval."

Analysis

EFFICIENCY OF THE PROCESS. The Civil Code does not contain detailed provisions concerning the procedures for establishing a public interest corporation. The standards for documentation required for application include cabinet and ministerial orders concerning establishment and supervision of public interest corporations, as well as the "Agreement on Documentation, etc., to be Attached to Applications for

Approval of Establishment of a Public Interest Corporation," by the Liaison Council for Supervision of Public Interest Corporations. None of these standards, however, state under what conditions approval will be granted. Furthermore, there is no legal obligation to disclose information on public interest corporations, and thus there is no way of knowing whether or not approvals are being fairly granted.

CLARITY OF THE PROCEDURES. The lack of clear standards under law for establishing a public interest corporation is the main issue that needs to be addressed. The current system provides supervisory agencies with too much discretion in rendering their decision. Applicants find it difficult to utilize a system that does not clarify what conditions, if met, will result in establishment.

PUBLIC KNOWLEDGE OF THE PROCEDURES. Persons wishing to establish a public interest corporation inquire directly with the supervisory government agency. However, the relevant agency differs depending on the activities of the applicant. This creates confusion as to which is the proper agency for inquiry. In most cases, therefore, interested parties consult the Japan Association of Charitable Organizations (an incorporated foundation) and ask whether or not they can establish a public interest corporation, to which agency they should apply, and what documentation should be compiled.

Attorneys at Law, Certified Public Accountants, Certified Tax Accountants, and Administrative Scriveners may also act as agents for those wishing to establish a public interest corporation, but few actually specialize in this service.

SIMPLICITY OF THE PROCESS. Because of the mass of supervisory government agencies and the complex approval system, the establishment process has become extremely difficult to understand. Moreover, organizations that are flexible and engage in a broad range of activities encompassing many sectors find the supervisory agency system to be rigid and difficult to negotiate.

ABILITY TO DETER ABUSES. Public interest corporations are subject to supervision by the relevant government agency even after their establishment. Consequently, they are required to submit annual program plans, budgets, program reports, closing financial statements, and similar documents. Based on these documents, the agency determines whether or not the public interest corporation has been actively engaged in public interest activities. If necessary, the agency may also make on-site inspections, and if the corporation is found to be in violation of the law, the agency may order the corporation to reform or give other guidance as required. Since the establishment and operation of a public interest corporation is entirely under the approval and oversight of the relevant agency, it may be that abuses can be eliminated, as long as government agencies thoroughly supervise and guide the public interest corporations under their purview.

It is important to understand, however, that public disclosure of information is not required. Without public disclosure, it is impossible to ascertain whether or not the system is being abused or whether the authorizing agencies are properly supervising and guiding the public interest corporations over which they have authority.

Examples of abuse have on occasion been discussed in the media. These examples include the problem of using public interest corporations as a loophole to evade taxes. Under Japan's present tax system, public interest corporations are taxed on their profit-making activities, although at a reduced rate. Nevertheless, a public interest corporation is only subject to taxation on those profit-making activities that it conducts on a continuous basis. A public interest corporation is exempt from taxation on profit-making activities that it conducts solely on an occasional basis.

ABUSE OF SUPERVISORY AGENCY DISCRETION. Agencies that supervise public interest corporations are afforded discretion in their decisions, both concerning the establishment of corporations and in their subsequent supervision of them. As a result, founding a public interest corporation under direct instructions from an agency is easier than establishing one without such agency direction. Examples of corporations that receive such instructions include testing and evaluation institutions formed to undertake activities that normally would have been performed by the national government or by local governments. These entities appoint former bureaucrats as their directors, and this can easily result in a patronage system for retired bureaucrats.

Recommendations

The present legal system is not sufficient, since the Civil Code does not provide for any type of nonprofit organization other than a public interest corporation and because the requirements for becoming a public interest corporation are quite rigorous. Unless provision is made in another special law, nonprofit organizations cannot acquire corporate status if they do not fit within the narrow definition of a public interest corporation.

Japan needs a general law for nonprofit corporations. For example, the Civil Code could cover nonprofit organizations and for-profit organizations, but public interest corporations, which are nonprofit but have a higher level of public interest, would be covered under a separate special law.

The present Civil Code relies on the system of supervisory government agencies for approving public interest corporations. Under this system, the supervising agencies have full discretion in their decisions, both in establishing public interest corporations and in supervising them after establishment. This functions as a barrier to flexible activity and limits the creativity of the nonprofit sector. Consequently, the approval system should be abolished and replaced by a normative system of regulation.

In the current approval system, the supervisory agency has full discretion over whether or not a given application will be approved. An application can be rejected if it is perceived by the agency as being contrary to the interests of the government, even if it satisfies the other conditions. Citizens' groups should be free to respond to the country's changing needs, however, and are not suitable objects for such judgments. Ideally, corporate status should be given without much in the way of restrictions, and the performance of public interest corporations should be checked and monitored by citizens who have obtained information through disclosure measures.

Since a public interest corporation is accorded favorable tax treatment, however, it is understandable that approval and supervision by an authorizing agency is required. Therefore, full disclosure of information should be mandated for the purpose of ascertaining whether or not an organization is actively engaged in public interest activities and whether it is engaged in profit-making activities. It would also help to establish authorizing agencies that are not divided along vertical jurisdictional boundaries. One idea is to establish a Public Interest Assessment Commission, composed of private citizens, to appraise organizations from the point of view of the public interest.

REQUIRED AND PERMITTED ACTIVITIES

The Standards offer the following general guidelines:

1. Public interest activities must conform with the following, except for those activities undertaken for profit-making purposes that are con-

ducted on an incidental basis. Furthermore, activities that conform to the following need to constitute at least one-half of total expenditures.

- The activities must be suitable in view of the purposes of the corporation.
- The content of the activities must be specifically and clearly stated in the articles of association or the act of endowment.
- The main activities must not be ones that are recognized by their nature and content as appropriately being performed by a for-profit enterprise.

If as a result of social or economic changes the substance of the activities comes into competition, or may be in competition, with activities of a for-profit enterprise, the following measures shall be taken for the purpose of reforming activities that can be recognized as appropriate for a public interest corporation:

- Increasing the public interest served in operation of the activities by measures such as making the activities available to many and nonspecific persons
- Adding new activities that offer a high contribution to the public interest

Thus public interest corporations must actively engage in activities that offer a significant contribution to the public interest, that do not compete with for-profit enterprises, that are suited to a public interest corporation, and that serve many and nonspecific persons. These requirements are abstract and difficult to understand.

The Standards also state that a supervisory agency may instruct a public interest corporation to convert to for-profit status if it fails to carry out the above measures, and if the public interest corporation does not take the necessary steps within a specific time period, the agency may revoke its grant of approval.

2. Any profit-making activities of a public interest corporation must comply with the following criteria. Expenditures for profit-making activities must be at a level that is appropriate in principle to meet the expenses of the corporation's public interest activities and proper, in view of the actual status of said public interest corporation, for the purpose of proper development of those activities. If at all possible, the expenditures for profit-making activities should not exceed one-half of total expenditures.

3. The type of profit-making activities must not be injurious to the reputation of the public interest corporation within society at large. Activities injurious to the reputations of public interest corporations include those that may affect public morals, such as businesses related to licentious activities; the making of high-interest loans; and speculative management.

4. With the exception of amounts required for the sound operation of the corporation in question, profits from profit-making activities must be used for public interest activities. If at all possible, the amount used for public interest activities should be at least one-half of the profits.

The supervisory government agency may instruct a public interest corporation to reform if any of these guidelines are not followed. Moreover, the agency may revoke its grant of approval if the public interest corporation fails to obey the agency's instructions or violates the law. The agency may also instruct a public interest corporation to convert its business into a stock company if the corporation has illegally engaged in activities of a for-profit nature. Consequently, if the activities of a nonprofit corporation are the same as those of a for-profit enterprise, the corporation will not simply be denied preferential tax status by the tax authorities; rather, the authorizing agency will cancel the grant of approval for the public interest corporation.

The Civil Code does not necessarily prohibit political action by public interest corporations. A public interest corporation may engage in a wide variety of activities as long as the organization does not deviate from the spirit of its articles of association (in the case of incorporated associations) or act of endowment (in the case of incorporated foundations) approved at the time the public interest corporation was established. Nevertheless, a public interest corporation is prohibited from activities such as sponsoring events to support specific individuals.

The bill for the Law to Advance Citizens' Activities, however, does contain restrictions against political or religious activities by "Citizen Activity Corporations." This bill has been placed before the Diet and is currently being debated. [That bill was enacted into law on March 19, 1998, and is discussed in the Conclusion.]

Analysis

Restrictions on the purposes and activities of public interest corporations are not clearly stated in the statutes. Instead, the supervisory and guiding functions of the authorizing agency are relied on to fill this need. It is possible that thorough supervision and guidance would prevent abuses by public interest corporations, since a public interest corporation executes its public interest activities under the supervision and direction of the authorizing agency. Nevertheless, there is a danger that public interest corporations will be prevented from freely undertaking activities of a voluntary nature, since they are subject to the control of their supervisory agency.

Recommendations

Supervision and guidance by an authorizing agency is not suitable to monitoring the public interest activities of organizations run by private citizens, as such activities are undertaken freely and are characterized by flexibility and creativity. Consequently, there is a vital need to enact a nonprofit corporations law providing a normative system for the establishment of nonprofit corporations that engage in activities other than those that supplement government administrative functions. It is also important that a system be created under which citizens would determine the level of abuses of the corporate structure, through public disclosure of information.

TAX EXEMPTIONS

In principle, a public interest corporation is taxed only on income from profit-making activities; it is not taxed on its other income (for example, donations, dues, grants, or assistance). Furthermore, the tax rate for a public interest corporation is 27 percent, even if it is engaged in profit-making activities. This is lower than the 37.5 percent rate applied to regular corporations. Thus if an authorizing agency approves a public interest corporation, the corporation automatically receives favorable tax treatment on its corporate taxes.

Taxation of profit-making activities of public interest corporations is necessary for balanced treatment of for-profit and public interest corporations. Nevertheless, a public interest corporation and a regular corporation cannot be treated as exactly the same, since the main purpose of a for-profit corporation is to distribute this income to its shareholders, whereas a public interest corporation applies its income from profit-making activities to the support of its public interest activities. Furthermore, a public interest corporation cannot distribute its income internally. Consequently, different tax rates were established under the Corporation Tax Law, with regular corporations taxed at a rate of 37.5 percent and public interest corporations taxed at a reduced rate of 27 percent.

For tax purposes, the public interest corporation with business activities is bifurcated. The nonprofit part is tax-exempt. The business part is taxed on its profits but with the ability to deduct from that business income a certain percentage if the funds are used for nonprofit purposes or given to another public interest corporation. The usual deduction percentage is 20 percent, but that ceiling is raised to 50 percent for contributions to certain educational organizations. Consequently, if a public interest corporation earns ¥1 million in income from its profit-making activities, it may pay out, tax-free, ¥200,000 for public interest activities and need only pay corporate taxes, assessed at 27 percent, on the remaining ¥800,000. No other country has this type of system; it is unique to Japan. The 27 percent corporate tax rate in principle applies to cooperative consumption associations as well, which are classified separately in the nonprofit sector. If a cooperative consumption association earns more than ¥1 billion, however, it is taxed at a rate of 30 percent. The constructive contribution system does not apply to cooperative associations, including cooperative consumption associations.

As stated previously, no taxes are assessed on income from sources other than profit-making activities. Thus, receipts such as donations and dues are tax-exempt, and investment income earned on the principal assets of a public interest corporation (including dividends and interest) are also exempt from taxation.

Preferential tax status is automatically granted to a public interest corporation when approval is granted by the authorizing agency. No decision is made by the tax authorities. Only income from profit-making activities is taxed. Thirty-three types of activities are named as profit-making activities in Article 5(1) of the Corporation Tax Law Enforcement Order. Activities in these categories (such as sales of products, real estate, or subcontracted services) are taxed even if they are directly related to public interest activities (and even if they *are* public interest activities, if they result in income). Furthermore, since approval as a public interest corporation automatically brings preferential tax status, the tax status alone cannot be canceled. If an organization neglects its public interest activities and only conducts profit-making activities, the corporation will be instructed to reform. If the corporation does not obey these instructions, then the approval will be revoked.

Analysis

Public interest corporations receive preferential tax treatment on several levels. The essential premise is that a public interest corporation will use its profit-making activities for public interest activities. If this is the case, then a public interest corporation does not receive sufficient tax relief if it is allowed to exclude only 20 percent of its income from profit-making activities for expenses made to promote public interest activities.

Recommendations

As previously stated, the Standards require a public interest corporation to pay out, for public benefit, at least half of its income from profit-making activities. Given this requirement, a public interest corporation should be given a tax deduction in the same amount. If, however, a public interest corporation undertakes profit-making activities to meet overhead costs, such as personnel and rent, rather than to pay for public interest activities, then the public interest corporation should pay corporate taxes at the same rate as a regular corporation.

TAX DEDUCTIONS

The tax treatment of donors depends on whether the donor is a corporation or an individual. The tax advantages also differ depending on the type of recipient organization. Tax law classifies donations as either prescribed contributions or general contributions. Prescribed contributions refer to donations made to the national government or to local governments, donations to recipients designated by the Minister of Finance, and donations made to special public interest–promoting corporations. All other types of donations are considered general contributions. A company may deduct the entire amount of any donations it makes to the national government, local governments, or recipients designated by the Minister of Finance. An individual may deduct up to 25 percent of his or her income for the amount of the above types of contributions that is in excess of ¥10,000. Since neither donations to the government nor donations to designated recipients applies to public interest corporations, a detailed explanation of these has been omitted. What follows is an explanation of deductibility of donations to special public interest–promoting corporations and deductibility of general contributions.

Donations to Special Public Interest–Promoting Corporations

Approval from an authorizing agency to incorporate does not automatically make donations to the applicant organization deductible. The organization must first be recognized as a special public interest–promoting corporation, and only certain donations to it will be tax-exempt. Special public interest–promoting corporations are nonprofit legal persons, such as public interest corporations, that have been so designated through the consultation of the authorizing agency and the minister of finance (Corporation Tax Law, Article 37[3]–3, and Income Tax Code, Article 78[2]–3). The scope of organizations that fall within this category is given in Article 217 of the Enforcement Ordinance of the Income Tax Law and in Article 77 of the Enforcement Ordinance of the Corporation Tax Law. As of April 1, 1995, thirty-four types of organizations—such as legal persons conducting scientific research and experiments, educational corporations, social welfare corporations, and corporations providing rehabilitation for criminal offenders—were defined as special public interest–promoting corporations.

The scope of legal persons eligible for approval as special public interest–promoting corporations is widening, though the number actually approved is small. Of the 26,000 public interest corporations recognized pursuant to Article 34 of the Civil Code, only 880 are special public interest–promoting corporations, or only 3.4 percent of the total. As of April 1, 1996, there were 17,000 special public interest–promoting corporations in total, but most of them are social welfare corporations (14,830) and educational corporations (1,125).

Under Article 34 of the Civil Code, a public interest corporation is generally designated as a special public interest–promoting corporation for a two-year period, which may be renewed. In some cases the time is extended to five years. A company may deduct donations to a corporation qualified as a special public interest–promoting corporation up to twice the amount of consolidated losses (explained later). An individual may deduct up to 25 percent of his or her annual income, minus ¥10,000. The small number of organizations for which donations are tax deductible, however, narrows the choices available to prospective business and individual donors.

Deductibility of General Contributions

Corporate donors figure deductibility of their general contributions using this formula: $(\text{capital} \times 2.5/1{,}000) + (\text{income} \times 2.5/100) \times \frac{1}{2}$ (Incorporation Tax Law, Article 37[2]). Corporate donations are defined as contributions of money or property for a purpose not directly related to the execution of the corporation's business activities. Thus corporate donations are not confined to causes for the public good but also include, for example, the purchase of tickets for political fundraisers.

Analysis

The first requirement for designation as a special public interest–promoting corporation eligible for tax-deductible contributions is that the organization must be a corporation. Nonincorporated nonprofit organizations cannot obtain eligibility for tax-deductible contributions. Moreover, they cannot enter into contracts or be eligible to hold title in real estate registrations.

The scope of special public interest–promoting corporations eligible for tax-deductible contributions is gradually being widened, but it remains limited. Furthermore, Japan has yet to develop a tax system that encourages individual contributions to worthy causes.

The Japan Association of Charitable Organizations has for some years published its registry of special public interest–promoting corporations. Nevertheless, lists of organizations eligible for designated contributions are only published from time to time in tax journals, which makes it difficult for the general public to obtain information.

A special public interest–promoting corporation is designated through consultation between the authorizing agency and the Minister of Finance. However, the requirements for designation are not clearly stipulated in the law. Broad discretion is granted to the designating authorities, making it difficult for public interest corporations to qualify. Furthermore, such organizations must undergo a renewal process every two years. Under this process, a corporation will be required to resubmit substantial documentation, and time is required before a renewal is approved. In some cases, there can be a blank period during which a corporation cannot accept donations that span fiscal years.

In general, contributions by individual donors are not tax deductible. Only those contributions designated as prescribed donations (those made to national or local governments or to recipients designated by the Minister of Finance) and special public interest–promoting corporations) are tax deductible. In other words, there is no tax incentive for individuals to make donations to public interest corporations unless the recipient is one of the two types described here. Restricting individuals in this way while allowing tax deductions on any donations by businesses is unfair and can be said to discourage contributions by individuals to causes for the public good.

Recommendations

The requirements for designation as a special public interest–promoting corporation are too restrictive. Both the Corporation Tax Law and the Income Tax Law prescribe a limited list of categories eligible for special public interest–promoting status. This type of legal system is not sufficient, since public interest corporations with multiple activities across a broad sector have difficulty obtaining approval. The designation of special public interest–promoting corporation is granted by the authorizing agency and the Minister of Finance, but the criteria for making this designation are not necessarily clear. Therefore, establishment of specific criteria, such as a certain ratio (for instance, 70 to 80 percent) of revenue allocated to public interest–promoting activities, should be considered.

Allowing individuals to deduct general contributions from their income would provide an incentive for them to make donations. Possibilities include allowing deductions of up to ¥100,000 per year on a final return or allowing deductions of up to 1 percent of annual income. This type of incentive should also apply to contributions made to nonprofit organizations that have not acquired corporate status.

CAPITAL FORMATION

There are no rules that require a public interest corporation to pay out a certain percentage of its assets for public interest activities. In many instances, administrative guidance is given to incorporated foundations advising them to maximize their principal assets so that they can conduct public interest activities on a stable basis, using the revenues from their principal assets. Furthermore, the supervisory agencies prefer cash to real estate or similar assets for the principal assets of an incorporated foundation. Real estate and other valuable assets are not looked on with favor unless they are to be directly used in the public interest activities, since these assets will not generate revenues.

To apply for establishment of an incorporated association, an organization must have enough members to generate a certain level of income (from dues). In addition, the organization will be instructed under administrative guidance to set aside a "principal fund" consisting of several tens of millions of yen. However, there is no basis under law for either of these requirements.

The 1996 Standards provide that a public interest corporation must have a secure financial foundation necessary to continue sound operation of its activities and must keep proper accounts. Consequently, the finances and accounts of a public interest corporation must conform to the following:

- Proper accounts must be kept, pursuant to the Accounting Standards for Public Interest Corporations.
- An incorporated association must have income from dues or investment income from its assets sufficient to carry out the activities necessary to fulfill the purposes of its establishment.
- An incorporated foundation must have investment income from donated assets at the time of its establishment, or grant or similar income on a permanent basis, sufficient to carry out the activities necessary to fulfill the purposes of its establishment.

The Standards also contain the following rules regarding the investment of assets by a public interest corporation:

- Except in instances in which the donor has designated the method of investment and management at the time of donation, the corporation must invest and manage its principal assets or funds in a manner by which reasonable investment earnings for fixed assets can be obtained, or which creates value.
- With the exception of assets necessary for the sound operation of the corporation (notably cash and buildings), the corporation must invest and manage its investment assets in a manner by which there is a high probability that the principal can be recovered, and which yields as much investment income as is possible.

The method for investing the assets is to be provided in the act of endowment (for a foundation) or the articles of association (for an association). At the time of establishment, the authorizing agency provides guidance concerning the language required in these documents. In many cases, this results in investment in secure term deposits, either in a postal account or with a bank.

It is also desirable to manage assets for daily activities safely and securely. The assets for daily activities can be managed through stock investment and investment trusts that include stock. However, it is not allowed to obtain stock to maintain a subsidiary corporation or without going through the public market (discussed later).

The Standards in principle prohibit a public interest corporation from holding corporate stock, with the following exceptions:

- For management of investment assets, limited to such corporate stock as can be obtained through a securities company in a normal transaction, such as listed shares or shares traded over the counter
- If the shares have been donated as principal assets for an incorporated foundation

In either case, a public interest corporation may not hold more than one-half of the shares issued and outstanding of any corporation. In other words, a public interest corporation may not control any stock corporation.

There are no restrictions on funds received from abroad. In the case of making grants overseas, a foundation could avoid restrictions on investments by making a grant to a foreign foundation, which in turn could invest in stocks and regrant to citizens' groups.

Analysis

Certainly a public interest corporation must have principal and investment assets sufficient to ensure enough income for the corporation to carry out the activities necessary to fulfill its purposes. Nevertheless, the law does not specify any minimum amount. The principal assets of an incorporated foundation constitute the core substance of the foundation, and consequently a foundation with substantial principal assets will have more income, thereby enabling it to carry out its activities on a continuing basis. Given the current low interest rates, however, even a fund of several hundred million yen would not be sufficient to ensure stable operation if the assets may only be invested in a term savings account.

An incorporated association must also have enough members to ensure a level of income from dues sufficient for the corporation to consistently carry out its public interest activities. However, there are no clear standards for a minimum number of members or income from dues. If a substantial amount of principal assets or membership sufficient to obtain a certain level of income from dues is a requirement to ensure the continuity of public interest activities, then one partial solution would be to allow public interest corporations to be established for a designated period of time (for example ten years, or until the twenty-first century). Authorizing agencies in Japan, however, will not permit the establishment of public interest corporations that have an expiration date on their incorporation.

Recommendations

Security is given top priority as the goal of investing principal assets and investment assets, and the investment method must be defined either in the act of endowment or the articles of association. Given these strictures, one cannot expect public interest corporations to become more active unless the authorizing agencies show a willingness to be flexible about accepting changes to investment methods.

Unless a minimum principal asset amount is determined under law, the public interest corporation structure will remain difficult to utilize, since organizations have no way of knowing what amount of assets will be sufficient, even assuming that an incorporated foundation must have as large a principal asset base as possible. A further problem is presented by the fact that approval is not granted for donation-supported public interest corporations that have small funds. The required amount of principal assets is determined to be an amount sufficient to allow the corporation to exist on its interest alone, even if other donations or other income is not available in the future. Corporations with limited principal assets should be allowed if they plan to conduct activities that use the assets in a certain period of time, such as twenty years, or if they are financed primarily by donations.

INTERNAL GOVERNANCE

Officers of Incorporated Associations and Foundations

Both incorporated associations and foundations have directors, auditors, and councilors. Incorporated associations also have a general meeting of members, an institution unique to incorporated associations.

DIRECTORS. Directors are responsible for carrying on the business of a corporation under Civil Code, Article 52(1). The articles of association or the act of endowment determines the procedures for selection, dismissal, and termination of directors. The initial directors of a foundation are selected at the meeting of the founders, with subsequent directors selected according to the method determined under the act of endowment. In most cases, this is through selection by the advisory council. Directors of an association are elected through a general meeting of members. In both cases, the names and addresses of directors must be stated in the corporate registry (Civil Code, Article 46[1][viii]).

Directors of a corporation owe a fiduciary duty to the corporation. They must exercise due care with respect to those matters that are in the articles of association or the act of endowment (Civil Code, Article 644). A director has no right to represent the corporation in matters involving a conflict of interest between the director and the corporation (Civil Code, Article 57). No person who has been deprived of his or her public rights or had them suspended may be a director (Civil Code Enforcement Law, Article 27). Nationality does not matter in nominating directors; however, practical issues, such as whether a foreign director could attend the director's meetings, may be considered.

AUDITORS. The main duties of an auditor are to audit the assets of a corporation to implement the decisions of the board and to report any improprieties to a general meeting of members (for an association) or to the authorizing government agency. Auditors are not required by the Civil Code but by the Standards that specify that an auditor cannot simultaneously serve as a director. Appointment, dismissal, and termination of auditors is to be determined by the articles of association, the act of endowment, or a general meeting of members. According to the Standards, auditors may be paid reasonable compensation.

GENERAL MEETING OF MEMBERS. The general meeting of members is the highest decision-making body of an incorporated association. With the exception of those tasks delegated to directors or other officers, all activities of an incorporated association are determined through resolution by the general meeting of members. General meetings of members consist of regular general meetings and extraordinary general meetings. Regular general meetings are convened at least once a year by the directors.

Under the Standards, a general meeting of members "shall specify requirements for a quorum for resolutions, so that the intent of the majority of the members is properly reflected."

COUNCILORS. Councilors are not required under the Civil Code. Nevertheless, since an incorporated foundation does not have a general meeting, a foundation does not have any organ to select its directors.

Consequently, the Standards provide that in principle a foundation shall have councilors and an advisory council, which shall select the directors or function as an advisory body to the directors. Procedures for selection, dismissal, and termination of councilors are to be stipulated in the act of endowment or in the articles of association.

Officers of Other Nonprofit Corporations

By law, a social welfare corporation must have at least three directors and at least one auditor. Although an advisory council is not required under law, administrative guidance is given that in principle an advisory council should be established, with the number of councilors to be at least twice the number of directors.

An educational corporation is required under law to have at least five directors, at least two auditors, and an advisory council consisting of at least twice the number of councilors as directors of the corporation.

A religious corporation is required under law to have at least three responsible officers in place of directors. One officer shall be the representative officer who shall represent the religious corporation and be the general executive of its activities.

Analysis

In reality, few individuals undertake the post of director or councilor with an understanding of their roles and responsibilities. Furthermore, auditors are responsible for auditing the activities of the corporation in addition to its accounts. Nevertheless, in practice auditors do not actually audit corporate activities.

Recommendations

Meetings of directors and members are required under the Civil Code. The Civil Code should be revised to include a requirement for an auditor and councilors as well. Although the role of auditor is to ensure proper activities and sound financial management, in reality they only review and sign documents prepared by the secretariat. Therefore, especially in the case of larger corporations, such as those with budgets exceeding ¥100 million, an examination by an outside certified public accountant should also be required.

REPORTING OBLIGATIONS

The activities of a public interest corporation are under the supervision of the authorizing agency (Civil Code, Article 67). The authorizing agency issues ministerial orders concerning the establishment and supervision of public interest corporations. In addition, agencies require public interest corporations to file, on a specific date each year, a report that includes program plans and budgets, program reports and closing financial statements, a list of assets as of the end of the previous year, and an account of any changes of membership (for an incorporated association). A public interest corporation must also obtain approval from the authorizing agency for any changes to its articles of association or its act of endowment.

If a public interest corporation has been designated as a special public interest–promoting corporation and is thereby eligible to receive tax-deductible contributions, the corporation must submit an application every two or five years to renew its eligibility (Corporation Tax Law Enforcement Order, Article 77[1][iii], and Income Tax Law Enforcement Order, Article 217[1][iii]).

Any public interest corporation that engages in profit-making activities must file a notice concerning these activities with the tax office having jurisdiction over the corporation. Moreover, as a result of the 1996 tax reform (for incorporated NPOs), from January 1997 any public interest corporation with income of ¥8 million or more must file an accounting report with the tax office, even if the corporation does not engage in profit-making activities.

Although a public interest corporation is required to submit activity and accounting reports to its authorizing agency, the corporation has no duty to disclose information to citizens at large. A public interest trust, however, does face this requirement under the Trust Law. In addition, a public interest trust must by law publish a report of its activities and financial condition once every year (Trust Law, Article 69[2]).

Analysis

Since public interest corporations receive some tax advantages, it seems only natural that they should be required to publish reports on their activities and accounts. The fact that no duty of disclosure has been prescribed by law does present a problem. Since these corporations must report to their authorizing agencies, then it would seem that the authorizing agencies should disclose this information. However, the Standards merely state that "information including the activities and finances of public interest corporations should be disclosed on a voluntary basis." Until now it has not been common practice for corporations to voluntarily disclose internal information. It is necessary to consider what information they should be required to disclose.

Recommendations

Information disclosure should be required of public interest corporations. Although corporations should be allowed to decide the method of publication, that method should be specified in the act of endowment or articles of association. Almost all public interest trusts, which must meet disclosure requirements, publish this information in an official gazette.

DISSOLUTION

Cause for Dissolving a Public Interest Corporation

The Civil Code provides four grounds for dissolution of a public interest corporation that apply to both incorporated associations and incorporated foundations, as well as two grounds that apply only to incorporated associations. The grounds common to both entities are as follows (Civil Code, Article 68[1][i] through [iv]):

- If reason has occurred as provided in the articles of association or act of endowment
- If the activities constituting the purposes of the corporation have been accomplished or their accomplishment becomes impossible
- If the corporation falls into bankruptcy
- If the authorization for establishment of the corporation has been canceled by the authorizing agency.

The following reasons apply only to incorporated associations (Civil Code, Article 68[2][i] and [ii]):

- There is a resolution to dissolve at a general meeting of shareholders that reflects the intent of all members.
- There are no longer any members.

Cancellation of Approval for a Public Interest Corporation

Article 71 of the Civil Code states that the authorizing agency may cancel approval of a public interest corporation. Under this article, the following constitutes reason for cancellation of approval:

- If the corporation has engaged in activities outside its purposes as defined in the articles of association or act of endowment
- If the corporation has violated the conditions under which it received approval for establishment
- If the corporation has violated supervisory orders issued by the authorizing agency
- If the corporation has not conducted its activities for a continuous period of three or more years without a just and proper reason

The Civil Code Enforcement Law, Article 25, requires an authorizing agency to conduct a prior inquiry if it intends to cancel its approval of a corporation. This is to guarantee proper procedure and to prevent abuses of the system by the authorizing agency, since a cancellation of approval would be an adverse disposition for a public interest corporation. As part of this inquiry, the authorizing agency must indicate the reasons for its disposition to the affected parties and provide an opportunity for them to state their opinions and present arguments in their defense. If the affected parties are dissatisfied with the decision, they can initiate a legal proceeding, and the right of appeal is ensured.

Distribution of Corporate Assets After Dissolution

The Civil Code provides the following three methods for determining what entity will be vested with the remaining assets after a corporation is dissolved (Article 72):

1. Any person designated before the fact under the articles of association or the act of endowment shall receive the assets.
2. If no entity was so designated, and if approval from the authorizing agency is obtained, the assets may be transferred to another public interest corporation with purposes similar to those of the corporation being dissolved.

3. If no vesting entity has been determined even under the previous two methods, the assets will become the property of the national treasury.

In almost all cases, the articles of association or act of endowment will specify at the time the public interest corporation is established that any remaining assets after dissolution will be vested with a public interest corporation with similar purposes or with the national government or a local government body.

Analysis

Although dissolution of a public interest corporation may be conducted in accordance with the requirements specified under law, cancellation of approval by an authorizing agency is a complicated procedure. In some cases, the corporation did not receive guidance or instruction that a permit was to be canceled, and consequently the authorizing agency had difficulty in actively pursuing a cancellation.

Recommendations

Having the same authorizing agency responsible for approval and cancellation should be avoided. Since cancellation involves an investigation into whether or not there was dissatisfaction with the initial approval, or with oversight, a better alternative would be to place the cancellation process under the jurisdiction of the court, which would be a fair and neutral third party.

APPENDIX: THE STANDARDS

Following is an unofficial translation of the Standards for Permitting the Establishment of Public Interest Corporations, as well as Guidance and Supervision Thereof (1996 Cabinet Directive).

Purposes

A public interest corporation must be for the purpose of actively benefiting many and nonspecified persons. Consequently, the following would not be appropriate as a public interest corporation:

1. An alumni association, hobby association, or other organization formed mainly for such purposes as friendship, interaction, or exchanging opinions among the members thereof
2. Organizations that have welfare, mutual self-aid, or other similar objectives as their main purpose and are solely for members of a specific organization or for persons in a specific occupation
3. Organizations for the purpose of providing emotional or economic assistance to specific individuals, such as a support organization

Activities

1. The activities of a public interest corporation must fulfill all of the requirements set forth below (except for those activities undertaken for profit-making purposes that are conducted on an incidental basis). Moreover, activities that fulfill these requirements must if possible constitute at least one-half of total expenditures:

i. The activities must be of a suitable content in view of the purposes of said corporation.
ii. The content of the activities must be specifically and clearly stated in the articles of association or the act of endowment.
iii. The main activities must not be activities that by their nature and content should be recognized as appropriately being performed by a for-profit enterprise.

2. If as a result of social or economic changes the substance of the activities comes into competition, or may be in competition, with activities of a for-profit enterprise, the following measures shall be taken for the purpose of reforming them into activities that can be recognized to be appropriate for a public interest corporation:

i. Increasing the public interest served in operation of the activities by measures such as reducing the consideration, or making the activities available to many and nonspecific persons
ii. Adding new activities that offer a high contribution to the public interest

3. If the measures stated in (2) above cannot be taken, the public interest corporation shall convert to a for-profit corporation or similar entity.

4. Once the necessary structure is in place to convert to a for-profit corporation or similar entity, the supervising government agency shall take steps for supervising (3) above, and if the necessary measures are not taken within three years, the agency shall respond to the issue at hand, which may include canceling the permit for establishment.

5. Public interest corporations shall endeavor to achieve a balance of income and expenditures by reducing the consideration for public interest activities involving consideration, or by expanding the targets thereof, so that these activities do not generate profits in excess of the amount necessary for the sound operation of said corporation.

6. When a public interest corporation undertakes for-profit activities (which shall mean activities undertaken for profit-making purposes that are conducted on an incidental basis; the same shall apply hereinafter), said activities must meet all of the following requirements and must contribute to the promotion of the public interest activities:

i. *Scale.* Expenditures for the for-profit activities must be at a level that is necessary mainly to meet the expenses of public interest activities and is proper, in view of the actual status of said public interest corporation, for the purpose of proper development of the public interest activities. If at all possible, the for-profit activity expenditures should not exceed one-half of total expenditures.

ii. *Type of Business.* The type of business of the for-profit activities must not be of a type that would be injurious to the reputation of a public interest corporation within society at large.

iii. *Use of Profits.* With the exception of amounts required for the sound operation of the corporation in question, profits from for-profit activities must be used for public interest activities. If at all possible, the amount used for public interest activities should be at least one-half of the profits.

Name

The name of a public interest corporation must be a name that is acceptable to society at large as properly expressing the purposes and substance of the corporation. The following shall not be appropriate as names:

1. A name that may be mistaken for an organ, and so on, of the national government or a local government
2. A name that may be mistaken for that of an existing corporation or organization affiliated therewith
3. A name that deviates from the scope of activities of the subject corporation

Administration

From the perspective of enabling sound and continuous management and operation of the subject corporation, administrative organs of a public interest corporation must at least meet the following requirements:

1. *Directors and Boards of Directors.*

i. The number of directors shall be a number that is suitable from the perspective of the substance of the corporation, including the scale and content of its activities, and must not vary excessively between the maximum and minimum numbers.

ii. Directors of an incorporated association shall be selected by a general meeting, and directors of a foundation shall in principle be selected by the advisory council thereof.

iii. The term of office for directors shall in principle be two years.

iv. Succeeding directors shall be appointed promptly upon the expiration of the term of office or resignation of a director, and it shall be stipulated that a director shall have an obligation to continue to execute his or her duties until such time as his or her successor is appointed.

v. Not more than one-third of the current number of directors shall respectively be from the same family (meaning individuals within the third rank of consanguinity or having a special relationship with said individuals), persons related to a particular enterprise (such as directors, employees, or substantial shareholders), or individuals who served with the relevant supervising government agency. Moreover, not more than one-half of the current number of directors shall be affiliated with the same industry.

vi. Benefits such as compensation and retirement bonuses to full-time directors shall not be inordinately excessive in view of the assets of the corporation concerned, its income, and expenditures or when compared to wage standards in the private sector.

vii. Requirements shall be specified for holding meetings of the board of directors, and for reaching resolutions thereof, in order to properly reflect the intent of the majority of directors.

2. *Auditors.*

i. Since auditors constitute an important administrative organization for the purpose of auditing the status of such matters as corporate accounting, assets, and execution of operations by the directors, a public interest corporation shall at all times have at least one auditor.

ii. An auditor shall not serve jointly as a director.

iii. The provisions of (1)(ii),(iv), and (vi) above shall apply *mutatis mutandis* to auditors.

3. *General Meetings of Incorporated Associations.*

i. Requirements shall be specified for such matters as convening general meetings of an incorporated association, and approving resolutions thereof, in order to properly reflect the intent of the majority of members.

ii. Measures shall be taken to properly reflect the intent of the majority of members, even in such situations as where many members exist or they are spread throughout Japan.

4. *Councilors and Advisory Councils.*

i. A foundation shall, in principle, have councilors and an advisory council, which shall select the directors and auditors and serve as an advisory body for material matters concerning the corporation.

ii. The advisory council shall be selected by the board of directors.

iii. In principle, a councilor shall not serve jointly as a director or as an auditor. Even if under unavoidable circumstances councilors serve jointly as directors, the ratio of said councilors shall be at a level that would not constitute substantive control of the advisory council.

iv. The provisions of (1)(i), (iii), (iv), and (vii) above shall apply *mutatis mutandis* to councilors and to the advisory council, and the ratio of members of the same family, a particular enterprise, or individuals who served with the relevant supervising government agency or are affiliated with the same industry shall be at a level that would not constitute substantive control of the advisory council.

5. *Secretariat and Employees.* A secretariat shall be installed for the purpose of handling the administration of the subject corporation, with consideration given to such issues as the scale and content of activities, and shall have the necessary employees (if possible, full-time employees).

Finances and Accounting

A public interest corporation must have a secure financial foundation necessary to continue sound operation of its activities and must furthermore keep proper accounts. Consequently, the finances and accounts of a public interest corporation must conform to the following:

1. Proper accounts must be kept, which in principle shall be pursuant to the Accounting Standards for Public Interest Corporations.
2. An incorporated association must have income from dues or investment income from its assets to carry out the activities necessary to fulfill the purposes of its establishment.
3. An incorporated foundation must have investment income from donated assets at the time of its establishment, or grant or similar income on a permanent basis, to carry out the activities necessary to fulfill the purposes of its establishment.
4. Except in instances in which the donor has designated the method of investment and management at the time of the donation, the corporation must invest and manage its principal assets or funds in a manner by which reasonable investment earnings for fixed assets can be obtained or that creates utility value.
5. With the exception of assets necessary for the sound operation of the corporation (notably cash and buildings), the corporation must invest and manage its investment assets in a manner by which there is a high probability that the principal can be recovered and that yields as much investment income as is possible.

6. If a public interest corporation is to take out long-term loans (which shall mean loans with a payment period of more than one year), the corporation shall compile a full repayment plan and otherwise take close care that such loans do not interfere with its public interest activities. The corporation shall also take such measures as clearly stating a budget of income and expenditures, obtaining approval from the board of directors and general meeting, and submitting a notification to the supervising government agency.
7. Care shall be taken that internal reserves do not become excessive.
8. The ratio of administrative expenses to total expenditures shall be kept from becoming excessive and if possible shall be not more than one-half. The ratio of personnel expenses to administrative expenses shall also be kept from becoming excessive.

Holding of Shares, Etc.

1. In principle, a public interest corporation shall not hold shares of stock and such in any for-profit corporations, with the exception of the following circumstances:

i. For management and investment of investment assets under Finances and Accounting, item (5), above, provided that this shall be limited to instances that clearly constitute portfolio investment, such as through a public stock exchange.
ii. If the shares have been donated as principal assets for an incorporated foundation.

2. Even if shares are held pursuant to (1) above, the shareholding ratio must not exceed one-half of the shares issued and outstanding of the for-profit corporation concerned.

Disclosure

Information concerning matters such as the operations of a public interest corporation or the finances thereof shall be voluntarily disclosed.

Transitional Measures, Etc.

1. Supervising government agencies shall instruct public interest corporations that are not in conformance with these standards to conform with the standards in principle within three years; provided, however, that for corporations that have already been established and that are industrial organizations that have become public interest corporations because their sole means for acquiring corporate status was pursuant to Article 34 of the Civil Code, adjustments for completely unavoidable circumstances shall be made after the comprehensive legal reform concerning corporations. During the interim period, the supervising government agencies shall forcefully guide these organizations to ensure fairness and impartiality by installing as auditors persons who are not affiliated with the relevant industry or from the supervising government agency and to execute their prescribed activities as specified in their respective articles of association properly.

2. Technical examination shall be made and specific standards established for the following stipulations contained in these Standards: Finances and Accounting, item (7) (internal reserves); Holding of Shares and Such (including adjustments for corporations that have already made investments); and Disclosure.

3. Conversion to a for-profit corporation as stated in Activities, item (3), above shall be executed after examination by the relevant government agencies and after the necessary structure is in place.

6

JAPAN

Yoshinori Yamaoka

THE BASIC PROVISIONS of Japan's legal incorporation system are determined by the Japanese Civil Code. The Civil Code was promulgated in 1896 and put into effect in 1898. Thus more than one hundred years have now passed since its promulgation.

In the Meiji era, Japan was forced to modernize under foreign pressure, after a long history of being a closed country. One of the country's first tasks was to modernize its domestic legal code, to persuade Western countries to revise certain "unequal treaties" that Japan had been forced to conclude at the end of its feudal era. Indeed, one condition for revising these treaties was that Japan promulgate a Civil Code and a Criminal Code.

The initial draft of Japan's Civil Code followed the French Civil Code, which was at the time the most modern code available. This draft was criticized as unsuited to conditions in Japan, and it was never put into effect. After translation and review of the German Civil Code and, it appears, the corporate provisions of the Italian Civil Code, the Civil Code of Japan was enacted, becoming effective in 1898.

Under the current Civil Code, corporations are discussed in Articles 33 through 84 (which currently includes Article 84–2). These provisions appear to have been drafted with reference to the civil codes of Germany, Italy, and France. Both France and Italy took a relatively obstructionist stance toward corporations, whereas Germany classified corporations into for-profit and nonprofit categories and allowed them to be easily established. Japan's Civil Code classifies corporations into public interest and for-profit categories and includes an approval system for public interest corporations, thereby rendering these corporations subject to bureaucratic control. This appears to be inherited from France and Italy. For-profit corporations, however, which are covered under a normative system of regulation, are not ruled by bureaucratic fiat. This system appears to be inherited from the German Civil Code. In contrast with Europe, Japan did not have politically influential religious organizations, although it did have temples and shrines. Consequently, the drafters were not required to take the interests of these organizations into account. This explains the decision to permit the establishment of public interest corporations but not to encourage their founding. Furthermore, Japan did not have a federal system of government, as was the case in Germany. Thus the intent of the drafters was to subject public interest corporations to unified regulation by the central authorizing agency, with the bureaucracy fulfilling the role of supplementing the provisions of the law.

At the time the Civil Code was enacted, no one foresaw that the private sector would be engaged in public interest activities to the extent that it is today, and there was no consciousness of the importance of these activities. The decision to allow for-profit corporations to be freely established was also influenced by the social conditions of the time. Japan had embarked on a road toward rapid modernization after a long period as a closed country. Under the slogan "rich country, strong army," the founders of Japan's modern state felt that allowing free economic activity would contribute to the profit of society as a whole. Even though Japan adopted a new Constitution after World War II, the Civil Code promulgated under the Meiji Constitution has not been revised, save for provisions related to family law. The effects of Japan's postwar democratization seem to have bypassed the laws forming the core of the incorporation system.

The Civil Code regulates incorporated public interest nonprofit associations and foundations as well as for-profit incorporated associations. It does not, however, regulate nonprofit incorporated associations operating in areas unrelated to the public interest as defined by the Civil Code, although one would certainly expect that it would. The Civil Code defines public interest activities as those related to rites, religion, charity, academic activities, arts and crafts, and so on. Only those nonprofit citizens' organizations that the approving agency recognizes as engaging in public interest activities receive authorization to incorporate. This means many nonprofit organizations fall through the legal cracks and are unable to gain approval for incorporation. The fact that "the public interest" is determined solely according to the judgment of the government poses a fundamental question in the debate concerning the Civil Code.

Within the past one hundred years, the first fifty of which ended with the conclusion of World War II, no revisions were made to the Civil Code. Furthermore, no laws were established for other systems, either, aside from the Industrial Union Law (1900), which regulates the system of credit unions, sellers' unions, buyers' unions, private benefit unions, and so on, and the Trust Law (1922), which regulates the Public Interest Trust System. The Public Interest Trust System was not actually implemented until 1977. Within the second fifty-year period, various legal systems for public interest and nonprofit organizations were established under the Special Law. They include the following:

- The 1946 Religious Corporation Law
- The 1948 Consumer Life Cooperative Union Law (Consumer's Cooperative Union Law)
- The 1949 Private School Law (Educational Corporation Law)
- The 1950 Medical Law (Medical Corporation Law)
- The 1951 Social Welfare Services Law (Social Welfare Corporation Law)
- The 1984 Revision to the Construction Property Division Law (Managerial Union Corporation Law or Collective Housing Law)
- The 1991 Revision to the Regional Local Autonomy Law (Regionally Approved Registered Group Law)

Nevertheless, a hundred years have already passed since the compilation of the Civil Code. The time for amending the code to meet the conditions of our present society is long overdue.

INCORPORATION OF NONPROFIT ORGANIZATIONS

Table 6.1 compares the system for incorporating associations and foundations under the Civil Code with the system for incorporating nonprofit organizations under the Special Law. The approving agency and the procedures for establishment vary according to the type of corporation. Three different terms describe the degree of government discretion

Table 6.1. A Comparison of Japan's Incorporation Systems.

Corporate Type		***Legislative Basis, Effective Date***	***Purpose, Content, Nature (Name of Rules)***
Corporation Under the Civil Code	Association	Civil Code, Article 34 (1897)	Associations with the objectives of worship, religion, charity, education, arts and crafts, and other activities for public interest, and not for profit (Articles of Association)
	Foundation	Civil Code, Article 34 (1897)	Foundations with the objectives of worship, religion, charity, education, arts and crafts, and other activities for public interest, and not for profit (Act of Contributions)
Social Welfare Corporation		Social Welfare Business Law, (Article 22 (1951)	Corporations established under the law with the objective of social welfare business (Articles of Association)
Educational Corporation		Private School Law, Article 3 (1949)	Corporations established under the law for the purpose of establishing a private school (Act of Contributions)
Religious Corporation		Religious Corporation Law, Article 4 (1951)	Corporations having the purpose of evangelizing, conducting religious rites, and educating and nurturing believers (Rules)
Consumers' Cooperative Union		Consumers' Cooperative Union Law, Article 2 (1948)	Cultural and economic improvement and advancement in the lives of union members (Articles of Association)

Authorizing Agency	***Corporation Under the Civil Code***	
Minister of respective government agency, prefectural governor, board of education (permission)	Chartering Ministry	3,623
	Prefectural Governor/ Education	8,244
	Total	11,867
		(10-1-1991)
Minister of respective government agency, prefectural governor, board of education (permission)	Chartering Ministry	3,390
	Prefectural Governor/ Education	9,424
	Total	12,814
		(10-1-1991)
Prefectural governor, minister of health and welfare (approval)	Prefectural Governor	13,307
	Minister	116
	Total	13,426
		(including 3,068 social welfare councils)
		(10-1-1991)
Minister of education, prefectural governor (approval)	University, High Schools	879
	Elementary, Middle Schools	2,118
	Kindergartens	8,768
	Total	11,765
		(5-1-1991)
Prefectural governor, minister of education (certification)	Prefectural Governor	183,521
	Minister	373
	Total	183,894
		(12-31-1991)
Prefectural governor, minister of health and welfare (approval)	Prefectural Governor	1,210
	Minister	99
	Total	1,309
		(including 79 federations)
		(12-1992)

(*continued*)

Table 6.1. (*continued*)

Corporate Type	***Legislative Basis, Effective Date***	***Purpose, Content, Nature (Name of Rules)***
Medical Corporation	Medical Law, Article 39 (1950)	Association or foundation whose objective is to establish a hospital or clinic where doctors and dentists are regularly in attendance, or a facility for the health and welfare of the elderly (Articles of Association or Act of Contributions)
Managers' Union Corporations; Collective Housing Managers' Union Corporation	Laws Concerning the Construction of Property in Wards, etc., Articles 47 and 66 (1984)	Corporations for the management of building, sites, or attached facilities managed by all divided property owners (Rules, but not required)
Approved Community-Based Organizations	Local Autonomy Law, Article 260(2) (1991)	Organization formed by homeowners of a community in the same district as a *tow* or *aza* or a certain place in a town or village (Rules)
Public Charitable Trust	Trust Law, Article 66 (1923) (promulgated 1923; applied 1977)	Trust with the objectives of worship, religion, charity, education, arts and crafts, and other articles for public interest (Trust Contract)

Source: *National Institute for Research Advancement. Research Report on the Support Systems for Citizens' Public-Interest Activities. Tokyo: National Institute for Research Advancement, March 1994, p. 23. Used by permission.*

Authorizing Agency	***Corporation Under the Civil Code***	
Prefectural governor (approval)	Hospitals	4,377
	Minister	9,671
	Total	14,048
		(10-1-1991)
District legal affairs bureau where a corporation's main office is located (register)	Number	105
		(3-31-1992)
Mayor or town, village headperson (approval similar to notification)	Number	841
		(3-31-1992)
Minister of respective government agency, prefectural governor, board of education (permission)	Chartering Ministry	153
	Prefectural Governor/ Board of Education	280
	Total	433
		(3-31-1993)

affecting the authorization to incorporate. For associations and foundations, "authorization," or *kyoka,* is completely dependent on the judgment of the authorizing agency and is given only in special circumstances. Educational corporations and social welfare corporations fall under the category of "approval," or *ninka.* In this type of authorization, incorporation is approved automatically as long as the organization meets the proper requirements and all documentation is in order. Religious corporations receive "certification," or *ninsho.* In practical terms, this kind of authorization is identical to *ninka,* but the word *ninsho* has a different nuance that implies that in matters of religion, governmental judgment is to be avoided as much as possible.

NEED FOR A COMPREHENSIVE NONPROFIT INCORPORATION SYSTEM

Extensive nonprofit activities by private citizens began in Japan with the antipollution and environmental movements of the 1960s. Subsequently, private nonprofit activities have expanded into a broad variety of sectors, with roots in local areas and making use of unique ideas and personal efforts. These activities include welfare activities, international exchanges, cultural and educational activities, environmental protection, urban planning, and recycling. Grant-making foundations have been established to assist nonprofit activities by private citizens, and there is now an awareness of the need for a cooperative relationship between local governments and citizens' groups. Consequently, the substantial trend toward volunteer activities will have an impact on changes to the current system and tax policy toward public-interest corporations.

The many incorporation systems notwithstanding, there are numerous voluntary groups in Japan that operate without corporate status. In recent years particularly, citizens' organizations have grown and proliferated. If these groups sought incorporation, they conceivably would fall into the categories of associations or foundations under the Civil Code or social welfare corporations under the Social Welfare Services Law. They cannot qualify as incorporated entities, however, because each of these legal forms has such stiff capitalization and other requirements. Even if qualification were possible, these groups would still choose to remain unincorporated voluntary organizations, because they fear that once they are under the thumb of the authorizing agency they would lose their freedom and self-determination.

It is not necessary for this type of citizens' organization to incorporate while the scale of its activities is small. In fact, practically speaking, being unincorporated gives these voluntary groups flexibility and the freedom to organize or disband as they please. Nor are there any problems with regard to taxation. Yet, as a group's activities grow in scale and achieve continuity and the group wishes to hire staff and maintain a fixed office location, organizational growth is difficult unless the organization is incorporated. Incorporation is necessary to establish the group's identity as an organization, to interact with other organizations in such matters as concluding contracts and receiving donations, and to open a bank account in the name of the organization. It is also important to maintain the group's identity abroad as a nonprofit organization.

For these reasons, Japan needs an incorporation system different from the current one, under which qualification depends on strict requirements based on the government's definition of the public good and under which incorporated organizations must submit to government superintendence. It is imperative that the incorporation system change to one that guarantees free and wide-ranging citizens' activities, without the interference of the authorizing agencies.

The need to incorporate is not limited to citizens' organizations; various nonprofit organizations, such as academic groups, think tanks, and artists' organizations, would also benefit from incorporation. Fundamental revisions to the Civil Code are essential to realizing a comprehensive legal incorporation system for nonprofit organizations. I headed a group, composed of concerned people in the nonprofit sector, commissioned by the National Institute for Research Advancement to study the feasibility of revising the relevant laws. We recommended two proposals in a report published in May 1996, *Research on Laws and Systems for Promoting Citizens' Public-Interest Activities: Research Report on the Support System for Citizens' Public-Interest Activities (No. 2).*

RECENT EFFORTS TO CONSTRUCT A SYSTEM

The need for a new legal system for the nonprofit sector, including possible revision of the Civil Code, was recognized well before the recent proliferation of citizens' organizations. Debate on the topic has become more vigorous in the past few years, however, as the visibility of citizens' groups has increased.

The January 1995 Hanshin-Awaji earthquake instantly turned the debate on the legal system for the nonprofit sector into a concrete policy issue. In the past year and a half, the government, political parties, and citizens' groups have diligently applied themselves to this challenge.

On February 3, 1995, as directed by the Chief Cabinet Secretary, the government formed the Liaison Committee for Related Government Ministries and Agencies Regarding Volunteer Activities, which gathered representatives from eighteen government ministries and agencies to discuss the feasibility of incorporation for citizens' public interest organizations and related topics. The Economic Planning Agency acted as secretariat. The committee compiled its midterm report at the end of October, but the report was not publicly released because of opposition by members of the ruling coalition trying to put this matter on the agenda in the Diet. The report remained in limbo. Also in February 1995, the Liberal Democratic Party, the Social Democratic Party of Japan, and the New Party Sakigake established the Nonprofit Organization (NPO) Project Team. At the end of June, the team agreed on the objectives of its legislative proposal, and its Citizens' Activities Promotion Bill was drafted in December. The bill could not win approval from the individual parties; thus the team was unable to submit the bill to the ordinary session of the Diet in June 1996. Later, the agreement by the three parties was made, and the bill was submitted to the extraordinary session held in December 1996. The bill was again discussed in the ordinary session in June 1997 and passed the Lower House. The bill was sent to the Upper House and is still under deliberation.

In March 1995, the New Frontier Party established a committee called NPO Partners to draft a legislative proposal. Their proposal, called the Bill for Incorporation Qualifications for Citizens' Groups Operating in the Public Interest, was submitted to the extraordinary session of the Diet in November. The bill was tabled by the extraordinary session for further discussion in the ordinary session in 1997. The bill was finally rejected in the Lower House in June 1997.

The Communist Party announced its proposal, Guidelines for Nonprofit Corporation, in June 1996. The Communist Party's bill is ideal for citizens' organizations in that any organization can be incorporated without dealing with public administration as long as they satisfy certain prerequisites. However, it would be impossible for the proposal to be accepted soon, because it calls for fundamental changes in the current incorporation system. Therefore, the bill was rejected in the June session of the Diet.

The Democratic Party of Japan was founded in September 1996. The party did not submit its own bill and asked the three ruling parties to amend their bill, complying with requests from citizens' organizations. The Democratic Party of Japan became a joint proposer of the amendment.

On the part of citizens' groups, the Coalition for Legislation to Support Citizens' Organizations (known simply as C's), formed in November 1994, had been attempting to draft a legislative proposal reflecting the position of grassroots organizations since before the earthquake. In response to the activities of the government's Ministry and Agency Liaison Group, C's submitted a petition to the prime minister in February 1995. At the end of February, the NPO Research Forum released an urgent statement concerning revisions to the legal incorporation system, and in early March, another citizens' organization, the Committee to Study the Infrastructure for Citizen's Public Interest Activities, submitted a petition to the government, the ruling coalition, and the opposition parties. On April 15, 1995, these three groups formed a loose alliance of citizens' groups called the Liaison Committee Concerning the System for Supporting Citizens' Activities, which hosted forums around the country to facilitate the exchange of opinions.

The committee changed its name to the Liaison Committee for Citizens' Activities System and began working to resolve the basic problematic issues surrounding the revision of the legal incorporation system.

Many other types of citizens' organizations have individually wrestled with the issues. This is exemplified by the signature campaign, by demands by the Arts and Culture Promotion Liaison Committee concerning the incorporation of cultural and artistic groups, and by the recommendation on the establishment of the New Nonprofit Organization from the Japanese Bar Association.

Later, the citizens' organizations were active in pointing out problems and requesting improvements in each party's bill. Specifically, these organizations held frequent meetings with the Diet members involved with the bill since it was submitted by the ruling parties. These actions have affected the process of amendment work.

POINTS OF DEBATE ON ESTABLISHING A NEW SYSTEM

Establishment of the new legal incorporation system for nonprofit organizations should basically be handled by revising the Civil Code; however, because it will take many years to resolve all the related issues, the current thinking is to leave the Civil Code's public interest incorporation system as it is and to implement the new system pursuant to the Special Law. The key points in the debate surrounding this mechanism are what to do about the nature and content of organizations seeking incorporation, the application process for incorporation, government authority regarding superintendence after incorporation and dissolution of an organization, and the relationship between incorporation and preferential tax treatment.

On the first point, each political party takes a different position, and large differences of opinion exist concerning how to determine the spheres of activity for incorporated organizations, what degree of political activism should be allowed, and whether public interest objectives should be a requirement along with nonprofit objectives. In general, grassroots organizations are of the strong opinion that fields of activity and public interest objectives should not be criteria for judgment, that political activities should be allowed, that nonprofit objectives should be the only requirement, and that incorporation should be allowed for a wide range of organizations.

Regarding point two, both the New Progressive Party and the ruling coalition are calling for government approval at the national and local level, but it remains to be seen how their proposals differ concerning actual management of the incorporation process. Citizens' organizations strongly support a working practical rule that does not rely on government discretion.

On point three, concerning government authority after incorporation, all political parties agree that some degree of supervision and authority on the part of respective local governments should be recognized, particularly in regard to dissolution. Whether this stance is relevant and realistic is debatable, however, because the right to superintendence makes the government responsible for overseeing organizations, and the more the government exercises this right, the more strict the incorporation process will become. Such a situation would be incompatible with the preservation and development of free citizens' activities. Citizens' groups think that governmental supervision should be kept as loose as possible and that only the courts should have the power to direct a group to disband. In this sense, the activities of the citizens' groups must be transparent so the groups can be held accountable to the public.

On point four, concerning preferential tax treatment, it appears that receiving preferential tax status at the time of incorporation is most desirable, but this kind of system could result in even stricter restrictions on incorporation. Therefore, citizens' groups disagree on this issue. In my opinion, the issues of incorporation and tax status should be treated separately; once incorporated, organizations should be able to receive preferential tax treatment after meeting certain conditions.

The Citizens' Activities Promotion Bill, which was submitted by the ruling parties, was passed in the House of Representatives after incorporating requests from the citizens' organizations, and it is still under consideration in the House of Councilors at the time of this writing. When this bill is passed, the Japanese nonprofit incorporation system will enter a new age.

Editor's Note: After Yoshinori Yamaoka submitted this report, the bill he refers to was enacted into law (on March 19, 1998) as the Law to Promote Specified Nonprofit Activities. The text of that law follows, and it is analyzed in the Conclusion section of Chapter One.

APPENDIX: LAW TO PROMOTE SPECIFIED NONPROFIT ACTIVITIES

Following is an unofficial translation of the Law to Promote Specified Nonprofit Activities, translated by the Japan Center for International Exchange. The law was promulgated on March 25, 1998.

Chapter I. General Provisions

PURPOSE

ARTICLE 1. The purpose of this law is to promote the sound development of specified nonprofit activities in the form of volunteer and other activities freely performed by citizens to benefit society through such measures as the provision of corporate status to organizations that undertake specified nonprofit activities, and thereby to contribute to advancement of the public welfare.

DEFINITIONS

ARTICLE 2.

1. "Specified nonprofit activities" under this law shall mean those activities specified in the attached schedule, which are for the purpose of contributing to the advancement of the interests of many and unspecified persons.
2. "Specified nonprofit corporation" under this law shall mean an organization that has as its main purpose the implementation of specified nonprofit activities, that conforms with each of the following items, and that is a corporation established under the provisions of this law.
   i. An organization that conforms with both of the following conditions and is not for the purpose of generating profits.

   a. Provisions regarding acquisition and loss of qualifications for membership are not unreasonable.
   b. The number of officers receiving remuneration totals no more than one-third of the total number of officers.
 ii. An organization whose activities conform with each of the following items:
   a. The activities are not for the purpose of propagating religious teachings, performing ceremonies, or educating or fostering believers.
   b. The activities are not for the purpose of promoting, supporting, or opposing a political principle.
   c. The activities are not for the purpose of recommending, supporting, or opposing a candidate (including a prospective candidate) for a public office (meaning a public office as specified in Article 3 of the Public Offices Election Law [Law No. 100 of 1950]; the same shall apply hereafter), a person holding a public office, or a political party.

Chapter II. Specified Nonprofit Corporations

Section 1: Common Provisions

PRINCIPLES

ARTICLE 3.

1. A specified nonprofit corporation must not engage in operations for the interests of a specific individual or corporation or other organization.
2. A specified nonprofit corporation must not be used for a specific political party.

RESTRICTION ON USE OF NAME

ARTICLE 4. No entity other than a specified nonprofit corporation may use the words “specified nonprofit corporation” within its name or any wording that can be confused with same.

REVENUE-GENERATING OPERATIONS

ARTICLE 5.

1. A specified nonprofit corporation may engage in operations for the purpose of generating revenue (referred to hereafter as “rev-

enue-generating operations") to be used in the specified nonprofit activities thereof to the extent that said revenue-generating operations do not interfere with operations relating to specified nonprofit activities.
2. The account for revenue-generating operations must be separate from the account for operations relating to specified nonprofit activities implemented by said specified nonprofit corporation and administered as a special account.

ADDRESS

ARTICLE 6. The address of a specified nonprofit corporation shall be the location of its main office.

REGISTRATION

ARTICLE 7.

1. A specified nonprofit corporation must be registered as prescribed by cabinet order.
2. In regard to matters requiring registration as specified in the preceding paragraph, a specified nonprofit corporation cannot contest claims by third parties until after registration.

MUTATIS MUTANDIS APPLICATION OF THE CIVIL CODE

ARTICLE 8. The provisions of Articles 43 and 44 of the Civil Code (Law No. 89 of 1896) shall apply *mutatis mutandis* to specified nonprofit corporations.

COMPETENT AUTHORITY

ARTICLE 9.

1. The government agency with jurisdiction for a specified nonprofit corporation shall be the governor of the *to, do, fu,* or *ken* (prefecture or equivalent) in which the main office of the specified nonprofit corporation is located.
2. Notwithstanding the provisions of the preceding paragraph, the director general of the Economic Planning Agency shall be the government agency with jurisdiction for any specified nonprofit corporation that has offices in two (2) or more *to, do, fu,* or *ken* (prefectures or equivalent).

Section 2: Establishment

AUTHENTICATION OF ESTABLISHMENT

ARTICLE 10.

1. A person who intends to establish a specified nonprofit corporation must submit an application together with the following documents as prescribed by ordinance of the Prime Minister's Office (or ordinance of a *to, do, fu,* or *ken* [prefecture or equivalent], in the case of a specified nonprofit corporation other than a nonprofit corporation specified in Article 9.2; the same shall apply hereafter, with the exception of Article 26.3 and Article 44.2) and must obtain authentication of establishment.
   - i. Articles of incorporation
   - ii. The following documents concerning officers:
     - a. A list of officers (meaning a listing of the name and address or residence of each officer)
     - b. A letter of acceptance from each officer and a document as prescribed by ordinance of the Prime Minister's Office, attesting to the address or residence of each officer
     - c. A certified copy of an affidavit from each officer stating that he or she is not covered by Article 20 and that he or she will not violate the provisions of Article 21
     - d. A document listing the names of those officers who will receive remuneration
   - iii. A document listing the names of at least ten (10) members (which for corporate members shall mean the name of the corporation and the name of the representative), as well as their addresses or residences
   - iv. A document indicating that conformance with Article 2.2.ii and Article 12.l.iii has been verified
   - v. A prospectus
   - vi. A list of promoters (meaning a listing of the name and address or residence of each promoter)
   - vii. A certified copy of minutes attesting to a decision of intent to establish a specified nonprofit organization
   - viii. An inventory of assets at the time of establishment
   - ix. A document stating the initial fiscal year after establishment, if a fiscal year is to be established
   - x. An operating plan for the initial year and the following year after establishment (which shall mean the first fiscal year and

the following fiscal year if a fiscal year is to be established; the same shall apply to the following item)

xi. A budget statement of revenue and expenditure for the initial year and the following year after establishment.

2. If an application for authentication has been submitted as specified in the preceding paragraph, the government agency with jurisdiction must promptly publish that fact, as well as the matters specified below, and must provide the documents specified in items i, ii.a, v, x, and xi for public view at a designated location for two (2) months from the date of acceptance of the application.
   i. The date on which the application was submitted
   ii. The name of the specified nonprofit corporation related to the application, as well as the name of the representative, the location of the main office, and the purposes specified in the articles of incorporation

ARTICLES OF INCORPORATION

ARTICLE 11.

1. The articles of incorporation of a specified nonprofit corporation must specify the following:
   i. Purposes
   ii. Name
   iii. Types of specified nonprofit activities to be undertaken and types of operations related to said specified nonprofit activities
   iv. Location of the main office and any other offices
   v. Matters relating to acquisition and loss of qualifications for membership
   vi. Matters concerning officers
   vii. Matters concerning meetings
   viii. Matters concerning assets
   ix. Matters concerning accounts
   x. Matters concerning the types of and other particulars of any revenue-generating operations that are to be undertaken
   xi. Matters concerning dissolution
   xii. Matters concerning amendment of the articles of incorporation
   xiii. Method of public notice
2. The initial officers after establishment must be listed in the articles of incorporation.

3. If provision is made in the matters specified in 1.xi above for an entity to succeed to remaining assets, said entity must be a specified nonprofit corporation or another entity selected from those specified below.
   i. The national government or a local public organization
   ii. A corporation established under the provisions of Article 34 of the Civil Code
   iii. A school corporation as specified in Article 3 of the Private Schools Law (Law No. 270 of 1949)
   iv. A social welfare corporation as specified in Article 22 *of* the Social Welfare Services Law (Law No. 45 of 1951)
   v. A relief and rehabilitation corporation as specified in Article 2.6 of the Relief and Rehabilitation Enterprise Law (Law No. 86 of 1995)

CRITERIA FOR AUTHENTICATION, ETC.

ARTICLE 12.

1. The government agency with jurisdiction must authenticate establishment if it is recognized that the application for authentication specified in Article 10.1 conforms with the following:
   i. The procedures for establishment, the application, and the content of the articles of incorporation comply with laws and regulations.
   ii. The specified nonprofit corporation of said application is an organization as specified in Article 2.2.
   iii. The specified nonprofit corporation making said application is not a violent criminal organization (meaning a violent criminal organization as stipulated by Article 2.ii of the Law Concerning the Prevention of Irregularities by Gangsters [Law No. 77 of 1991]; the same shall apply hereafter) or under the control of a violent criminal organization or its members (including members of a constituent organization of a violent criminal organization).
   iv. The specified nonprofit corporation of said application has at least ten (10) members.
2. Authentication or denial pursuant to the provisions of the preceding paragraph shall be made within two (2) months from the date of expiration of the period specified in Article 10.2 unless there is just and proper reason to the contrary.

3. If the government agency with jurisdiction denies authentication pursuant to the provisions of paragraph 1, the government agency with jurisdiction must provide prompt notification in writing to the person who submitted the application, stating the reason for denial.

DATE OF ESTABLISHMENT, ETC.

ARTICLE 13.

1. A specified nonprofit corporation shall be established through registration of establishment at the location of its main office.
2. A specified nonprofit corporation that has made the registration specified in the preceding paragraph shall promptly submit to the government agency with jurisdiction written notification, together with a certified copy of registration attesting that said registration has been made.

MUTATIS MUTANDIS APPLICATION OF THE CIVIL CODE

ARTICLE 14. The provisions of Article 51.1 of the Civil Code (limited to those sections that concern the time of incorporation) shall apply *mutatis mutandis* to establishment of a specified nonprofit corporation.

Section 3: Administration

OFFICERS

ARTICLE 15. A specified nonprofit corporation shall have three (3) or more directors and one (1) or more auditors as its officers.

REPRESENTATION BY DIRECTORS

ARTICLE 16. The directors shall represent a specified nonprofit corporation in all the business thereof, with the proviso that their power of representation may be restricted by the articles of incorporation.

DETERMINATION OF BUSINESS

ARTICLE 17. The business of a specified nonprofit corporation shall be determined by majority vote of the directors, unless otherwise specified in the articles of incorporation.

ARTICLE 18. Supervisors shall perform the duties specified in each of the following items:

1. Inspect the status of business conducted by the directors.
2. Inspect the status of assets of the specified nonprofit corporation.
3. If as a result of the inspection specified in the preceding two items improper conduct or important facts indicating violation of laws, regulations, or the articles of incorporation with regard to the business or assets of the specified nonprofit corporation are discovered, report same to a general meeting or the government agency with jurisdiction.
4. If necessary to submit a report as specified in the preceding item, convene a general meeting.
5. Present opinions to the directors on the status of business conducted by the directors or the status of assets of the specified nonprofit corporation.

PROHIBITION OF DUAL FUNCTIONS BY AUDITORS

ARTICLE 19. An auditor may not concurrently be a director or staff member of the specified nonprofit corporation.

REASONS FOR DISQUALIFICATION AS AN OFFICER

ARTICLE 20. No person who is covered by any of the following may become an officer of a specified nonprofit corporation.

1. An incompetent or quasi-incompetent person
2. A bankrupt person whose rights have not been reinstated
3. A person who has been sentenced to imprisonment or a more severe penalty and for whom two (2) years have yet to pass from the date of expiration of execution of the sentence or the date on which said person became no longer subject to execution of sentence
4. A person who has been sentenced to a penal fine as a result of violation of the provisions of this law or the provisions of the Law Concerning the Prevention of Irregularities by Gangsters, excluding the provisions of Article 31.7 of said law or Article 204, Article 206, Article 208, Article 208–2, Article 222, or Article 247

of the Criminal Code (Law No. 45 of 1907) or the provisions of the Law Concerning Punishment of Violent Acts, Etc. (Law No. 60 of 1926), and for whom two (2) years have yet to pass from the date of expiration of execution of the sentence or the date on which said person became no longer subject to execution of sentence

5. A person who was an officer of a specified nonprofit corporation at the time of dissolution thereof, authentication of establishment having been revoked pursuant to the provisions of Article 43, and for whom two (2) years have yet to pass from the date on which said authentication of establishment was revoked.

LIMITATIONS ON RELATIVES, ETC., OF OFFICERS

ARTICLE 21. Officers may not include more than one (1) person who is a spouse or relative within the third degree of consanguinity of any one (1) officer, and said officer and his or her spouse and relatives within the third degree of consanguinity may not constitute more than one-third of the total number of officers.

FILLING VACANT OFFICES

ARTICLE 22. If the offices of more than one-third of the fixed number of directors or auditors fall vacant, they shall be filled promptly.

NOTIFICATION OF CHANGES CONCERNING OFFICERS

ARTICLE 23.

1. A specified nonprofit corporation must promptly notify the government agency with jurisdiction in the event of any change in the name or the address or residence of an officer.
2. When making the notification specified in the preceding paragraph when a new officer has been installed (excluding instances of reappointment simultaneously with expiration of the term of office), a specified nonprofit corporation shall submit to the government agency with jurisdiction the documents listed in Article 10.1.ii.b and c in regard to said officer.

TERMS OF OFFICE OF OFFICERS

ARTICLE 24. The articles of incorporation shall specify a term of office of not more than two (2) years for officers. However, reappointment shall not be prohibited.

AMENDMENT OF ARTICLES OF INCORPORATION

ARTICLE 25.

1. Any amendment of the articles of incorporation shall take place by resolution of a general meeting as specified in the articles of incorporation.
2. Any resolution specified in the preceding paragraph must be approved by at least three-fourths of the members present at a general meeting attended by at least one-half of the members, unless otherwise specified in the articles of incorporation.
3. No amendment of the articles of incorporation shall be effective unless approval is obtained from the government agency with jurisdiction, including amendments involving the matters specified in Article 11.1.iv (limited to those not involving a change of competent authority), as well as the matters specified in viii and xiii of the same paragraph (referred to in paragraph 6 as "amendment of the articles of incorporation regarding minor matters").
4. If a specified nonprofit corporation wishes to obtain the approval specified in the preceding paragraph, said specified nonprofit corporation must submit an application to the government agency with jurisdiction, together with a certified copy of the minutes of the general meeting at which amendment of the articles of incorporation was approved, as well as the amended articles of incorporation.
5. The provisions of Article 10.2 and Article 12 shall apply *mutatis mutandis* to the approval specified in paragraph 3.
6. A specified nonprofit corporation must notify the government agency with jurisdiction promptly in the event that it makes any amendment of the articles of incorporation regarding minor matters.

ARTICLE 26.

1. The application specified in paragraph 4 of the preceding article for approval of amendment of the articles of incorporation involving a change of government agency with jurisdiction must be submitted to the government agency with jurisdiction after the change via the government agency with jurisdiction prior to the change.

2. In the event of the preceding paragraph, in addition to the documents specified in Article 25.4, the documents specified in Article 10.1.ii.a and iv, as well as the most recent activity report, etc., as specified in Article 28.1 (which for the period from establishment through compilation of said documents shall mean the documents specified in Article 10.1.viii and for the period from a merger through compilation of said documents shall mean the inventory of assets specified in Article 35.1) must be attached to the application.
3. In the event of paragraph 1, if the government agency with jurisdiction approves amendment of the articles of incorporation, the government agency with jurisdiction shall promptly take over administrative work from the prior competent authority as prescribed by ordinance of the Prime Minister's Office.

ACCOUNTING PRINCIPLES

ARTICLE 27. Accounts for a specified nonprofit corporation must be kept as prescribed in this law as well as in accordance with the following principles:

1. Revenue and expenditure must be based on a budget.
2. Account books must be kept accurately, in keeping with the principles of formal bookkeeping.
3. The inventory of assets, balance sheet, and statement of revenue and expenditure must clearly state the truthful extent of revenue and expenditure and of finances on the basis of the account books.
4. The standards and procedures adopted for processing accounts must be followed consistently each year (or each fiscal year, if a fiscal year has been established; the same shall apply in Article 28.1 and Article 29.1) and must not be changed indiscriminately.

KEEPING OF ACTIVITY REPORT, ETC., AND VIEWING THEREOF

ARTICLE 28.

1. A specified nonprofit corporation must compile, within the first three (3) months of each year, as prescribed by ordinance of the Prime Minister's Office, an activity report, inventory of assets, balance sheet, and statement of revenue and expenditure (referred to in the following paragraph, Article 29, and Article 43.1 as

"activity report, etc.") for the previous year (or the previous fiscal year if a fiscal year has been established; the same shall apply hereafter in this paragraph); a list of officers (meaning a listing of the names and addresses or residences of all persons who were officers the previous year); a document listing the names of all persons listed in said list of officers who received remuneration the previous year; and a document listing the names of at least ten (10) members (which for corporate members shall mean the name of the corporation and the name of the representative), as well as their addresses or residences (referred to in the following paragraph, Article 29, and Article 43.1 as "list of officers, etc."), and said specified nonprofit corporation must keep these documents at its main office until the last day of the second successive year after the year in question (or the second successive fiscal year if a fiscal year has been established).

2. If a member or other interested party asks to view the activity report, etc. (which for the period from establishment through compilation of said documents shall mean the documents specified in Article 10.1.viii and for the period from a merger through compilation of said documents shall mean the inventory of assets specified in Article 35.1; the same shall apply in Article 29.2); the list of officers, etc.; or the articles of incorporation or copies of documents relating to the authentication or registration of same (referred to in Article 29 and Article 43.1 as "articles of incorporation, etc."); said specified nonprofit corporation must allow viewing thereof unless there is just and proper reason to the contrary.

SUBMISSION AND PUBLIC DISCLOSURE OF ACTIVITY REPORT, ETC.

ARTICLE 29.

1. A specified nonprofit corporation must submit its activity report, etc.; list of officers, etc.; and articles of incorporation, etc. (limited to articles of incorporation that have been amended, as well as copies of the documents relating to approval and registration of said amendment), once a year to the government agency with jurisdiction as prescribed by ordinance of the Prime Minister's Office.
2. If a request is made to view the activity report, etc.; or registry of officers, etc. (limited to those submitted within the last three

[3] years); or the articles of incorporation, etc. submitted to the government agency with jurisdiction by a specified nonprofit corporation, the government agency with jurisdiction may permit viewing thereof as prescribed by ordinance of the Prime Minister's Office.

MUTATIS MUTANDIS APPLICATION OF THE CIVIL CODE

ARTICLE 30. The provisions of Article 54 to Article 57 and Article 60 to Article 66 of the Civil Code shall apply *mutatis mutandis* to a specified nonprofit corporation. In this case, "the court . . . on the application of any person interested or of a public prosecutor" in Article 56 of the Civil Code shall be read as "the government agency with jurisdiction . . . on the application of any interested party or by the authority of his or her post."

Section 4: Dissolution and Merger

REASONS FOR DISSOLUTION

ARTICLE 31.

1. A specified nonprofit corporation shall be dissolved for any of the following reasons:
   i. Resolution of a general meeting to that effect
   ii. The occurrence of any reason for dissolution specified in the articles of incorporation
   iii. The impossibility of successful performance of operations relating to the nonprofit activities that are its objective
   iv. Absence of members
   v. Merger
   vi. Bankruptcy
   vii. Revocation of authentication of establishment in accordance with the provisions of Article 43
2. Dissolution for the reason specified in item iii of the preceding paragraph shall not take effect without the approval of the government agency with jurisdiction.
3. A specified nonprofit corporation wishing to obtain approval as specified in the preceding paragraph shall submit to the government agency with jurisdiction a document attesting to the reason specified in paragraph 1, item iii.

4. The liquidator shall, when dissolution is effected for the reasons specified in paragraph 1, item i, ii, iv, or vi, promptly notify the government agency with jurisdiction to that effect.

ASSIGNMENT OF REMAINING ASSETS

ARTICLE 32.

1. The remaining assets of a dissolved specified nonprofit corporation shall, except in the cases of merger and bankruptcy, be assigned to the entity stipulated by the articles of incorporation at the time of notifying the government agency with jurisdiction of the completion of liquidation.
2. If there is no provision in the articles of incorporation regarding assignation of remaining assets, the liquidator may, upon receipt of approval by the government agency with jurisdiction, transfer them to the national government or a local public organization.
3. Any assets that are not disposed of under the provisions of the preceding two paragraphs shall be assigned to the national treasury.

MERGER

ARTICLE 33. A specified nonprofit corporation may merge with another specified nonprofit corporation.

PROCEDURES FOR MERGER

ARTICLE 34.

1. Any merger by a specified nonprofit corporation must be approved by resolution of a general meeting.
2. The resolution specified in the preceding paragraph must be approved by at least three-fourths of the members unless otherwise specified in the articles of incorporation.
3. No merger shall be effective unless approval is obtained from the government agency with jurisdiction.
4. If a specified nonprofit corporation wishes to obtain the approval specified in the preceding paragraph, said specified nonprofit corporation must submit an application to the government agency with jurisdiction, together with a certified copy of the minutes of the general meeting at which the resolution specified in paragraph 1 was approved.

5. The provisions of Article 10 and Article 12 shall apply *mutatis mutandis* to the approval specified in paragraph 3.

ARTICLE 35.

1. A specified nonprofit corporation shall, upon approval by the government agency with jurisdiction as specified in Article 34.3, prepare an inventory of assets and a balance sheet within two (2) weeks from the date of notification of said approval.
2. A specified nonprofit corporation shall, upon approval by the government agency with jurisdiction as specified in Article 34.3, give public notice to creditors within two (2) weeks from the date of notification of said approval that they shall present objections, if any, during a fixed period and further shall give separate notice to the same effect to each known creditor, provided that said fixed period is not less than two (2) months.

ARTICLE 36.

1. If no creditor presents an objection to the merger during the period specified in Article 35.2, it shall be deemed that the merger has been consented to.
2. If any creditor presents an objection, the specified nonprofit corporation must satisfy his or her claims or furnish him or her with equivalent collateral or entrust equivalent assets to a trust company or a bank engaged in trust business for the purpose of satisfying said creditor. However, this is not necessary when there is no possibility that the merger will harm said creditor.

ARTICLE 37. When a specified nonprofit corporation is to be established by merger, preparation of the articles of incorporation and other matters relating to establishment of said specified nonprofit corporation shall be attended to by joint action of persons selected by each specified nonprofit corporation.

EFFECT OF MERGER

ARTICLE 38. A specified nonprofit corporation that continues to exist after merger or a specified nonprofit corporation established by merger shall succeed to all the rights and obligations of the specified nonprofit corporation or corporations ceasing to exist by reason of merger (including the rights and obligations possessed by said specified nonprofit corporation or corporations by virtue of permission and other dispositions granted by the administrative authorities in connection with the business thereof).

TIME OF MERGER

ARTICLE 39.

1. Merger of specified nonprofit corporations shall take effect upon completion of registration at the locality of the main office of the specified nonprofit corporation that continues to exist after merger or of the specified nonprofit corporation that is established by merger.
2. The provisions of Article 13.2 shall apply *mutatis mutandis* to the registration specified in the preceding paragraph.

MUTATIS MUTANDIS APPLICATION OF THE CIVIL CODE

ARTICLE 40. The provisions of Article 69, Article 70, Article 73 to Article 76, Article 77.2 (limited to the portion relating to reporting), and Article 78 to Article 83 of the Civil Code, as well as the provisions of Article 35.2, Article 36, Article 37.2, Article 136 to Article 137, and Article 138 of the Law of Procedure for Noncontentious Matters shall apply *mutatis mutandis* to dissolution and liquidation of a specified nonprofit corporation. In this case, "the competent authorities" in Article 77.2 and Article 83 of the Civil Code shall be read as "the government agency with jurisdiction."

Section 5: Supervision

REPORTS AND INSPECTION

ARTICLE 41.

1. If there is sufficient reason to suspect that a specified nonprofit corporation has violated laws, regulations, administrative dispositions based on laws or regulations, or the articles of incorporation, the government agency with jurisdiction may have said specified nonprofit corporation make a report concerning the status of its business or assets or have officials of the government agency with jurisdiction enter the office or offices and other facilities of said specified nonprofit corporation and inspect the status of its business or assets or its account books, documents, and other materials.

2. If the government agency with jurisdiction has the inspection specified in the preceding paragraph performed, the government agency with jurisdiction shall have its officials present a document stating the sufficient reason of said paragraph to the officers of the specified nonprofit corporation or other persons with authority to supervise the office or offices and other facilities that are subject to inspection (referred to hereafter in this paragraph as "officers, etc., of the specified nonprofit corporation") and must deliver said document if the officers, etc., of the specified nonprofit corporation demand delivery thereof.
3. Any official performing the inspection specified in paragraph 1 must carry a certificate attesting to his or her official status and must show it to those concerned.
4. The authority to inspect specified in paragraph 1 shall not be construed as the authority to conduct a criminal investigation.

ORDERS TO IMPROVE

ARTICLE 42. The government agency with jurisdiction shall order a specified nonprofit corporation to take such measures as are necessary within a fixed period if the government agency with jurisdiction deems that said specified nonprofit corporation does not meet the requirements of Article 12.1.ii, iii, or iv or otherwise violates laws, regulations, administrative dispositions based on laws or regulations, or the articles of incorporation or that its operations are materially lacking in propriety.

REVOCATION OF AUTHENTICATION OF ESTABLISHMENT

ARTICLE 43.

1. The government agency with jurisdiction may revoke its authentication of establishment of a specified nonprofit corporation if said specified nonprofit corporation violates an order specified in Article 42 and the government agency with jurisdiction cannot fulfill the objectives of supervision through other means or if a specified nonprofit corporation has not submitted an activity report, etc.; registry of officers, etc.; or articles of incorporation, etc. as specified in Article 29.1 for at least three (3) years.
2. The government agency with jurisdiction may revoke its authentication of establishment of a specified nonprofit corporation even without issuing the order specified in Article 42 if said specified nonprofit corporation violates laws or regulations and if it is clear

that improvement cannot be expected as a result of such an order and that the objectives of supervision cannot be fulfilled through other means.

3. If a specified nonprofit corporation so requests, efforts must be made to hold public hearings on the dates of hearings concerning the revocation of authentication of establishment as specified in the preceding two paragraphs.
4. If the government agency with jurisdiction does not hold public hearings on the dates of hearings when a request as specified in the preceding paragraph has been made, the government agency with jurisdiction must deliver to the specified nonprofit corporation a written statement of the reason for not holding public hearings.

Section 6: Miscellaneous Provisions

PROVISION OF INFORMATION

ARTICLE 44.

1. The director general of the Economic Planning Agency must deliver copies of documents for viewing as specified in Article 29.2 (excluding copies of documents already delivered pursuant to this paragraph) to the governor of the *to, do, fu,* or *ken* (prefecture or equivalent) in which an office of a specified nonprofit corporation specified in Article 9.2 is located.
2. A specified nonprofit corporation specified in Article 9.2 must submit copies of the documents specified in the preceding paragraph to the director general of the Economic Planning Agency as prescribed by ordinance of the Prime Minister's Office.
3. The governor of a *to, do, fu,* or *ken* (prefecture or equivalent) may permit viewing of the copies of the documents that he or she receives pursuant to paragraph 1 as prescribed by ordinance of his or her prefecture or equivalent.

REGULATIONS FOR IMPLEMENTATION

ARTICLE 45. In addition to the provisions of this chapter, the procedures for implementation thereof, as well as other particulars necessary for implementation, shall be prescribed by ordinance of the Prime Minister's Office.

Chapter III. Special Treatment Under Tax Law

ARTICLE 46.

1. A specified nonprofit corporation shall be deemed to be a public interest corporation, etc., as specified in Article 2.vi of the Corporation Tax Law (Law No. 34 of 1965) for the purposes of application of said law and other laws and regulations relating to corporation taxes. In this event, for the purposes of applying Article 37 of said law, the wording "public interest corporations, etc." in paragraph 3 of said article shall be read as "public interest corporations, etc. (excluding corporations; hereafter referred to as specified nonprofit corporations), specified in Article 2.2 of the Law to Promote Specified Nonprofit Activities (Law No. 7 of 1998)," and the wording "public interest corporations, etc." in paragraph 4 of said article shall be read as "public interest corporations, etc. (excluding specified nonprofit corporations)"; for the purposes of applying Article 66 of said law, the wording "ordinary corporations" in paragraphs 1 and 2 of said article shall be read as "ordinary corporations (including specified nonprofit corporations)," and the wording "public interest corporations, etc." in paragraph 3 of said article shall be read as "public interest corporations, etc. (excluding specified nonprofit corporations)"; and for the purposes of applying Article 68–6 of the Special Taxation Measures Law (Law No. 26 of 1957), the wording "those corporations deemed" in said article shall be read as "those corporations deemed (which for corporations specified in Article 2.2 of the Law to Promote Specified Nonprofit Activities [Law No. 7 of 1998] shall be limited to corporations designated by cabinet order as small-scale corporations)."
2. For the purposes of applying the Consumption Tax Law (Law No. 108 of 1988) and other laws and regulations concerning the consumption tax, a specified nonprofit corporation shall be deemed to be a corporation as specified in Schedule 3 of the Consumption Tax Law.
3. For the purposes of applying the Land Value Tax Law (Law No. 69 of 1991) and other laws and regulations concerning the land value tax (excluding the provisions of Article 33 of said law), a specified nonprofit corporation shall be deemed to be a public interest corporation, etc., as specified in Article 2.vi of the

Land Value Tax Law, with the proviso that for the purposes of applying the provisions of laws or regulations concerning exemption from land value tax pursuant to Article 6 of said law, a specified nonprofit corporation shall be deemed to be an organization, etc., without juridical personality as specified in Article 2.vii of said law.

Chapter IV. Penal Provisions

ARTICLE 47. A person who violates an order specified in Article 42 shall be liable to a fine not exceeding 500,000 yen.

ARTICLE 48. If a representative or proxy or an employee or other worker of a specific nonprofit corporation commits any violation specified in the preceding article in connection with the business of said specified nonprofit corporation, the specified nonprofit corporation as well as the offender shall be liable to the penalty prescribed in said article.

ARTICLE 49. Directors, auditors, or the liquidator of a specified nonprofit corporation shall be liable to a nonpenal fine not exceeding 200,000 yen in any of the following cases:

1. Registration as specified in the provisions of the cabinet order specified in Article 7.1 has been neglected.
2. Preparation of an inventory of assets as specified in the provisions of paragraph 1 of Article 51 of the Civil Code, applicable *mutatis mutandis* to Article 14, has been neglected, or matters required to be included in said inventory have not been included, or untrue entries have been made.
3. Notification has not been given, in violation of the provisions of Article 23.1 or Article 25.6, or false notification has been given.
4. The keeping of the documents specified in the provisions of Article 28.1 has been neglected, or matters required to be included in said documents have not been included, or untrue entries have been made.
5. Submission of the documents specified in Article 29.1 has been neglected.
6. Preparation of the documents specified in Article 35.1 has been neglected, or matters required to be included in said documents have not been included, or untrue entries have been made.

7. The provisions of Article 35.2 or Article 36.2 have been violated.
8. Application for adjudication of bankruptcy as specified in Article 70.2 or Article 81.1 of the Civil Code, applicable *mutatis mutandis* to Article 40, has been neglected.
9. Public notice as specified in Article 79.1 or Article 81.1 of the Civil Code, applicable *mutatis mutandis* to Article 40, has been neglected, or untrue public notice has been given.

ARTICLE 50. A person who violates the provisions of Article 4 shall be liable to a nonpenal fine not exceeding 100,000 yen.

Supplementary Provisions

ENFORCEMENT DATE

1. This law shall be in force and effect from the date prescribed by cabinet order within one (1) year from the date of promulgation.

EVALUATION

2. The specified nonprofit corporation system shall be evaluated within three (3) years from the date of enforcement of this law, and such measures as are necessary shall be taken pursuant to the results of this evaluation.

TRANSITIONAL MEASURES

3. The wording "within two (2) months" in Article 12.2 shall be read as "within ten (10) months from the enforcement of this law" for the purposes of applying the provisions of said article to applications for authentication as specified in Article 10.1 that are made within six (6) months from the date of enforcement of this law.

AMENDMENT OF THE LOCAL TAX LAW

4. The Local Tax Law (Law No. 226 of 1950) shall be amended as follows:
   i. The wording "community organizations, as well as" in Article 24.5 shall be amended to read "community organizations,"

and after "political organizations," the words "as well as corporations specified in Article 2.2 of the Law to Promote Specified Nonprofit Activities (Law No. 7 of 1998)" shall be added.

ii. The wording "community organizations, as well as" in Article 53.2.iii shall be amended to read "community organizations," and after "political organizations" the words "as well as corporations specified in Article 2.2 of the Law to Promote Specified Nonprofit Activities" shall be added.

iii. After "public interest corporations, etc." in Article 53.12, the words "(including corporations specified in Article 2.2 of the Law to Promote Specified Nonprofit Activities)" shall be added.

iv. The following item shall be added to Article 72–5.1: "xii. corporations specified in Article 2.2 of the Law to Promote Specified Nonprofit Activities."

v. The wording "community organizations, as well as" in Article 294.7, Article 312.3.iii, and Article 701–34.2 shall be amended to read "community organizations," and after "political organizations," the words "as well as corporations specified in Article 2.2 of the Law to Promote Specified Nonprofit Activities" shall be added.

AMENDMENT OF THE LAW ESTABLISHING THE ECONOMIC PLANNING AGENCY

5. The Law Establishing the Economic Planning Agency (Law No. 263 of 1952) shall be amended as follows:

    i. The following item shall be added after Article 4.x: "x-ii. handling administrative work concerning implementation of the Law to Promote Specified Nonprofit Activities (Law No. 7 of 1998), excluding work delegated to a *to, do, fu,* or *ken* (prefecture or equivalent)."

    ii. The following item shall be added after Article 5.vi: "vi-ii. authority as the government agency with jurisdiction pursuant to the Law to Promote Specified Nonprofit Activities (Law No. 7 of 1998), as well as assistance to the Prime Minister in compiling, amending, and revoking ordinances of the Prime Minister's Office pursuant to delegation under said law."

Attached Schedule (Article 2)

1. Promotion of health, medical treatment, or welfare
2. Promotion of social education
3. Promotion of community development
4. Promotion of culture, the arts, or sports
5. Conservation of the environment
6. Disaster relief
7. Promotion of community safety
8. Protection of human rights or promotion of peace
9. International cooperation
10. Promotion of a society with equal gender participation
11. Sound nurturing of youth
12. Administration of organizations that engage in the above activities or provision of liaison, advice, or assistance in connection with the above activities

Supplementary Resolution Concerning Law to Promote Specified Nonprofit Activities

(Adopted by the House of Representatives Cabinet Committee on March 17, 1998)

In order to contribute to the sound development of specified nonprofit activities, it is resolved that the necessary measures be taken regarding the following items:

1. In connection with the enforcement of this law, mindful of the freedom of religion, association, and expression stipulated by the Constitution of Japan, efforts shall be made to ensure that the independence of specified nonprofit corporations is fully respected and to strive for a fair and transparent administration in light of the purpose of the law and the deliberations at the Diet.
2. Specified nonprofit corporations, including the taxation system for the promotion and support for specified nonprofit activities, shall be reviewed and conclusions arrived at, on the basis of the actual status of activities thereof, within two years from the date of enforcement of this law.

3. Comprehensive review of the systems of nonprofit corporations, including the system of public interest legal persons established under the provisions of Article 34 of the Civil Code, shall be conducted in future.
4. For the twelve (12) items on the attached schedule, efforts shall be made to manage the items so as to include a wide array of specified nonprofit activities.
5. In connection with reorganization of central ministries and agencies, due consideration shall be given to establishing a responsible system for jurisdiction and implementation of this law from a new perspective.

7

KOREA

Ku-Hyun Jung
Tae-Kyu Park
Chang-Soon Hwang

THE LAWS AND REGULATIONS governing nonprofit organizations (NPOs) greatly affect the contours and practices of nonprofit activities and philanthropy in every country. The extent of nonprofit activities in a particular country may also be influenced by the culture of giving and receiving, the religious tradition, and the economic situation. However, the nonprofit laws are among the most important factors in determining the size and degree of nonprofit activities in many countries (Salamon and Flaherty, 1996).

This chapter presents the legal and regulatory context of NPOs in Korea. First, we briefly review the general legal system of Korea. We then describe and analyze the legal systems and regulatory environments that are related to NPOs, particularly focusing on the Act Concerning Incorporation and Operation of a Nonprofit Corporation. After introducing the legal system of Korea, we sketch a general picture of NPOs in Korea. In the main portion of the chapter, we systematically analyze seven major issues related to Korean nongovernmental organizations (NGOs) and recommend revisions to Korea's nonprofit laws and regulations. This chapter is ultimately intended to contribute to the creation of a favorable environment in Korea for philanthropy in general and to facilitate the formation and operation of grant-making foundations in particular.

LEGAL SYSTEM IN KOREA

To understand the legal environment of Korean NPOs, it may be helpful to review the general picture of Korea's legal system. Although traditional Korean law was modeled after Chinese law, modern Korean legal systems evolved from the system in Japan at the beginning of the century. Of course, an indigenous Korean legal culture has shaped the current legal practice in one way or another as well. Although Chinese legal institutions and Japanese law (essentially German and French in origin) have influenced the Korean legal system, more recently, common law elements from American law have been consistently incorporated in a series of legal changes and revisions. The American legal influence is probably greatest in the Commercial Code.

Basically, Korea adheres to the civil law tradition; however, the common law tradition has been gradually implanted into various areas of the Korean legal system. One of the principal features of the Korean legal system is its emphasis on codified law. A set of five legal codes (the Civil Code, the Criminal Code, the Commercial Code, the Code of Civil Procedure, and the Code of Criminal Procedure), plus the Constitution, are collectively known as the Yukbop (literally, "the six codes"). Laws enacted and promulgated by state authorities pursuant to the Constitution are recognized as the primary source of law and are permeated by the concept that the mission of law is fulfilled best by reliance on enacted law. A variety of terms are used to designate Korean laws, usually denoting the issuing authorities.

Laws may be divided into four main categories: statutes passed by the legislature; decrees issued by the President of the Republic, the cabinet, and various ministries; rules and regulations instituted by other state agencies and local governments; and international agreements. The Civil Code prescribes that in the absence of statutes, customary law is to be relied on, and if the latter is lacking, sound reasoning is to serve as the basis for deciding civil cases.

LAWS RELATED TO NONPROFITS

The Constitution

The body of law most broadly related to NPOs can be found in the Constitution. The constitutional right to freely associate and assemble is guaranteed in Article 21 of the Constitution of the Republic of Korea.

The right to establish and maintain NPOs is also similarly guaranteed, as a part of the rights and duties of citizens under the Constitution. Article 21 of the Constitution provides that

1. All citizens shall enjoy freedom of speech and the press and freedom of assembly and association.
2. Licensing or censorship of speech and the press and licensing of assembly and association shall not be recognized.

However, the Constitution permits some limitations on those freedoms if necessary for national security, the maintenance of law and order, or the public welfare. Article 37 of the Constitution provides that

1. Freedoms and rights of citizens shall not be neglected on the grounds that they are not enumerated in the constitution.
2. The freedoms and rights of citizens may be restricted by law only when necessary for national security, the maintenance of law and social order, or for the public welfare. Even when such restriction is imposed, no essential aspect of the freedom or right shall be violated.

The Civil Code

Basic rules for the formation of legal persons are provided in Article 31 of the Civil Code. Article 31 provides that "no legal person can come into existence other than in accordance with the provisions of the laws."

Specifically, the formation of NPOs is governed by Article 32 of the Civil Code: "An association or foundation relating to science, religion, charity, art, or social intercourse or otherwise relating to enterprises not engaged for profit or gain may be made a legal person subject to the permission of the relevant ministries."

Article 33 of the Civil Code also establishes the importance of registration: "A judicial person shall come into existence by making registration for formation at the location of the principal office of the legal person."

Article 39 of the Civil Code states the conditions for cancellation of permission for the formation of a legal person: "In case a legal person operates such business outside the scope of its creative purpose, violates conditions attached to the permission for its formation, or engages in acts harming public interests, the relevant ministries may cancel the permission."

The Act Concerning Incorporation and Operation of a Nonprofit Corporation

In the early 1970s, a special law was enacted to supplement the provisions of the Civil Code regarding the incorporation and operation of a public benefit corporation. The purpose of this special law, the Act Concerning Incorporation and Operation of a Nonprofit Corporation (hereafter "the Nonprofit Act" or simply "the Act"), is to enable a legal entity to maintain its public and charitable purposes and carry out its activities by supplementing the provisions of the Civil Code relating to incorporation and operation of a public benefit corporation. Even though there have previously been many tax-related laws affecting the incorporation and operation of a nonprofit corporation, it is this Act that directly affects incorporation and operation of a nonprofit corporation in terms of their legal status.

The Decree Supplementing the Nonprofit Act

In addition to the Nonprofit Act, there are other acts, mostly tax related, that are directly or indirectly related to foundations and associations. Each act is accompanied by a decree that interprets the act. In legal practice, the decrees have the same legal authority as the acts. The Nonprofit Act also has a decree that supplements and interprets it. Strictly speaking, the National Assembly, the Korean legislative body, establishes the law. To implement an act, however, the government needs some additional rules and regulations that the act does not provide in detail. Even though the decree is subordinate to the act, it usually has the same legal effect and authority, in practice. The decree supplementing the Nonprofit Act provides detailed information about the incorporation and operation of nonprofit corporations.

The Rules and Regulations of Each Ministry

Most ministries that approve the formation of nonprofit corporations have internal rules and regulations governing the creation and operation of such entities. However, these rules do not have as much legal authority and effect as the acts and decrees; they simply function as guidelines for the administrative procedure.

DEFINITIONS AND CLASSIFICATIONS OF NPOS

Different Types of NPOs in Korea

Under the old Civil Code, corporations were not designated for-profit or nonprofit entities. This made it impossible for nonprofit and nongovernmental organizations to gain legal status. In the newly revised Civil Code, corporations are differentiated by for-profit or nonprofit status. Nonprofit corporations are further classified into two categories: public benefit NPOs and NPOs not oriented toward providing a public benefit.

Furthermore, nonprofit corporations may be either incorporated foundations or incorporated associations, depending on the basis of their establishment. A foundation's basis lies in property, and an association is based on membership.

Although most incorporated foundations belong to the public benefit category, incorporated associations can belong to either category of nonprofit corporations. The areas in which the public benefit nonprofit foundations are most active include the environment, human rights and civil freedom, children and youth, and human social services. Among these categories, the main public benefit areas are scholarships or educational funds, support or payment of research expenses, science, and charity. Table 7.1 shows the place of NPOs among various kinds of legal persons. In a narrow sense, the organizations to which the nonprofit laws and regulations are best applied are the public benefit nonprofit foundations, which in our legal tradition are called *Gongick Jaedan,* or "public benefit corporations."

Table 7.1. Number of For-Profit and Nonprofit Corporations Since 1990.

Types	*1990*	*1991*	*1992*	*1993*	*1994*
For-Profit	67,320	80,837	92,200	101,933	114,363
	(87.8 %)	(89.3 %)	(90.3 %)	(90.8 %)	(91.2 %)
Nonprofit	9,318	9,716	9,936	10,329	11,050
	(12.2 %)	(10.7 %)	(9.7 %)	(9.2 %)	(8.8 %)
Total	76,638	90,553	102,136	112,262	125,413

Source: *Kim, 1996. Used by permission.*

Statistical Data on Korean NPOs

Table 7.1 shows the number of for-profit and nonprofit organizations in Korea from 1990 to 1994, based on registration. The number of NPOs has gradually increased from 9,318 to 11,050, whereas for-profit corporations have increased more rapidly. Among NPOs, public benefit organizations total 3,920, accounting for 39.5 percent of all registered NPOs in 1990. By 1995, the number of public benefit organizations had increased to 4,463, representing a 13.9 percent increase over three years. However, the financial status of NPOs is very weak. More than half of all NPOs have basic assets of less than U.S.$600,000. This indicates the fragility of the financial basis of registered nonprofit corporations in Korea.

Table 7.2 shows the number of nonprofit corporations that each ministry has registered. The Ministries of Education and Health and Social Welfare register more corporations than any other ministries. The Ministry of Culture and Sports, which handles religious organizations and youth organizations, ranked third in terms of number of registered organizations.

Table 7.3 shows the functional areas in which each incorporated organization operates. The three dominant types of nonprofit corporations are schools, research and scholarship support organizations, and social welfare organizations. Religious organizations, groups that support art and culture, and medical corporations are three other popular types of nonprofit corporation.

Table 7.2. Number and Percentage of NPOs Registered by Various Ministries.

Ministry	*Number of NPOs Registered*	*Percentage of NPOs Registered*
Agriculture and Fishery	108	2.1 percent
Environment	172	3.5 percent
Health and Welfare	1,799	36.3 percent
Commerce	312	6.3 percent
Culture and Sports	861	17.4 percent
Education	1,073	21.7 percent
Others	631	12.7 percent
Total	4,950	100 percent

Source: *Son, 1995. Used by permission.*

Table 7.3. Functional Areas of NPOs.

	1992	(percent)	1995	(percent)
Total	3,920	(100.0)	4,463	(100.0)
School Research and Social Religious	1,078	(27.5)	1,091	(24.4)
Art and Medical	919	(23.5)	1,194	(26.8)
All	721	(18.4)	892	(20.0)
Scholarship	267	(6.7)	278	(6.2)
Welfare	250	(6.4)	252	(5.6)
Culture	170	(4.3)	229	(5.1)
Others	515	(13.2)	527	(11.8)

Source: *Kim, 1996. Used by permission.*

ESTABLISHMENT AND REGISTRATION

Description

In our legal system, formal registration is necessary for NPOs to function in society and particularly for them to enjoy the rights of a legal person. The Civil Code in general, and the Nonprofit Act and accompanying Decree in particular, provide the specific procedures and requirements for formal establishment of a nonprofit corporation as a legal entity. The Nonprofit Act was promulgated on December 31, 1975, and entered into force on January 3, 1976, to maintain the public good by supplementing the provisions of the Civil Code concerning the incorporation and operation of a legal person.

Article 4 of the Act states the standard of permission for incorporation of a nonprofit corporation:

1. When an entity applies for permission to incorporate a nonprofit corporation pursuant to Article 32 of the Civil Code, the relevant ministry shall investigate related facts and permit the incorporation of the nonprofit corporation only if the nonprofit corporation may achieve its purpose with revenues derived from property if it is an incorporated foundation or with financial resources derived from dues, donations, and so on if it is an incorporated association (hereafter referred to as “basic assets”).
2. The relevant ministry, which permits the incorporation of the nonprofit corporation, may append matters relating to collection

of dues, beneficiaries, and other necessary conditions in accordance with the Presidential Decree.

3. In the event that the nonprofit corporation intends to run a business for profit to achieve its purpose, it shall obtain the approval of the relevant ministry for every business pursuant to the Articles of Incorporation.

Registration is limited to organizations that aim to promote scholarship or educational funds; pay research expenses, in part of in full; support art or science; or provide charity as an incorporated foundation or an incorporated association.

The laws and procedures for registration are very similar for foundations and associations, except for minor differences. The key difference is that an endowment is necessary for registration of a foundation, while dues or donations are necessary for registration of an incorporated association.

Any government ministry is a potential registration office. The selection of the appropriate ministry depends on the characteristics of the organization and the purpose the organization wants to pursue.

NPOs may also be formed as unincorporated associations. This type of organization is essentially a group of people bound together for common purposes or interests. Because this type of organization is not legally established, it usually cannot enjoy the general rights, benefits, and protections of legal persons.

The number of unregistered NPOs is unknown; we can estimate it, however, by comparing recent survey data on Korean NGOs with the figures in Table 7.1. Recent survey data estimate the number of all NPOs, including both registered and unregistered, at about 60,000. The total of 11,050 registered nonprofit corporations shown in Table 7.1 thus accounts for about 18 percent of all NPOs in Korea. Why so many NPOs, more than 80 percent, have not registered is not known. Presumably, the absence of any practical benefit from registration is a factor. However, this issue should be clarified in future research.

Anyone who wants to establish a corporation and receive a formal corporate charter must submit an application form, with the following documents and information, to the relevant ministry:

1. A document listing the names, addresses, and occupations of the founders. If any are legal persons, this must include their official name, place of principal office, address, Articles of Incorporation, and recent activities.

2. A statement of the organization's purposes.
3. A copy of the Articles of Incorporation.
4. Incorporated foundations must attach a list of assets detailing the kind and amount of assets and demonstrating the foundation's legal right to endowed property and donations. Incorporated associations must attach a list of expected financial resources from dues, or a certificate of donation.
5. Certificate of registrar offices or banks that shows real estate, money in savings account, and stocks.
6. A document stating the date when activities began, and a general plan of activities.
7. In the case of incorporated associations, minutes of the first general assembly meeting and a list of participating members, including their names and addresses.

The relevant ministry will permit accreditation of the nonprofit corporation if the corporation, on the basis of the submitted documents, satisfies the following requirements:

1. The purposes and activities of the nonprofit corporation are fairly specific and reasonable.
2. The nonprofit corporation seems able to achieve its purposes with revenue derived from property (in the case of incorporated foundations) or dues, donations, and so on (in the case of incorporated associations).
3. Its purposes and activities do not harm public interests.

There are limits on the time that the registration process may take. The relevant ministry must review the application and inform the applicant of its final decision, permission or rejection, within twenty days, unless there are special circumstances. The ministry may also make permission subject to certain conditions.

Registration and Tax-Exempt Status

Korean laws and regulations on NPOs are different from those of some other countries in that registration and tax-exempt status are achieved simultaneously. When a relevant ministry permits the registration of an NPO, it automatically becomes entitled to tax-exempt status. The nonprofit corporation simply informs the Internal Revenue Service of its registered status.

Analysis and Recommendations

A complaint that has consistently been raised since the promulgation of the Nonprofit Act concerns the application of the principle of permission in establishing public benefit nonprofit corporations. At least two specific problems are caused by this principle.

First, there is no way to regulate the discretion of the government agencies in deciding whether to permit an organization to become a legal person. Additionally, there are inconsistencies and discrepancies among different government ministries in their granting of permission. This is because each government agency may have different criteria for approval, even though the Civil Code provides general principles and requirements. For example, whereas some agencies focus on the financial aspects of the organization, others emphasize the public benefit nature of the organization's objectives.

Second, the amount of basic assets required is not specified, so it is very likely that financially fragile foundations and associations will receive approval. The simple guideline that the basic assets should be sufficient to achieve the corporation's purposes is not clear enough in practice, even though some government agencies have guidelines on the amount of basic assets required.

PURPOSES AND ACTIVITIES

Description

As noted previously, Article 2 of the Nonprofit Act describes the required purposes and activities of various types of NPOs: support or payment of education expenses, provision of scholarship or research funds, support of science, and charity to benefit the public interest. The nonprofit corporation must focus its activities on one or more of these activities.

If nonprofit corporations want to change their purpose (or one of their purposes, if they have multiple objectives), they must obtain the permission of the relevant ministry by requesting approval for a change in their Articles of Incorporation. The source of this rule is Articles 42–2, 45–3, and 46 of the Civil Code, which describe the general regulations on legal persons. When nonprofit corporations want to engage in profit-oriented activities, the purpose of those activities should be to support public benefit objectives. Whether nonprofit corporations can engage in profit-oriented activities depends on whether they gain the approval of the relevant ministry. Paragraph 3 of Article 4 of the Nonprofit Act provides that: "In the event that the nonprofit corporation intends to run a business for profit in order to achieve its purpose, it shall obtain the approval of the relevant ministry for every business pursuant to the Articles of Incorporation."

Analysis and Recommendation

The Nonprofit Act's provision regarding purposes and activities of nonprofit corporations is simple and straightforward. Regulation of required activities is very strict in the sense that every foundation and association must focus only on its declared activities. Even though they may pursue profitable activities, the ultimate goal of such activities must be the advancement of the declared objectives.

The most important theme in this portion of the Act is the regulation of the profit-oriented activities of NPOs. Currently, if a nonprofit corporation pursues profitable activities, it is subject to the same corporate tax rate as for-profit corporations. The rationale for this practice is to maintain fair competition between the nonprofit and market sectors. Some tax specialists in Korea argue that it is not necessary for nonprofit corporations to pay the same tax rate as for-profit corporations. They say that the corporate tax rate for the business activities of nonprofit corporations should be lowered. Instead, more strict monitoring of the use of income from profit-oriented activities is necessary to check whether such income is spent on public benefit objectives.

TAX EXEMPTIONS

Corporation Tax

Korean law gives preferential treatment to nonprofit corporations under the Corporation Tax Law, the Value-Added Tax Law, and local tax laws. Among these, the corporation tax has been the most important, providing tax incentives for nonprofit corporations with profit-seeking businesses. Under the Corporation Tax Law, all domestic corporations with headquarters in Korea are subject to the corporation tax. The law imposes a corporate tax rate of 16 percent on taxable income of 100 million won or less, and 28 percent on taxable income in excess of 100 million won on the following sources of income:

> Business income—that is, income from agriculture, hunting and forestry, fisheries, mining, manufacturing, and so on—accruing in each business year
>
> Interest as defined by Article 16, Section 1 of the Income Tax Law
>
> Dividends as defined by Article 17, Section 1 of the Income Tax Law
>
> Capital gains from transactions involving stock shares
>
> Revenue from selling real estate
>
> Other income from continuing profit-seeking businesses

Korean tax law provides a generous exception to these rules, however. The Corporation Tax Law stipulates that as long as they are set aside as a reserve for the public benefit activities stipulated by the Articles of the NPO and used for those purposes within five years from the last day of the business year in which the income accrued, the following items may be claimed as deductions in calculating the nonprofit corporation's tax base:

1. Interest prescribed by Article 16, Section 1 of the Income Tax Law
2. Dividends from most stock
3. Interest from loans that have been made to members in accordance with special law such as the Nonprofit Act, Private School Law, or Social Welfare Activity Law.
4. Up to 50 percent of business income stipulated by Article 1 of the Corporation Tax Law.

But according to Article 61, Section 3 of the Tax Exemption and Reduction Law, educational corporations established under the Private School Law, social welfare corporations established under the Social Welfare Activity Law, and arts and cultural organizations stipulated by the Presidential Decree may include all business income as losses when it is set aside as a reserve for the public benefit activities stipulated by the Articles of the nonprofit corporation concerned.

According to the Corporation Tax Law, salaries and wages directly related to the public benefit activities stipulated in the Articles of Incorporation are treated as necessary expenses for pursuance of nonprofit activities. But according to the current Corporation Tax Law, salaries and wages, even though they are incurred in pursuing the nonprofit activities stipulated by the articles, are not treated as necessary expenses of the stipulated activities.

Any remaining reserves that are not used for the designated purposes after five years from the last day of the business year in which the income accrued are included as gains in calculating the taxable income for the fifth year following that business year. Nonprofit corporations are subject to the same tax rate as ordinary profit-seeking corporations: 16 percent on the first one hundred million won of taxable income, and 28 percent on the excess.

A nonprofit corporation must keep separate accounts of income from profit-seeking and nonprofit activities for the purpose of calculating taxable income. Under Article 26 of the Corporation Tax Law, nonprofit corporations as well as profit-seeking corporations must file a report on their taxable income and tax liability, including an income statement, a balance sheet, and a detailed statement on reserves set aside for public benefit purposes, to the district tax office within fifteen days from the last day of the business year, or thirty days if attaching a taxation adjustment statement prepared by a certified public accountant or tax accountant. According to the 1996 tax reform legislation, an external audit of the management practices of nonprofit corporations is also required. The main purpose of this audit is to determine whether or not the financial management of a nonprofit corporation has been appropriate and to prepare a report on that management for the head of the regional tax office.

According to Article 1 of the Corporation Tax Law, nonprofit corporations include two categories of domestic corporations:

1. Corporations established under Article 32 of the Civil Law and Article 10 of the Private School Law
2. Corporations established under other special laws to pursue purposes stipulated by Article 32 of the Civil Law or similar purposes, such as academic, religious, social welfare, technical, artistic, and other nonprofit activities.

Nonprofits pay corporate tax only on income from profit-seeking business activities. A nonprofit corporation without a profit-seeking business is not necessarily required to file a report on interest. In this case, taxes on the unreported interest income are withheld at the source and are not included in the nonprofit corporation's tax return for that business year. Later, the tax paid on interest is returned after a tax return has been filed by the nonprofit corporation.

Tax-Exempt Status

With approval of the relevant ministry, a nonprofit corporation is automatically eligible for preferential tax treatment, as explained previously. But when a nonprofit corporation starts a profit-seeking business, the following two conditions must be satisfied:

1. A nonprofit corporation conducting a for-profit business shall file a report, within sixty days of the beginning day of operation of that business, providing the following details: name of the corporation, address of its headquarters, name of the person representing the corporation and the person responsible for management, the approved purposes of the nonprofit corporation, the type of profit-seeking business, the date the business will begin operations, and the place of business.
2. Any nonprofit corporation engaging in a profit-seeking business shall keep account books by a double-entry bookkeeping method.

The report must be filed with the district tax office. Usually it is processed without any additional examination, delay, or charge. The registering ministry conducts a thorough examination during the approval process, and the tax authority usually recognizes the corporation's special tax position.

When a nonprofit corporation is established, the relevant ministry determines whether it is operating properly, consistent with its stated purposes. If it is not, the ministry can order dissolution of the nonprofit corporation, in which case it loses its special tax status automatically. The tax authority does not determine whether a nonprofit corporation is operating properly or whether it can maintain its tax status; the relevant ministry has complete responsibility for all matters related to nonprofit corporations, from incorporation to dissolution.

Under the Corporation Tax Law, passive investment income, such as interest, rents, and royalties (excluding royalties from publications), is considered gain and is included in the income base for figuring corporate tax. But these items are deductible as losses as long as they are used for the required purposes or for contributions stipulated by the Corporation Tax Law within five years from the year in which the income was received.

Under current law, all interest and dividend income of NPOs is subject to corporate tax. Most NPOs may deduct 50 percent of their interest income from their taxable income as long as it is reserved for the approved nonprofit activity. By contrast, dividend income may not be deducted. Hence, interest and dividend income are treated differently under the current corporate tax law. This demonstrates the policy goal of preventing nonprofit corporations from being used as holding companies.

All remaining reserves that are not used for the designated purposes within the required period of time are included as gains in calculating the organization's taxable income for the fifth year following the business year in which the income was received.

The following revenues are not included in taxable income:

1. Membership fees
2. Royalties from publications
3. Compensation for an estate requisitioned by the local or central government
4. Foreign aid or assistance from a charitable public aid fund

Capital gains from real estate sales are included in the ordinary taxable income for the corporate tax, and an additional tax on such income is specially assessed and added to the amount of ordinary corporate tax. Consequently, capital gains of a corporation are subject to double taxation. However, the additional tax on capital gains is not assessed on the nonprofit corporations stipulated by the Tax Exemption and Reduction Control Law or on private schools established under the Private School Law, and social welfare organizations established under the Social Welfare Activity Law and religious organizations established under the Civil Law or the relevant associated special law are exempt from the tax as long as the real estate has been used for more than three years for the required purposes and the capital gains are used for the required purposes.

According to the Basic Law of National Taxes, an association or foundation that is not incorporated is deemed to be a nonprofit corporation for the purpose of the corporate tax. As part of the 1994 tax reform legislation, the government expanded the scope of organizations deemed nonprofit corporations, to provide tax incentives to a broader area.

When an unincorporated nonprofit association or foundation starts a profit-seeking business, it can apply to a district tax office to obtain the same preferential status as an incorporated NPO, as long as the following conditions are satisfied:

1. The association or foundation must have written Articles of organization and operation and have a representative or manager.
2. It must own assets and gains that are kept and managed in its own accounts.
3. It cannot distribute gains to its members.

Table 7.4 summarizes the different tax exemptions provided to nonprofit corporations and unincorporated associations under the Corporation Tax Law and the Tax Exemption and Reduction Control Law.

Analysis

The tax laws of Korea contain incentives to encourage activities by NPOs, whether incorporated or not, that satisfy certain conditions. Usually the district tax office approves the special tax status of an unincorporated NPO without any delay or charge, and the NPO's special tax status is retained until it is dissolved.

In practice, nonprofit corporations are subject to the supervision of the tax authority with respect to tax payment and exemptions on business income. Nonprofit corporations are also supervised by the ministry to ensure that their activities and expenditures serve their approved purposes. Because of this dual supervision system and a lack of administrative staff, the tax authority has not generally conducted strict audits of nonprofit corporations. As a result, nonprofit corporations are not likely to file accurate tax returns. The system is vulnerable to abuse. Moreover, nonprofit corporations that do not operate a profit-seeking business are totally beyond the tax authority's control, as they are not required to file a report to a district tax office. Unincorporated NPOs are also not under the control of the district tax office, due to a lack of administrative manpower and incentives.

All information concerning tax exemptions is widely available to the public, free of charge. But few nonprofit corporations have experienced staff members who are familiar with the information and know the tax exemption procedures. In Korea, there is no active association of nonprofit organizations that provides member organization with tax assistance or advice.

Table 7.4. Comparison of the Corporation Tax Law and the Tax Exemption and Reduction Control Law.

Type of Corporation	***Type of Income***	***Included in Tax Base***	***Conditions for Favorable Treatment Under the Corporation Law***	***Conditions for Favorable Treatment Under the Tax Exemption and Reduction Control Law***
Nonprofit corporation	Interest and business income	Yes	50 percent deductible as losses if used for required purposes within five years	For nonprofit corporations stipulated by Article 61, section 2 of the law, 100 percent deductible as losses if used for required purposes within 5 years
Nonprofit corporation	Capital gains from real estate	Yes (taxed twice)		Nonprofit corporations stipulated in Articles 73 and 74 are exempt from the additional tax if the real estate is used for more than three years for the required purposes and the capital gains are used for the required purposes.
Unincorporated association	All income	Yes	Receives same treatment as nonprofit corporation if the conditions of the Basic Rule of the Corporation Law, Article 1–1-8, are met.	
Educational and welfare organizations	Business income	Yes	100 percent deductible as losses if used for required purposes within five years	

Table 7.5. Inheritance and Gift Tax Law.

Type of Corporation	***Type of Contributed Asset***	***Conditions for Favorable Treatment***
		Exempt if (1) used for the required purposes within three years (gift tax only), (2) contributed within six months of inheritance (inheritance tax only), (3) not used to benefit the contributor or his or her immediate relatives, (4) persons with a special relationship to the contributor do not have decision-making power on important corporate matters, (5) no more than 5 percent of all the issued stock of a company was contributed (not applied to a faithful nonprofit corporation)
	Revenues from sale of income-generating asset	Exempt if 80 percent of the revenue is used for required purposes within three years and above conditions are met

Table 7.6. Other Tax Laws.

Type of Corporation	***Value-Added Tax***	***Local Taxes***
Nonprofit corporation (all)	Exempt for goods and services provided for beneficiary	Exempt from acquisition (1) if used for required purposes within one year (2) if not luxurious assets prescribed by the Presidential Decree
Nonprofit corporation		Exempt from property of nonprofit corporation stipulated by the Local Tax Law if used for the purposes stipulated in Articles 107, 127, and 184 of that law

Table 7.7. Individual Income Tax and Corporation Income Tax Law.

Type of Contributor	*Type of Income*	*Type of Contribution*	*Favorable Treatment Under Individual Income Tax Law*	*Favorable Treatment Under Corporation Law*
Individual contributor	Wage and salary or global income	Law-designated and contribution under Article 62 of the Tax Exemption and Reduction Control Law	100 percent deductible as a special deduction with a maximum of gross income	
		Designated contribution and contribution under Article 61, Section 2 of Tax Exemption and Reduction Control Law	Deductible as a special deduction up to 5 percent of gross income	
	Business, real estate, and timber income	Law-designated and contributions under Article 1, Section 2 and Article 62 of the Tax Exemption and Reduction Control Law	Deductible as expenses up to aggregate income after deduction of losses carried over	
		Designated contribution	Deductible as expenses up to 7 percent of gross income minus losses carried over minus deduction for contribution, plus 2 percent of difference between total business assets and total debt	
Corporate contributor		Law-designated and contributions under Article 61, Section 2 and Article 62 of the Tax Exemption and Reduction Control Law		Deductible as expenses up to aggregate income after deduction of losses carried over

Recommendations

With respect to the possible abuse of tax exemptions for nonprofit corporations, the tax authority should take a more active and responsible role in supervising and controlling them. The tax authority should put more effort into its oversight of nonprofit corporations conducting profit-seeking businesses, to induce them to abide by the tax regulations and not abuse their special tax status. In addition to strengthening the supervisory role of the tax authority, Korea should increase the amount of the penalties charged for failure to meet the requirements for the use of contributed assets and business income. To this end, nonprofit corporations should be required to submit copies of their establishment and registration documents to the tax authority even if they are not operating a profit-seeking business.

To make external audits more effective, they should include an audit of the organization's financial statements by an independent certified public accountant. Under the current corporation tax law, only interest income is allowed as a tax-free reserve for use in pursuing an organization's approved purposes. To improve nonprofit corporations' ability to pursue public benefit activities, we recommend that this tax-free reserve be expanded to include income from dividends.

TAX DEDUCTIONS AND CREDITS

Individual Contributors

Under the Income Tax Law, individual contributors receive a tax deduction for contributions to nonprofit corporations. The extent of the allowable tax deductions for individual contributors depends on two factors: the type of income and the type of activity in which the nonprofit corporation is involved. Specifically, the amount of any tax deduction depends on whether the donor has business, real estate, or timber income; is a wage earner; or has interest or dividend income besides wages. The size of the tax deduction also depends on the type of nonprofit activities for which the contribution is made. Contributions are classified as either "law-designated contributions" or "designated contributions," depending on the intended use of the donated funds.

Law-Designated and Equivalent Contributions

For individual contributors who have business, real estate, or timber income, the following rule is applied: contributions for so-called law-designated nonprofit activities (designated by Article 34, Section 3 of the Income Tax Law and Articles 61 and 62 of the Tax Exemption and Reduction Law) may be deducted from taxable income, to a maximum limit of the aggregate income for each tax period after deduction of losses carried over.

The following donations are designated by Article 34, Section 3 of the Income Tax Law as deductible expenses:

1. The value of money and goods donated to government agencies and local autonomous bodies without compensation
2. Contributions for national defense and war relief
3. The value of money and goods donated for the relief of disaster victims

Under Article 61 of the Tax Exemption and Reduction Law, the following items are included as deductible expenses:

1. The value of money and goods donated to research institutes established by the Research Promotion Law or the Law for Establishment of Industry and Energy Infrastructure
2. Contributions to the Culture and Art Promotion Fund established by the Culture and Art Promotion Law
3. Contributions to private school foundations established by the Private School Law
4. The value of money and goods contributed to a worker's welfare fund established by a company
5. Contribution to the Independence Memorial Hall
6. Contributions to the Winter Universiad Organizing Committee
7. Contributions to the Korea Foundations
8. Contributions to the Pusan Asia Olympic Organizing Committee

Under Article 62 of the Tax Exemption and Reduction Law, contributions to political parties are also deductible. Under Article 61 of the same law, individual contributors who have only wage, salary, or foreign income (excluding business, real estate, or timber income) may deduct up to 5 percent of their gross income as a special deduction. But Under Article 34, Section 3 of the Income Tax Law and Article 62 of the Tax Exemption and Reduction Law, all expenses are deductible with a maximum of aggregate income.

Designated Contributions

Contributions for social welfare, cultural, arts, education, religious, charity, and other activities prescribed by the Presidential Decree and designated in Article 34, Section 1 of the Income Tax Law may be deducted as losses up to a maximum limit of 7 percent of gross income minus expenses carried over and deductions allowed under Article 34, Section 3 of the Income Tax Law and Article 61 of the Tax Exemption and Reduction Law, plus 2 percent of capital up to a maximum of 5 billion won.

The following contributions are allowed as deductions for necessary expenses by the Presidential Decree:

1. Contributions to public interest entities having proper government approval, such as social welfare organizations and religious organizations.
2. Donations for the purpose of research, technical development, or athletics to public interest organizations established with permission of the proper government authority. For individuals who have wage income only or foreign income other than business, real estate, or timber income, designated contributions of up to 5 percent of gross income are allowed as special deductions.
3. Contributions to religious organizations registered with the proper government authority.
4. Contributions to public interest entities established under special laws, such as the Korea Federation of Freedom, the Korea Veterans Association, the Korea Red Cross, scouting organizations, the Korea Federation of Youth, and nonprofit social welfare organizations for the elderly.
5. Other donations, as prescribed by Ministry of Economy and Finance decrees, for public interest entities established with permission of the proper government authority.

Corporate Contributions

In the case of corporate donors (and individual contributors with business, real estate, or timber income), contributions for nonprofit activities or corporations designated in Article 18, Section 3 of the Corporation Tax Law and Articles 61 and 62 of the Tax Exemption and Reduction Law may be included as deductions in calculating tax liability, to a maximum limit of the aggregate amount of income in each taxable period minus losses carried forward. Contributions for activities designated in Article 18, Section 1 of the Corporation Tax Law may also be deducted, to a maximum limit of 7 percent of gross income minus losses carried over and deductions allowed under Article 47 of the Income Tax Law and Article 61 of the Tax Exemption and Reduction Law, plus 2 percent of capital, up to a maximum of 5 billion won.

Analysis

Tax incentives for contributions to nonprofit corporations under the Income and Corporation Tax Law are generous in terms of the size of the deductions allowed. Neither corporations nor individual contributors complain that the maximum limits are too low to attract more contributions. Tax deductions and credits for contributions are widely available to the public, and contributors can easily obtain this tax benefit. The donor simply submits the receipt received from the nonprofit corporation when filing his or her tax return. The extent of the tax benefit depends on the type of nonprofit corporation or activity. On the one hand, all contributions to political parties, private school foundations, and the government are deductible, with a limit of gross receipts minus losses carried over. On the other hand, contributions to nonprofit corporations engaged in the activities stipulated in Article 34, Section 1 of the Income Tax Law or Article 18, Section 3 of the Corporation Tax Law may be only partially deducted. And contributions for other nonprofit activities, not stipulated by the tax laws, may not be included as deductible expenses for corporate or individual income tax. These selective tax benefits are based on political reasons, not economic ones. The current tax law provides greater tax benefits for contributions to government or government-related organizations and activities. This indicates a view that nonprofit activities are the main responsibility of the government, not of the private sector.

The two major tax laws, the Inheritance Tax Law and the Corporation Tax Law, apply inconsistent criteria in determining the tax treatment of gifts. The former favors contributions to certain designated nonprofit corporations, whereas the latter favors contributions for certain designated purposes. Thus some deductions allowed by the Corporation Tax Law, such as for contributions to Korea Red Cross and other public interest organizations, are not allowed by the Inheritance Tax Law. As a result, contributions to a designated nonprofit corporation pursuing favored activities may be deducted by the donor, but the nonprofit corporation receiving the contributions is not exempt from paying gift or inheritance tax on the donation. And contributions for activities stipulated in the Inheritance Tax Law but not the Corporation Tax Law are not deductible for a contributor corporation. This inconsistency between the two tax laws reduces the effectiveness of tax policy aimed at encouraging nonprofit activities and contributions from individual and corporate donors.

Recommendations

We recommend that the scope of nonprofit activities eligible for tax deductibility of contributions be extended to include activities that are not favored under the current tax laws but deserve to be to attract more donations from the private sector. The current tax laws, which provide differential tax benefits for contributions to different nonprofit activities, should be restructured based on objective criteria. For example, donations to political parties currently provide greater tax benefits than do donations for other activities.

For tax policy to be more effective in promoting contributions, the discrepancies between the Inheritance and Gift Tax Law and the Corporation Tax Law with respect to stipulation of nonprofit activities for favorable tax treatment should be remedied. Those activities stipulated in the Inheritance and Gift Tax Law should be included in those stipulated in the Corporation Tax Law as well. This would help promote contributions from the private sector, as both donor and donee would benefit from the tax incentive system in a more effective way.

CAPITAL FORMATION

Description

The general regulations on capital formation appear in Article 11 of the Nonprofit Act, which provides that

1. The assets of a nonprofit corporation shall be divided into basic assets and ordinary assets, in accordance with the Presidential Decree.
2. Inventory and the appraised value of basic assets shall be stated in the Articles of Incorporation. In case the appraised value changes, the Articles of Incorporation shall be amended without delay.
3. In the event that a nonprofit corporation intends to sell, donate, lease, or exchange its basic assets; alter the use thereof; furnish them as collateral security; or obtain money equal to or exceeding the fixed amount provided by the Presidential Decree on a long-term loan, it shall obtain the permission of the relevant ministry.
4. Nonprofit corporations shall manage their assets with the care of a prudent manager, to achieve their purpose.

The Act compels a nonprofit corporation to spend half of its annual budget on its grant-making and operating programs within the scope of its declared activities. Article 5–1 of the Presidential Decree of the Nonprofit Act raises the minimum distribution requirement further: "It is required that more than half of their annual budget should be spent on direct service including grant making and service delivery."

Any change to the basic assets of a nonprofit corporation requires the permission of the relevant ministry. According to Article 11–3 of the decree that supplements the Nonprofit Act, "The nonprofit corporation, in case of intending to sell, donate, lease, or exchange the permanent property, alter the use thereof, furnish it as a collateral security, or obtain money not less than the fixed amount provided by the Presidential Decree on long-term loan, shall obtain the permission of the pertinent ministry."

Article 12 of the act imposes general regulations on the nonprofit organization's budget and financial operations. According to Article 12,

1. The fiscal year of nonprofit corporations shall be the same as that of the government.
2. Nonprofit corporations shall submit their business plan and budget for the following fiscal year before the beginning of each fiscal year and report the actual results of business and year-end finances after the end of each fiscal year to the relevant ministry in accordance with the Presidential Decree. In such case, an audit

certificate of a certified public accountant may be appended to a report of year-end finances in accordance with the Presidential Decree.

3. Nonprofit corporations may credit surplus funds of year-end finances to basic assets or carry them forward to the next fiscal year.
4. The asset management practices, budget compilation procedures, and accounting principles of nonprofit corporations shall be provided by the Presidential Decree.

Analysis and Recommendation

These regulations are intended to protect the basic assets of nonprofit corporations from any risk of loss or diminution of value because this property is the basis of a foundation's existence. It is repeatedly pointed out, however, that excessive regulation often hampers the natural increase of basic assets, income from which could become a major source of grant-making and service delivery among most endowed foundations.

There is no current law or regulation that bars Korean foundations from specific types of investments. Indeed, Article 11(4) of the Act, which imposes a prudent management standard, implies that foundations may invest just as other fund managers do. However, foundations must report any change in their basic assets. Thus the pertinent ministry can easily notice changes of property, including investments in stocks. Government ministries very often do not permit or accept the transfer of basic assets to stocks because if the stocks fall in value, the foundation will lose its permanent property. This would severely weaken the capacity of grant-making foundations to serve the public. However, this practice prevents foundations from gaining access to the major vehicle for capital formation. This has become a serious obstacle to capital formation for most NPOs in Korea.

Successful capital formation is one of the most important factors for the continuing development of Korean nonprofit corporations. However, current practical restrictions on capital formation do not provide a positive prospect for Korean NPOs. One way to overcome this obstacle is for foundations to develop professional fund management skills and manage other income-generating projects.

INTERNAL GOVERNANCE

Description

The Nonprofit Act discusses internal governance in detail. Of the Act's twenty articles, six (Article 5 through Article 10) address issues of internal governance. This shows how important the governance structure of nonprofit corporations is in Korea. Article 5 of the Act states that

1. Nonprofit corporations shall have five to fifteen directors and two auditors, but they may increase or decrease these numbers with the approval of the relevant ministry.
2. Officers shall hold office with the approval of the relevant ministry.
3. The term of office of directors and auditors shall be provided by the Articles of Incorporation; however, the terms of directors and auditors shall not exceed four years and two years, respectively. Directors and auditors may be reappointed to office.
4. The majority of directors shall be citizens of the Republic of Korea.
5. The number of directors with close relationships to donors shall not exceed one-fifth of the directors in office.
6. The following persons shall not become officers of a nonprofit corporation: minors; persons adjudged to be incompetent or semicompetent; persons who are bankrupt and not yet rehabilitated; persons who have been punished by imprisonment or more severe punishment, if three years have not elapsed since completion of or exemption from the punishment; and persons subjected to revocation of appointment under Article 14, if two years have not elapsed since such revocation.
7. In the event of a vacancy in the office of a director or auditor, a replacement shall be made within two months.
8. An auditor shall not be a person with a special relationship with the directors, pursuant to Paragraph 5. The relevant ministry may recommend one auditor with knowledge and experience of law and accounting, in accordance with the Presidential Decree.
9. Nonprofit corporations shall determine a quorum of full-time officers with the approval of the relevant ministry and shall remunerate them.

The Board of Directors occupies the central position in a nonprofit corporation. The Act specifies the general characteristics and functions of the Board of Directors, how to call their meetings, and ways of adopting resolutions. Article 6 states the general characteristics of the Board of Directors:

1. A nonprofit corporation shall have a Board of Directors.
2. The board of directors shall be composed of directors.
3. The chairman shall be elected from the directors in office.
4. Meetings of the Board of Directors shall be called by the chairman, who shall preside at the meeting.

The Board of Directors decides the agenda and tasks of the nonprofit corporation. Article 7 of the Act provides that

1. The Board of Directors shall deliberate on and decide the following:

    The budget, the year-end finances, loans, and the acquisition, disposal, and management of property of the nonprofit corporation

    Amendments to the Articles of Incorporation

    Dissolution of the nonprofit corporation

    Appointment and removal of officers

    Business engaged in for profit

    Other matters within its authority, pursuant to the laws and regulations or the Articles of Incorporation

2. In the event that the interests of the chairman or other directors conflict with those of the nonprofit corporation, such person or persons shall not attend meetings for resolution of the matters concerned

Regulations and procedures for calling meetings of the Board of Directors are provided in Article 8 of the Act:

1. The chairman may call the meeting of the Board of Directors whenever he deems it necessary.
2. The chairman shall call the meeting of the Board of Directors within twenty days following a request for a meeting if at least

a majority of all the directors in office request holding a meeting and present the purpose for such meeting, or auditors request a meeting pursuant to Article 10(1)v.

3. To hold a meeting of the Board of Directors, a notice that clearly states the purpose of the meeting shall be sent to each director at least seven days before the meeting. However, this shall not apply to cases where all directors gather and request a meeting of the Board of Directors.
4. In case it is impossible to hold a meeting of the Board of Directors for seven days or more because the person with authority to call a meeting is absent or evades the meeting, the meeting may be held by obtaining approval of the supervisory ministry with the consent of a majority of all the directors in office. In such case, a director specified by the Articles of Incorporation shall preside over the meeting of the Board of Directors.

The officers of a nonprofit corporation consist of directors and auditors. Even though both are considered officers in incorporated foundations and associations, they have different duties in these two types of organizations. Article 10 of the Nonprofit Act specifies the official duties of an auditor as follows:

1. An auditor shall carry out the following duties:

   Audit the business and financial conditions of the nonprofit corporation, request submission of necessary data or opinions thereon from directors, and present the findings at meetings of the Board of Directors

   Sign and seal minutes of the meetings of the Board of Directors

   State opinions to directors about the business and financial conditions of the corporation

   Report to the Board of Directors when he or she discovers unlawful or improper activities as a result of auditing the business and financial conditions of the corporation

   Request a meeting of the Board of Directors if necessary to make such a report
2. In the event that an auditor discovers unlawful or improper activities as a result of auditing the business and financial condition of the corporation, he shall report it to the relevant ministry without delay.

3. In the event that a director performs an *ultra vires* act or other acts in violation of the Nonprofit Act, the Order pursuant to that act, or the Articles of Incorporation and such act may cause significant harm to the corporation, an auditor may apply to the court for suspension of the duties of such director.

In addition to directors and auditors, nonprofit corporations may have other full-time employees, including a secretary general and others. The internal regulations and rules of NPOs determine the number of employees and their positions and duties. The secretary general, who is responsible for accounting and day-to-day operations, is usually the most important member of the operating staff. The number and kinds of other full-time employees is usually determined by the size and financial situation of each nonprofit corporation. This structure of internal governance is equally applicable to incorporated foundations and incorporated associations.

The rules for decision making by the Board of Directors are well specified in Article 9 of the Nonprofit Act:

1. Resolutions of the Board of Directors shall be adopted with an affirmative vote of a majority of all the directors in office, unless there are special provisions in the Articles of Incorporation.
2. Each director has an equal voting right.
3. Resolutions of the Board of Directors shall not be based on proxy.
4. Resolution of the Board of Directors requires that a majority of directors present at the meeting be citizens of the Republic of Korea.

Analysis and Recommendation

The goal of the restriction on the number of directors who may have a particular relationship with a donor is to maintain public trust and to avoid arbitrary management by founders. Despite these good intentions, however, this rule creates problems. For example, this rule requires that foundations and associations appoint persons who do not have any experience in nonprofit management or in the area in which the nonprofit organization operates. Another complaint is that the paperwork of nonprofit corporate directors is too burdensome.

Of the internal governance requirements currently required by Korean law, restrictions on the selection of directors are most in need of reform. We recommend that the restriction on the number of directors who have a particular relationship with a donor should be abolished. Recently, a revision of the Korean death tax abolished this regulation, thought to be ineffective. Although the Nonprofit Act was not revised accordingly, we believe that it should follow suit.

TERMINATION OR DISSOLUTION

Description

When a nonprofit corporation fails to meet the mandatory standard for foundation activities, the relevant ministry may revoke its corporate status. The conditions and procedures for revocation are provided both in the Civil Code and in Article 16 of the Nonprofit Act. According to Article 16 of the act:

1. The relevant ministry that permitted the incorporation of the nonprofit corporation may revoke its permission, for any of the corporation's purposes, for the following reasons. If the nonprofit corporation has two or more purposes, the same principles shall be applied to each purpose.

   Permission to incorporate was obtained by deceit or other unjust means.

   The corporation has violated any of the conditions attached to the permission for incorporation.

   It is impossible for the corporation to achieve its purpose.

   The corporation has been operating a business beyond the scope of its purpose.

   The corporation has violated the Nonprofit Act, ordinances pursuant to that act, or its Articles of Incorporation.

   The corporation is engaging in acts that harm the public interest.

   The corporation has not begun operations within six months of obtaining permission for incorporation, without justifiable cause, or it has not shown actual results of business for one year or more.

2. Permission to incorporate shall be revoked if supervision by the relevant ministry cannot be achieved or the corporation does not comply with a correction order from the supervisory ministry within one year.

Section 2 of Article 16, which was added in the revised 1994 version of the act, explains the procedure and method for administrative appeal: "In the event that the relevant ministry intends to revoke permission for incorporation pursuant to Article 16, it must provide the party subject to revocation or their representative with an opportunity to present their opinion in accordance with the Presidential Decree, unless such party or their representative does not respond without a justifiable cause or their addresses, whereabouts, etc. are not known."

The status of the remaining assets upon dissolution is also defined in Article 14 of the act:

1. Surplus assets of a dissolved nonprofit corporation shall revert to the nation or local autonomous entity in accordance with the Articles of Incorporation.
2. Surplus assets that are reverted to the nation or local autonomous entity pursuant to Paragraph 1 shall be used for the public interest or donated or loaned without compensation to a nonprofit corporation that has a similar purpose.

Analysis and Recommendation

Problems on termination of nonprofit organizations are minor rather than major, but they are important nonetheless. Article 16 of the Nonprofit Act provides clear, well-defined rules for revocation of nonprofit corporate status. The Act does not, however, provide rules for dissolution of NPOs other than corporations. Those rules should be included in the next revision of the act.

APPENDIX: ACT CONCERNING INCORPORATION AND OPERATION OF A NONPROFIT CORPORATION

Following is an unofficial translation of the Act Concerning Incorporation and Operation of a Nonprofit Corporation (Law No. 2814), promulgated on December 31, 1975.

Article 1 Purpose

The purpose of this act is to enable a legal entity to maintain its public and charitable purposes and to carry out activities thereof by supplementing the provisions of the Civil Code relating to incorporation and operation of a legal entity.

Article 2 Jurisdiction

This act shall apply to a legal entity (hereinafter referred to as "nonprofit corporation") that promotes scholarship or educational funds, support or payment of research expenses, art and science, or charity as an incorporated foundation or an incorporated association.

Article 3 Provisions to the Articles of Incorporation

1. The nonprofit corporation shall set forth the following in its Articles of Incorporation:
    - i. Purpose
    - ii. Name
    - iii. Place of office
    - iv. Type, condition, and appraised value of assets at the time of incorporation
    - v. Methods of administration of assets and accounts
    - vi. Number, term of office, and appointment and removal procedures for directors and auditors
    - vii. Voting rights and representative powers of directors
    - viii. Procedures for amending the Articles of Incorporation
    - ix. Procedures for public notice, and manner thereof
    - x. Period of duration, cause of dissolution, and methods of disposal of surplus assets
    - xi. Requirements for audits of business and inspection of accounts
2. Matters to be entered in the Articles of Incorporation in accordance with Paragraph 1 and other necessary matters shall be provided by the Presidential Decree.

Article 4 Standard of Permission for Incorporation

1. When an entity applies for permission to incorporate a nonprofit corporation pursuant to Article 32 of the Civil Code, the relevant ministry shall investigate related facts and permit the incorporation of the nonprofit corporation only if the nonprofit corporation may achieve its purpose with revenue derived from property, if it is an incorporated foundation, or with financial resources derived from dues, donations, etc., if it is an incorporated association (hereafter referred to as "basic assets").
2. The relevant ministry, which permits the incorporation of the nonprofit corporation, may append matters relating to collection of dues, beneficiaries, and other necessary conditions in accordance with the Presidential Decree.
3. In the event that the nonprofit corporation intends to run a business for profit in order to achieve its purpose, it shall obtain the approval of the relevant ministry for every business pursuant to the Articles of Incorporation.

Article 5 Office

1. The nonprofit corporation shall have five to fifteen directors and two auditors, but it may increase or decrease these numbers with the approval of the relevant ministry.
2. An officer shall hold office with the approval of the relevant ministry.
3. The term of office of directors and auditors shall be provided by the Articles of Incorporation; provided, the terms of directors and auditors shall not exceed four years and two years, respectively. Directors and auditors may be reappointed to office.
4. The majority of directors shall be citizens of the Republic of Korea.
5. The number of directors with special relationships provided by the Presidential Decree shall not exceed one-fifth of the directors in office.
6. Any person who falls under any of the following subparagraphs shall not become an officer of the nonprofit corporation:
   i. Minor
   ii. Person adjudged to be incompetent or semicompetent
   iii. Person bankrupt and not yet rehabilitated

iv. Person who has been punished by imprisonment or more severe punishment, and three years have not elapsed since completion of or exemption from punishment
v. Person subject to revocation of appointment under Article 14(2), and two years have not elapsed since such revocation

7. In the event of a vacancy in the office of directors or auditors, replacements shall be made within two months.
8. An auditor shall not be a person with a special relationship with directors pursuant to Paragraph 5. The relevant ministry may recommend one auditor among persons with knowledge and experience of law and accounting in accordance with the Presidential Decree.
9. The nonprofit corporation shall determine a quorum of full-time officers with the approval of the relevant ministry and shall remunerate them.

Article 6 Board of Directors

1. The nonprofit corporation shall have a Board of Directors.
2. The Board of Directors shall be composed of directors.
3. The chairman shall be elected from directors in office.
4. The meeting of the Board of Directors shall be called by the chairman, and he shall preside at the meeting.

Article 7 Function of the Board of Directors

1. The Board of Directors shall deliberate on and decide the following:
   i. Budget, year-end finances, loans, and acquisition, disposal, and management of property of the nonprofit corporation
   ii. Amendments to the Articles of Incorporation
   iii. Dissolution of the nonprofit corporation
   iv. Appointment and removal of officers
   v. Business pursued for profit
   vi. Other matters within its authority pursuant to the laws and regulations or the Articles of Incorporation
2. In the event that the interests of the chairman or directors conflict with those of the nonprofit corporation, such person or persons shall not attend the meeting for resolution of the matters concerned

Article 8 Calling the Meeting of the Board of Directors

1. The chairman may call the meeting of the Board of Directors whenever he deems it necessary.
2. The chairman shall call the meeting of the Board of Directors within twenty days following a request for a meeting if the request falls under any of the following:
   i. At least a majority of all the directors in office request holding a meeting and present the purpose for such meeting
   ii. Auditors request a meeting pursuant to Article 10 (1)v.
3. To hold a meeting of the Board of Directors, a notice that clearly states the purpose of the meeting shall be sent to each director at least seven days before the meeting. However, this shall not apply to cases where all directors gather and request a meeting of the Board of Directors.
4. In case it is impossible to hold a meeting of the Board of Directors for seven days or more because the person with authority to call a meeting is absent or evades the meeting, the meeting may be held by obtaining approval of the supervisory ministry with the consent of a majority of all the directors in office. In such case, a director provided by the Articles of Incorporation shall preside over the meeting of the Board of Directors.

Article 9 Resolutions

1. Resolutions of the Board of Directors shall be adopted with an affirmative vote of a majority of all the directors in office unless there are special provisions in the Articles of Incorporation.
2. Each director has an equal voting right.
3. Resolutions of the Board of Directors shall not be based on proxy.
4. Resolutions of the Board of Directors require that a majority of directors present at the meeting be citizens of the Republic of Korea.

Article 10 Official Duties of Auditor

1. An auditor shall carry out the following duties:
   i. Audit business and financial conditions of the nonprofit corporation, request submission of necessary data or opinions

thereon from directors, and present the findings at the meetings of the Board of Directors

ii. Sign and seal minutes of the meetings of the Board of Directors

iii. State opinions to directors about the business and financial conditions of the nonprofit corporation

iv. Report to the Board of Directors when he discovers unlawful or improper activities as a result of auditing business and financial conditions of the nonprofit corporation

v. Request a meeting of the Board of Directors if necessary to make a report as prescribed in Paragraph 4.

2. In the event that an auditor discovers unlawful or improper activities as a result of auditing the business and financial condition of the nonprofit corporation, he shall report it to the relevant ministry without delay.
3. In the event that a director performs an *ultra vires* act or other acts in violation of this act, the order pursuant to this act, or the Articles of Incorporation, and such act may cause significant harm to the nonprofit corporation, an auditor may apply to the court for suspension of the duties of such director.

Article 11 Assets

1. The assets of the nonprofit corporation shall be divided into basic assets and ordinary assets in accordance with the Presidential Decree.
2. The inventory and the appraised value of basic assets shall be stated in the Articles of Incorporation. In case the appraised value changes, the Articles of Incorporation shall be amended without delay.
3. In the event that the nonprofit corporation intends to sell, donate, lease, or exchange the basic assets; alter the use thereof; furnish them as collateral security; or obtain money equal to or exceeding the fixed amount provided by the Presidential Decree on a long-term loan, it shall obtain the permission of the relevant ministry.
4. The nonprofit corporation shall manage assets with the care of a prudent manager in order to achieve its purpose.

Article 12 Budget and Year-End Finances

1. The fiscal year of the nonprofit corporation shall be the same as that of the government.

2. The nonprofit corporation shall submit its business plan and budget for the following fiscal year before the beginning of each fiscal year and report the actual results of business and year-end finances after the end of each fiscal year to the relevant ministry in accordance with the Presidential Decree. In such case, an audit certificate of a certified public accountant may be appended to a report of year-end finances in accordance with the Presidential Decree.
3. The nonprofit corporation may credit surplus funds at the end of the year to basic assets or carry it forward to the next fiscal year.
4. Management of assets, a guide to budget compilation, accounting principles, etc. of the nonprofit corporation shall be provided by the Presidential Decree.

Article 13 Reversion of Surplus Assets

1. Surplus assets of a dissolved nonprofit corporation shall revert to the nation or local autonomous entity in accordance with the Articles of Incorporation.
2. Surplus assets that are reverted to the nation or local autonomous entity pursuant to Paragraph 1 shall be used for the public interest or donated or loaned without compensation to a nonprofit corporation that has a similar purpose.

Article 14 Supervision

1. The relevant ministry shall supervise operation of the nonprofit corporation.
2. The relevant ministry may revoke the approval of appointment of a director for causes provided by the Presidential Decree.
3. The relevant ministry may order the nonprofit corporation to change or suspend its business for either of the following reasons:
   i. Using revenues for purposes other than its stated purpose.
   ii. Continuing business operation is considered to violate the purpose of the nonprofit corporation.

Article 15 Reduction and Exemption of Taxes

Inheritance tax, donation tax, income tax, corporate tax, and local tax imposed on property that is donated or contributed to the nonprofit corporation may be reduced and exempted in accordance with the Tax Reduction and Exemption Control Act.

Article 16 Revocation of Permission for Incorporation

1. If the nonprofit corporation has two or more purposes, the relevant ministry that permits the incorporation of the nonprofit corporation may revoke its permission, for any of the purposes, for the following reasons:
   i. Permission to incorporate was obtained by deceit or other unjust means.
   ii. Violation of conditions attached to the permission for incorporation.
   iii. Impossibility of achieving its purpose.
   iv. Operation of business beyond the scope of its purpose.
   v. Violation of this act, an ordinance pursuant to this act, or the Articles of Incorporation.
   vi. Engaging in acts that harm the public interest
   vii. The nonprofit corporation does not operate within six months of obtaining permission for incorporation without justifiable cause, or it does not engage in business for one year or more.
2. Permission to incorporate the nonprofit corporation pursuant to Paragraph 1 shall be revoked if the purpose of supervision cannot be achieved, or if the nonprofit corporation does not comply with a correction order of a supervisory ministry even though one year has lapsed.

Article 16-2 Hearing

In the event that the relevant ministry intends to revoke permission for incorporation pursuant to Article 16, it must provide the party subject to revocation or their representative with an opportunity to present their opinion in accordance with the Presidential Decree unless such party or their representative does not respond without a justifiable cause or their addresses, whereabouts, etc. are not known.

Article 17 Audit

The relevant ministry shall provide appropriate supervision if necessary by ordering the nonprofit corporation to submit a business report or by auditing the management of property and accounting, and shall guide the nonprofit corporation to enable it to perform its purpose.

Article 18 Delegation of Authority

The relevant ministry may delegate a part of its authority provided by this act to a subordinate office or local autonomous entity in accordance with the Presidential Decree.

Article 19 Penalty

1. Those who violate Article 4(3), Article 11(3), or Article 12(3) shall be punished by a penal servitude not exceeding three years or a fine not exceeding ten million won.
2. The following shall be punished by a penal servitude not exceeding one year or a fine not exceeding three million won:
   i. Violation of order pursuant to Article 14(3)
   ii. Violation of Article 12(2), or false report
   iii. Rejection or evasion of audit pursuant to Article 17
   iv. Abandonment or refusal by an auditor to perform official duties without justifiable reason
3. In case a director or an auditor commits acts mentioned in Paragraph 1 and Paragraph 2 above, the nonprofit corporation shall be punished with fines provided in above paragraphs, and the individual shall also be punished accordingly. However, the above shall not apply to acts of an auditor who was recommended by the relevant ministry.

Article 20 Enforcement Ordinance

Matters necessary to enforce this act shall be provided by the Presidential Decree.

Addenda

1. (ENFORCEMENT DATE). This act shall become effective three months after the date of its promulgation.

2. (INTERIM MEASURES TO EXISTING NONPROFIT CORPORATION). The nonprofit corporation that was incorporated with the approval of the relevant ministry at the time of enforcement of this act shall be deemed to be incorporated pursuant to this act.

3. (DITTO). The nonprofit corporation of Addenda Paragraph 2 shall take necessary measures provided by this act, and apply for permission to amend the Articles of Incorporation within six months.

4. (DITTO). When the relevant ministry approves the amendment to the Articles of Incorporation under Addenda Paragraph 3, it may provide conditions pursuant to Article 4(2).

Addenda

(Promulgated on Dec., 17, 1994)

1. (ENFORCEMENT DATE). This act shall become effective three months after the date of its promulgation.

2. (INTERIM MEASURES TO EXISTING DIRECTORS). In the event that the number of directors with a close relationship to a contributor exceeds one-fifth of the directors in office, only the directors without such relationships may be appointed until the corporation complies with the 20 percent cap on related directors.

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8

PHILIPPINES

Carol C. Lerma
Jessica Los Baños

NONPROFIT LAW HAS NOT YET EVOLVED as a specialized field of law in the Philippines. Despite being a civil law country, the Philippines has no single codified law to govern its large nonprofit sector, comprising 95,820 domestic and 154 foreign registered corporations and a large but undetermined number of unregistered organizations. Rules and regulations governing nonprofit organizations are widely dispersed, scattered throughout many legislative enactments and agency pronouncements, including the 1987 Philippine Constitution; the Rules of Court; Batas Pambansa Bilang 68, otherwise known as The New Corporation Code of the Philippines; Republic Act 7160, otherwise known as the Local Government Code; Presidential Decree No. 902–A, otherwise known as the Securities and Exchange Reorganization; the National Internal Revenue Code; and the Tariff and Customs Code.

Nonprofit organizations (NPOs) in the Philippines, a category that includes nongovernmental organizations (NGOs), are generally defined as private, nonprofit, voluntary organizations committed to the task of socioeconomic development and established primarily for service, including organizations established for religious, cultural, charitable, and other purposes. These organizations are formally registered with certain government agencies as either cooperatives, foundations, associations, or nonprofit corporations.

Included in this category are church-initiated or secular groups; federated or networked NGOs, or associations of foundations; grassroots or people's organizations, or bona fide associations of citizens; and service or intermediary NGOs, or self-reliance organizations. Cooperatives or associations that provide goods or services owned and operated by their members are considered NPOs for purposes of this definition.

Although the Philippine government promotes and encourages the creation of NPOs, it fails to accord all NPOs the same protections and benefits under the law. Currently, only NPOs registered with the Securities and Exchange Commission (SEC), such as corporate and family foundations; charitable institutions, NGOs, and cooperatives registered with the Cooperative Development Authority (CDA); and labor unions registered with the Department of Labor and Employment enjoy tax benefits and other rights arising from formal registration.

Nonregistered NPOs, such as people's organizations and informal associations, although generally able to conduct nonprofit work without government interference, are not extended similar privileges. People's organizations are bona fide associations of citizens with a demonstrated capacity to promote the public interest and with an identifiable leadership, membership, and structure, whereas informal associations are loosely composed of members who join together to promote a common purpose or cause similar to those espoused by nonprofit organizations, including community organization and development, institution building, local enterprise development, capacity building, and similar objectives.

There is a preference for the corporate form as the best vehicle for NPOs. This is evident not only due to the manner in which lawsuits may be brought against unorganized entities but also from the benefits and privileges accorded corporate entities. As a consequence, development of a legal mechanism to ensure the continued viability of the less structured people's organization has been slow and inhibited. As they are not generally incorporated and registered, they do not possess legal-person status, which would enable them to enjoy, in a similar manner, the benefits granted by law to incorporated NPOs. Although they are regarded by the government as partners for social progress, unincorporated NPOs merely enjoy the benefits of informal accreditation, limited recognition for meritorious service to the public, and occasional funding for their various projects as beneficiaries of government and NPO programs, but not the benefits that flow from formal registration and the conferment of legal-person status.

The 1987 Philippine Constitution recognizes the important role of NGOs and other nonprofit organizations in nation building. Section 23 of Article II of the 1987 Philippine Constitution provides: “The state shall encourage nongovernmental, community-based, or sectoral organizations that promote the welfare of the nation.” Their roles and rights are enshrined in Article XIII of the Constitution, as follows: “The state shall respect the role of independent people’s organizations to enable the people to pursue and protect, within the democratic framework, their legitimate and collective interests and aspirations through peaceful and lawful means. The right of the people and their organizations to effective and reasonable participation at all levels of social, political, and economic decision making shall not be abridged. The state shall, by law, facilitate the establishment of adequate consultation mechanisms.”

The Local Government Code of 1991 recognizes the role of nongovernmental units in local governance. The National Internal Revenue Code and the Tariff and Customs Code contain provisions pertaining to the special taxation of nonprofit organizations, and the New Civil Code defines their rights and obligations. People’s organizations and other informal associations, although considered NPOs with respect to their purposes, are excluded from this study, as they are not generally included within the purview and coverage of nonprofit laws. Cooperatives, although considered NPOs as regards their purposes and formation, are likewise excluded, as they are not, strictly speaking, nonprofit entities. Similarly, mutual benefit associations, although technically considered NPOs, being organized as nonprofit entities, are excluded from the category of NPOs, as their contributions come in the form of fixed dues and assessments collected from members.

Accordingly, only NPOs registered as nonprofit, nonstock corporations, as contemplated under the Corporation Code of the Philippines, are the subject of this study. Henceforth in this chapter, “NPOs” refers to nonprofit corporations registered with the Securities and Exchange Commission.

REGISTRATION

The Corporation Code

Philippine corporate law is a blend of Spanish, American, and Philippine sources. During the Spanish regime, Philippine corporations were governed by the provisions of the Code of Commerce, which was based on the Spanish Code of 1885, promulgated in 1888. They were not referred to as "corporations" but as *"sociedades anonimas,"* which though not identical with the present-day corporation had similar features, including limited liability of members and centralized management of affairs.

With the advent of American sovereignty, the attention of the Philippine Commission was drawn to the fact that there was no entity in Spanish law exactly corresponding to the notion of the corporation in English and American law. Thus the Philippine Commission passed the Corporation Law, which took effect on April 1, 1906. Aimed at replacing the *sociedad anonima* with the American concept of a corporate entity, it nevertheless gave the *sociedad anonimas* the choice to continue as such or to reorganize under the Corporation Law. Any organization choosing to remain a *sociedad anonima* would continue to be governed by the Code of Commerce in matters relating to its organization, its method of transacting business, and the rights within the organization of its members. However, with respect to its relationship to the public and public officials, the organization would be governed by the new Corporation Law. This statute remained the governing law until May 1, 1980, when Batas Pambansa Bilang 68 was passed "to establish a new concept of business corporations so that they are not merely entities established for private gain but effective partners of the national government in spreading the benefits of capitalism for the social and economic development of the nation."

The present Corporation Code of the Philippines serves as the general incorporation law for business and nonbusiness entities not organized by virtue of special laws. The current rule is to grant corporate franchises by way of this general incorporation law and to discourage their creation by way of special legislative enactments.

The Securities and Exchange Commission

Among the significant changes from the old Code is the grant of ample powers to the SEC, the quasi-judicial body charged with the enforcement of all laws affecting corporations, to enable it to exercise adequate supervision over the operations and activities of private corporations. Its jurisdiction includes nonprofit corporations.

Section 3 of Presidential Decree No. 902–A, "Reorganization of the Securities and Exchange Commission," provides: "The Commission shall have absolute jurisdiction, supervision, and control over all corporations, partnerships, or associations who are the grantees of primary franchises and/or a license or permit issued by the government to operate in the Philippines, and in the exercise of its authority, it shall have the power to enlist the aid and support of and to deputize any and all enforcement agencies of the government, civil or military, as well as any private institution, corporation, firm, association, or person" (as amended by Presidential Decree No. 1758).

The SEC is empowered to issue rules and regulations as necessary for the proper execution of all the laws administered by it and to issue rulings and opinions as to the proper interpretation and application of laws entrusted to it for administration.

Nonstock, Nonprofit Organizations

In the Philippines, nonprofit status is a necessary consequence of being a nonstock corporation. Thus the title "nonstock, nonprofit corporation." These corporations are governed generally by Sections 87 and 88 of the Corporation Code, which set forth the following important rules:

1. No part of the income of nonstock corporations shall be distributed as dividends to their members, trustees, or officers.
2. Any profit incidental to their operations shall be used in furtherance of their purpose or purposes.
3. They may be formed or organized for charitable, religious, educational, professional, cultural, recreational, fraternal, literary, scientific, social, civil service, or similar purposes, like trade, industry, agriculture, and similar associations, or any combination thereof, subject to the special provisions governing particular classes of nonstock corporations such as educational foundations and corporations sole.

Nongovernmental educational institutions, although falling under the general category of NGOs, are classified as special corporations different from ordinary nonstock corporations formed or organized for educational purposes under Section 88 of the Corporation Code. They are governed first by special laws, second by the special provisions of the Corporation Code, and last by the general provisions of said code. Other than this distinction, the laws and regulations governing this type of organization do not significantly differ from the general form of NPOs except with respect to their taxability, and as such the general discussion in this chapter applies to them.

Nature of the Registration Process

In view of NPOs' significance and contribution to social development, government regulation and control of them is moderately lax. An NPO, its rights being constitutionally guaranteed, does not have to be formally registered to exist and function in society. Pursuant to this constitutional mandate, the Local Government Code institutionalized the partnership between NPOs and local government units; even unregistered people's organizations are recognized as meeting the minimum requirements for membership and participation of such organizations in special bodies of a local government unit. Government agencies such as the Department of Agrarian Reform, the Department of Social Welfare and Development, and the National Housing Authority have likewise begun to institutionalize tripartite mechanisms for dialogue and cooperation between Peoples' Organizations (POs) and Government Organizations (GOs) at the local and national levels and to facilitate working linkages with other government agencies. Therefore, registration becomes necessary only when the NPO wishes to obtain legal-person status and to avail itself of the benefits provided by law. Unregistered POs or associations, lacking legal-person status, must act through their individual members, who remain responsible in their individual capacities in matters relating to the conduct of their organization's work or as beneficiaries of government and nonprofit organizations. POs are prohibited from representing themselves as registered corporations. If they misrepresent themselves as a validly constituted corporation, *quo warranto* proceedings for the usurpation of corporate franchise may be brought by the government against any or all of the members through the solicitor general or a public prosecutor in the proper courts of law. Where a judgment of corporate usurpation is found, the parties are ousted as members of the association or organization, and their respective rights and liabilities are determined, including imposition of costs in favor of the government and against the person or persons claiming to be a corporation.

NPOs are registered or accredited by the relevant government agency. Registration and accreditation serve different purposes. Registration is the legal conferment of legal-person status on an NPO after it has met certain basic requirements set under Philippine law. Accreditation, by contrast, is the official recognition of the merits of an NPO in meeting the standards of an agency to deliver specific services.

For NPOs other than cooperatives and labor unions, the SEC is the registering agency. The accrediting agency differs according to the purposes and proposed activities of the NPO.

Registration Requirements

With the exception of cooperatives and labor unions, NPOs are required and encouraged to apply for incorporation with the SEC. In addition to the criteria provided under Sections 87 and 88 of the Corporation Code of the Philippines, a prospective NPO applicant for registration must file with the SEC, through the "express lane" or the "regular lane," the following registration requirements:

BASIC REQUIREMENTS

1. Name verification slip regarding corporate name
2. Articles of Incorporation (three copies)
3. Bylaws (optional)
4. Written undertaking to change corporate name (three copies)
5. Resolution of the board of trustees that the corporation will comply with SEC requirements for nonstock corporations (three copies)
6. List of members of the association certified by the secretary (three copies) and undertaking to submit list of additional members to the SEC from time to time
7. Undertaking to comply with SEC reporting requirements (three copies)
8. List of contributors and amount contributed certified by the treasurer (three copies)
9. Registration data sheet
10. Filing fees for Articles of Incorporation and bylaws
11. Legal research fee

Under the express lane system, applications for registration of Articles of Incorporation and bylaws with cash payment of subscription are processed upon presentation of all documents, and the certificate of registration is released twenty hours after filing.

ADDITIONAL REQUIREMENTS

A. Religious corporations or corporations sole
    - Statement of faith or rules and discipline of the church

- Certificate of election or letter of appointment of the chief priest, minister, rabbi, or presiding elder, duly certified to be correct by a notary public (for corporation sole only)
- List of properties to be administered
- Affidavit of affirmation or verification by the chief priest, minister, rabbi, or presiding elder

B. NPOs with "Foundation" as part of corporate name
- Use of the word *foundation* as part of the corporate name is allowed only for nonstock nonprofit corporations organized for charitable, religious, educational, professional, cultural, literary, or scientific purposes, civic services, or similar purposes.
- An initial capital fund of at least P50,000 is required at the time of incorporation, as evidenced by a certificate of bank deposit.
- Public fundraising initiated by the foundation may be conducted, subject to the applicable laws, rules, and regulations implemented by the appropriate government agency.
- Foundations must submit a cash flow statement to the SEC, which shall form part of the annual financial statements required to be submitted by nonstock corporations under existing regulations.

C. Associations, foundations, or corporations acting as trusts for charitable uses
- Certificate of registration from the Insurance Commissioner. If a nonprofit corporation intends to actively solicit gifts, donations, or contributions for charitable, educational, religious, or other uses for the public at large or for the benefit of an indefinite number of persons, the Articles of Incorporation cannot be filed without a certificate of registration from the Insurance Commissioner, who is given supervisory powers over these corporations acting as "trustees for charitable uses," for the protection of the public.

D. Educational institutions
- Prior clearance and a favorable endorsement from the Department of Education and Sports (DECS), the Commission on Higher Education (CHED), or the Technical Education and Skills Development Authority (TESDA).
- Temporary permit and government recognition to offer educational services to the public. As a prerequisite to the grant of a corporate franchise, these educational institutions must first acquire prior clearance and a favorable endorsement from the

Department of Education, Culture, and Sports. The SEC shall not accept or approve the Articles of Incorporation and by-laws of any educational institution without such favorable recommendation. In addition, educational institutions must also secure a temporary permit and government recognition to legally offer educational services to the public from DECS for primary and secondary education, CHED for tertiary education, TESDA for vocational courses.

Grant of Corporate Franchise

As an incident to its regulatory function over all corporations, the SEC is vested with the power to grant corporate franchises and to issue the corresponding certificates of registration to corporations. The SEC, upon receipt of the required documents from the applicant, examines them to determine whether they are in conformity with law. If they are not, the SEC, through a preliminary conference with a representative of the proposed corporation, advises the applicant of the objectionable portions of the Articles of Incorporation and to change them accordingly.

The Corporation Code enumerates two grounds for rejection or disapproval of the Articles of Incorporation:

1. The Articles of Incorporation or any amendment is not substantially in accordance with the prescribed form.
2. The purpose or purposes of the corporation are patently unconstitutional, illegal, immoral, or contrary to government rules and regulations.

On a much broader ground, the SEC may, after consulting with the Board of Investments or other appropriate government agency, deny registration or any corporation, partnership, or association if its establishment, organization, or operation is not consistent with the declared national economic policies.

Commencement of Corporate Existence

The Corporation Code does not provide for a period of time within which the SEC must act on a corporate application and grant the primary franchise. Actual practice indicates that the certificate of registration is usually issued within three weeks from the filing of the Articles of Incorporation and other supporting documents if the regular procedure is followed. If the application is filed with the SEC's Express Lane, the certificate may be issued after twenty-four hours. If there are errors in the application or in cases of noncompliance with the prescribed application form, the process may take two to three months.

In case of amendments in the Articles of Incorporation, the code provides for its implied approval if the application is not acted upon by the Commission within six months from the date of filing for a cause not attributable to the corporation.

Any decision of the Corporate and Legal Department (CLD) of the SEC disapproving or rejecting the Articles of Incorporation may be appealed to the SEC Commission en banc. The Commission's affirmation of the CLD's disapproval or denial may further be raised to the Court of Appeals by way of a petition for review in accordance with the Rules of Court.

The private corporation formed or organized immediately commences to have corporate existence and legal-person status upon issuance by the SEC of its certificate of registration. The incorporators, stockholders and members, and successors-in-interest thereafter constitute themselves a body politic and corporate under the name stated in the Articles of Incorporation for the period of time mentioned therein.

Accreditation Process

The government recognizes the vital role of NPOs as partners in the promotion of the welfare of the disadvantaged population through complementarity of goals, objectives, and methodology. The annual General Appropriations Act includes a statement to the effect that government agencies are authorized to provide grants-in-aid to nonprofit corporations and other NGOs for operations and activities that are in line with the services rendered by the government, whenever it is impractical or more expensive for the government to directly undertake such operations. Accordingly, government agencies are encouraged to set accreditation standards for delivery by NPOs of basic services to the relevant target sectors in exchange for government incentives such as technical and financial assistance, recommendations for exemption from duty tax and other applicable taxes relative to foreign donations, and participation in the formulation and development of government plans and policies.

As a general rule, to be accredited by the relevant government agency, the NPO must be

- Known to be of integrity and committed to social issues

- Reputable and socially acceptable to the concerned or affected community
- Locally based and possessed of adequate basic resources
- Possessed of technical capability and the ability to be trained if there are technical capability gaps
- Possessed of a proven track record

Subject to the special documentary requirements of the relevant government agency, NPOs wishing to apply for accreditation shall submit the following documents:

- Certificate of good community standing
- Completed NGO data sheet with organizational setup
- SEC, DOLE, DSWD, or CDA registration
- Audited financial statements
- List of community activities undertaken
- Curricula vitae of key officers and implementing staff

Local government units (LGUs) also provide a system of NPO accreditation. Upon application made by an NPO (supported by a duly approved board resolution, certificate of registration, and list of officers, accomplishments, and financial data), the *sanggunian* (city or municipal legislative body) concerned accredits the organization based on the following criteria:

- It must be registered with the SEC, CDA, DOLE, DSWD, or any recognized national government agency that accredits people's organizations, NGOs, or the private sector. If not formally registered, the organization may be recognized by the *sanggunian* for purposes only of meeting the minimum requirements for membership of such organization in local special bodies.
- It must have an organizational purpose and objectives promoting community organization and development, institution building, local enterprise development, livelihood development, capability building, and similar developmental objectives and considerations.
- It must be community based, with a project development and implementation track record of at least one year.

- It must demonstrate reliability, evidenced by the preparation of annual reports and conduct of annual meetings duly certified by the board secretary of the organization.

The government has likewise recognized the importance of an independent self-accrediting mechanism for the nonprofit sector. The Tax Reform Act of 1997 has paved the way for the possible recognition of a private accrediting agency in accordance with rules and regulations to be promulgated by the Secretary of Finance. Under Section 34(h) of the new tax code, the Philippine Council for NGO Certification, a private voluntary organization created for this purpose, may now enter into a Memorandum of Agreement (MOA) with the Secretary of Finance to establish the regulatory framework of its rights and obligations as an accrediting agency under the law.

Implementation of Registration and Accreditation

The registration and accreditation of nonprofit organizations is basically simple. Rules and regulations governing these processes are widely available to the public, in a form that is easily understood, without charge. The simplicity of the procedures set by law is manifested in the "permit" type rather than the "registration disclosure" type of regulation adopted by the SEC and the relevant government agencies. Unlike the "registration disclosure" type of regulation, where the relevant government agency merely accepts applications for registration without exercising regulatory functions, the "permit" type vests in the agency charged with administering it the power not to grant the franchise or accreditation if the applicant fails to meet the agency's standards.

Although the registration and accreditation processes are adequate and effective for the purpose for which they were established, there is ample room for improvement. The SEC does not distinguish between nonstock nonprofit corporations and for-profit corporations, whose registration is lodged in its Corporate and Legal Department. To address the peculiar needs of the nonprofit sector, the SEC could be reorganized to include a separate division for nonstock nonprofit corporations. The separate division for nonstock nonprofit corporations would be tasked not only with accepting registration applications but also with direct and active monitoring and supervision of these organizations. To create an extensive database on the nonprofit sector, the application forms and supporting documentation requirements of nonprofit organizations can be redesigned to include specific services offered and target markets of each NPO. Further, to facilitate linkage and coordination of efforts between nonprofit corporations and the government, nonprofit organizations, after due accreditation by the relevant government agency, should be required to submit the corresponding certificate of accreditation to the SEC. The SEC then would become a one-stop information center, equipped to provide the basic economic and technical analysis and information on which donors can make their judgments on aid levels, project selection, needs for different types of aid, and aid administration for particular recipients.

REQUIRED PURPOSES AND ACTIVITIES

No part of the income of a nonstock corporation is distributable as dividends or may inure to its members, trustees, or officers. Profits, if any, obtained as an incident to a nonstock corporation's operations shall, whenever necessary or proper, be used for the furtherance of the purpose or purposes for which the organization was organized. Nonstock organizations are formed for charitable, religious, educational, professional, cultural, fraternal, literary, scientific, social, civic, public service, or similar purposes, or any combination thereof. Aside from the purpose requirement, NPOs must comply with two additional rules: there may be no shareholders, and no part of their income may be distributed to their members.

Failure to state the preceding substantive requirements in the Articles of Incorporation at the time of registration will be deemed noncompliance with the prescribed form, and the Articles may be rejected. The organization, however, through a preliminary conference with an SEC legal officer, will be given an opportunity to make the necessary corrections to the Articles of Incorporation. When the appropriate changes have been made and the proposed objectives and purposes are found to have substantially complied with the foregoing rules and guidelines, the SEC will then file and approve the Articles of Incorporation and issue the corresponding certificate of incorporation.

Changes in Purposes or Activities

A significant change in the purpose of an organization and the conduct of its affairs after the issuance of a certificate of incorporation should be reflected in the Articles of Incorporation of the organization by way of an amendment. The proposed change in the purposes or activities must not contemplate any of the following:

- Lending any part of the organization's income or property without adequate security and a reasonable rate of interest
- Purchasing any security or property for more than an adequate consideration in money or goods and services
- Selling any part of the security or other property for less than adequate consideration in money or goods and services
- Diverting income or transferring property, by way of lease or sale, to any member of the board of trustees, the founder, or the principal officers or any member of their families or to any corporation controlled directly or indirectly by the aforesaid individuals or their families in accordance with the attribution of stock ownership
- Using any part of the organization's property, income, or seed capital for any purpose other than that for which the corporation was organized or created
- Engaging in any activity contrary to law, public order, or public policy

The SEC may cancel the organization's certificate of registration should any change in the purpose be unauthorized and, after due notice and hearing, impose a daily fine until such violation or default ceases. The tax-exempt status of the organization may likewise be revoked. If a donor is found to have participated or consented to the violation, the donor shall be deprived of the benefits provided under existing laws, and the corresponding tax due on the donation, including statutory increments, will be accordingly imposed and collected.

Prohibition Against Personal Economic Benefits

The law expressly prohibits deriving personal economic benefits from the organization. Profits acquired from any authorized activity must be used exclusively for the furtherance of the purpose or purposes for which the organization was organized and should not be apportioned as dividends to the organization's members, trustees, or officers. Subject to the provisions of law for the retention of tax-exempt donee institution status, the Articles of Incorporation, or the bylaws, a nonprofit corporation may provide for the distribution of assets among its members upon dissolution. Generally, however, no part of the organization's income must inure to the benefit of the individual member of the nonstock corporation.

Limitations on Business or Commercial Purposes

A nonprofit organization cannot engage primarily in business or economic activities. It may engage in an income-generating activity expressly allowed by its Articles of Incorporation or in an activity that is incidental, necessary, or essential to carry out the expressed objectives of the organization, subject to the condition that profits realized therefrom shall be used for the furtherance of those objectives. A nonprofit organization can legally invest in any business for the purpose of acquiring land or other assets to be used solely for the maintenance and implementation of its projects. It may deposit or leverage its funds, subject to the rules on utilization by private foundations and other nonprofit corporations of their income, in banks or other financial institutions.

Although they are allowed to invest funds or income for profit, nonprofit organizations cannot lawfully engage directly and actively in business. They cannot operate as manufacturers and dealers of construction materials nor engage in small-scale mining activities, because these activities are not incidental or necessary to carry out their objectives. To ensure that a proposed activity is tax-exempt under Philippine law, a nonprofit organization should request an opinion on the tax consequences of such activity from the Bureau of Internal Revenue.

Limitations on Lobbying and Political Activity

There is no express prohibition under Philippine law against NPOs' influencing legislation. As long as the nonprofit organization acts within the bounds of generally acceptable and permissible advocacy in accordance with Article 19 of the Civil Code, as when an organization actively requests a certain senator or congressman to support a legislative enactment, lobbying is allowed, as long as no organizational funds or income is actually expended thereon.

The same rule applies for the purpose of influencing the outcome of any election of a public official, although the Philippine Omnibus Election Code, Batas Pambansa Bilang 881, Section 95, prohibits nonprofit corporations, particularly those that are funded by the government and those claiming tax and other exemptions, from soliciting or receiving any aid or contribution of whatever form or nature for purposes of influencing the results of an election.

Other Limitations on NPO Purposes and Activities

NPOs that receive financial assistance from their accrediting agencies are required to enter into a Memorandum of Agreement (MOA) or a similar document. The MOA must contain the following:

1. Project statement including identification of beneficiaries.
2. Standards for project implementation by the NGO or PO and acceptance by the GO, to include completion date.
3. Systems and procedures for project implementation; such as, but not limited to, the procurement of the goods and services by the NGO or PO and the schedule of release of fund assistance by the GO. In the development of the systems and procedures, the GO and the NGO or PO shall be guided by generally accepted principles for economical, effective, and efficient operations.
4. Reporting, monitoring, and inspection requirements.

While the MAO is in effect, the NPO is prohibited from using the funds for money market placement, time deposits, and other forms of investments not related to the project. Moreover, the NPO is required to return any amount not utilized, although it may request to use the savings for activities allied to the project, such as the purchase of additional medicines for medical services, books for manpower development, or desks and chairs for school buildings.

NPOs are further mandated to

- Ensure project implementation in accordance with the MOA
- Keep and maintain separate savings accounts and subsidiary records for assistance received from each GO
- Require beneficiaries to issue their acceptance of accomplishment or completed project
- Submit the required financial and physical status reports
- Submit a certificate of accomplishment with required proof, and for projects with an assistance of P100,000 or more, submit duly audited financial statements
- Return to any GO any amount not utilized, or request to use the savings for activities allied to the project, such as purchasing

additional medicines for medical services, purchasing books for manpower development, purchasing desks and chairs for school buildings, and so on

If these obligations are not complied with, NPOs may be subjected to the sanctions provided under the law, such as cancellation of the organization's accreditation and tax-exempt status and termination of other benefits.

TAX EXEMPTIONS

Nonstock nonprofit corporations are exempted from paying certain taxes, as an incentive for their contribution and participation in social development and nation building, which are basically government functions. To gain this privilege, they must file an application for exemption with the Bureau of Internal Revenue (BIR) or other relevant government agencies. The law and pertinent rules and regulations are construed strictly, not against the government but against the one who asserts the claim of exemption. It is only after the Certificate of Exemption has been duly issued by the appropriate agency that all donations, contributions, or gifts received from donors, individual or corporate, are exempt from taxes.

Income Taxation

Nonprofit corporations are generally exempt from income taxation. This is explicitly provided in Section 30 of the Tax Reform Act of 1997, which provides for the income tax exemption of the following nonprofit organizations:

- Nonstock corporations or associations organized and operated exclusively for religious, charitable, scientific, athletic, or cultural purposes or for the rehabilitation of veterans, providing no part of their net income or assets belongs to or inures to the benefit of any member, organizer, or officer or any other specific person
- Business leagues, chambers of commerce, and boards of trade not organized for profit, providing no part of their net income inures to the benefit of any private stockholder or individual
- Civic leagues, or organizations not organized for profit but operated exclusively for the promotion of social welfare

- Nonstock and nonprofit educational institutions
- Government educational institutions

On the condition that no part of their net income inures to the benefit of any private stockholder or individual, any flow of wealth to these organizations, whether in the form of fees, donations, gifts, grants, or contributions, from local or foreign sources, is not taxed as income.

However, income generated from the use of assets with the purpose of earning profit, whether directly related to the primary purpose or not, is subject to income tax as strictly enunciated in the same provision of law, as follows: "Notwithstanding the provisions in the preceding paragraphs, the income of whatever kind and character of the foregoing organizations from any of their properties, real or personal, or from any of their activities conducted for profit, regardless of the disposition made of such income, shall be subject to tax imposed under this code."

Even if nonprofit corporations are allowed to engage in business as an incident to their primary and secondary purposes, they are not afforded the benefits of income tax exemption for income earned from such business activities. Thus if a charitable organization generates a surplus in the conduct of activities for profit, it is liable for the tax on the income derived from such commercial activity.

Even for tax-exempt organizations, the extent of the exemption, and the applicable tax rate, depends on the income source. Contributions and gifts are exempt. The tax treatment of passive or investment income received by an NPO differs by type, with royalties, prizes, and most interest taxed at 20 percent and dividends paid by domestic corporations exempted. Business income is taxed at 34 percent.

Under Section 52 of the Tax Reform Act, NPOs are required to render, in duplicate, true and accurate quarterly income tax returns and a final, or adjustment, return. The returns are prepared by the president, vice president, or other principal officer; sworn to by such officer and by the treasurer and assistant treasurer; and filed with authorized agent banks, the Revenue District officer, or an agent or the duly authorized treasurer of the city or municipality having jurisdiction over the location of the principal office of the corporation filing the return or the place where the main books of accounts and other data from which the return of the corporation is prepared are kept. This is in addition to other reporting requirements of the Bureau of Internal Revenue with respect to NPOs' functions as withholding agents of the government (as employers) and of other relevant government agencies.

Educational Institutions

Educational institutions in the Philippines enjoy preferential tax benefits. In support of education, the 1987 Philippine constitution provides, in Article XIV, Section 4, that "All revenues and assets of nonstock, nonprofit educational institutions used actually, directly, and exclusively for educational purposes shall be exempt from taxes and duties. Upon the dissolution or cessation of the corporate existence of such institutions, their assets shall be disposed of in the manner provided by law."

Proprietary educational institutions, including those cooperatively owned, may likewise be entitled to such exemptions, subject to the limitations provided by law, including restrictions on dividends and provisions for reinvestment. This constitutional provision underscores the importance of quality education for all in the Philippines and is designed to enlist the support of the nonprofit sector in making affordable quality education more widely available.

Prior to the passage into law of the Tax Reform Act of 1997 on January 1, 1998, the scope of the tax exemption for nonprofit schools was unusually broad. The exemption for "all revenues and assets" of nonprofit schools did not turn on source. It extended to all sources of income, not just donations, fees, and tuition. During the deliberations of the 1986 Constitutional Commission, the following colloquy occurred:

MR. AZCUNA: The revenues of nonstock and nonprofit educational institutions must actually, directly, and exclusively be used for educational purposes. So, until the revenues are plowed back to an educational purpose and are just retained in the school for reserve, would the school have to pay taxes on these revenues?

MR. SUAREZ: If the reserve will be used for educational purposes, actually, directly, and exclusively, the school will also enjoy the same exemption.

MR. AZCUNA: But the taxable year is reckoned from year to year, and the reserve may not be actually used until five years from then; so is the tax postponed until such time as it is used?

MR. SUAREZ: There is no postponement in the enjoyment of the exemption, because it could very well happen that they may be reserved funds there but are intended for the purchase of laboratory equipment, books, et cetera.

MR. AZCUNA: How about "retained earnings"? Would they have to pay taxes on retained earnings?

MR. SUAREZ: No, retained earnings would have to be considered in the form of reserve, in the same category.

MR. AZCUNA: So there will be no tax on that?

MR. SUAREZ: No, there will be no tax.

In view of the foregoing constitutional guarantee, the recent enactment into law of the Tax Reform Act of 1997 may raise controversial constitutional issues that may become the subject of intense debate as soon as strict implementation of the code is commenced by the Bureau of Internal Revenue.

Section 30(f), last paragraph, of the tax code provides that notwithstanding the tax exemption for nonprofit, nonstock educational institutions, income of whatever kind and character from any of their properties, real or personal, and any of their activities conducted for profit, regardless of the disposition made of such income, is subject to income tax. In effect, the constitutionally mandated exemption from income taxes for nonprofit educational institutions has been revoked. Unless the proper courts of law declare this provision unconstitutional, it will likely be enforced by the Bureau of Internal Revenue.

TAX DEDUCTIONS AND CREDITS

Registration of a nonstock nonprofit organization with the Bureau of Internal Revenue does not vest legal-person status on the organization but rather confers tax-exempt donee institution status on it. This enables donors and contributors to obtain the benefits set forth in the Tax Reform Act of 1997, Batas Pambansa Bilang 45, BIR-NEDA Revenue Regulations No. 1–81, and other pertinent rules and regulations.

Any NPO may apply for tax-exempt donee status with the Registration and Regulatory Section of the Office of the Revenue District Officer and Assistant Revenue District Officer within ninety days from the issuance of their corporate charter by the SEC by submitting the following statements and documents:

- A sworn statement or affidavit describing the character of the organization, the purpose for which it was organized, its actual activities, proposed projects, sources and disposition of its income, and other facts relating to its operation that are relevant to qualification as a tax-exempt donee institution.
- A copy of its Articles of Incorporation and bylaws
- A financial statement showing the assets, liabilities, receipts, and disbursements of the organization

If the Regional District Officer of the BIR finds the application in order, he shall forward the same to the National Office with his favorable recommendation for the issuance of the Certificate of Income Tax Exemption. Donations to organizations made after the date of registration shall qualify for the benefits described in the next section.

Amount of Deductions or Credits

With the enactment into law of the Tax Reform Act of 1997, Philippine tax law now provides reasonable incentives to donors. Section 34(H) of the new tax code provides:

> Contributions actually made within the taxable year are deductible in an amount not in excess of 10 percent in the case of individuals and 5 percent in the case of a corporation, of the taxpayer's taxable income derived from trade, business, or profession. The contributions must be made to or for the use of the government of the Philippines or any of its agencies or any political subdivision thereof exclusively for public purposes, or to accredited domestic corporations or associations organized and operated exclusively for religious, charitable, scientific, youth and sports development, cultural, or educational purposes or for the rehabilitation of veterans, or to social welfare institutions or to nongovernment organizations. The donee organization may not confer excessive economic benefits on any insider.

Corporations and self-employed individuals and those engaged in the practice of their profession are allowed to deduct total annual contributions up to a percentage of their taxable income before contributions: 5 percent in the case of corporations and 10 percent in the case of individuals. Pure compensation income earners, however, remain prohibited from claiming deductions for contributions made to nonprofit organizations from their gross income in the computation of their income tax liability to the government.

Aside from this incentive, corporations and individuals who are self-employed and engaged in their professions can also deduct in full donations to government organizations, certain foreign institutions, and accredited nonprofit domestic corporations that meet the following conditions:

1. They must be organized and operated exclusively for scientific, research, educational, character-building and youth and sports development, health, social welfare, cultural, or charitable purposes, or a combination thereof, providing no part of their net income inures to the benefit of any private individual.
2. They must, no later than the fifteenth day of the third month after the close of the taxable year in which the contributions are received, use the donations directly for the active conduct of the activities constituting the purpose or function for which they are organized and operated, unless an extended period is granted by the Secretary of Finance.
3. Their level of administrative expense must, on an annual basis, conform with the rules and regulations prescribed by the Secretary of Finance upon the recommendation of the Commissioner, and in no case may exceed 30 percent of their total expenses.
4. They must stipulate that in the event of dissolution, their assets will be distributed to another nonprofit domestic corporation organized for similar purposes or to the state for a public purpose or be distributed by a court to another organization to be used in such a manner as, in the judgment of said court, shall best accomplish the general purpose for which they were organized.

Under the new tax code, corporate and individual donors are allowed to deduct in full contributions made to any such institution, in addition to the ordinary deductions for contributions to other nonprofit organizations.

Accountability

Rules and regulations of the BIR rules and the pronouncements and circulars of government agencies are replete with verification and substantiation procedures for donations to nonprofit organizations, as a mechanism for accountability, control, and deterrence of illegal transfers of property for the purpose of evading payment of taxes.

For every donation received, qualified donee institutions must issue a certificate of donation. Contributions or gifts are allowed as deductions only if verified under the rules and regulations prescribed by the Secretary of Finance. The certificate, indicating the name and address of the donor and the amount or market value of each donation, is prepared in three or four copies and distributed within thirty days after the donation is received, as follows: the original copy is given to the donor; the duplicate copy is given to the BIR; the triplicate copy is retained by the donee; and, in the case of qualified donees under the National Priority Plan, the quadruplicate copy is furnished to the National Economic Development Authority. Not later than the fifteenth day of the fourth month after the close of its taxable year, the NPO must file an annual information report of all donations received during the preceding year with the BIR, together with its income tax return. If the donee institution's activities are covered by the National Priority Plan, the organization is required to furnish a copy of the return to the NEDA. The report must be certified by the authorized official of the institution or association and must contain

- A list of donations and income received during the year, showing the name and address of the donor, the source of income, the amount or market value of each donation and items of income, and the disposition thereof
- A list of activities or projects undertaken by the institution, indicating the cost of each undertaking and, in particular, where and how the donation has been utilized
- A list of projects, their corresponding costs, the amounts set aside, and the status of the funds balances at the end of the year
- Certification that the utilization requirements have been sufficiently complied with

- Certification that no part of its net income inures to the benefit of any private stockholder or individual
- A report of the status of project implementation

Failure to comply with these reporting requirements may result in the revocation of the corporation's tax-exempt status. The books of accounts as well as the operations of the organization may also be verified annually by the Commissioner of Internal Revenue or his duly assigned representative to ascertain whether or not the organization has met the requirements for maintaining tax-exempt status. This is in addition to the current reporting requirements, such as the registration data sheet, of the Supervision and Monitoring Department of the SEC for the maintenance of nonprofit status of a corporation.

For their part, donors are required to give notice of every donation worth over P1,000 to the Commissioner of Internal Revenue within thirty days from their receipt of the certificate of donation from the donee. They must submit evidence to the BIR showing actual receipt by the donee of the donation, the date it was received, and the amount of the donation before their claim for limited or full deductibility is processed. The claim for exemption must be lodged in the proper revenue office at the time the individual's or corporation's income tax return is filed and during the taxable year in which the donation was made. Late claims are not accepted.

CAPITAL FORMATION

Nonprofit organizations accumulate capital through donations, endowments, and contributions from local and foreign donors. Since there are no limitations on the right to receive local or foreign funding, funds are generally able to flow freely and without restrictions into NPOs.

Aside from funding support from accrediting government agencies, NPOs may seek financial assistance through the Official Development Assistance Program of the National Economic Development Authority. Funding from the World Bank, Asian Development Bank, and other bilateral and multilateral donors is coordinated through the NEDA. To avail itself of these funds, a nonprofit organization can submit project proposals endorsed by the relevant accrediting agency to the NEDA for evaluation. Under Mode I, donor governments provide funds directly to local NPOs through their existing NGO facilities or windows, such as the Philippine-Australian Community Assistance Program and the Philippine Development Assistance Program of Canada. Under Mode II, funds are coursed by donors through the GOP for receipt by NGOs that follow the same procedures adopted for public sector projects. Proposals of NGOs are reviewed, prioritized, and endorsed by the GOP. Mode III is a scheme whereby foreign NPOs provide funds directly to local NPOs. In this case, the donor and donee agree during bilateral consultations on the framework, eligibility criteria, and implementing and reporting mechanisms to be adopted by the parties. In this instance, government approval will no longer be a prerequisite to donor approval, and funding of NGO projects and evaluation will generally be on a "no objection" basis.

Despite the plethora of possible sources of funding, an NPO's ability to raise capital is restricted by the utilization requirements provided in Section 34(h) of the Tax Reform Act of 1997. This is particularly significant for NPOs whose donors intend to claim full deductions for contributions. These NPOs must, no later than the fifteenth day of the third month after the close of the taxable year in which contributions are received, utilize the funds directly for the active conduct of the activities constituting the purpose or function for which it was organized. Utilized funds, for this requirement, means

1. Any amount in cash or in kind (including administrative expenses) paid or utilized to accomplish one or more of the purposes for which the NPO was created or organized
2. Any amount paid to acquire an asset used (or held for use) directly in carrying out one or more of the purposes for which the NPO was created or organized

An amount set aside for a specific project that falls within one or more purposes of the organization may be treated as utilized, but only if at the time such amount is set aside, the NPO has established to the satisfaction of the Commissioner that the amount will be used for the specific project within a period prescribed in rules and regulations to be promulgated by the Secretary of Finance, but not to exceed five years, and the project is one that can be better accomplished by setting aside such amount than by immediate spending of those funds. This is referred to as "constructive" use of funds and allows NPOs to generate, to a limited extent, income from investments of such funds for profit in time deposit accounts, shares of stocks, or treasury bills.

INTERNAL GOVERNANCE

The internal governance of corporations in the Philippines benefits from a hands-off policy on the part of the state. NPOs are able to run themselves with minimal interference from the government, except for those broad restrictions imposing public accountability set forth in the Corporation Code.

Under the Corporation Code, the general supervision and active management of corporations, including the exercise of all corporate powers, the conduct of corporate business, and the control and administration of all corporate properties, are vested in a governing board. This body is called a board of directors in stock corporations and a board of trustees in nonstock corporations. The board represents the corporate body, and its members are the executive representatives of the corporation. This peculiar relationship grows out of the legal inability of the corporation to act except through its directors or trustees.

The powers of the board of trustees are original and undelegated. In instances expressly provided for in the Articles of Incorporation or when the corporation collaborates or enters into joint ventures or strategic alliances with other nonprofit organizations in pursuit of one or more of its objectives, the organization may be governed by multiple bodies.

Although the powers of the board are plenary, subject only to restraints under the law and those provided in the Articles of Incorporation and bylaws of the corporation, the board members of NPOs are generally not compensated for their services. Section 30 of the Corporation Code prohibits payment of salaries to the members of a board of trustees for performing the usual and ordinary duties pertaining to their office, except for reasonable per diems. They may receive compensation, the total yearly amount of which must not exceed ten percent of the net income before tax of the corporation during the year, in any of the following instances:

- When fixed in the bylaws of the corporation
- When granted and approved by majority vote of all the members at a regular or special meeting
- When the members of the board render extraordinary or unusual services not properly incidental or pertaining to their office

A newly registered nonprofit corporation must state in its bylaws the compensation of its board of trustees or a formula for its determination; otherwise its members will not be eligible to receive any form of remuneration for services rendered by them. However, if the organization wants to qualify for or maintain a status as a donee institution whose donors may fully deduct contributions to it, the members of the board of trustees must not receive any form of remuneration, even if expressly allowed under its bylaws.

Election of the Board of Trustees

The members of the board of trustees are directly elected into office by the members of the nonprofit corporation or, in the case of a newly established one, by the incorporators. Unless the bylaws provide for other qualifications, the law requires only the following:

- All board members must be members of the organization.
- A majority of the board members must be residents of the Philippines.
- No board member may have been convicted by final judgment of any offense punishable by imprisonment for a period exceeding six years, and no board member may have violated the Corporation Code within five years prior to the date of election or appointment.

Membership in the organization, as well as the rights and obligations of members, is subject to the bylaws and internal rules and regulations passed by the board of trustees. The bylaws or the rules may provide that new members may be admitted by a majority of the members of the board of trustees or by a committee on membership. The corporation may issue a certificate of membership entitling the holder to exercise rights of membership. Membership in a nonstock corporation, and all rights arising therefrom, is personal and nontransferable, unless provided otherwise in the Articles of Incorporation or the bylaws.

After election into office, unless otherwise provided in the Articles of Incorporation or the bylaws, the members of the board of trustees of nonprofit corporations, which may be more than fifteen but no less than five in number as fixed in the Articles of Incorporation or bylaws, shall classify themselves so that the term of office of one-third of the number shall expire every year. Subsequent elections of trustees composing one-third of the board are then held annually, and trustees so elected may have a term of three years. In the absence of specific restrictions in the corporation's Articles of Incorporation or bylaws, the term of office of the board of trustees is staggered, thereby allowing continuity in the organization's policies and programs.

In the case of educational institutions, Section 108 of the Corporation Code expressly provides for the management board to be of a number not less than five nor more than fifteen, provided that such numbers shall be in multiples of five. Unless otherwise provided in the Articles of Incorporation or bylaws, the term of office of the trustees shall be staggered by a one-year interval. Trustees subsequently elected shall have a term of five years. This rule does not apply to educational institutions organized as stock corporations. The term of the management board of these stock corporations is fixed at one year, and no staggering of terms is allowed.

For stock corporations opting to convert to educational foundations, the board of trustees, as the governing body, shall be composed of ten elective members, with a term of five years. The terms are staggered, with two expiring every year. The foundation exists, unless dissolved for any reason, in which case all its assets escheat to the state.

In nonstock corporations, there is no right to cumulative voting unless the Articles of Incorporation or bylaws expressly grant such right. Under the same provision, a majority of the trustees shall constitute a quorum for the transaction of business, and their powers and authority shall be defined in the bylaws.

Term of Office

The members of the board of trustees are allowed to serve for a maximum term of five years. A longer or unlimited term is not allowed, since Section 7 of the Corporation Code, which limits the privilege to be elected as director of a stock corporation to a period of five years, applies to nonstock corporations as well. To allow the directors to serve for a longer term would unduly deprive other members of the organization of the opportunity to participate in the management and operation of the corporation and could allow the potential abuse of power.

Removal from Office

A trustee or director of a nonprofit corporation may be removed from office, with or without cause, by a vote of two-thirds of the members entitled to vote, taken at a regular or special meeting called for that purpose, with notice of the time and place of such meeting as well as the intention to propose such removal. The special meeting is called by the secretary on order of the president or on the written demand of a majority of the members entitled to vote. Should the secretary fail or refuse to call the special meeting upon such demand or fail or refuse to give notice, or if there is no secretary, the call for the meeting may be addressed directly to the members by any member signing the demand. The board has no power to remove one of its members, as that authority is lodged in the members. If the members of the board of trustees are also members of the corporation, they do not vote on removal as a collegial body but in their individual capacities. Any removal from office of a member of the board of trustees for mismanagement of the affairs of the corporation, neglect, or other cause is not the subject of a judicial remedy. The trustee removed may, however, challenge the action before the SEC, which has jurisdiction over controversies in the election or appointment of directors, trustees, and officers of such corporations or associations. Any decision of the SEC on such removal may be appealed to the Court of Appeals by way of a petition for review. The vacancy resulting from the removal may be filled by election at the same meeting, without further notice, or at any regular or special meeting called for that purpose. Trustees elected to fill vacancies occurring before the expiration of a particular term shall hold office only for the unexpired period.

Duties of the Board of Trustees

The basic management and operating functions of the board of trustees do not extend to changes of a fundamental character in the corporation but relate to the ordinary or regular business of the corporation. As fiduciaries, the members of the board of the corporation have the following duties and responsibilities:

1. To exercise utmost good faith, honesty, and fair dealing in all transactions relating to their duties to the organization and its property and in their dealings with and for the organization
2. To exercise their powers for the benefit of the organization and not for their own personal benefit
3. Not to profit as individuals by virtue of their position
4. Not to acquire an interest adverse to that of the organization while acting in its behalf or when dealing individually with third persons

5. Not to evade their responsibility and authority in running the affairs and operations of the organization

The members of the board of trustees of a nonprofit corporation are, however, not obliged to actively manage the organization. They may delegate that task to officers of the organization. Immediately after their election, the trustees are required to elect or designate a president, who shall be a director; a treasurer, who may or may not be a director; a secretary, who shall be a resident and citizen of the Philippines; and such other officers as may be provided for in the organization's bylaws. The corporate officers so elected shall then perform the duties enjoined on them by the board of trustees, the law, and the bylaws of the organization.

Although direct supervision and active management of the organization may be delegated to corporate officers, the board of trustees remains directly responsible for the full control and management of the organization. They are obliged to act in the best interest of the organization and in accordance with their best judgment. Any violation of the best-judgment rule is actionable before the SEC, which has jurisdiction over devices or schemes employed by, and any acts of, NPOs' boards of directors, business associates, and officers or partners that amount to fraud and misrepresentation detrimental to the interest of the public or the members of associations or organizations registered with the Commission. Such action must be brought before the SEC by an officer of the corporation, a member of the board of trustees, or a member of the corporation in a derivative suit on behalf of the organization, provided they were not parties to such fraud, device, or scheme. In the absence of dishonest purpose, bad faith, fraud, or negligence so gross as to amount to breach of trust, the discretion of the board will not be reviewed by the courts or by the SEC in an action questioning its conduct. This rule exists to protect and promote the full and free exercise of the power of management given to the directors.

Members of the board of trustees and officers who willfully and knowingly vote for or assent to patently unlawful acts by the organization, are guilty of gross negligence or bad faith in directing the affairs of the corporation, or acquire any personal or pecuniary interest in conflict with their duty to the corporation shall be liable jointly and severally for all damages resulting therefrom suffered by the organization, its members, and other persons. When a trustee or officer, in violation of his duty, acquires or attempts to acquire any interest adverse to the corporation in respect to any matter that has been entrusted to him in confidence, as to which equity prohibits him from benefiting himself, he shall be liable as a trustee and must account for the profits that otherwise would have accrued to the organization. He may be subjected to a general penalty consisting of a fine or imprisonment of not less than thirty days but not more than five years, or both, without prejudice to any criminal or civil sanctions imposed by law.

TERMINATION OR DISSOLUTION

Termination or dissolution, or the complete and permanent cessation of operations, may be voluntary or involuntary. Voluntary dissolution may occur under the law upon any of the following:

- A vote of the board of trustees and resolution of two-thirds of the members, when no creditors are affected
- Judgment of the SEC after hearing a petition for voluntary dissolution signed by a majority of the board of trustees or other officers having management of the organization's affairs, verified by its president or one of its trustees, and approved by at least two-thirds of the members, when creditors are affected
- An amendment of the Articles of Incorporation to shorten the corporate term

When no creditors are affected, the following documentation must be filed with the SEC:

1. A resolution dissolving the corporation, adopted by affirmative vote of two-thirds of the members at a meeting held on the call of the trustees after publishing notice of the time, place, and object of the meeting for three consecutive weeks in the place where the principal office of the said corporation is located and, if no newspaper is published in such a place, then in a newspaper of general circulation in the Philippines, and after sending notices to each member, either by registered mail or personal delivery, at least thirty days prior to said meeting
2. A director's certificate signed by at least a majority of the directors and countersigned by the secretary, certifying the approval of the resolution dissolving the corporation
3. An affidavit of any trustee, officer, or member assuming any valid claim against the corporation

4. An affidavit of a publisher regarding the publication of the notice of time, place, and object of the members' meeting approving the dissolution once a week for three consecutive weeks in a newspaper of general circulation

When creditors are affected, a petition for dissolution must be filed with the SEC, with the following documentation:

1. A resolution dissolving the corporation, adopted by affirmative vote of two-thirds of the members at a meeting held on the call of the trustees
2. A petition signed by the majority of the board of trustees or other officers having the management of the organization's affairs and verified by its president or one of its trustees, setting forth all claims and demands against the corporation and certifying that the dissolution was approved in accordance with law

After submission of the petition for dissolution, the SEC shall issue an order reciting the purpose of the petition and fixing the date on or before which objections to the petition may be filed by any person, which shall not be less than thirty days nor more than sixty days after the entry of the order. Before such date, a copy of the order must be published once a week for three consecutive weeks in a newspaper of general circulation published in the municipality or city where the principal office of the corporation is located, at the expense of the corporation. The order must likewise be posted for three consecutive weeks in three public places in the municipality or city where the corporation is located. Upon five days' notice given after the date for filing objections, the SEC shall hear the petition and try any issue made by the objections filed, and if proper, the SEC shall render judgment dissolving the corporation and directing such disposition of its assets as justice requires and may appoint a receiver to collect such assets and pay the debts of the corporation.

Whether the dissolution of the corporation is voluntary or involuntary, the assets of the nonprofit organization must be distributed as follows:

1. For the payment, discharge, and satisfaction of all liabilities and obligations of the corporation.
2. When the assets are held upon a condition requiring a return, transfer, or conveyance and such condition occurs by reason of

the dissolution, the same shall be returned, transferred, or conveyed in accordance with such requirements.

3. When the assets are received and held subject to limitations permitting their use only for charitable, religious, benevolent, educational, or similar purposes but not held upon a condition requiring return, transfer, or conveyance by reason of the dissolution, they shall be transferred to one or more corporations, societies, or organizations engaged in activities in the Philippines substantially similar to those of the dissolving corporation, according to a plan of distribution adopted pursuant to law.
4. Other assets, if any, shall be distributed in accordance with the provisions of the organization's Articles of Incorporation or bylaws, to the extent that the Articles of Incorporation or bylaws determine the distributive rights of members or any class or classes of members or provide for distribution.
5. In any other case, the assets may be distributed to such persons, societies, organizations, or corporations, whether or not organized for profit, as may be specified in a plan of distribution.

Despite provisions in the Articles of Incorporation or the bylaws providing for specific methods of distribution, assets owned by nonstock nonprofit corporations whose donors are entitled to full deductibility must be distributed to another domestic corporation or association or to the government for a public purpose, or as may be directed by a competent court of justice in accordance with the accomplishment of the general purpose for which the dissolved organization was organized.

Nonprofit organizations, for the sake of convenience, sometimes opt to simply cease operations and cede, sell, assign, or transfer their assets to other entities by donation or some other method of disposition without resorting to the procedure laid down by law. In this case, the corporation is still considered to legally exist, even though it has ceased operations and may be charged by the SEC the appropriate fines for violating its rules, particularly the annual reporting requirements.

CONCLUSION

The Philippine nonprofit legal system is one of the most democratic and least regulated nonprofit systems in the world. Despite perceived inadequate implementation of laws, rules, and regulations governing the nonprofit sector, nonprofit organizations have continued to flourish and increase in number. The current Philippine nonprofit legal system cannot be deemed inadequate, difficult to operate in, or unduly burdensome.

Corporate donors have begun recently to look beyond tax benefits to larger issues of corporate citizenship and are beginning to exhibit a shift in management philosophy from social response to social contribution. Individual donors may not be as aware of the important contributions of NPOs in nation building. Because of the prominence of the Catholic Church and other religious denominations, most individuals make charitable contributions directly to religious institutions, from which no accountability is demanded.

The most enabling nonprofit legal system cannot conclusively guarantee the development of philanthropy in the absence of strong support from donors. Donor disposition is not a creation of the legal system. The legal system can only provide an atmosphere conducive to philanthropic giving. If recommendations are to be made, they must be aimed not only at awakening the general public to the role of NPOs but also at fostering confidence in them so that a concomitant flow of donations into these institutions will be forthcoming.

Public Support for NPOs

It is undeniable that the general public is a major source of potential funding for nonprofit organizations. NPOs must continuously inform the public of their activities, plans, and programs. This will not only increase public awareness of their developmental efforts but also encourage the creation and growth of this philanthropic funding source.

Self-Accreditation of NPOs

To gain public trust and confidence, a self-accreditation mechanism aimed at policing the ranks of NPOs and guarding against fly-by-night NPOs must be instituted to uplift the image of NPOs and ensure adherence to a certain code of ethics. The self-accreditation body should be nongovernmental in nature to ensure the independence of the nonprofit sector. This private self-accreditation body will complement the existing Philippine legal structure in terms of linkage and coordination of efforts between the government, NPOs, and people's organizations and facilitate the legal conferment of tax-exempt status on the latter.

Financial Sustainability of NPOs

To guarantee their financial sustainability, NPOs must be allowed to generate income for themselves while operating within the limitations provided by law on unrelated trade or business. The law should permit them to explore innovative alternatives for capital formation that are consistent with their nature.

Influencing Government Policy on Administrative Matters

To make philanthropy more convenient for the public, financial institutions can be commissioned to act as depository agents for cash donations to donee institutions. This will facilitate increased capital formation capability among NPOs. Such a system, however, presupposes a well-functioning self-accreditation system that can win for these NGOs the public's trust and confidence.

Influencing Legislation

NPOs have a limited impact on national policy. NPOs should be encouraged to use the collective experience and strength of their members to develop specific and sound policy recommendations for sustainable development, to mobilize the participation of other sectors in developing and enhancing these recommendations, and to find ways to convince the government to adopt these recommendations.

Reforming the Tax Law

One way of addressing the issue of financial sustainability is to grant tax exemptions to NPOs on income generated from donated capital and the conduct of activities for profit. This would allow NPOs to enjoy the full benefits of these donations. The legislature should help NPOs achieve financial sustainability consistent with their nature and character as not-for-profit organizations. Since they are taxed on income generated from for-profit activities, a preferential tax rate of 10 percent should be imposed rather than the regular corporate income tax rate.

With respect to income subject to final tax, for which NPOs are currently not exempted, it is suggested that exemption privileges be likewise extended to them, particularly in situations where adequate proof of such entitlement exists.

The legal mechanism needed to encourage philanthropy in the Philippines and to provide financial sustainability and manpower for NPOs, although not adequately implemented, is sufficiently in place. Recommendations made in this chapter merely seek to provide refinements to Philippine nonprofit law. What seems to be the more important issue is the perceived lackadaisical administration and enforcement of these laws by the relevant government agencies. To some degree, this attitude may be influenced by how NPOs react to government intervention. Unless the nonprofit sector can collectively decide on the proper degree of government involvement in matters affecting their operation and administration, the effectiveness of the Philippine legal framework in terms of developing philanthropy cannot be ascertained.

9

SINGAPORE

Corinna Lim
Dipa Swaminathan
Nicole Tan Siew Ping

THE DEVELOPMENT OF NONPROFIT ORGANIZATIONS (NPOs) in Singapore can be divided into three phases: the growth of Chinese NPOs in colonial Singapore, a decline of NPOs following independence, and the emergence of reformist groups in the mid-1980s. The first significant NPO activity was that of early Chinese immigrants who banded together to form clan associations, dialect associations, and secret societies. This arose as a result of the colonial government's neglect of the welfare of these immigrants and their need to find kinship in a foreign land.

In 1965, Singapore, led by the People's Action Party (PAP) government, gained independence. The PAP government proved to be an effective and strong one, providing the country with rapid economic growth and the necessary social services and thus minimizing the role of NPOs such as trade unions and student organizations. As a result,

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NPOs with an interest in social policy took a backseat in Singapore until the mid-1980s.

During this period, parapolitical organizations played an important mediating role between the people and the state, displacing, in part, the role usually assumed by NPOs. The three main parapolitical (or "grassroots") organizations, the community centers (CCs), citizens' consultative committees (CCCs), and residents' committees (RCs) are government-sponsored organizations under the control of the Prime Ministers' office. They act as channels of communication between the government and the people, provide welfare and social services, and provide opportunities for people to participate and become involved in the community.

In the mid-1980s, as a result of higher education and the deepening maturity of the society, a new breed of NPOs started to emerge. These were formed by people who had an interest in social issues and who wanted to influence change in society through their involvement and through the education and mobilization of people. Groups such as the Association of Women for Action and Research (AWARE), the Nature Society, and the Association of Muslim Professionals (AMP) fall into this category. The last twenty years have also seen the development of state-initiated NPOs, such as the community self-help groups set up along ethnic lines (for example, the Singapore Indian Development Association [SINDA], the Chinese Development Assistance Council [CDAC], the Council for the Development of the Singapore Muslim Community [MENDAKI] and the Eurasian Association), welfare organizations linked to the National Council of Social Services (for example, the Society for Aid to the Paralyzed), and professional associations (for example, the Singapore Professional Center). Many of these have informal rather than formal links to the government.

Singapore has a common law legal system based primarily on English law. The sources of law in Singapore are case law and statutes passed by the Singapore Parliament.

Since attaining independence in 1965, Singapore has begun to actively develop its own body of law. Many of these developments are unique to Singapore, whereas others find their origin in England and other common law countries like Australia, New Zealand, Canada, and the United States.

The body of nonprofit law developed almost independently of the development of NPOs in Singapore. The only piece of legislation that was enacted specifically for NPOs was the Societies Act. This is still the main legislation governing NPOs, although, as discussed later in the chapter, it has outlived its original purpose and, it is argued, inhibits rather than promotes the growth of NPOs.

It is informative to look at the history of this act. The earliest version of the act was the Societies Ordinance, enacted in 1889 by the Legislative Council of the Straits Settlement as a response to unlawful activities carried on by the secret societies, or triads, which were rampant in Singapore. The act makes it mandatory for all associations to register with the government. Those that do not are deemed unlawful, and their members are liable to penal sanctions. Article 14 of the Constitution of Singapore gives all citizens the right to form associations. This right is subject to restrictions Parliament may impose by law, as it considers necessary or expedient, to protect the security of Singapore, public order, or morality. Despite the British belief in freedom of association, the legislative council felt that the situation warranted the passing of this Ordinance, and the Ordinance proved effective at curbing secret society activities.

In 1966, Parliament passed an amended version of the act. Secret societies are no longer a major problem in Singapore today, yet the Societies Act continues to apply and to require all NPOs to be registered under this act, unless they are registered under the Companies Act or any other legislation.

Aside from the Societies Act, NPOs may be governed by other laws, such as the Companies Act and the Trade Unions Act. In addition, NPOs are regulated by the general body of laws relating to diverse subject matters such as charities, internal security, and maintenance of religious harmony.

These different components also have different origins. The law on charities is of English heritage, and the Companies Act is modeled after the companies legislation from New South Wales, Australia, whereas statutes such as the Internal Security Act and the Maintenance of Religious Harmony Act were specifically enacted to deal with problems or situations peculiar to Singapore. The Maintenance of Religious Harmony Act is a fairly recent piece of legislation, enacted to prohibit acts that cause feelings of enmity between different religious groups and to prevent people from promoting political causes in the name of religion. This act was deemed necessary in view of Singapore's vulnerable position as a young, small, densely populated, multiracial, multireligious, and multicultural country.

In summary, there is no coherent body of law designed to govern NPOs. The only act specifically enacted to regulate associations (the Societies Act) is outmoded, in the sense that the original reason for its enactment no longer applies. The other laws that affect NPOs are not specific to and were not enacted specifically for NPOs.

Singapore may possibly be entering into its fourth phase of NPO development. The Prime Minister, Goh Chok Tong, in his recent speech to Parliament outlining his vision for Singapore in the twenty-first century, emphasized the need for a civil society where "people participate actively and become involved in community and national issues." In his speech he expressly acknowledged that for civil society to grow, "the government itself must be prepared to take a back seat, especially on local community issues, and allow some free play to develop."

One of the ways the government can promote the growth of a strong civil society is to review and revise the legal framework governing NPOs. The present legal framework is made up of laws that have either outlived their purpose or do not relate specifically to NPOs and did not arise to meet society's needs in relation to them. With the Prime Minister's call for the development of a strong civil society, it is an opportune time to review, update, and improve the legal framework of NPOs.

This chapter attempts to review and analyze the legal and regulatory framework governing NPOs in Singapore and makes recommendations where appropriate.

REGISTRATION

In Singapore, an NPO may take one of several forms: a society, a company, a trade union, a school, and so on. All NPOs have to be registered as one or more of these forms, and the registration process depends on the form sought by the particular organization. The most commonly chosen form is that of a society or company. But an organization that is a society and also a charity has to be registered under both the Societies Act and the Charities Act.

Not unlike in other countries, the administration of statutes promulgated by Parliament is left to the administrative arm of the government. Oftentimes, the statutes also provide that the administrators have certain discretion in carrying out the business of administration. Throughout this chapter, we refer to certain decisions regarding NPOs, such as decisions concerning their registration, that are left to the discretion of the administrative arm of the government. We would like to highlight that the discretion granted to government administrators is not unbridled; administrative decisions are open to judicial review (unless specifically provided otherwise by statute), even if there is no right of appeal from the decision to the relevant minster. A case that illustrates that there is "no absolute and untrammeled" administrative authority is *JB Jeyaratnam* v. *PP,* 1 MLJ 129 (1990). The court held that government authorities can be compelled to give explanations for their decisions and that if their explanations are beyond the scope of the authorizing act or are unconstitutional, their decisions will be struck down. Another example is the 1991 case of *Jessie Tan Gek Neo,* where the court overturned the decision of the Registrar of Companies because he took into account irrelevant considerations.

Societies

The law governing societies is the Societies Act.

DEFINITION. A society is defined widely under the Societies Act to include any club, company, partnership, or association of ten or more persons, whatever its nature or object, except, inter alia, registered companies or any company, association, or partnership formed for the sole purpose of acquiring gain through the conduct of a lawful business.

The terms *club* and *association* are not defined in the Societies Act. However, past cases have taken a wide interpretation of these terms and indicate that a group constitutes a society when the following two requirements are satisfied:

- The persons who constitute the group must necessarily share in the pursuit of some joint or common interest.
- The motivation of the members in joining the group should include the desire to associate together.

GROUNDS FOR REFUSAL OF REGISTRATION. Registration under the Societies Act is not a formality. It is very much a discretionary act. A society will not be registered under the Societies Act if the Registrar of Societies determines any of the following:

- The rules of the society are insufficient to provide for its proper management and control.
- The society is likely to be used for unlawful purposes or for purposes prejudicial to public peace, the public welfare, or good order in Singapore.
- The application for registration does not comply with the provisions of the Societies Act.

- It would be contrary to the national interest for the society to be registered.
- In the case of any society that is a political association, its rules do not provide for its membership to be confined to citizens of Singapore, or it has an affiliation or connection with any organization outside Singapore that is considered by the Registrar of Societies to be contrary to the national interest of Singapore.

It is not clear what yardsticks are used by the Registrar to determine national interest, public peace, the public welfare, and good order in Singapore. From interviews we conducted in the course of preparing this chapter, we understand that applications for registration to the Registry of Societies are commonly routed by the Registry to other relevant authorities and organizations for their comments and feedback. We specifically raised these issues for clarification in a written inquiry to the Registry but received no substantive response.

If the Registrar of Societies is satisfied that one or more of the above circumstances exist, he is *bound by law* to refuse registration. In the following circumstances, however, the Registrar of Societies has *discretion* to refuse registration:

- The Registrar is satisfied that the society is connected with a society that has been previously refused registration.
- A dispute arises among the members of the society as to the persons who are to be officers or who are to administer the property of the society.
- The name of the society is identical to that of another society, is otherwise likely to mislead the public, or is in the opinion of the Registrar undesirable.

UNLAWFUL SOCIETIES. Under the Societies Act, every society that is not registered is an unlawful society. Penalties prescribed by the Societies Act would attach to any person who, inter alia,

- Manages or assists in the management of an unlawful society
- Is a member of, or attends a meeting of, an unlawful society
- Grants the use of his or her premises for meetings of unlawful societies
- Solicits for membership in an unlawful society

- Seeks aid for an unlawful society
- Transmits or publishes materials that are or appear to be issued by or on behalf of an unlawful society

The Societies Act also contains presumptions to help the prosecution prove the commission of an offense under the act. When it is proved that a club, association, partnership, or company exists, the presumption, though rebuttable, is that such an association is a "society" as defined under the Societies Act and has had, at all material times, ten or more members. There is no necessity to prove that the society was constituted, that it has a name, or that it is known under a particular name. Similarly, if any materials that belong or appear to belong to a society are found in the possession of any person, that person is presumed to be a member of the society until the contrary is proved.

OTHER MATTERS. The Societies Act does not recognize the distinction between an association and a foundation, with regard to registration requirements or otherwise. The administrative authority in charge of enforcing the Societies Act is the Registrar of Societies. There is no legally stipulated time limit for the Registrar of Societies to accept or refuse registration. In practice, this process may take between four months to one year. A person aggrieved by the Registrar's decision to refuse registration may appeal to the Minister of Home Affairs within thirty days of the decision. There is no further appeal from the decision of the Minister under the Societies Act.

Companies

The law governing companies is the Companies Act. Instead of registering under the Societies Act, NPOs may choose to incorporate under the Companies Act as a company limited by guarantee or by shares. In the case of companies limited by guarantee, liability of the members is limited to the amount each has undertaken to contribute to the assets of the company. In the case of companies limited by shares, liability of the members is limited to the subscription price of the shares each member holds in the company. In Singapore, NPOs that have incorporated themselves have done so as companies limited by guarantee (with only one exception known to us). Most NPOs do not consider it appropriate to incorporate as companies limited by shares, because such companies are perceived to be structured precisely for the distribution of profits among members. Further, there are no significant advantages to an NPO's being incorporated as a company limited by shares over its incorporating as a company limited by guarantee.

Incorporation offers advantages not available to societies, especially in the case of larger organizations, such as the benefits of perpetual succession, the elimination of the need for trustees to hold the society's land, greater efficiency in conducting the organization's affairs, and the application of the comprehensive provisions of the Companies Act. The latter may provide potential donors with greater assurance that their donations will be properly applied and accounted for and thus have the effect of encouraging donations.

The Registry of Companies and Businesses (RCB) is responsible for the registration of companies. The criteria for registration as set out in the Companies Act are wide, namely:

- Association for a lawful purpose
- Subscription of names to a memorandum
- Approval and reservation of name
- Lodgment of the memorandum and articles, together with the payment of fees

Aside from the above requirements, the Act also sets out grounds for refusal of registration:

- The proposed company is likely to be used for an unlawful purpose or for purposes prejudicial to public peace, the public welfare, or good order in Singapore
- Registration would be contrary to national security or the national interest.

In the case of an application for the incorporation of an NPO, the present government policy does not encourage an organization to register as a company limited by guarantee even if the applicant is able to satisfy the requirements for registration. It is understood that such applicants are encouraged to register with the Registry of Societies instead. The RCB would only incorporate an association as a company limited by guarantee in exceptional cases, and the promoters of the company would have to show good reasons why an exception should be made. The RCB has made exceptions in the past when it was shown that the NPO required a separate legal entity, perpetual succession, and the ability to hold property in its own name. Exceptions are also made when the number of members of the NPO is less than ten, and therefore the NPO cannot be registered as a society, and when the funds involved are substantial, and the applicants or sponsors prefer to set up the NPO as a company rather than as a society to attract greater scrutiny and control under the Companies Act. These exceptions are made on a case-by-case basis, after careful examination of the application by the RCB.

In most cases in which an NPO applies to be registered as a company limited by guarantee, it will usually apply concurrently to be incorporated without the word *limited* in its name. The term *limited* gives the impression that the company has a profit-making objective and may deter potential donors from making donations. Thus it is useful for a nonprofit company to remove this term from its name. This application is made to the Minister of Finance, and the applicant will have to satisfy the Minister that the proposed company

- Is being formed for the purpose of providing recreation or amusement or promoting commerce, industry, art, science, religion, charity, pension or superannuation schemes, or any other object useful to the community
- Has some basis for promoting national or general public interests
- Is in a financial position to carry out the objects for which it is to be formed
- Will apply its profits (if any) to promote its objects and will prohibit the payment of any dividends to its members

Concerning the third of these criteria, the RCB will usually not allow the company to have borrowing powers unless

- The applicant can demonstrate a genuine need to borrow.
- The applicant can demonstrate that the funds are to be used in a manner that will further the objects of the company.
- The company is in a position to finance the loan.
- The borrowing does not exceed the company's net tangible assets.
- The lender is an established financial institution, like a bank or a finance company.

These restrictions, together with the means and purpose of acquiring the loans, should be clearly spelled out in the Memorandum and Articles of Association of the nonprofit company.

Concerning the fourth criterion, the Memorandum of Association would usually state that the income and property of the company shall not be distributed to the members of the company and shall be applied toward promoting the objects of the company.

The application for a license to omit the word *limited* will be considered by the RCB, which will make the necessary recommendations to the Minister of Finance. The RCB usually requires a fair amount of detail on the funding plan of the proposed company and an assurance that the company will be able to sustain itself.

Registration of an NPO under the Companies Act can be a lengthy process because the applicant must satisfy the RCB on many issues.

If the RCB refuses to register an NPO on grounds other than the public policy grounds under Section 20(2) of the Companies Act, this decision may be appealed to the court. If the refusal to register is on the basis of public policy grounds under Section 20(2), the aggrieved applicant may appeal to the Minister, whose decision shall be final.

Charities

On top of the registration requirements described previously, all charities (save for exempt charities) must apply for registration with the Commissioner of Charities. In practice, most organizations register in order to obtain tax benefits.

DEFINITIONS. The Charities Act affords little guidance concerning what a charity is. It defines a charity as any institution, corporate or not, that is established for charitable purposes and is under the jurisdiction of the High Court with respect to charities. The nebulous phrase "charitable purposes" is in turn defined as purposes that are exclusively charitable according to the law of Singapore. One must look at case law to determine what "charitable purposes" are. Fundamentally, "charitable purposes" have been categorized into the following four broad categories, as propounded by Lord Macnaughton in *Income Tax Special Purposes Commission* v. *Pemsel,* AC 531 (1891): purposes for the relief of poverty, purposes for the advancement of education, purposes for the advancement of religion, and other purposes beneficial to the community.

Although Lord Macnaughton's test has since been generally adopted in textbooks and subsequent judicial cases, it must be noted that the four categories (especially the last) provide flexibility for the courts to maneuver to adapt to the changing social milieu. Many have argued for a more rigid formulation for the sake of certainty. However, if such a formulation were adopted, the flexibility would definitely be lost and the law would become ossified. Alternatively, to achieve flexibility, the rigid framework might be turned on its head, and lawyers (and judges) might find themselves contorting words and phrases to achieve the desired results. The Commissioner of Charities indicated to us that he, too, relies on English common law and its locus classicus, the *Pemsel* case, for guidance in determining whether an organization or trust qualifies to be registered as a charity. As discussed previously, a lay person's difficulty in appreciating what a "charity" is may be further aggravated by the fluid development of case law and the fact that English common law and local common law might develop along different paths (see discussion later in the chapter).

REGISTRATION. The registration of a charity is not a mere formality. Charity trustees are duty-bound to apply to register a charity that is not an exempt charity, in default of which they would be guilty of an offense and would, on conviction, be liable to a fine, imprisonment, or both.

No time frame is imposed on the Commissioner of Charities to make his decision as to registration. The registration process also does not make a distinction between an association and a foundation.

The Commissioner's decision regarding the registration of an institution as a charity is subject to appeal in the High Court. However, after the appeal has been decided by the High Court, the Commissioner of Charities can consider the matter afresh, as the matter is "not [to] be concluded by" that decision of the Court if it appears to the Commissioner that there is a change of circumstances or that the appeal decision is inconsistent with a later judicial decision.

Analysis and Recommendations

REGISTRATION UNDER THE SOCIETIES ACT. It appears that, in practice, the Registrar of Societies exercises a great deal of discretion in the registration of societies under the Societies Act. This can be contrasted to the incorporation of profit-oriented companies under the Companies Act, for which registration is almost automatic in most cases provided that the procedural requirements have been complied with. This is also reflected in the time required for registration under both acts. The registration process under the Societies Act usually requires a minimum of four months, compared with the two-week period usually required for the incorporation of companies.

When the Registrar rejects an application for registration of a society, he usually does not give reasons for his decision. Further, appeals against the Registrar's decision may be made only to the Minister of Home Affairs and not to the courts. The requirement for registration under the Societies Act should be reviewed and the following issues addressed:

Is registration necessary? In many countries, the right to associate is an unconditional right, and registration of NPOs confers benefits but is not mandatory. The registration requirement arose to curb the proliferation of secret societies. However, there may not be any compelling reason to continue this requirement, especially in light of other existing legislation such as the Penal Code, the Internal Security Act, and the Maintenance of Religious Harmony Act. These Acts should be sufficient safeguards against the use of societies for unlawful purposes.

The present requirement for registration would seem to hamper the growth of a civil society. Not only do the formalities constitute a practical obstacle to the formation of NPOs, but the spirit of the Societies Act, with its penal sanctions for nonregistration, presumptions of proof against unregistered societies, lack of transparency, and lack of recourse to the courts (as discussed later), does not give rise to a conducive climate for the growth of NPOs.

Even if there are good reasons for requiring registration, should the present practice of allowing a high degree of administrative discretion be continued, or should the practice be liberalized to match that of the RCB in the registration of profit-oriented companies, such that registration would be almost automatic as long as the procedural requirements are satisfied? Again, this would promote the growth of NPOs. The present system lacks transparency in that no reasons are given for refusals of registration, there are no public records of the details of refusals, and there are no appeals to the courts. This can be improved by

- Minimizing administrative discretion by specifying the exact criteria for registration and making registration almost automatic when these criteria are satisfied
- Requiring that reasons be given when applications for registration are refused
- Providing for appeals to the courts against refusal of registration

Given the present needs of society, as articulated in the Prime Minister's speech of July 7, 1997, it is time to conduct a comprehensive review of this act to see how it can serve those needs. What is required is a more liberal framework to promote NPOs rather than a strict regime to control and regulate them.

INCORPORATION UNDER THE COMPANIES ACT. Under the present system, the policy of the RCB is to allow incorporation of NPOs only under exceptional circumstances. This policy should be reviewed and liberalized, especially in the case of larger NPOs.

Incorporation is necessary for larger NPOs, as it provides the benefits of perpetual succession, eliminates the need for trustees to hold the society's land, promotes greater efficiency in conducting organizational affairs, limits the liability of organization members, and allows for application of the comprehensive provisions of the Companies Act. The Societies Act does not provide a comparably sophisticated structure for larger NPOs.

A more comprehensive solution is to adopt a Nonprofit Corporation Act. This would be preferable to the current legal regime because many of the provisions and principles under the Companies Act that were formulated to govern for-profit companies may be inappropriate for incorporated NPOs. One possible model is the Australian Associations Incorporation Act 1991, as the Companies Act of Singapore is based on the companies legislation from New South Wales, Australia.

Alternatively, the Societies Act may be revamped to govern both unincorporated and incorporated NPOs. The Societies Act would then form a comprehensive code governing all NPOs.

REGISTRATION UNDER THE CHARITIES ACT. There is no statutory definition of *charity,* and the judicial definition (as laid down in past cases) continues to apply. There should be more guidance for the lay person concerning what constitutes a charity, as registration is compulsory and there are penal consequences for nonregistration. To provide greater transparency and certainty in this matter without introducing the rigidity of a statutory definition, the Charities Commissioner could provide a list of recognized charitable objects (which may be updated when necessary) and an annual publication of the Commissioner's decisions on this point.

PURPOSES AND ACTIVITIES

Restrictions on the purposes and activities of NPOs are found in legislation specific to organizations, such as the Societies Act, and in general laws, such as the Internal Security Act and the Penal Code.

Restrictions in Specific Legislation

SOCIETIES ACT. The Societies Act restricts the purposes and activities of registered societies. Prohibited purposes under the Societies Act include unlawful purposes and purposes prejudicial to public peace, the public welfare, or good order in Singapore. A registered society may be dissolved by the Minister of Home Affairs if he is satisfied that the society is being used for such purposes. Further, if it appears to the Minister that a society is operated for purposes that are "incompatible with the objects and rules of the society," it may be dissolved. There is no provision for appeal to the courts in the case of dissolution by the Minister.

Unlawful activities include triad rituals, gambling on the society's premises, introduction of materials for gambling or drug taking into the society's premises, trade union activity, attempts at restricting or interfering with trade or adversely affecting consumer interest, political activity, holding a lottery without the approval of the relevant authorities, and raising funds without the approval of the Head of the Licensing Division of the Singapore Police Force and other relevant authorities. It appears that a society that desires to operate as a political party should declare its intentions to the Registrar of Societies and seek registration as such. If a society is registered as a political party, the prohibition clauses on political activities will be waived with respect to that society.

Most of the prohibitions relating to activities are contained in the model constitution prescribed by the Registry of Societies. It is not clear if all applicants are required to adopt this model. We raised this specific issue in a written inquiry to the Registry of Societies but did not receive a substantive response.

Engaging in an unlawful activity prior to registration may result in denial of registration, and engaging in an unlawful activity after registration (which includes activities contrary to the society's constitution, by virtue of the Societies Act) may result in dissolution.

COMPANIES ACT. The Companies Act restricts the purposes and activities of registered companies. The Registrar of Companies has the power to refuse to register a company that is likely to be used for an unlawful purpose or for purposes prejudicial to public peace, the public welfare, or good order in Singapore or whose registration would be against national security or interests. Similarly, the courts may, on the petition of the Minister of Finance, order the dissolution of a company that is being used for an unlawful purpose or for purposes prejudicial to public peace, the public welfare, or good order in Singapore or against national security or interests. The act does not specify the types of objects or activities that might fall under these categories.

Further, when an NPO registers as a company limited by guarantee and wishes to omit the word *limited* from its name, it is not allowed to make payment of any dividends to its members and must apply its profits to promote its objectives (which must include the provision of recreation or amusement or the promotion of commerce, industry, art, science, religion, charity, pension or superannuation schemes, or any other objective useful to the community or that promotes the national or general public interest).

Finally, a company is required to operate within the objectives and powers specified in its constitution.

CHARITIES ACT. A registered charity that does not function for charitable purposes may be struck off the Register of Charities. The Charities Act and its subsidiary legislation give no indication as to whether a charity's purposes must be exclusively charitable or whether it can have noncharitable purposes as well. However, in the Memorandum entitled "Setting up a Charity, Responsibilities and Duties of Charity Trustees" issued by the Commissioner of Charities, it is stipulated that the constitution of a charity must state that its objects are *exclusively* charitable and that any power to carry out activities in support of the main objectives should be provided under an incidental clause.

Restrictions Under General Laws

The general law provisions against unlawful and subversive acts are not peculiar to NPOs, but they can nonetheless impose restrictions on their activities. Some significant restrictions are discussed in the following paragraphs.

PENAL CODE. The Penal Code is a codification of the criminal law of Singapore. The code makes unlawful assembly an offense. An unlawful assembly is an assembly of five or more persons whose common objective is the resistance of any legal process; commission of mischief, criminal trespass, or any offense; "overawing" the government or the exercise of lawful power by a public servant by means or show of criminal force; interference with a person's rightful enjoyment of property by means or show of criminal force; or compelling a person to commit an illegal act or omission by means or show of criminal force.

An intentional participant in an unlawful assembly is considered a member of the unlawful assembly and is liable to penalties as such. Criminal sanctions are also imposed on persons who commit or provoke rioting and persons who have an interest in premises in which unlawful assembly or rioting takes place.

The Penal Code provides that "any male person who, in public or private, commits, or abets the commission of, or procures or attempts to procure the commission by any male person of any act of gross indecency with another male person, shall be punished with imprisonment, which may extend to two years." There is no corresponding provision for females, and it is not clear if similar activities by females would be covered by another provision in the Penal Code that decrees that any person who "voluntarily has carnal intercourse against the order of nature with any man, woman, or animal" is guilty of an "unnatural offense." Accordingly, an NPO that has for its purpose the promotion of gay or lesbian rights may be considered "unlawful" or contrary to the "national interest" and denied registration under the Societies Act and the Companies Act.

INTERNAL SECURITY ACT. The Internal Security Act (ISA) was enacted to provide for the internal security in Singapore and to prevent subversion. The ISA confers various powers on the authorities, including the power to detain persons without warrant or trial, the power to take possession of any land or building, and the powers of seizure, closure, entry, and investigation without warrant. Although the ISA applies to both individuals and organizations, it is particularly germane to the latter, as they have greater potential to disrupt the internal security of Singapore.

Of specific relevance to NPOs, the ISA confers on the authorities the power to, inter alia, prohibit any publication that appears prejudicial to the national interest, public order, or security in Singapore; require the delivery of the subversive documents; and prohibit subversive exhibitions or entertainment. There is no right of appeal to the courts against the authorities' exercise of their wide powers under the ISA. Except with regard to compliance with procedural requirements under the ISA, acts done or decisions made by the President of Singapore or the Minister of Home Affairs pursuant to the ISA are not subject to judicial review.

MAINTENANCE OF RELIGIOUS HARMONY ACT. As discussed previously in the chapter, this legislation was enacted to provide for the maintenance of religious harmony in Singapore. Under the Maintenance of Religious Harmony Act, the Minister of Home Affairs may make restraining orders against officials or members of any religious group or institution, or any other person, if the Minister is satisfied that such party has

- Caused feelings of enmity, hatred, ill-will, or hostility between different religious groups
- Carried out activities to promote a political cause or a cause of any political party while or under the guise of propagating or practicing any religious belief
- Carried out subversive activities under the guise of propagating or practicing any religious belief
- Incited disaffection against the President or the government of Singapore while or under the guise of propagating or practicing any religious belief
- Attempted any of the above

Restraining orders may also be made against any person who, in the opinion of the Minister, incites or encourages any religious group or any member or official of a religious group to carry out any of the activities mentioned above. The orders so made could, inter alia, restrain the persons from addressing audiences; distributing, editing, or in any way contributing to the publications of a religious group; or making statements on religious matters.

The person against whom the restraining order is intended to be made is required to be given notice thereof by the Minister of Home Affairs, supported by grounds and allegations. The Minister is also required to notify the person of his right to make written representations in response to the notice, which representations the Minister should have regard to when making the order. Restraining orders made by the Minister will be referred to the Presidential Council for Religious Harmony, which will in turn make recommendations thereon to the President of Singapore. Any order not confirmed by the President within thirty days of his receipt of the Council's recommendations will cease to have effect. Decisions of the Minister and the President and recommendations of the council made under this act cannot be called into question in any court.

Analysis and Recommendations

As discussed previously, the requirement for registration of societies should be reviewed. There appear to be sufficient safeguards under the general law to discourage unlawful and subversive behavior by NPOs without using registration as an additional means of control. The requirement for registration and the current practice of the Registry of Societies to exercise broad discretion in the consideration of every application for registration may hinder the growth of NPOs and the civil society.

The promotion of the growth of a civil society requires a framework of law that is both transparent and appears just. What is considered "out of bounds" should be established with certainty and be sufficiently publicized, and parties who are alleged to have overstepped these boundaries should be given a chance to defend themselves before a tribunal. The present framework confers upon the authorities a great deal of administrative discretion that cannot be challenged in court. The decisions of the various authorities under the Societies Act, the Charities Act, the ISA, and the Maintenance of Religious Harmony Act should be subject to court supervision.

TAX EXEMPTIONS

The national agency in charge of the administration and enforcement of income and other taxes in Singapore is the Inland Revenue Authority of Singapore, which was established under the Inland Revenue Authority of Singapore Act. The legal authority for the assessment and collection of income tax under the Income Tax Act is the Comptroller of Income Tax, who is appointed by the Minister of Finance.

As regards income tax exemptions, a distinction may be made between NPOs that are generally tax-exempt and those that are not generally tax-exempt but are eligible for tax exemptions.

Organizations That Are Generally Tax-Exempt

Organizations in Singapore that are generally exempt from paying income tax are named in the First Schedule to the Income Tax Act. This schedule consists of three categories:

- Public authorities, boards, or funds constituted by statute in Singapore
- Specified clubs, corporations, and institutions in Singapore, such as the YMCA, the Lee Kuan Yew Exchange Fellowship, and the National Crime Prevention Council of Singapore
- Specified authorities not incorporated in Singapore. The only current member of this category is the Board of Commissioners of Currency, Malaya and British Borneo.

Under Section 13(1)(e) of the Income Tax Act, all income received by the organizations named in the first schedule is exempt from income tax, except dividends an organization receives from any company in which it holds more than half of the issued share capital (and even this may be exempted from tax by the Minister of Finance).

Organizations That Are Not Generally Tax-Exempt

Organizations that are eligible for tax exemptions but are not generally tax-exempt include mutual benefit organizations, cooperative societies, trade unions, charitable institutions, clubs and associations, and trade associations. These organizations are not entitled to apply for tax-exempt status, but they may apply for exemption from income tax for each year. The criteria that an organization has to satisfy to obtain this tax exemption depends on the type of organization it is. Examined in the following sections are the criteria for charitable institutions and for clubs and associations. Tax exemption may not be granted if it is felt that the objectives of the organization have not been complied with.

CHARITABLE INSTITUTIONS. The income tax returns of charitable institutions are assessed not by the Comptroller of Income Tax but by the Charities Unit of the Inland Revenue Authority of Singapore. This unit assists the Commissioner of Charities in the performance of his functions under the Charities Act. As such, the unit's functions include registering charitable organizations, supervising charities to check abuses, issuing orders pursuant to the Commissioner of Charities' powers under the Charities Act, and assessing the income tax returns of charities.

Income tax exemptions are given to charitable institutions for a particular year on the following conditions:

- If any trade or business is carried on by a charitable institution, the income derived from it will be exempt from tax only if it is applied solely for charitable purposes and either the trade or business is conducted in the course of the actual carrying out of a primary purpose of the charitable institution or the work in connection with the trade or business is mainly carried on by the persons for whose benefit the charitable institution was established.

- The income of the charitable institution will be exempt from tax only if the institution spends, in any year of assessment, not less than 80 percent of its donations (in money or money's worth) and income on charities and charitable objects in Singapore, unless the Comptroller otherwise permits.
- If the charitable institution fails to spend 80 percent or more of its income and donations in accordance with its charitable objects, it will be liable to tax on that part of the income and donations not used for charitable purposes.

CLUBS AND ASSOCIATIONS. Clubs and associations are eligible for tax exemption for that part of their income that is not profit from investment income (for example, dividends, interests, and rent) or business income. Under the Income Tax Act, the income of a club or association is deemed to be business income if less than half of the gross receipts of the club or association is received from its members (including entrance fees and subscriptions). In such a case, the entire income will be taxable.

However, if the club or association receives from its members more than half of its gross receipts (including entrance fees and subscriptions), such income will not be deemed to be business income and will be eligible for tax exemption.

Appeals

A person aggrieved by the Comptroller of Income Tax's assessment may first apply to the Comptroller, by notice of objection in writing, for review and revision of the assessment made. An appeal of the decision of the Comptroller may be made to the Board of Review. The members of the Board of Review are appointed by the Minister of Finance. In any case in which the amount of tax payable exceeds S$200, the appellant or the Comptroller may appeal to the High Court from the decision of the Board upon any question of law or mixed question of law and fact. Decisions of the High Court may go up on appeal to the Court of Appeal, but only to the extent that a decision of the High Court made in the exercise of its original civil jurisdiction can be appealed against.

Analysis and Recommendations

In recognition of the contribution of NPOs to society, the present tax regime governing NPOs should be reviewed to consider more generous tax provisions and exemptions for NPOs. We recommend the following possibilities for reform:

1. Tax-deductible donations should be made tax-exempt for the recipient NPO.
2. NPOs should enjoy further exemptions from other forms of tax, such as stamp duty and goods and services tax.
3. The conditions for the exemption of tax on income derived from trade or business carried on by a charitable institution should be reviewed. Fundraising is an increasingly difficult affair, and charities may well have to resort to businesses that are unrelated to their charitable purposes to gain enough funds to meet their objectives. So long as a charity's trade income is used solely for charitable purposes, tax relief or exemption should be granted even if the trade or business was not conducted in the actual carrying out of a primary purpose of the charitable institution or if the work in connection with the trade or business was not carried out by the beneficiaries of the charity. Even if full tax exemption cannot be granted, such income should be taxed at a lower rate.
4. The requirement that a charity has to spend not less than 80 percent of its donations (in money or money's worth) and its income on charities and charitable objects in Singapore to obtain tax exemption inhibits charities from accumulating capital and growing. There should be some flexibility on this requirement, as it may be desirable for a charity to be allowed to accumulate capital. Further, to encourage philanthropic activities on a wider scale, the restriction on the application of funds outside Singapore should be lifted.
5. Some NPOs have both mutual benefit as well as public benefit purposes. As a result of having the former purposes, they are not entitled to obtain charitable status and are not entitled to apply for the tax exemptions that a charity is entitled to. The tax regime should be flexible enough to give such NPOs recognition and credit for their public benefit purposes in terms of tax exemptions.

TAX DEDUCTIONS OR CREDITS

Income Tax

Only outright cash donations to organizations specifically designated as institutions of a public character (IPC) qualify for tax deductions under Section 37(2)(c) of the Income Tax Act. Under the Income Tax Act, IPCs include:

- Any hospital, public or benevolent institution, or public authority or society that is not operated for profit
- Any educational institution (including a university) or public fund to establish, enlarge, or improve such an institution
- Public or private funds to provide for scholarships, exhibitions, or prizes in an educational institution
- Public funds established for the purposes of relief of public distress
- Charitable institutions, bodies of persons, or trusts established for charitable purposes only
- Organizations engaged in the promotion of culture, the arts, and sports but not primarily operated for profit

IPC status is granted by the Minister of Finance upon application by the concerned organization. This status is only granted to organizations located in Singapore.

Gifts in kind to IPCs do not qualify for deduction. A donor who presents a gift in kind, such as a vehicle, will therefore derive no tax benefit. But if the donor donates money and the IPC uses that money to buy the vehicle from the donor, the donor will be eligible for a deduction.

Donations to IPCs are allowed as deductions only to the extent that the aggregate donations do not exceed the taxpayer's statutory income for the relevant year, after the deduction of trade and business losses, if any. Any excess cannot be carried forward to subsequent assessment years. That apart, there are no percentage limits on the amount of donation that is deductible from the donor's income.

When a donor gives money to an IPC, he or she will receive a receipt from the institution. This receipt may be submitted along with the donor's income tax returns to claim the tax deduction.

A recent and noteworthy trend in this area has been that the Minister of Finance grants IPC status primarily to key umbrella organizations, which are then empowered to grant receipts on behalf of their members for donations made to the members. For example, the National Arts Council (NAC), the umbrella organization for arts organizations, has the power to issue receipts for arts organizations that are registered under the NAC Special Accounts Scheme. This new policy is useful in that it

- Decentralizes the supervision of IPC benefits to these key organizations, which are in a better position to determine and supervise the organizations that deserve to enjoy the privilege of providing receipts for tax deductions to their donors.
- Allows a wider range of organizations to give their donors such receipts, if indirectly.
- Allows for a system of checks by the umbrella organization at the point where the receipts are issued; the umbrella organization is in turn responsible to the tax authorities, thus making for multiple stages of accountability.

The umbrella organization that can grant tax deduction receipts for environmental groups is the National Environmental Council, and that for social services is the National Council of Social Services.

Analysis and Recommendations

Tax deductibility should be made available for donations in kind. Also, when the donor gets a tax deduction for the donation made, the donee organization should receive a corresponding tax benefit by way of a tax exemption on the donation.

CAPITAL FORMATION

General Restrictions on Use of Funds

The Societies Act and the Companies Act do not compel NPOs to spend or distribute a minimum amount of their income or assets. However, a charitable institution is required to spend at least 80 percent of its donations and its income on charities and charitable objects in Singapore in each year of assessment to obtain tax exemption on its income.

Restriction on Funds Raised for Foreign Charitable Purposes

There are certain restrictions on the use of funds raised by NPOs for foreign charitable purposes under the Charities Regulations (Fundraising Appeals for Foreign Charitable Purposes). An NPO that wants to conduct or participate in any fundraising appeal for foreign charitable purposes must obtain a permit from the Commissioner of Charities. The application must be made thirty days before the fundraising appeal. Any charitable, benevolent, or philanthropic purpose connected wholly or partly with persons, events, or objects outside Singapore is considered a foreign charitable purpose. Contravention of this regulation constitutes an offense.

Under the said Regulations, the Commissioner may grant a permit or may

- Refuse to grant a permit if he or she believes that, inter alia, an excessive proportion of the proceeds likely to be received will be used for administrative expenses or as remuneration to persons participating in the fundraising appeals, or the fundraising appeal is for a charitable purpose or institution that is illegal, fictitious, or objectionable on grounds of public policy. The Commissioner indicated to us that he would also refuse to grant a permit if there were a lack of evidence to show that the foreign charity is adequately supported by foreign sources.
- Grant a permit conditionally. The commissioner indicated to us that the usual conditions for the issuance of permits are, inter alia, that the cause for the fundraising is well-known, the foreign charitable organization is a bona fide organization supported by its government, and the expenses for raising the funds are not too high (preferably not more than 20 percent of the funds raised).

Further, the regulations also stipulate that unless the Commissioner allows it, at his discretion, a permit will not be granted for a fundraising appeal for foreign charitable purposes unless the applicant undertakes to spend not less than 80 percent of the net proceeds of the fundraising within Singapore. The Commissioner indicated that “if there is a need and there are good and worthy causes for raising funds for foreign charitable purposes” he will use his discretion to grant permits without imposing the 80 percent retention requirement (as examples, the fundraising appeal by the United Nations Students' Association of the National University of Singapore for children in India for UNICEF, the appeal by the British Airways for UNICEF, the appeal by the Cleft Lip and Palate Association of Singapore for reconstructive surgery treatment on two patients from Myanmar, the appeal by Hong San See Temple for flood victims in the People's Republic of China, the appeal by the Singapore National Union of Journalism for Cambodian and Vietnamese children, and the appeal by the Singapore Red Cross Society for alleviating the food shortage in North Korea).

When the Commissioner of Charities refuses to grant a permit or revokes one, he or she must give written notice stating the right of appeal and the grounds on which the permit was refused or revoked (unless the ground is undesirability). Within fourteen days after the notice of refusal or revocation, an appeal can be made to the Minister of Finance, whose decision shall be acted upon by the Commissioner of Charities.

Restrictions on Investment

There are no restrictions on investment under the Societies Act and the Companies Act, but the Trustees Act contains certain restrictions. The Trustees Act sets out in its First Schedule an extensive list of investments in which a trustee is allowed to invest (at his discretion) the funds in his hands. The list of allowable investments in the First Schedule is in turn broken up into three parts, as follows:

I. Government securities, interest-bearing deposits held in Singapore currency in the Post Office Savings Bank or a bank or finance company in Singapore, and negotiable certificates of deposit denominated in Singapore currency and issued by any bank in Singapore

II. Units or shares of investments subject to the trusts of an authorized unit trust scheme; securities issued by a company listed on the Stock Exchange of Singapore or for which prices are quoted on the Central Limit Order Book (CLOB) International; bank and trade bills denominated in Singapore currency that are endorsed by a bank in Singapore and will mature within three months after the date of investment; and land in Singapore with freehold titles, grants in perpetuity, or leases (other than mining leases) with an unexpired term of at least thirty years

III. Fixed income securities of a foreign government having a AAA credit rating or the equivalent given by Moody's Investors Service, Inc., USA, or Standard and Poor's Corporation, USA, to hedge the foreign currency exposure from such investments back into Singapore currency.

When the trustee exercises his powers of investment, he shall have regard to the need for diversification of investments of the trust (as is appropriate for the trust), the degree of risk of the investment, and the suitability of the investment to the trust. In investing in the items listed in Part II and Part III of the First Schedule or when the trustee retains any investment, he or she shall periodically obtain and consider written proper advice or proper advice that has been confirmed in writing. The requirement for proper advice need not be complied with if one of two or more trustees is the adviser to the cotrustee(s), the Public Trustee, or a trust company.

Finally, the total amount invested in the investment items listed in Part III at any time shall not exceed 30 percent of the funds of the trust. After making the investments, the trustee can vary the investments from time to time.

Analysis and Recommendations

It is commendable that various legal and administrative safeguards have been put in place to protect against the depletion and misuse of the funds of NPOs and funds raised for foreign charitable purposes. Our comments are therefore limited to the extent of the restrictions on the use of funds raised from public appeals for foreign charitable purposes and also the discretion given to the Commissioner to determine which charitable causes should be granted a fundraising permit.

The authorities expressed two reasons why the 80 percent retention requirement was put in place: first, to exercise some "front-end controls" (that is, controls within Singapore) on fundraising for foreign charitable purposes, and second, to regulate contributions so that the perceived limited pool of contributions would not be depleted by donations' being diverted to what is deemed less deserving or less worthy charitable purposes.

We are of the view that the evils posed by unscrupulous fundraisers for bogus charitable purposes or by badly managed fundraisers who waste much of the funds in administrative costs (the reasons given for requiring "front-end controls") have very much been cured by making fundraisers apply for permits from the Commissioner. If the Commissioner is satisfied with the bona fide nature of the fundraising appeal and its intended recipients and grants a permit, we surmise that enough protection is afforded by the authorities as far as the coffers of the public are concerned.

On a practical level, it is questionable whether the imposition of the 80 percent retention requirement has achieved its stated objective of regulating donations to other more worthy causes. The average donor walking down a street will drop his spare pennies into a collection tin without much care as to the nature of the cause he or she has contributed to. With regard to this group of donors, the amount he donates, though small, is very elastic; he would donate as long as there is a persistent fundraiser on the street. We doubt if the 80 percent retention requirement would effectively regulate the pool of donations from this group of donors. If the donor group that the authorities are concerned with is the group of donors who budget their annual donations and make a conscious decision as to what worthwhile charitable cause they should support, imposing an 80 percent retention requirement effectively wrestles the decision away from these conscientious donors and makes them donate indirectly to local purposes contrary to their choice.

The principle behind the condition that a substantial portion of funds raised from the public for a specified foreign purpose should be applied within Singapore merits reexamination. Philanthropy is, after all, a very private and personal matter. A decision on whether to donate to a particular charitable purpose is colored by the cultural, social, and religious makeup of the donor. It seems somewhat inequitable that out of the dollar that a donor decides to donate to building a Buddhist temple in a small village in a Third World country, 80 cents is required to be spent in Singapore instead. Further, insofar as the general perception is that Singapore is a wealthy nation that can afford to help the less fortunate in the international arena, the imposition of the 80 percent retention requirement sounds tightfisted. (These criticisms lose some persuasiveness when one considers that in a number of instances the Commissioner has lifted the 80 percent retention requirement.)

In conclusion, if there appear to be no compelling policy reasons for maintaining this 80 percent retention requirement and if, in fact, it is not enforced and, even if enforced, does not achieve its stated purposes, then perhaps the requirement could be removed altogether.

INTERNAL GOVERNANCE

Societies Act

The Societies Act does not contain any provisions regarding the internal governance of societies. However, the model constitution prescribed by the Registry of Societies contains clauses that deal with internal governance. A society that willfully breaches its own constitution may be dissolved under the Societies Act, and the permission of the Registrar of Societies is required before any amendments to the constitution may take force.

The supreme authority of a society is vested in a General Meeting of Members. The society is required to hold Annual General Meetings, and Extraordinary General Meetings when 25 percent of the total voting membership or thirty members so requests in writing.

Every society is also required to have an elected management committee, and the manner and frequency of elections are described in the model constitution. The management committee is subordinate to the General Meeting of Members.

The President of a society is required to chair all general and committee meetings of the society, and he is also required to represent the society in its dealings with outside persons. The Vice President is required to assist the President and deputize for him in his absence.

The Secretary is required to keep all nonfinancial records of the society and will be held responsible for their correctness. He or she is also required to keep minutes of all meetings and maintain an up-to-date register of members at all times.

The Treasurer is required to keep all funds, collect and disburse monies on behalf of the society, and keep an account of all the monetary transactions of the society. The Treasurer will be held responsible for the correctness of the accounts. The society is required to maintain a bank account, and checks for withdrawals from the bank must be signed by the Treasurer and either the President or the Vice President. These officers' duties are specified by the model constitution.

In addition, the society may appoint as many committee members as it chooses and assign such functions to them as it sees fit. The society may also make its own regulations with regard to the removal of committee members from office.

If and when a society acquires immovable property, such property is to be vested in trustees, subject to a declaration of trust. Between two to four trustees are required to be elected by the General Meeting of Members. The trustees cannot effect any sale or mortgage of property without the prior approval of the General Meeting of Members.

The Societies Act also provides that “no judgment in any suit or action against a registered society shall be put into force against the person or property of any officer or member of the society but only against the property of the society.” The only stated exception to this rule is that when a registered society or its officers (on its behalf) institutes legal proceedings, the court may require the society or its officers to provide sufficient security for costs, if the court has reason to believe that the society or its officers will be unable to pay costs if the defendant is successful in its defense.

Companies Act

A company is governed by a board of directors. The directors are usually nominated by members at the Annual General Meeting, and there must be a minimum of two directors. Every company is also required to have a Company Secretary.

The board of directors is collectively responsible for the management of the company, although the actual operations are usually delegated to employees in larger companies. The members of the company are not entitled to intervene directly in the management of the company. Their main control over the directors is their right to select and remove directors (unless the Articles of Association of the company do not so provide for a right of removal).

There are, however, certain matters that can only be done with the consent of the members, including

- The sale of the business or a substantial part of the company’s property
- Substantial property transactions with a director or persons connected with a director

Directors have the duty to act honestly and to use reasonable diligence in the discharge of their duties of office. This has been interpreted to impose on directors the duty

- To act in what they honestly consider to be the company’s interests and not the interests of some other person or body
- Not to place themselves in a position of conflict of interest

Charities Act

The Commissioner of Charities' memorandum provides that if a charity is constituted by a written constitution, its constitution should

- Provide for the appointment of a committee of trustees sufficiently large for the effective management of the charity, and where the charity is set up by a trust deed or incorporated as a company, provide that the minimum number of trustees should be three
- Specify the term of office of the trustees and that the post of (assistant) Treasurer is not to be held by the same person for more than two years
- Stipulate the number of trustees or members required to form a quorum
- Set out the circumstances under which the charity can be dissolved

Any amendment to the constitution of a charity must be approved by the Commissioner of Charities. Save for an excepted charity, the Commissioner of Charities may, with the consent of the Attorney General, suspend or remove any trustee, charity trustee, officer, agent, or employee of the charity if he is satisfied that there is or has been any misconduct or mismanagement in the charity and that such action is necessary or desirable to protect the property of the charity or the application of that property. Notwithstanding anything in the trust instruments of the charity, misconduct and mismanagement extends to the employment for excessive remuneration or reward of persons acting in the affairs of the charity or for other administrative purposes, as compared with the value of the property that is or is likely to be applied or applicable for the purposes of the charity.

Trustees Act

In addition to the requirements of the Societies and Companies Acts, if an NPO involves a trust, the trust is governed by the instrument creating the trust and the Trustees Act. Save for trustees for charitable, religious, or public purposes, the number of trustees cannot be more than four. If more than four are named in a trust instrument, only the first four named (who are able and willing to act as trustees) can be appointed as trustees.

A trustee may be removed pursuant to the terms of the trust instrument. If a trustee is so removed or if the trustee is a corporation and it desires to be discharged, a new trustee can be appointed.

If there is only one original trustee (and the sole trustee is not a trust corporation) or there are three or fewer trustees (and none of them is a trust corporation), then the person(s) nominated by the trust instrument to appoint new trustees, if any, may in writing appoint additional trustees. If the trust instrument does not so provide, or if it does but the nominating person is unable or unwilling to so act, then the appointment is to be made by the other trustee(s). The appointment of additional trustees is subject to any contrary provision in the trust instrument or any other written law.

The power of appointment of trustees is also vested in the courts by the Trustees Act. Whenever it is expedient to appoint new trustees and it is found inexpedient, difficult, or impracticable to do so without the assistance of the court, the court may appoint new trustees in substitution of or in addition to exiting trustees. A substitute trustee would be appointed, for example, for a trustee who is imprisoned, suffers from mental disorder or unsoundness of mind, or is a bankrupt (or, in the case of a corporation, is in liquidation or has been dissolved).

Trustees—Common Law

Aside from the duties imposed under the specific acts described previously, the common law also imposes on trustees the duty to observe the trust, the duty to protect the trust property, the duty to apply for a *cy pres* scheme when the trust is no longer applicable, and the duty of loyalty.

The duty of loyalty is the duty not to let personal interest conflict with the duty of trust nor to put oneself in a position of conflict of interest. It includes the duty to act gratuitously and the duty not to profit from the trust. It is a breach of the duty of loyalty for the trustee to purchase trust property (what is termed "self-dealing") or to sell or loan his own assets to the trust. Further, the trustee is liable to account as constructive trustee for profits received by virtue of his position as a trustee, including gains acquired through the exploitation of opportunities arising from the trust office.

ACCOUNTABILITY

Societies Act

The Registrar of Societies can, at any time, require a registered society to produce any such information concerning the society as may be required or any documents, accounts, or books relating to the society. The obligation to provide such information is binding on every officer of the society and on every person managing or assisting in the management of the society in Singapore.

Failure to meet the above obligations will result in penalties being imposed, unless the person can satisfy the court that he exercised due diligence and failed to comply with the order for reasons beyond his control. Supplying false information will also result in penalties unless the person satisfies the court that he had good reason to believe that the information was true, correct, and complete.

Any person who pays the prescribed fees can inspect and copy documents belonging to a registered society that are in the possession of the Registrar or the Assistant Registrar of Societies.

Under the model constitution for societies drafted by the Registry of Societies, every society is required to appoint as honorary auditors either two voting members who are not committee members or a firm of certified public accountants. The accountants are required to audit each year's accounts and present a report on them to the Annual General Meeting of the society, and they may be required by the President to audit the society's accounts for any period within their tenure of office and present a report to the management committee.

Companies Act

Members have a right to inspect all the registers that a company is required by law to maintain, including the registers of members, directors, managers, secretaries, and auditors. These records are also available for inspection by the public on payment of a nominal fee.

All companies are required to keep accounting records sufficient to allow the company to prepare a profit and loss statement and balance sheet at the end of the year. The balance sheet and profit and loss statements are required to be audited before they are presented to the Annual General Meeting together with the directors' report and the auditors' report. Members do not have a right to inspect the accounting records of the company.

Income Tax Act

Every NPO must furnish income tax returns to the Comptroller of Income Tax within a specified time. A charity, club, or association must satisfy the conditions for obtaining tax exemption every year.

The Comptroller of Income Tax's powers to call for additional particulars are wide and include the powers to call for any books, documents, accounts, or returns he or she may consider necessary; the power to inspect, copy, and make extracts from such documents; and the power to freely access any place or building.

Charities Act

GENERAL INQUIRIES OF THE COMMISSIONER OF CHARITIES. The Commissioner of Charities has extensive powers of inquiry and may order any person to

- Furnish accounts and statements
- Return answers in writing to any question or inquiry and verify any account, statement, or answer by statutory declaration
- Furnish copies of documents in his custody or control and verify such copies by statutory declaration
- Appear personally to give evidence or produce documents

A person who fails to comply with an order of the Commissioner is guilty of an offense and will be liable to fine, imprisonment, or both. A person who willfully alters, suppresses, conceals, or destroys any document that he may be required to produce is also guilty of an offense and is liable to a fine or imprisonment.

CALL FOR DOCUMENTS AND SEARCH FOR RECORDS. The Commissioner may order any person to provide any information in his or her possession that relates to any charity and may order any person who has custody or control of any document relating to any charity to provide an extract or copy of the document or transmit it for inspection. A person who fails to comply with such an order is guilty of an offense. The only excuse allowed for confidential treatment of information is if the person is under any statutory obligation to keep the information confidential.

A person who knowingly or recklessly provides the Commissioner of Charities with information that is materially false or misleading is guilty of an offense and is liable to fine or imprisonment.

DISCLOSURE OF INFORMATION TO AND BY THE COMMISSIONER OF CHARITIES. Unless written law expressly provides otherwise, any government department, statutory authority, or police officer and any body or person discharging public functions may disclose to the Commissioner any information received to enable the Commissioner to discharge his function. The Commissioner may similarly disclose information to them in the discharge of his function or to assist them in discharging their function.

ACCOUNTING RECORDS. Save for an exempt charity or a charity that is a company, the charity trustees are to ensure that accounting records are kept that are sufficient to show and explain the charity's transactions so as to disclose at any time, with reasonable accuracy, the financial position of the charity.

The records must also contain entries showing all sums received and expended and the matters for which receipt and expenditure of funds took place on a day-to-day basis. The records are to be kept for seven years.

ANNUAL STATEMENTS OF ACCOUNTS. Except for an exempt charity or a charity that is a company, the trustees of a charity must prepare a statement of accounts for each financial year or a receipts and payments statement and a statement of assets and liabilities if the gross income of the charity in any financial year is less than S$50,000. The trustees are to preserve the statements and accounts for at least seven years.

ANNUAL AUDIT. If the charity's gross income or total expenditures in the relevant year or either of the two most recent financial years exceeds S$250,000, its accounts for that year must be audited by a person approved as a company auditor pursuant to Section 9 of the Companies Act. Otherwise, the accounts must either be, at the election of the trustees, examined by an independent person reasonably believed by the trustees to have the requisite ability and experience to carry out the examination or audited by an approved company auditor.

The Commissioner may require the accounts to be audited by a person appointed by the Commissioner if it appears that the examination or audit was not performed within ten months from the end of the financial year or that, although not necessary, it is desirable for the accounts to be audited by an approved company auditor. The expenses so incurred are to be paid by the trustees personally unless the Commissioner deems it impractical, in which case payment will be made from the funds of the charity.

Failure to give an approved company auditor or independent examiner access to books, documents, and other records relating to the charity concerned or information and explanations from past and present trustees, officers, employees, or auditors of the charity constitutes an offense.

ANNUAL REPORTS. Save for exempt charities, the charity trustees are to prepare an annual report for each financial year, describing the activities of the charity during the year, within six months from the end of that year. The annual report should be accompanied by the statement of accounts, together with a report by the auditor or independent examiner. If the charity is a company, the annual accounts as prepared pursuant to the Companies Act, together with the auditors' report, must be attached to the annual report.

All annual reports are to be kept by the commissioner and are open for public inspection. When an interested person requests in writing a copy of the charity's most recent accounts from the trustees and pays the trustees reasonable fees, the trustees must comply with the request within two months.

Charities Regulations (Fundraising Appeals for Foreign Charitable Purposes)

As discussed previously, a permit must be obtained from the Commissioner of Charities to conduct fundraising appeals for foreign charitable purposes. The Commissioner may impose certain conditions for the granting of the permit, such as requiring that the accounts of the appeal be audited by a qualified auditor and submitted to the Commissioner within sixty days of the close of the appeal.

The Charities (Fundraising Appeals for Foreign Charitable Purposes) Regulations also stipulate that proper accounts and other records must be kept by the permit holder and that he or she must ensure that all payments out are correctly made and properly authorized. The accounts must be prepared in accordance with generally accepted accounting principles, and the records must be kept at all times at the address, registered office, or principal place of business of the permit holder. The permit holder must also furnish to the Commissioner the statements of account within sixty days from the last day of the fundraising appeal (or such other period as the Commissioner of Charities may allow). If the permit holder fails to comply with these requirements, he or she will be guilty of an offense. Upon conviction, the permit holder will be liable to a fine, imprisonment, or both.

Trustees Act

All incorporated trustees are to keep full and true accounts of all moneys received and paid on account of their body or association. The incorporated trustees are required to prepare and make accounts of

- Gross income arising from any endowment during the year ending on the preceding December 31
- All balances in hand at the commencement of the year and all moneys received during the same year
- All payments for the period
- All moneys owing to or from such body or association

The accounts must be certified by the trustees who are in Singapore, audited by the auditor of the body or association, and filed with the Public Trustee within fourteen days after the day designated for making the accounts. For a fee, any person may inspect such accounts and take copies of them.

At the time of filing the abovementioned accounts,

- If it is the first time that such accounts have been filed, the trustees are to file an account of any endowment of the body or association, showing the manner in which any immovable property is rented or occupied, the existing investment or employment of any movable property, and the names under which such investments are made
- Thereafter, the trustees are to file an account of the acquisition of any endowment or alienation, charge, or transfer of any property.

It is an offense for any person to willfully make a false statement (in any material particular) in any document filed with the Public Trustee.

A trustee commits an offense when he or she fails to comply with or take all reasonable steps to secure compliance with the filing requirements.

Analysis and Recommendations

The provisions with regard to the accountability of NPOs are comprehensive so as to guard effectively against the abuse of public funds and interests and to ensure a responsible and professional approach to the management of nonprofit and charitable organizations and activities. NPOs that seek more freedom and space should, in the interests of maintaining a balance, also endeavor to increase their accountability and professionalism. In Singapore, the legal infrastructure for maintaining the accountability of charitable organizations is already in place.

TERMINATION OR DISSOLUTION

Societies

Provisions relating to the voluntary dissolution of societies are found in the model constitution for societies prescribed by the Registry of Societies. No society can be dissolved except at a General Meeting and with the consent of at least 3/5 of the total voting membership of the society that is resident in Singapore.

On dissolution, all debts and liabilities legally incurred on behalf of the society must be fully discharged, and the remaining funds must be disposed of in such manner as the General Meeting of Members may determine or donated to an approved charity or charities in Singapore. A certificate of dissolution should be provided within seven days of the dissolution to the Registrar of Societies.

When a society voluntarily dissolves itself in accordance with its rules, it should so inform the Registrar of Societies in writing. A certificate of dissolution signed by the President, the Secretary, and the Treasurer should be sent to the Registrar within one week of the society's dissolution. On receiving the certificate of dissolution, the Registrar is required to publish a notification in the Gazette that the society has ceased to exist.

A society may be involuntarily dissolved by the Minister of Home Affairs if it appears to him that

- The society is being used for unlawful purposes or for purposes prejudicial to public peace, the public welfare, or good order in Singapore.

- The society is being used for purposes incompatible with the objects and rules of the society.
- The rules of the society are inadequate for its proper management and control or the rules of a society that is a political association do not provide for its membership to be confined to Singapore citizens, and the society has failed, without showing reasonable cause, to amend its rules within three months of and in accordance with a directive from the Registrar to amend its rules for those purposes.
- A society that is a political association has an affiliation with any organization outside Singapore that the Registrar of Societies considers contrary to the national interest and has failed to satisfy the Registrar that it has taken appropriate steps to sever that affiliation within three months of and in accordance with a directive from the Registrar to take such action.
- The society has willfully contravened any provision of the Societies Act, any regulation made thereunder, or of any of the rules of the society.

Once an order of dissolution is made against it, a society is thereafter considered an unlawful society. Every person who was an officer of the society at the time that an order of dissolution was made against it will be ineligible for a period of three years from the date of the order to act or be elected as an officer of any other society, except with the written permission of the Minister of Home Affairs.

The other consequences of an order of dissolution are as follows:

- The property of the society will vest immediately in the Official Assignee or such other officer as may be appointed by the Minister of Home Affairs.
- The Official Assignee or other officer will proceed to wind up the affairs of the society and satisfy its debts and liabilities and will provide for the costs of winding up the society. Any surplus will be paid into the consolidated fund if the Minister of Home Affairs so directs or, in the absence of such direction, to the members of the society in accordance with the rules of the society.

Companies

A company may be voluntarily dissolved by passage of a special resolution by the members, if the company is solvent. A company may also be dissolved by the court (compulsory dissolution). This often occurs in cases where the company is insolvent. In such a case, the petition to dissolve the company will be presented by the unpaid creditor. The other grounds for compulsory dissolution include the following:

- The directors have acted in the affairs of the company in their own interests rather than in the interests of the members as a whole, or they have acted in any other manner that appears to be unfair or unjust to other members.
- The court is of the opinion that it is just and equitable to dissolve the company.
- The company is being used for an unlawful purpose or for purposes prejudicial to public peace, the public welfare, or good order in Singapore.

Upon winding up a company's affairs, the liquidator takes over the administration of the company to close down the business, sell the assets, pay off creditors, and distribute the surplus to the members.

Analysis and Recommendations

The compulsory dissolution of a society under the Societies Act should not be decided solely by the Minister. The judgment as to whether a society should be compulsorily dissolved should be left to the courts. It is recommended that a procedure similar to the compulsory dissolution of companies be adopted for the compulsory dissolution of societies; that is, the Minister presents a petition for dissolving the society to the court, which would make an order for dissolution in the appropriate circumstances.

10

TAIWAN

Joyce Yen Feng

NONPROFIT ORGANIZATIONS (NPOs) in Taiwan are governed by the Civil Code, originally enacted in 1927. Foundations and associations, the two types of NPOs, are treated in different chapters of the Civil Code. This chapter focuses primarily on foundations.

According to the Civil Organization Law, associations are under the jurisdiction of the social welfare authorities of the central, provincial, and municipal government. The Civil Organization Law governs professional organizations (as unions, in Chapter 7), social organizations (as associations, in Chapter 8), and political organizations (as parties, in Chapter 9).

Taiwan distinguishes between associations and foundations. The Civil Organization Law requires associations to have at least thirty founders, whose background must relate to the association's mandate and purpose. Associations cannot accept or solicit donations from the general public; they can only solicit donations from their members. Foundations must have an endowment and a number of directors who are responsible for the foundation's governance.

Under the Civil Organization Law, there are two types of orders: authorized orders, which include civil organization practice supervision

Note: Joyce Yen Feng is the primary author of this chapter. Michael Wei Mou provided an early draft primarily on tax matters.

measures, civil organization suffrage and recall measures, civil organization environment measures, and social association staff management measures; and duty orders, which include social association permission procedures and regulations.

In addition to the Civil Code, six other laws or groups of laws deal with government responsibilities related to encouraging and regulating the establishment of special purpose foundations: the Private School Law; the Medical Law; the Child, Youth, and Elderly Welfare Laws; the After Care Act; the Chinese Economic Research Institute Installation Code; and the Industrial Technology Research Institute Installation Code.

Foundations are regulated by specific government agencies based on their stated purpose or mandates. There are thirteen such governing agencies, each with their own regulations governing foundations (see Table 10.1). Within this framework, Taiwan has an active and vigorous nonprofit sector.

REGISTRATION

In general, establishing a foundation involves three steps. The donor must apply for an operating permit from the appropriate governing agency (see Table 10.2), set aside an endowment fund for the foundation, and register with the local District Court. The endowment fund is the foundation's registered property and may not be disposed of freely. The different categories of foundations shown in Table 10.2 have different endowment requirements.

The registration procedures for all District Courts are the same regardless of the type of NPO. However, regulations and procedures vary among different government authorities. The registration process involves the exercise of discretion by the agency, but the extent of discretion depends on the stated purpose of the foundation and the agency's policies.

There is no specific time limit for the determination process, but in practice a decision is usually issued in approximately one month. Applicants may file a complaint if it takes more than one month to decide an application. The registering process at the District Court usually depends on its caseload. Usually the court acts within a reasonable time.

If the application is denied, the applicant may appeal the lower agency decision to a higher agency. If the higher agency denies the petition, the applicant may resubmit the application or file a lawsuit against the agency in accordance with applicable administrative law.

Table 10.1. Agency Regulations Governing Foundations.

Authorized Agency (in Central Governments)	***Foundations and Regulations***	***Number of Foundations***
Ministry of Interior Affairs (Social Welfare Section)	Social Welfare and Charitable Foundations: Supervising Guiding Principles	69
Environment Protection Administration	Environment Protection Foundation: Permission and Supervising Guiding Principles	20
Ministry of Economic Affairs	Economic Affairs Foundation: Supervising Guiding Principles	33
Ministry of Education	Education Affairs Foundation: Supervising Guiding Principles	587
Government Information Office	Media Communication Affairs Foundation: Permission and Supervising Guiding Principles	5
Council for Agricultural Development	Agricultural Affairs Foundation: Supervising Guiding Principles	10
National Health Administration	Health Affairs Foundation: Supervising Guiding Principles	75
Labor Council	Labor Affairs Foundation: Supervising Guiding Principles	5
Ministry of Legal Affairs	Legal Affairs Foundation: Permission and Supervising Guiding Principles	8
Mainland Affairs Committee	Mainland Affairs Foundation: Permission and Supervising Guiding Principles	11
Ministry of Transportation	Transportation Affairs Foundation: Permission and Monitoring Gist	10
Ministry of Finance	Financial Affairs Foundation: Monitoring Measures	6

Table 10.2. Foundation Categories and Endowments Required.

Foundation Category	*Endowment Required*
Transportation affairs foundations, financial affairs foundations	There is no prescribed amount.
Media communications affairs foundations	The endowment should be sufficient, but no specific amount is prescribed
Social welfare and charitable foundations, education affairs foundations, atomic energy affairs foundations, health affairs foundations, labor affairs foundations, legal affairs foundations, mainland affairs foundations, economic affairs foundations, agricultural affairs foundations	A minimum endowment is required, and it is described in general terms.
Environment protection foundations	A minimum endowment is required, but there is no general description.

PURPOSES AND ACTIVITIES

Under Section 39 of the Civil Organization law, the purposes of associations (social organizations) are to promote cultural, academic, medical, health, religious, charitable, sports, friendship, social services, or other philanthropic goals. Each of the thirteen different foundation regulations clearly states that a foundation must have philanthropic purposes within the governing agency's jurisdiction to obtain permission from that agency. An application will be rejected if the stated purpose is outside the scope of the governing agency.

If an NPO's purposes or activities exceed their permitted scope after the formation period, the governing agency will issue an order to correct the situation. If the misconduct does not cease within a specified time, the governing agency may terminate the NPO establishment permit, and the District Court may order the involuntary dissolution of the NPO.

An NPO cannot provide economic benefits to any person other than the beneficiary class stated in its governing document, the Articles of Endowment. Misconduct in this area can lead to corrective action by the applicable governing agency. The governing agency may bring either a civil or a criminal court action against the NPO to recover any improperly transferred assets.

All thirteen categories of foundation regulations include restraints on the use of foundation assets, such as a ban on loaning funds to directors or auditors for their private use. The regulations also contain the vague statement that an NPO "should not have for-profit purposes and activities." Other than this, there is no express legal limit on the business or commercial purposes and activities of NPOs. The governing agencies and other public officials oppose the conduct of for-profit activities by NPOs, but there is neither a clear definition of that category of activity nor a sound mechanism for monitoring them. In practice, charging fees for services is considered for-profit activity.

Taiwan's laws do not restrict the purposes or activities of NPOs in connection with influencing legislation or election to public office. However, under Section 2 of the Civil Organization Law, the purposes of an NPO may not include advocating communism or separation of the nation.

TAX EXEMPTIONS

As a general principle, under relevant Republic of China (ROC) laws and administrative regulations, all taxes, duties, and levies chargeable to individuals and profit-seeking enterprises are also chargeable to non-profit organizations, except for qualified tax-exempt entities and items.

Article 4(13) of the ROC Income Tax Law provides that an educational, cultural, public interest, or charitable organization established in accordance with the Executive Yuan regulations is exempt from income tax.

On the basis of the Income Tax Law, the Executive Yuan promulgated the Criteria for Income Tax Exemption of Educational, Cultural, Public Interest, and Charitable Organizations or Agencies on July 19, 1979 (most recently amended on December 30, 1994). Except for income generated from the sale of goods or services, any educational, cultural, public interest, or charitable institution or organization is entitled to an income tax exemption on its own income and the income of its subordinate operating units.

The criteria provide that, as a condition for income tax exemption, a foundation must comply with certain conditions, including proper registration, use of assets in accordance with the stated objectives of the foundation, restrictions on the operational and financial involvement of donators, and proper financial reporting and auditing procedures. The most important one is that an NPO must spend at least 80 percent of total interest received, plus any other regular annual income, on the conduct of activities related to its stated objectives, except if approval is granted by the Ministry of Finance (MOF), on request of the authority in charge and after due investigation, to alter this requirement. An NPO that satisfies these threshold requirements files an annual income tax return as required by Article 71 of the Income Tax Law. The National Tax Bureau reviews the return and determines whether the NPO qualifies in that year for tax-exempt status. If so, the NPO is exempt from tax in that year; if not, tax is assessed.

Specifically, to qualify as a tax-exempt entity, an NPO must satisfy the following conditions set forth under the criteria:

1. *Proper establishment.* The NPO must be established in accordance with the Civil Code as a public interest association or foundation or registered and recorded with the competent government authority in accordance with other relevant laws and regulations.

2. *No private benefit.* Other than necessary payments for activities related to the purpose of its establishment, the NPO shall not provide any pecuniary payment to the donors or their related parties that would amount to dividend distribution in disguise.

3. *Nondistribution constraint.* The governing documents of the NPO must provide that upon dissolution, the remaining assets of the NPO shall belong to the local government where the NPO is located or to one or more other NPOs designated by the competent government authority. However, this provision does not apply to an NPO that has disposed of its remaining assets in accordance with the objectives or purposes for which it was formed or pursuant to the related laws and regulations, subject to the approval of the MOF.

4. *No unrelated activities.* The NPO may not engage in activities that are unrelated to its stated objectives or purposes.

5. *Investment limitations.* The assets and various income of the institution or organization, with the exception of petty cash, shall be deposited in a bank as a time deposit or invested in government bonds, treasury bills, transferable bank certificates, bank-guaranteed bills of exchange, promissory notes guaranteed by a bank or bill financing company, bonds issued by a public bank, or Category A stocks or bonds (the "Blue Chip" stocks in Taiwan designated by the Securities and Exchange Commission under MOF). The percentage of such investment shall be prescribed by the MOF. Currently, the "investable" percentage of NPO assets is 40 percent.

6. *Governance limitations.* No more than one-third of the total number of directors and supervisors of the NPO may be elected from the

major donors, their spouses, or relatives within the first three degrees of relationship. If the major donor is a profit-seeking enterprise, the number of directors appointed from donor directors, supervisors, or shareholders acting as donor representatives shall not exceed one-third of the directors of the NPO. In this context, "major donor" means a founder of the NPO or a person or profit-making enterprise that has donated one-half or more of the total registered funds of the NPO. The limit on the role of the major donor does not apply if the major donor is an educational, cultural, public interest, or charitable NPO established by a government agency.

Although the criteria place no restrictions on the number of foreign directors allowed, in practice the managing officials of the government authorities sometimes do. For example, the Ministry of Economic Affairs (MOEA) has maintained an administrative precedent that the number of foreign directors of a foundation whose main purpose involves economic affairs may not exceed one-third of the total governing body. Also, the MOEA prefers that a foreign director maintain residence in the ROC under an Alien Resident Certificate. The Government Information Office (GIO), the managing authority for foundations whose main purpose involves mass communications media, prohibits such a foundation from having any foreign nationals on its board. Technically, these restrictions are not part of the tax exemption qualification criteria but rather are regulatory supplements. However, Article 4(13) of the Income Tax Law requires that exempt organizations be established in accordance with the Executive Yuan regulations, so these restrictions are in effect additional requirements for tax-exempt status.

7. *No insider transactions.* An NPO may not have any irregular financial or business relationships with its donors or supervisors. The relationship between an NPO and other registered NPOs that have contributed to it is not affected by this rule, however.

8. *Minimum annual distributions.* An NPO must spend, each year, not less than 80 percent of total interest received, plus any other regular annual income, for its stated purposes. The MOF may approve exceptions to this rule, however, at the request of the competent government authority and after due investigation. If an NPO cannot use 80 percent of its annual income by the end of the year, then (subject to the approval of the MOF and the verification of the MOEA) it may carry the net income forward to the next year for financing one or more specific projects. In this case, the NPO must submit an application to the MOF via the MOEA, along with a detailed statement of the specific projects and an explanation of how the NPO intends to use the carried-forward net

income. The NPO may show the carried-forward net income in its financial reports as a reserve for specific purposes.

If a donor plans to give more to a tax-exempt entity than the entity has estimated in its annual budget statements, the excess may be treated as an advance donation for future years for accounting purposes. In this arrangement, the additional donation is not considered as income for the year when the money is actually received by the NPO; rather, it is treated as income in the following year or years in accordance with the donation agreement between the donor and donee. No further MOF or MOEA approvals are required.

9. *Financial records.* The NPO must issue, secure, and maintain legal evidence of its income and expenditures and maintain accounting records, whose accuracy is be certified by the competent auditing government authority.

10. *Audited tax returns.* An additional requirement for tax exemption applies to large NPOs—that is, educational, cultural, public interest, and charitable NPOs whose total assets or income for the current year is at least NT$10 million. To obtain a tax exemption for its own income and the income of its subordinate operating units, a large NPO must engage a certified public accountant approved by the MOF as a tax agent to audit, authenticate, and file a tax return on its behalf.

It is important to bear in mind that the exemption depends upon the NPO's continuing compliance with the criteria. If in any tax year the National Tax Bureau, during its screening process, determines that the NPO does not qualify for the exemption, it will assess tax accordingly. In effect, the NPO applies for an income tax exemption each year by filing its annual income tax return.

If the NPO disagrees with the government regarding its qualifications for tax exemption, the NPO may file for a reassessment with the authorized tax agency, and if that does not succeed, the NPO may request a ruling from the National Tax Bureau. If the NPO is not satisfied with the ruling, it may file an administrative complaint with the MOF. The NPO may appeal the MOF decision to the Administrative Court on the basis of wrongful application of the law. The decision of the Administrative Court shall be final on that particular case. However, the general practice is that unless the Administrative Court specifically orders that its ruling on that particular case constitutes a legal precedent, the MOF as well as the tax authorities will not be bound by the decision on other similar cases.

If an NPO qualifies for income tax exemption, it will not pay tax on contributions and gifts received. It will also be exempted from paying tax on its passive investment income (dividends, interest, rents, royalties, and the like). An NPO income from the sale of goods or services is taxable. However, if its income is not sufficient to finance the cost of conducting the NPO activities in support of its stated purposes, the excess cost may be deducted from the NPO's taxable income.

Income generated from the sale of goods or services by a private school that complies with the provisions of the criteria and whose establishment has been approved by the competent governmental authority is exempt from income tax. The private school must submit a plan for the use of the income generated from the sale of goods or services by the subordinate operating units operated by the private school, in accordance with Article 62 of the Private Schools Law, to the government agency responsible for educational administration. The plan is subject to the approval of the Ministry of Finance. The income must be used within three years after the year when it is generated. Income not used in accordance with the authorized plan is subject to income tax.

The meaning of "income derived from selling goods or providing services" is derived from the Business Tax Law. That law states that a transfer of ownership of goods to others for value constitutes a sale of goods, and rendering services or supplying goods to others for value, for use, or for generating revenues constitutes a sale of services. Since the amendment of the criteria took effect, the MOF has issued only one official ruling on this issue. That ruling, issued in 1995, contains the only exception thus far to the definition of "sale of goods or services": goods sold in auctions by charity sales, or performances given for charitable purposes by charity and relief organizations organized in accordance with law, are not considered sales of goods or services and may be exempted from income tax. The net proceeds of these activities must be used entirely by the NPOs themselves. To determine whether a particular activity would be interpreted as a "sale of goods or services," an NPO may apply for an official interpretation from the MOF regarding its particular situation by providing relevant information for consideration.

In all other cases, the income derived by an NPO from the conduct of income-producing activities is taxable.

TAX DEDUCTIONS OR CREDITS

According to Article 36, Item II of the Income Tax Law, the contributions and donations of a legally established and licensed profit-seeking enterprise to an educational, cultural, public interest, or charitable NPO may be reported as an expense or loss in the year of the donation up to a maximum limit of 10 percent of the donor's net income before tax (including the donation). The MOF provides the following formula for verifying the deductible donation in the Criteria for Auditing Corporate Income Tax Returns of Profit-Seeking Enterprises: (net income before tax plus donations under Item II, Article 36 of Income Tax Law $\times$ [1 + 10 percent)]) $\times$ 10 percent = verified deductible donation.

However, this tax deduction is only available to domestic enterprises. A foreign business entity without a permanent business office or business agent in Taiwan cannot take advantage of this tax deduction.

If the amount of a donation exceeds the amount that can be deducted in the year of the gift, the excess amount cannot be deducted unless the taxpayer obtains special approval from the MOF. In general, obtaining such special approval is difficult.

Under Article 17 of the Income Tax Law, an individual can make a deductible donation of up to 20 percent of his or her annual gross consolidated income. This tax benefit is the same regardless of what kind of property is contributed. The tax benefit is available only to donations made to a legally established educational, cultural, public interest, or charitable organization or institute. Annual donations made to legally established political parties may not exceed 20 percent of an individual's annual gross consolidated income or NT$200 million.

Although not specifically required by law, independent appraisals or other evidencing materials are customarily used to substantiate the value of contributed property, especially when tax authorities request this information under their administrative power. An NPO customarily gives the donor a written receipt for a gift. However, a transfer of property such as real estate may be evidenced by registration documents proving the transfer.

The tax authorities may audit a donor's claimed tax deductions.

CAPITAL FORMATION

As noted earlier, NPOs are required to distribute 80 percent of their income for their stated purposes. The investment of the remaining assets is governed by the regulations of the MOF. Under those regulations, NPOs may only invest as permitted by the Articles of Endowment set forth by the donor. NPOs may invest related to their stated purposes and activities. Their investments must be legal, and all profits must be used for the NPO activities. Only the Ministry of Finance monitors and reviews the investment policies of NPOs. The regulations do not impose any special requirements on NPOs with regard to the receipt of foreign funds.

INTERNAL GOVERNANCE

An NPO may have multiple internal governing bodies (directors and supervisors) unless otherwise restricted by the Article of Endowment Rule in Section 27 of the Civic Code. Directors receive no benefits or compensation.

The first step in the internal governance of a foundation occurs when the donors of the endowment meet as an organizational committee to discuss and adopt resolutions regarding the foundation name, location, fundraising, and so on. The donors also select the first directors of the foundation. A public interest foundation may have no more than fifteen directors. Detailed governance rules are contained in the regulations issued by the regulatory agencies, with the exception of those issued by the MOF, the Ministry of Communications, the Atomic Energy Council, and the Labor Committee. The Articles of Endowment generally specify the number of directors and auditors, their terms of service, and how they are to be selected and removed. The founders of a foundation make the initial determinations, and the board members determine these matters thereafter.

The members of the foundation governing body are obligated to manage the foundation. The functions of directors shall be exercised in accordance with the regulations of the governing agency. The power to supervise foundation operations may be delegated, but the power to delegate is restricted by the regulations. For example, two directors cannot delegate authority to the same person.

Directors are legally obligated to act in the interests of the foundation and not for their private interests, to avoid conflicts of interest between the directors and the foundation. The law does not provide any further guidance as to the standards directors must observe in carrying out their duties, however. If the directors fail to carry out their duty to manage the foundation properly, their actions may be deemed ineffective by the local District Court, and they may be held personally responsible for any resulting loss or damage.

ACCOUNTABILITY

NPOs are required to file annual financial reports with the National Taxation Bureau. The specific contents of the reports are set forth in the regulations adopted by the governing agencies. In general, a foundation report must include a fixed-asset ledger, a financial statement and report, an annual financial report, an annual activity report, and a schedule of increase and decrease of properties. These materials are due within three months after the end of the foundation's fiscal year.

The financial records are not required to be made available to the public for inspection, but the authorized agency may inspect them. The names of the endowment donors must be included in the foundation Articles of Endowment and submitted to the governing agency, and the names of subsequent donors must be disclosed in public written form regularly after the NPO is established. The names of an NPO's participants, clients, and grantees are not made public, nor are the salaries and benefits of its employees. The names of an NPO's board members are reported to the authorized agency.

TERMINATION OR DISSOLUTION

An NPO may voluntarily end its legal existence according to its own Articles of Endowment, as provided in Section 42 of the Civil Organization Law. In addition, the governing agency may request the court to dissolve an NPO for a breach of its Articles of Endowment, for a breach of Section 36 or 65 of the Civic Code, or for exceeding the scope of its stated purpose. It is then up to the District Court to decide whether the NPO should be dissolved.

Whether the dissolution is voluntary or involuntary, the assets must be distributed in accordance with the NPO's Articles of Endowment. If the Articles are silent on asset distribution at dissolution, then the assets will be distributed to the local government.

ANALYSIS

As is the case in many developing countries, the maturity of a civil society depends on the political and social planning of the government. In Taiwan, the formation of civil associations has often been encouraged by the government as a way of pursuing government objectives. This experience has provided a positive basis for the recent establishment and growth of other civil associations with grassroots origins. NPO registrations have increased in response to the recently adopted policy of contracting with NPOs for services. This policy has created a financial incentive for registration, to qualify for government contracts.

Since martial law ended in 1985, the government has adopted a pluralistic approach to the delivery of social welfare services, including health and education services. The government especially welcomed the establishment of foundations, viewing them as social resources ready to aid in the government functions of delivering services and distributing resources to society. Each of the governing authorities offers incentives for the creation of NPOs.

The current legal framework reflects a cooperative approach on the part of government, by which it intends to become involved in the goals, operations, and supervision of NPOs. However, responsibility for the NPO sector is divided among various governing agencies that lack the capacity to guide and supervise the sector efficiently. As a consequence, these authorities generally focus only on matters of form rather than on substance. Also, the administrative authorities are often subject to political and popular influences. As long as the legal system continues to delegate that much power to the administrative branch of the government, this situation will be difficult to change.

Governance and Supervision Issues

The multiplicity of regulations governing NPOs causes confusion and hinders the establishment of a strong nonprofit sector. Because the regulations do not clearly define which category of foundation should be governed by each agency, it is often difficult for applicants to understand where they should file their applications. Thus applicants may choose a governing agency based on how favorable its standards, requirements, and supervision practices are. Consequently, a governing agency perceived as lenient may be overwhelmed by permit applications. This heavy load may lower the quality of supervision.

Another example of this problem is the division of authority between the local District Court and the thirteen different governing agencies. NPOs often do not know whether to turn to the District Court or to their governing agency when they need supervision or assistance. Moreover, the District Court has no direct contact with the governing agencies. A foundation may obtain a permit from the governing agency only to find that the District Court has refused its application for registration.

This division of authority also reduces the ability of the public to hold NPOs accountable. No single agency is responsible for collecting data from all NPOs. The various agencies governing NPOs often do not communicate or share information with one another. For example, the Civil Code allows interested parties to file a complaint with the District Court, as the registering agency in cases of NPO misconduct, without consulting the supervising government agency. But only the governing agencies that supervise the NPO have information regarding the NPO's conduct. Therefore it is difficult for a court to deal with such cases. Moreover, the District Court can only investigate NPOs when it is requested to do so. This division of investigative authority and administrative authority does not contribute to a strong nonprofit sector.

Inconsistencies among the regulations of the governing agencies and in the administration of the regulations are common. For example:

- In theory, NPOs must submit detailed information to the governing agency in their applications. But four of the fourteen regulations are unclear about precisely what information must be submitted.
- Most of the governing agencies specify a minimum amount for a foundation endowment. But the Ministry of Finance and the Ministry of Transportation do not.
- The types of investments permitted under the tax exemption rules differ from the types permitted under the governing agencies' regulations.
- The Civil Code does not specify whether a foundation must have a board of directors.
- The regulations of the Ministry of Interior Affairs, the Environment Protection Administration, the Ministry of Education, the Council for Agricultural Development, the National Health Administration, the Labor Council, the Ministry of Legal Affairs, and the Ministry of Finance contain restrictions on the number and nationality of foundation directors. These regulations are not consistent with one another and are not relevant to the functions of NPOs.
- Except for the regulations promulgated by the Ministry of Economic Affairs, the governing agencies do not explain the grounds on which an application may be rejected or the procedure for reviewing applications.

Government support of the creation of new foundations has had many positive consequences, but it has also created a problem in that authorities are reluctant to terminate or dissolve a foundation. Even when a foundation tries to dissolve, the governing authority often tries to intervene and "save" the existing foundation, as long as it is properly registered, regardless of its own guidelines and principles. The governing authority places more emphasis on the foundation's utility in helping the government with its duties than on the operational issues at the foundation, such as the integrity of board members. As a result, the National Taxation Bureau is the only agency that actually monitors foundations, and the tax laws are not specific or comprehensive enough to support this function. Thus foundations are sometimes used by for-profit corporations and family enterprises as a tax-avoidance technique.

The government attitude toward associations is far more cautious, particularly with regard to two types of organizations specified in the Civil Organization Law: political organizations (parties) and professional organizations (unions). The administration of the Civil Organization Law is more prudent.

The government has proclaimed itself in favor of "encouraging NPOs to be self-governing." The defined governmental duties in support of this goal include inspecting application documents for their approval, in accordance with the Permission Procedures Regulations; guiding promoters in their preparatory work; granting permits, licenses, and official seals; enforcing the laws through administrative procedures (including reprimands, fines, terminations, reorganizations, dissolution, and criminal penalties); providing regular meeting guidance; providing business review and approval; and providing efficiency evaluation and encouragement. In fact, only the first three of these duties have been taken seriously by the managing officers. Reorganization has been the favored means of enforcing the laws.

Informal discussions with a government official responsible for reviewing applications revealed that only 2 to 3 percent of all applications are rejected. The most common reasons are activities outside the proper purposes of the organization, activities supporting the independence of Taiwan, and a founder's criminal status, bankruptcy, or inability to purchase assets. Delays in processing applications were attributed to staff shortages and the requirement to consult with the governing agency (the exchange of official mail is time-consuming). An effort to change from the current permission system to a registration system within the Ministry of Internal Affairs is under consideration.

Tax and Financial Issues

Generally, an NPO can obtain an exemption from income tax without difficulty. Information is readily available, and most governing authorities and tax agencies have call-in services to answer questions. Abuse rarely occurs, and when it does, the NPO has a remedy in the form of administrative complaints and judicial appeals. However, existing laws and regulations in this area are not comprehensive. They leave too many issues to the administrative discretion of the tax authorities. This situation creates substantial uncertainty in terms of tax and financial planning for NPOs.

The laws described in this chapter exist primarily to regulate the relationship between the government and NPOs. NPOs generally are not obliged to disclose their operational or financial information to the public. Due to the shortage of manpower in the authorized authorities and the lack of professional training for conducting the necessary supervision, most government agencies are quite passive, and sometimes inefficient, in performing their supervisory function. As such, the problem in protecting the public lies not only in the legal structure of relevant regulations but also in the limited capacity of government to implement these regulations.

However, in establishing a new NPO such as a foundation to fully utilize the applicable deductions, a donor may sometimes make donations in installments by establishing the foundation in progressive stages. For example, the Ministry of Interior (MOI) has set a minimum capital requirement of NT$30 million for a proposed foundation at the national level. The capital requirement at the local level, however, is only NT$10 million. A donor may establish a foundation at the local level initially and upgrade it to the national level when the NT$30 million has been fully raised.

Recommendations

The establishment procedures and governing regulations are not the real obstacles to the healthy development of a sound independent sector. Rather, it is the resources available to NPOs that determine their substance and effectiveness. These resources come primarily from fundraising and government subsidies. Therefore, clear and adequate regulations concerning fundraising and government purchase-of-service contracts are essential.

Accountability is also a challenge. The public is more interested in giving to a charitable cause than in reviewing an NPO's accreditation or following up on the use of their donations. Therefore, NPOs must police themselves. Toward this end, some NPO professionals have begun to develop a code of ethics for NPOs in Taiwan.

The dual regulatory system now in place can be improved by clarifying the different roles of the governing authorities and the judicial authorities. The administrative branch of government may continue to review the formalities for establishing an NPO, including confirming the nature of the entity and its qualification to apply for the annual tax exemption. However, subsequent supervisory responsibility should be assigned to the tax authorities and the judicial system. Organizations with particularly far-reaching or irreversible effects on society, such as religious organizations and environmental organizations, may still merit supervision by a governing agency within the administrative branch, as is currently the practice.

The quality as well as the training of government staff handling NPO matters, both in the judicial system and in the administrative system, should be substantially improved. Specialists with both practical and academic expertise could form a consulting team on a high administrative level to provide training and consultation to various government offices and their administrators.

On a more fundamental level, the nonprofit sector would benefit from a comprehensive law regulating all foundations and associations. The law should clearly specify the roles and duties of the governing agency and the registering agency, the scope of the various governing agencies' authority, and consistent criteria for investments. As a first step, the various governing agencies should collaborate with one another to standardize their regulations and procedures. The tax laws governing NPOs and their financial supporters should be clarified so that the terms of exemptions and deductions can be understood. The treatment of donations should be specified by law rather than by administrative precedent. Finally, the law should provide for the disclosure of NPOs' operational and financial information to the public.

There are obstacles to the adoption of these reforms, however. A clear and comprehensive public policy on these issues has not yet developed. The governing agencies and authorities do not appear to be willing either to take on increased responsibilities or to turn over their supervisory powers to an independent and professionally staffed agency. Finally, there is a shortage of qualified and capable administrative staff members.

To develop a public consensus on NPO matters, a series of open forums for comprehensive discussions should be held soon. An independent nongovernmental research group should be established to propose new laws regarding NPO governance and supervision and the tax treatment of gifts to NPOs.

11

THAILAND

Chinchai Cheecharoen
Titawat Udornpim

THAILAND HAS EXISTED as a Southeast Asian state for more than seven hundred years, with a Buddhist foundation and a patriarchal ruling system in which the kings were adored as the fathers of all people. The laws of Thailand have been codified in various forms throughout Thai history, reflecting the importance given to the rule of law. Early influences on Thai law came from India through the Pra Thammasat Code. In 1868, the influences of European laws became prominent as part of the reforms adopted by King Rama V to deal with claims of extraterritoriality. This influence was reflected in the Penal Code, promulgated in 1908. Then, in 1925, the Civil and Commercial Code, influenced by German, French, and Japanese laws, was enacted. In 1932, the first constitution of the Thai kingdom was adopted.

The Constitution of 1997, Act 45.3, states, “People have freedom to gather in the forms of association, unions, cooperatives, farmer groups, nongovernmental organizations, or other forms. No law may restrict the freedom to associate except for laws to protect the common interest of the people, to maintain the peace and good public morals, and to protect against economic monopolization.”

The Constitution is the principal law that enables nongovernmental organizations (NGOs) to be established. The Civil and Commercial Code of 1925 provides for the registration of associations and foundations. The National Culture Act of 1942 provides that associations or organizations with objectives related to cultural activity must receive permission from the National Culture Commission (NCC) before their establishment according to the Civil and Commercial Code. However, in practice, every type of association and foundation, whether or not related to cultural activity, must receive permission from the NCC. The intent of the Act is to promote and conserve the cultural heritage of Thailand, which is an affirmative formulation that also excludes communist influences. Associations and foundations are viewed as a means to preserve cultural heritage or to provide humanitarian assistance. But foundations are not permitted to be involved in politics.

Several other categories of nongovernmental nonprofit organizations exist under Thai law: trade associations, whose registration is governed by the Trade Association Act and Chamber of Commerce Act of 1966; cremation societies, governed by the Cremation Welfare Act of 1974; and labor unions, whose registration is governed by the Labor Relations Act of 1975. These categories are not further addressed in this chapter.

Changes are needed in the National Culture Act and the Civil and Commercial Code to reduce procedural delays and shorten the time required for the establishment and registration of associations and foundations. Associations should receive assistance and support from the government in their efforts to promote the public interest and help the less fortunate. Moreover, laws should provide rules and procedures for the operation of NGOs. At present, an act to promote social welfare is being drafted that will provide simplified registration procedures for public interest organizations, associations, foundations, and other NGOs. The bill has been approved in principle by the cabinet and is under consideration by the Office of the Juridical Council. If approved at that level, the bill will be resubmitted to the cabinet and presented to the House of Parliament.

REGISTRATION

Description

The National Culture Act states that the authority to *permit* the establishment of associations and foundations belongs to the NCC of Thailand under the Ministry of Education. The Civil and Commercial Code (1925) provides that the Department of Local Administration under the Ministry of Interior has the authority to *register* associations and foundations.

The term *association* refers to a group established for the purpose of any continuous communal activities that are not for profit (Article 78 of the Civil and Commercial Code). An association's activities must benefit the community. Its income and profits must not benefit individual members.

The term *foundation* refers to a fund set aside for particular charitable purposes in the fields of religion, the arts, science, literature, education, or any other area where the public benefits. No personal profits are permitted (Article 110 of the Civil and Commercial Code).

For all foundations and for most associations, obtaining formal permission from the NCC is a prerequisite to registration. The National Culture Act states, "Associations or organizations with objectives relating to the works of the Office of the National Culture Commission, including the ones established before the legislation of this law, must receive permission from the Office of the National Culture Commission for their establishment, or to continue; otherwise they must be terminated. The authority of the Office of the National Culture Commission covers the termination of associations or organizations if there is any reason to do so."

"Cultural affairs," as used in this law, is defined in Article 4 to mean activities promoting "the growth, discipline, and unity of the nation, including any activities that enhance good morals among people."

Until recently, all associations had to apply through the NCC for permission to be established, even though Article 14 of the National Culture Act requires only those associations whose work is related to the NCC to do so. But effective March 6, 1996, as the result of a consultation between the Ministry of Interior and the attorney general, the National Culture Act of 1942 only applies to associations whose objectives are related to the work of the NCC.

Application for the establishment of foundations, however, must still be made to the NCC, regardless of purpose. The application must be submitted with copies of the following documents: the foundation's internal rules and regulations; the minutes of the founders' meeting; the written permission of the foundation's landlord and its residence registration, as well as a map showing the foundation's location; the names, biographies, identification cards, and household residence registration of the foundation's founders (at least three founders are required); bank statements of donors; the names of people authorized to withdraw money from the foundation's bank account; and, when applicable, a certified letter giving permission to use someone's first and last names as the foundation's title.

The permission application procedure varies depending on the location of the foundation's office. In Bangkok, application documents can be sent by mail or by personal delivery to the office of the NCC. The secretary general of the NCC has the authority to grant or deny permission. An applicant has to register the foundation at the Division of Administration and Registration, Office of Bangkok Metropolitan Authority for the foundation to become a legal person.

In other provinces, applicants can submit application documents at an Office of Local Affairs or an Office of Provincial Affairs, and the documents will be forwarded to the NCC. The secretary general of the commission will authorize the documents, and those authorized documents will be returned to the Office of Local Affairs or an Office of Provincial Affairs. To become a legal person, a foundation must first be registered at the Administrative Section of the Office of Provincial Affairs. Both in Bangkok and in the regions, the application process currently takes about twenty working days.

Both associations and foundations must register with appropriate government authorities. The procedure for each type of nonprofit organization is different. An association must submit a registration application accompanied by copies of the association's regulations; the minutes of the meeting in which the association's board of directors was appointed; the names, addresses, occupations, and positions of the persons on the association's board of directors; and the names, addresses, and occupations of all members of the association.

In Bangkok, applicants must submit application forms and documents to the Royal Thai Police Department, which will examine the founders' biographies, the executive board, and the location of the offices. The permanent secretary of the Ministry of Interior, as a registrar, is authorized to give permission for registration. The permission will be published in the government gazette.

In the provinces, applicants must submit application forms and documents to an Office of Local Administrative Affairs. All documents will be examined. The provincial governors act as registrars. The copies are sent to the Registration Division, the Department of Local Administration, and the Ministry of Interior for advice. Then, the Office of the Cabinet Secretariat announces in the government gazette when the permission is granted.

An association must have at least three founders. The application process currently takes about forty-nine working days in Bangkok and thirty working days in other provinces.

The registration process for a foundation is different from that of an association. The foundation must demonstrate that it meets the statutory definition of a foundation: the presence of a fund or property held for the benefit of the public, and the absence of personal profits. The application must include copies of the following documents: the minutes of the foundation's establishment meeting and a statement of its purposes; the foundation's internal regulations and financial statements; a letter of confirmation from the donors of the foundation's initial funds; written permission from the landlord of the foundation's office, together with a map showing the foundation's location; the foundation's residence registration; the names of the persons on the foundation's board of directors, together with copies of their identification cards and household residence registrations; and a certificate of permission to establish a foundation, issued by the NCC. If the foundation owns real property, it must provide a certified letter of land valuation from the Department of Lands. If the foundation's title includes the name of an individual, the foundation must include a certified letter giving permission to use the name.

In Bangkok, after getting permission from the NCC, a foundation must apply to the Division of Local Administration and Registration, Office of the Bangkok Metropolitan Authority for examination. Then the application is forwarded to the Registration Division of the Department of Local Administration of the Ministry of Interior, which examines the organization's objectives. The authorization will be declared by the permanent secretary of the Ministry of Interior, who informs the secretary general of the cabinet. Finally, registration becomes official when it is published in the government gazette.

In other provinces, the application must be submitted to a local administration office of the Office of Local or Provincial Affairs for examination. The application is then forwarded to the provincial governor for authorization. Finally, the application is sent to the secretary general of the cabinet for publication in the government gazette. The registration process, in both Bangkok and other provinces, takes about fifteen to thirty working days.

The registration process is not automatic but involves the exercise of discretion on the part of the registrar, with regard to both foundations and associations.

If the application reveals problems with the objectives of an association or improper behavior of association board members, registrars can require applicants to make changes to bring them into compliance. Legal registration will then be allowed, and a certificate of registration will be given to the association.

In cases where the objectives of an association are contrary to the law, good morals, public order, or state security, applicants must make changes within thirty days from the day of notification. If the changes are not made within this period, registrars have the right to refuse the request without any delay. Applicants have the right to appeal to the Minister of the Interior by submitting a letter of appeal within thirty days of the notification. The Minister will consider the appeal and notify petitioners within ninety days from the day registrars receive the petition. The adjudication of the Minister is final.

The process of review is similar with regard to foundations. If registrars believe that a foundation's application forms or rules and regulations are not proper, that other information listed in the application document is not relevant to the objectives of the foundation, or that board members are unsuitable, they can require the applicant to make amendments. If the amendments are satisfactory, the applicant will receive registration certification.

If a registrar deems it necessary to deny registration because a foundation's objectives are contrary to the law, good morals, public order, or the security of the state or because the applicant does not make proper changes within thirty days from the day it receives notification from the registrar, the registrar can immediately refuse the application with an explanation to the applicant.

Applicants have the right to appeal the denied registration to the Minister of the Interior by filing a petition within thirty days from the notification date. The Minister will decide the appeal and inform the applicant of the decision within ninety days from the day the petition is received. The decision of the Minister is final.

Analysis

The registration procedure takes longer and is much more bureaucratic for associations and foundations than for companies or legal-person partnerships. Many offices are involved, the required paperwork is voluminous, and the process has more steps than necessary to ensure legal compliance.

The current laws have some important strengths, however. They include measures to prevent the improper management of NGOs, including measures against the abuse of state power. Moreover, in cases where foundation board members perform any activities contrary to laws or regulations or behave improperly with regard to the objectives of their foundation without reasonable grounds, registrars, public prosecutors, or interested persons can file an application with the court for the removal of those particular board members.

Recommendations

The request for permission to establish a foundation whose activities are not within the jurisdiction of the NCC should not be made through the office of the NCC.

Procedures for registration to become a legal person should be simplified. The registration of associations and foundations is now the responsibility of two offices under the Ministry of Interior: the Royal Thai Police Department registers associations, and the Department of Local Administration registers foundations. Responsibility for registration of both kinds of organizations should rest exclusively with the Department of Local Administration, because the operations of both associations and foundations are similar. Documents to be attached to an application form should be precisely specified, and the steps and time for application procedure should be shortened.

The decision of the Minister of the Interior is treated as final. However, if an application is rejected, the reasons for the rejection should be stated to prevent an abuse of discretion.

PURPOSES AND ACTIVITIES

Description

An association must be founded for the purpose of benefiting society, not to make profits or distribute income for individual profit. The management of an association must comply with the association's regulations and objectives.

A foundation administers a fund that is distributed for authorized purposes, excluding individual profit. The authorized purposes include public charity and support of religion, the arts, science, literature, education, or any other activity that benefits the public.

The purposes of associations and foundations must not be contrary to the laws, good morals, public order, or state security. Associations may not be operated to earn a profit or to distribute income. Foundations, similarly, must not be operated for any individual benefit, only for the objectives of the foundation.

According to the records of the NCC, as of April 4, 1996, there were 17,542 associations and foundations in Thailand—10,307 associations and 7,235 foundations. At present, the government is in the process of classifying the objectives of associations and foundations into eighteen different categories, in the areas of education, culture, environment, beliefs and religions, sanitation and medical services, poor people, occupations, sports and recreation, social meetings, charity, organizational welfare, curing illnesses, academic affairs, rights groups, gift giving, and other groups and activities.

Nonprofit organizations that redefine their objectives or management in a manner contrary to the laws, public order, good morals, or security of the state will suffer severe consequences. Registrars, public prosecutors, or other interested persons can file an application with the court to terminate the management of a foundation. As for associations, registrars have the authority to revoke an association's registration by deleting its name from the registry.

The rules differ as to political involvement of associations and foundations. Political activities are not prohibited for associations. Any association can be established with purposes related to politics, so long as no activities are conducted that threaten the national security. By contrast, a foundation's registration application must clearly state, "No politics involved." A foundation may not engage in political activity unless it is established for the purpose of promoting democracy under a constitutional monarchy. The law provides that such a foundation "should promote democracy under a constitutional monarchy with nonpartisan intentions." Such a foundation may provide a political subsidy to politicians or political parties only on a nonpartisan basis.

Analysis

Under the laws governing associations and foundations, a wide range of objectives is permitted. It is difficult to classify associations or foundations into certain categories. The absence of current information on the activities of NGOs is a weak point in the administration of the law. It probably accounts for the small incidence of actions to revoke the registration of foundations and associations.

The restriction on political activities for charitable purpose foundations is stated so broadly that many activities that are otherwise appropriate for a charitable foundation might be excluded as political.

Recommendations

For greater flexibility in management, the objectives and activities of associations and foundations should be defined broadly. However, the purposes and activities of associations and foundations should be stated clearly upon registration to improve the administration of the law.

For foundations with charitable purposes, the restriction on political activities should be reconsidered so that otherwise proper activities are not prohibited.

TAX EXEMPTION

Description

Article 39 of the Code of Revenue states that foundations and associations, as legal persons, are subject to income tax. If foundations or associations earn profits from doing business, they must also pay the value-added tax, or VAT.

The income tax is applied to the gross income of associations and foundations. However, the following categories of foundation and association income are exempt from taxation: registration fees or membership fees and money or property received from donations.

Business income is taxed at the rate of 2 percent of gross income. Investment income is taxed at the rate of 10 percent of other gross income.

Foundations and associations that are legal persons and that are organized for certain specified types of charitable purposes—specifically, for purposes of religion, education, nursing, or social work—may qualify for tax-exempt status as charitable organizations. An organization with three years of audited financial statements may send a written application to the Department of Revenue for review. The Department of Revenue then forwards the application to the Ministry of Finance, which administers the exemption process.

To qualify for exemption from tax, an organization must meet the following requirements:

- Its income must not come from the purchase or sale of goods or services for consideration.
- The foundation's name must not conflict with a trade name or trademark.
- The foundation's management must follow its objectives and may not receive personal benefits.
- At least 60 percent of the income of a foundation must have been distributed for charitable purposes for the past three accounting years, unless the foundation's governing documents provide otherwise or it was necessary to retain 60 percent or more of income to operate a project that furthered the foundation's objectives.

- At least 75 percent of the foundation's expenses during the past three accounting years, and at least 65 percent of all expenses in each of the three accounting years must further the foundation's charitable purposes.
- Expenditures for charity should be made in compliance with all stated objectives of the organization. No person, group, or organization may derive a personal benefit from such expenditures.

Organizations not established in a foundation form will not be considered unless they have similar objectives and are managed as foundations, in which case the applications will be considered on a case-by-case basis.

Any foundation or organization that does not qualify under these standards will not be considered for tax-exempt status as a charitable organization unless the Minister of Finance deems it advisable.

Any foundation, organization, nursing home, or educational organization that is considered to be a charitable organization by the Minister of Finance must provide receipts, with the ordering number certified by the Ministry of Finance, to donors of money or property. They must also submit minutes of a general meeting, a balance sheet, debit and credit accounts, and a report of management on the organization's past accounting year to the Revenue Department within 150 days from the last day of the organization's accounting year. The Red Cross, temples, and government nursing homes and educational organizations are exempt from these requirements.

The Revenue Department is vested with the duty of inspecting documents related to the management of tax-exempt charitable organizations certified by the Ministry of Finance. If irregularity is found, the organization does not meet the criteria prescribed, or it does not comply with the reporting requirements without reasonable grounds, the organization's tax-exempt status must be revoked effective from the year after the announcement of cancellation is made in the government gazette.

There is no limitation on the time allowed for consideration of an application for tax-exempt status. The denial of an application must be in writing and must state reasonable grounds. The right to appeal is not stated. In general, in case of factual or legal disputes between the taxpayer and tax collector, an appeal must be brought to the Appeal Committee within thirty days. The case cannot be brought to the court immediately. Any foundation and association that fails to qualify can resubmit an application for consideration once it has made suitable changes in the application.

Analysis

Charitable organizations are a small percentage of the total number of associations and foundations in Thailand. In fiscal year 1996, the Ministry of Finance certified 309 foundations and associations as charitable organizations, representing only 1.8 percent of the 17,542 foundations and associations in existence at the time.

The main problem that causes foundations or associations not to qualify as charitable organizations is that their expenditures for charitable purposes are less than required by the criteria of the Ministry of Finance. Revenue Department officials have discretion in applying these criteria. It is not easy to determine whether or not expenditures are for charity when officials do not know the facts of the management of foundations or associations. In particular, foundations or associations that spend their funds on development items, such as meetings, seminars, or providing training in various areas, find that these expenditures are not counted as being for charitable purposes.

The task of determining whether an association or a foundation is a charitable organization falls to the Revenue Department. Unfortunately, no representatives of any of the departments with knowledge of foundations or associations are involved in the determination.

Recommendations

The criteria of the Ministry of Finance for certifying charitable organizations should be amended to make the rules for classifying income and expenditures flexible and clear. Expenditures for public charity should be construed broadly. Officials from those government offices that are knowledgeable about associations and foundations should be appointed to committees to consider tax exemption for associations and foundations.

Foundations or associations that are certified as charitable organizations should be exempted from all taxes, including customs duties, income tax, VAT, land tax, and, especially, business tax.

TAX DEDUCTIONS

Description

Under Articles 47A and B of the Code of Revenue, an individual taxpayer may deduct donations to temples, schools, hospitals, or charitable organizations certified by the Ministry of Finance. The aggregate of such deductions may not exceed 10 percent of the taxpayer's total tax otherwise owed.

Article 65(3) of the Revenue Code states that companies, stores, and legal persons may deduct expenditures for charitable, public benefit, educational, and sports-related purposes as prescribed by a Director General and with the approval of a Minister, to the extent that the aggregate of such expenditures does not exceed 2 percent of such organizations' net profits. Expenditures for educational and sports-related purposes as prescribed by a Director General also are deductible, with the approval of a Minister, up to an additional 2 percent of net profits over and above the initial 2 percent.

Analysis

According to the Department of Revenue, few individuals or organizations currently reduce their taxes by claiming deductions for their charitable gifts. The rate of charitable giving is likely to increase if more donors are made aware of the link between charitable gifts and lower taxes. However, this will work only if more organizations are able to offer this tax benefit to their donors. Many legitimate organizations find it difficult to qualify for Ministry of Finance certification under the current criteria. As a result, their ability to generate substantial donations is limited. They are also unable to benefit from the recognition and validation that certification brings.

Recommendations

The certification process should be amended immediately so that more associations and foundations can receive tax exemptions. The Notification of the Director General of the Department of Revenue, Article 65(3) should be reviewed, and the list of charitable purposes for which donations will be tax deductible should be expanded to cover other areas, especially in helping various kinds of deprived or poor people. This will motivate the private sector to donate more to charity. Additionally, for individuals, the cap on deductions should be raised. A campaign to inform the public concerning associations and foundations should prompt increased donations.

CAPITAL REQUIREMENTS

Description

Foundations with the purposes of social work, education, sports, religion, prevention of public danger, treatment of illness, or research to protect patients from drugs or AIDS and foundations established by government organizations must have initial capital of at least B200,000, of which B100,000 must be in cash.

For foundations with other purposes, the minimum initial capital requirement is B500,000. To establish a foundation with less than this amount, founders must obtain the approval of the Ministry of the Interior.

Associations are not required to have any specific initial capital. However, association bylaws may provide for assessment of membership fees. At present, the government subsidizes certain NGOs annually, as can be seen in Table 11.1.

Associations and foundations may earn income from activities that are in accordance with their objectives. However, particularly for foundations, it is forbidden to distribute profits among members or directors. Concerning this, a resolution made by the Office of Juridical Council states, "A Foundation can conduct any activities for earning income in pursuit of its objectives that are not disproportionate as prescribed in the Civil and Commercial Code. If a foundation can do business as a partnership or a company, not only it is against the proportion allowed by law for establishment of a foundation, but it also will take the risk of using up the finance of a foundation by not managing in compliance with the foundation objectives."

Rules of the Ministry of Labor and Social Welfare were issued in 1993 governing the activities of foreign legal entities, institutes, organizations, and foundations working in Thailand that are not agencies of their own governments. Foreign organizations working for the Thai government or operating joint projects under agreements with the Department of Technology and Economic Cooperation pursuant to cabinet resolution are permitted to manage a Thai foundation or association. They may also provide subsidies to Thai organizations by way of financing or

Table 11.1. Government Subsidies of NGOs.

Organization	*Purpose*	*Extent (1997 Fiscal Year)*
Public Welfare Department	Social welfare, social work, social problem solving, and developing society	B40 million for 115 organizations (75 percent of projects are granted)
Office of the National Cultural Council	Cultural and social development	B1.2 million
Office of the Undersecretary of the Ministry of Public Health	General public health	B49.2
Department of Contagious Disease Control	AIDS prevention	B90 million

equipment or by conducting meetings, seminars, or conferences. Finally, they may make donations to legal persons, foundations, associations, or people in Thailand. The Department of Work Provision of the Ministry of Labor and Social Welfare has authority over receipt of funds from foreign countries.

To operate in Thailand, foreign private organizations must request approval from the Commission for Oversight and Management of Foreign Organizations. Such an organization must meet the following criteria:

- It must qualify as a legal entity under the laws of its country.
- It must be nonprofit and apolitical.
- Its goal must be to provide help or development for Thai people, legal persons, groups of people, or government organizations that have policy on country development and security consistent with the policy of Thailand.
- It must have clear objectives and a management policy.

Analysis

The initial capital requirements for registration are too high. As a consequence, many organizations remain unregistered because they cannot qualify.

As a proportion of the annual government budget, the financial subsidies from government to NGOs are still small.

The procedure for supervising foreign private organizations is overly detailed and complex. Moreover, the law does not establish any *de minimis* level below which grants are exempted from commission review. Even small grants must go through the commission procedure, a level of regulatory scrutiny that is not cost-effective in such cases.

Recommendations

The law should permit the formation of smaller foundations with a smaller minimum capital requirement, perhaps with a limited period of existence, and make their establishment more convenient. This will motivate people to start more associations and foundations.

Government subsidies for nonprofit organizations should be increased to encourage the development of such organizations and thus indirectly reduce the burden on the government of providing needed services. Often, NGOs receive some part of their support from government and some part from other funding sources.

The rules and regulations applicable to foreign NGOs wishing to operate in Thailand should be reviewed with the aim of facilitating their operations. In particular, the content of the application should be designated clearly. Other measures to support and provide some conveniences to motivate foreign NGOs to work in Thailand should be taken.

INTERNAL GOVERNANCE

Description

The Civil and Commercial Code stipulates that the following must be included in the governing documents of associations:

1. The title of the association
2. The objectives of the association
3. The locations of the main office and all branches
4. Description of member recruitment and term of membership (period until expiration)
5. Description of membership fees
6. The rules relating to the association's board (that is, the number

of board members, the appointment of board members, the term of board members, the termination of board members, and the meeting of board members)

7. The rules concerning the association's management, accounting, and finances
8. The rules dealing with general meetings

The rules and regulations of an association can be changed only by resolution of a general meeting that is attended by at least half of the ordinary members. At least two-thirds of the members present at the meeting must approve the changes.

The Civil and Commercial Code also specifies what must be included in the governing documents of foundations:

1. The title of the foundation
2. The objectives of the foundation
3. The locations of its main office and all branches
4. Description of the basic finances of the foundation
5. The rules for the foundation's internal governance, including the number of board members, the appointment and termination of board members, meetings of board members, the management of the foundation, and the foundation's finances and accounts

The internal governing body of an association or a foundation is the administrative board. Each organization may also have a subadministrative committee. The size of the board depends on the rules of the individual association or foundation. The Registration Section must be informed of appointments or the changing of board members.

The first board is elected by the founders of the association or foundation. When the initial terms expire, the ordinary general meeting of an association elects the next board members. With regard to foundations, any changes concerning the board can be made by an election or by a random drawing for the termination of the half of the board. The procedural details may be adapted for the rules of that particular foundation.

The qualifications of board members and the procedures for termination of the board are specified by the rules of each particular association or foundation. The law does not impose specific procedures but leaves it up to each organization. In general, both foundation boards and association boards consist of a president, a vice president, a secretary, a treasurer, a receptionist, a registrar, public relations officers, and other positions as may be necessary.

Analysis

The laws regarding the internal governance of foundations and associations are open and flexible and can be made suitable for any organization. Founders can easily designate rules for governance.

No legal structure is available if NGOs working in the same area want to join their organizations into a "council." The registration procedure must comply with the Civil and Commercial Code on association and foundation registration. The joint organization must be called a "council association." This creates unnecessary obstacles to joint efforts by foundations and associations.

Recommendations

The Civil and Commercial Code related to the gathering of NGOs in the form of a council should be amended, and the entity should be able to be called simply a council instead of an association council, so that it can represent both association and foundation members. It can also play a role in controlling the operations of all association and foundation members.

ACCOUNTABILITY

Description

Foundations and associations are accountable to those who are involved with them and also to government oversight agencies. Association members have the right to obtain information about the activities and assets of an association during working hours (Article 89 of Civil and Commercial Code). If more than one-half of the association members, one hundred members, or the number of association members prescribed in the association's rules make a request in written form to the association's board for a general meeting, they must conduct the meeting within thirty days. Otherwise, the requesting association members can call their own meeting themselves (Article 94). In the case of foundations, an ordinary meeting can be held if two or more board members ask the board chair or representative to call a meeting.

Both associations and foundations must have auditors. An association's authorized auditors must not be members of the association's board or staff. They have the authority to audit accounts, including making inquiries of association board members or staff members respecting the accounts and assets of the association. Foundation auditors, similarly, may not be board members or staff members.

Foundation auditors have the authority to audit the foundation's accounts and to prepare the annual balance sheets that foundation board members must provide to the Ministry of the Interior. Auditors have the right to audit accounts and documents related to them, including making an inquiry to the foundation's board and staff members with respect to the foundation's accounts and assets.

An association or foundation certified by the Ministry of Finance as a charitable organization must submit minutes of general meetings, balance and account sheets, income and expense sheets, and a report on their management for the past accounting year to the Revenue Department within 150 days after the last day of the organization's accounting year. The reports are required by regulations of the Ministry of Finance concerning provision for permission to become a charitable organization.

Associations and foundations must inform the office of the NCC of changes in their rules or in the location of their offices and must provide a list of administrative board members' names within seven days of any change. Minutes of meetings and an annual report must also be submitted to the office of the NCC at the end of the calendar year.

In Bangkok during every March, foundations must submit minutes of meetings, balance sheets, income statements, expense accounts, and reports on the management of the foundation to the Ministry of the Interior. In the provinces, these materials must be submitted to an Office of Local and Provincial Affairs. A similar rule applies to associations. Associations based in Bangkok must submit minutes of meetings and balance sheets of the past accounting year to the Special Branch Bureau of the Royal Thai Police Department, whereas in the provinces these items must be submitted to the Office of Local Affairs.

Analysis

By law, associations and foundations that do not receive tax-exempt status are not required to have their accounts audited by authorized auditors. As a practical matter, however, nearly all registrars require general associations and foundations to have authorized auditors.

Unfortunately, there is an insufficient number of auditors. Moreover, the cost of audits is prohibitive for small associations and foundations.

Recommendations

Regarding the auditing of accounts, the budget that needs to be audited should be designated. An exemption from audits should apply to associations or foundations with little capital or with small expenses. Government accountants should be assigned to serve as auditors of associations and foundations. The Auditor Association should be asked to provide a special rate for auditing accounts of associations and foundations.

TERMINATION OR DISSOLUTION

Description

The Civil and Commercial Code contains specific provisions governing the voluntary and involuntary termination of associations and the voluntary and involuntary termination of foundations.

ASSOCIATIONS. Under Article 101 of the Civil and Commercial Code, an association may be terminated for any of the following reasons:

1. An infraction related to the bylaws and regulations of an association has occurred.
2. The term of an association has expired.
3. The association's objectives have been accomplished.
4. The members of the association adopt a resolution of termination at a general meeting.
5. The association is declared bankrupt.
6. The registrar has deleted the association from the registry pursuant to Article 102 of the Civil and Commercial Code.
7. A judicial order has directed the registrar to delete the association from the registry pursuant to Article 104 of the Civil and Commercial Code.

Usually an association is terminated by resolution of a general meeting. At least half of the association's ordinary members must be present at the meeting. To terminate the association's existence, at least three-fourths of all ordinary members who attend the meeting must approve the termination. When an association is terminated, for any reason, any assets remaining after the association has paid off any debts will be distributed to legal persons with the objectives of charity or public benefit.

An association may also be terminated by the registrars under Article 102 of the Civil and Commercial Code by striking the association from the registry, for any of the following reasons:

1. It appears, after registration, that the objectives of the association are contrary to the law or against public order, good morals, or the security of the state, or the association fails to comply within the time provided with a registrar's order to make any change.
2. It appears that the association is being managed in a manner contrary to the laws or against public order, good morals, or the security of the state.
3. The association has not operated for more than two years.
4. It appears that the association allows people besides its board members to administer the association.
5. There are fewer than ten association members consecutively over two consecutive years.

In addition, Article 104 of the Civil and Commercial Code allows interested persons to petition a registrar to strike an association from the registry for any of the reasons specified in Article 102. The registrar must either grant the request or provide a timely statement of the reason for denial. Petitioners may appeal in court any denial of their petition or in case of failure of the registrar to act on it.

FOUNDATIONS. Article 130 of the Civil and Commercial Code authorizes the termination of foundations for any of the following reasons:

1. The foundation's board of directors votes to terminate the foundation in accordance with the foundation's internal regulations.
2. The foundation has reached its registration expiration date.
3. The objectives of the foundation (for foundations that were established for particular objectives) have been achieved or cannot be achieved.

4. The foundation cannot operate any longer, for any reason.
5. The foundation is terminated by judicial order according to Article 131 of the Civil and Commercial Code.

If a foundation is terminated by resolution of its board, for any reason, the board must designate another organization with legal-entity status to receive the foundation's remaining assets.

Foundations can be terminated without a court order for the following reasons:

1. Failure to receive the full amount of property promised to the foundation by funding sources
2. A two-thirds vote of the foundation's board in favor of termination
3. Inability of the foundation to find the number of board members required by the foundation's regulations
4. Inability of the foundation to proceed for any reason

A foundation may also be terminated involuntarily—that is, by the decision of persons other than the foundation's board of directors. Under Article 131 of the Civil and Commercial Code, registrars, attorneys, or interested persons may petition the court for the termination of a foundation for any of the following reasons:

1. It appears that the objectives of the foundation are contrary to the law.
2. It appears that foundation activities are against the law or contrary to public order, good morals, or the security of the state.
3. It appears, for any reason, that the foundation cannot operate any longer, or it has ceased operation for more than two consecutive years.

Distribution of Assets Upon Termination

When associations or foundations are terminated, the provisions of Book 3 of the Civil and Commercial Code regarding the settlement of accounts of registered partnerships, limited partnerships, and limited companies apply to associations or foundations *mutatis mutandis*.

Liquidators are appointed to supervise the settlement of the terminated organization's accounts. They may be board members or other persons. Public prosecutors or interested persons may file an application with the court for the appointment (Article 1251). Liquidators must publicize the termination in newspapers or in registered letters to all creditors so that they can file for the payment of any unpaid debts. Fees, encumbered charges, and expenses incurred during liquidation must be paid prior to other outstanding debts (Article 1263). If any creditors do not demand payment of a debt, liquidators must deposit money in the amount of the debt at the local Deposit Office in the residence area of the creditor (Article 1264 and 333).

The termination must be registered with the Royal Thai Police Department for associations or the Department of Local Administration for foundations (Article 1254).

The distribution of any remaining assets after payment of the organization's debts is governed by law. Article 107 of the Civil and Commercial Code states that when the accounts of an association are liquidated, any remaining assets must be transferred to associations or foundations with legal-entity status. Their charitable objectives must be expressly specified in the association rules or in a resolution of the general meeting. If the rules of an association or a resolution of the meeting do not specify what charity is to receive the assets or the specified transfer cannot be completed, the assets become the property of the state.

The distribution of a foundation's assets upon termination is governed by Article 134 of the Civil and Commercial Code. It provides that after the settlement of accounts, the remaining assets must be transferred to foundations or legal persons whose objectives are in accordance with Article 110. That law states the names of transferees as prescribed in bylaws and regulations of foundations. If the recipients of the foundation's assets are not expressly specified, public prosecutors, liquidators, or any interested person can file an application with the court to distribute the assets to other foundations with legal-entity status that have objectives similar to those of the terminated foundation.

When a foundation is terminated by a judicial order in accordance with Article 131(1) or (2) or the asset transfer pursuant to (1) cannot be accomplished, the assets of the terminated foundation become the property of the state.

Analysis

At present, many associations and foundations have ceased operations for more than two years. However, it is rare for registrars, public prosecutors, or interested persons to go to the effort of asking a court to terminate these organizations and transfer their assets. As a result, these assets remain in limbo. They are not being used to benefit the public.

Recommendations

Accelerate the survey of associations and foundations that have ceased their management. If any foundation does not name foundations or legal persons as transferees on dissolution, the court should allow any remaining assets to be transferred to foundations or legal persons with similar objectives (Article 136).

As for associations, Article 107 should be amended to state that if transferees are not specified, an application may be filed with the court to distribute the assets to associations or legal entities who have similar objectives.

If the assets are vested in the state, the state should adopt a policy (by legislation or otherwise) to allow these assets to be spent to support management of NGOs.

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VIETNAM

Nguyen Van Thanh
Dinh Duy Hoa

THE TERM *nonprofit organization* (NPO) is still new in Vietnam. It was officially used for the first time in the Law on Organization of the Government (1992) and now is used in a number of regulations, though there is no official definition yet of what an NPO is. Vietnam does, however, have organizations that are similar to what other countries call NPOs, especially in the field of humanitarianism and charity. These values have been part of our national tradition since time immemorial. They are embodied in many of our ancient proverbs, such as "The healthy leaf covers the torn" and "The gourd and pumpkin entwine on the same trellis."

Relief and mutual assistance in times of distress are the work of the state and of the people, with the Compassion Funds (CFs) among the most lively expressions of response. CFs originated in rural communities far back in Vietnam's history and were preserved after the August 1945 revolution. CFs may have begun at the beginning of the fifteenth century, when King Le Thanh Tong (1460–1497) reduced the paddy tax on well-to-do families at the commune level if the families contributed to the local fund according to their means. During the Nguyen dynasty, CFs became entirely a commune-based endeavor to address crop failures and consequent famine.

Thus CFs were a form of village convention that exhibited a clear democratic and collective sensibility. The village would audit the fund twice every year at a time of its choosing, and every village member over eighteen years of age had the right to take part in discussions and decisions regarding the fund.

Beginning in 1860, Emperor Tu Duc directed the expansion of CFs across the entire country so as to enhance coordination between the state and the citizenry in social services. Since all localities had CFs, the state could mobilize greater strength for relief, enjoy greater stability in socioeconomic affairs, and limit speculation and profiteering.

These early nongovernmental organizations not only focused on charity but also concentrated on other matters, including women's rights, as reflected by the Hong Duc Law (1483), which stipulated, "Daughters should enjoy rights equal to sons. When a wife and husband divorce, their assets shall be divided equally between them."

At the beginning of the twentieth century, when the French yoke on Vietnam was firm, a number of mass organizations came into being to coordinate social and revolutionary activities. In May 1904, Phan Boi Chau organized the Reform Association, marking the beginning of the Travel East (to Japan and China) movement, which appealed for general reform, championed the dissemination of the romanized Vietnamese script, advocated the reform of customs, encouraged the development of industry and commerce, and organized charities and farmers' associations.

Phan Chu Trinh, another reformist, set up forty-eight schools with the goal of strengthening civil consciousness. He campaigned for the abolition of outdated customs, opposed superstition, reformed lifestyles, criticized gangs and social parasites, encouraged men to cut their hair short, and carried out a massive propaganda campaign to oppose unpaid labor and exorbitant taxes. The Eastern Assistance (Hanoi) and Southern Compatriots (Saigon) trading associations, the Association for Cooperative Commercial Capital (Quang Nam), and many other organizations became centers for meetings and charitable activities.

During World War I (1914–1918), many secret societies were started in southern Vietnam. They were regarded as part of one of the greatest peasant movements of the beginning of the twentieth century.

In 1937, the Indochina Communist Party advocated the use of many new organizational forms to assemble the masses, such as the Anti-Imperialist Youth Union of Indochina, the People's Relief Association, the Workers' Association, the Peasants' Association, and the Women's Union. These organizations were able to reach out to the masses of laborers, skilled workers, small traders, and officials and urge them to join and become active in these ebullient societies of comradeship.

In rural areas, the forms of peasant organizations were diverse and included planting and harvesting societies, lending groups, family businesses, traditional opera societies, and literacy clubs.

Similarly, charity associations such as the Child Welfare Association (1931), societies to popularize the romanized script, the Charity Center, mutual assistance associations, burial societies, orphanages, and recreation clubs were set up in a number of towns and cities. Religious organizations also became engaged in a number of charitable activities through the St. Vincent de Paul Society and the Franciscans.

After the August Revolution in 1945, one of the first proposals of President Ho Chi Minh was to establish the National Salvation Rice Repository to avoid famine. In his appeal, the President said, "[To prevent famine] I suggest that we take up a collection. Once every ten days, all our compatriots should go without food at one meal. The rice saved can be collected and distributed to the poor."

In many articles and appeals, President Ho Chi Minh concentrated on the struggles against famine and illiteracy and dealt with issues concerning the environment in addition to fighting against foreign aggression. On August 31, 1963, he wrote, "Destroying the forest is easy, but regenerating it requires decades. Continued destruction of the forests will adversely affect the climate, production, and living conditions."

Throughout Vietnam's history, these traditions of mutual assistance, either promoted by the state or initiated by the people at the commune level, have followed closely one upon another. They reflect a sense of community and of sharing in both the sweet shavings of society's benefits and society's difficulties, in times of peace as well as in times of war.

From the end of 1970s, the weaknesses of the model of socialist construction then in place were in the main not yet overcome. The socioeconomic crisis persisted and became acute, with the inflation rate reaching 770 percent in 1986. The standard of living of wage earners and people on social welfare declined sharply. Many state enterprises, small industries, and handicrafts cooperatives slipped into stagnation and experienced losses. Hundreds of thousand of workers were forced to leave their jobs. Credit funds began to collapse.

In such serious circumstances, a multisector commodity economy operating along a market mechanism with state management began to take shape. At the same time, working people, liberated from the bondage of a good number of unreasonable mechanisms and having rediscovered their dynamism and creativity, showed greater initiative in seeking employment, generating additional income, and taking part in community activities.

By the end of the 1980s, the process of renewal had recorded important initial achievements, but the country had not yet emerged from its socioeconomic crisis. Corruption, smuggling, and the squandering of public property had yet to be checked. Polarization of wealth had rapidly increased between various regions, between urban and rural areas, and between different segments of the population. The living conditions among part of the population remained very hard. Poor people could not afford medical treatment or to send their children to school. Financial support from the state budget and other available resources that could be mobilized to respond to social welfare requirements remained both limited—as a result of the abolition of the subsidized system under the renewal policy—and poorly utilized. To face up to the problems created by polarization between the poor and the rich and the cult of money that tramples on ethics and fosters disunity, it is necessary to struggle resolutely to overcome and minimize the negative aspects of the market economy and achieve, step by step, social equity, to move toward enabling everybody and every household to become better off.

CURRENT STRUCTURE OF NONPROFITS

Traditionally, social work has been shared in Vietnam by both the government and the people. Vietnam has many mass organizations, now called People's Organizations, such as the General Confederation of Labor, the Ho Chi Minh Communist Youth Union, the Women's Union, the Peasants' Union, and the War Veterans Association. All of these People's Organizations are united in the Fatherland Front, a broad alliance and voluntary federation of sociopolitical organizations representing the various social classes and strata, ethnic groups, and religions. The Front and its affiliates constitute the political and social foundation for the people's power, a venue whereby to unify actions of the various strata of the population in striving to realize democracy and implementing economic, cultural, and social development.

All issues concerning social policies are resolved in a cooperative spirit. The state plays the key role in the settlement of social issues. The involvement of citizens, enterprises, and various organizations, as well as foreign organizations and individuals, is playing an increasingly important complementary part. Diverse forms of organizations have been called into action. The Communist Party recognizes the need "to vigorously turn toward the grassroots to develop their organization, consolidate and socialize their activities, train and forge their personnel." The Party has also proposed that "the state should promulgate a law on the founding of associations and facilitate the operation of people's organizations."

The greater political, economic, and social space now available for voluntary actions has resulted in a rapidly growing number of self-help groups working alongside the state and the traditional People's Organizations to address social problems. Thus by the early 1990s we had witnessed a vigorous voluntary movement nationwide, bearing a deep imprint of traditional values. The mass organizations are now struggling to find a new and more representational role. They are beginning to take responsibility for social service and development activities, particularly in the countryside. The newly organized social service groups, mostly in the form of funds but also associations, centers, and clubs, are taking shape in various localities, involving a great number of people from every walk of life. It is difficult to arrive at a precise number of those organizations. Nonetheless, a rough estimate puts the number at about five hundred at the provincial level and several thousand at the grassroots level.

The fact that the fund is the main form of the newly established organizations may be explained by the scarcity of resources in a country with per capita income measured at about U.S.$300 per year. Organized philanthropy is developing slowly. The fund, however, is an important vehicle to mobilize private contributions.

Comprehensive state regulation of the rapidly growing number of social organizations has lagged behind the development of this sector. The Law on Associations promulgated in 1957 cannot keep pace with changes in the society. Some policy regulations were issued in 1989 and 1990 on mass organizations and associations to encourage greater nonstate activity, but now they, too, are regarded as insufficient to regulate the rapid growth of the sector.

Meanwhile, there are no tax incentives presently available for such groups or for private or corporate giving, although some attempts in this direction are now under consideration. A policy and drafting committee is now drafting new legislation on nonprofit and nongovernmental groups that seeks to provide an enabling environment for their activities, to balance encouragement of voluntary movement and respect for state regulation.

LEGAL CLASSIFICATION OF NONPROFITS

The Civil Code, which became effective on July 1st, 1996, defines two types of social organizations. Article 114 recognizes legal persons:

> Social and socioprofessional organizations may be established and their charters approved, by the competent state authority. The assets of such organizations may consist of voluntary contributions and fees from members and other individuals or organizations. The purposes of such organizations are to meet the common needs and objectives of their members. Such organizations shall have the status of legal persons in civil relations.
>
> Social and socioprofessional organizations are responsible for their own liability, which may be satisfied out of their assets.
>
> A member of a social or socioprofessional organization is not personally liable for the debts, liabilities, or obligations of the organization.
>
> When a social or socioprofessional organization terminates its operation, its assets shall not be distributed to its members but shall be settled in accordance with the provisions of law.

Article 115 of the Civil Code deals with social and charitable funds:

> Social and charitable funds may be established and their charters approved by the competent state authority. Such funds shall operate for the purpose of encouraging nonprofitable cultural, scientific, charitable, and other social and humanitarian activities. Such funds shall have the status of legal persons in civil relations.
>
> Assets of the social and charitable funds shall be managed, used, and disposed of in accordance with the provisions of law and pursuant to the operational objectives of the funds as provided for in their charters.
>
> Social and charitable funds shall carry out only the activities provided for in their charters that have been approved by the competent state authority and only within the scope of the assets of their own funds and shall bear civil responsibility by utilizing those assets.
>
> Organizations that have established social or charitable funds shall not use the former's assets to cover civil responsibility regarding the latter's activities and shall not distribute the assets of the social or charitable funds while the funds are still in operation.

> In case a social or charitable fund terminates its operation, the assets of the fund shall not be distributed to the founders of the fund but shall be settled in accordance with the provisions of the law.

The Civil Code also includes the following nonprofit categories.

Associations

Historically, the association has been the primary and most important form of NPO in Vietnam. The two salient characteristics of social life in Vietnam, an agricultural country, are the village tradition and community integration. Therefore there are many community-based associations in each village, such as old-age protection associations, funeral and wedding associations, and mutual assistance associations. Although such associations were authorized under the Law of 1957, often they were not registered. Those associations that operate nationwide or provincially, on the contrary, must be registered and their charters approved by the state. These associations are incorporated for self-management of their own activities. As a rule, a nationwide association will have affiliates in every province; these affiliates are called branches or member associations. For example, the Vietnam Association of Gardening is a nationwide association with affiliates in provinces such as Hai Duong, Nam Dinh, and Ha Tay.

The establishment and operation of such associations, as with any other NPOs, are based on three principles:

> *Volunteerism*. The establishment of the association and the participation and withdrawal of its members are strictly voluntary.
>
> *Self-management*. Members of the association self-manage all of its activities.
>
> *Self-accounting*. All activities of an association are funded independently. This is not easy given the limited resources in Vietnam. In the past, once an association was allowed to be formed by the state, its activities were then subsidized. Nowadays, not all of the activities are subsidized, and fundraising has become of the utmost importance.

The many associations now in Vietnam include the following: friendship associations between Vietnam and other countries; technical and scientific associations, such as the Construction Association; mathematics associations; associations of physics; associations of geography; professional associations, such as the Journalists Association, the Association of Writers, the Association of Lawyers, the Association of Gardening, the Association for Beekeeping, and the Association for Shrimp Raising; humanitarian and charitable associations, such as the Red Cross Society; and associations for the protection and care of children, such as the Association for the Relief of Handicapped Children.

Unions or Federation of Associations

This form is an integration of associations operating in one field or profession, such as the Union of Scientific-Technical Associations. In principle, unions or federations of associations are established and operated as associations.

Funds (Foundations)

In the last few years, there has been an emergence of many funds (or foundations). Most are state-owned funds, since their initial capital and assets are provided by the state. Examples are the Fund for Young Talents, the Poverty Alleviation Fund, the Fund for Technical Creativity, and the Handicapped Children's Fund. Foundations with private or individual endowments, as in other countries, established for a specified purpose clearly stated in their articles of incorporation are virtually nonexistent in Vietnam. Nonetheless, the Civil Code approved by the National Assembly on October 28, 1995, which was validated on July 1, 1996, provides for funds and foundations as described here.

Many matters are not yet covered by law, however, such as the establishment procedure, the competent state authority to register, and the organization and management of funds and foundations. In the absence of a special law for funds and foundations, they are governed by the laws applicable to associations.

Centers

Centers are a form of organization that operates in many fields. They are similar to NPOs. Unlike associations, centers do not have members. The founders are often the ones who manage the center, with the title of director. Similar to associations, the operational purpose of centers is not-for-profit activities, and they are self-accounting. At the present time, however, separate legislation does not apply to centers. They are also governed by the association rules.

Clubs

The number of clubs is not as large as the number of associations. There are two different forms of clubs. The first form is meeting activities, which are stipulated by the regulations on meetings. The second form, which is incorporated, operates similar to associations, meaning that it has permanent members, membership fees, a management board, and so on. Therefore the regulations on associations are applicable to this type of club.

CURRENT LAWS AND REGULATIONS ON NPOS

The current laws and regulations on NPOs consist of the following:

- Article 69 of the 1992 Constitution stipulates that "citizens have the right to freedom of speech, freedom of press, the right to communication, meetings, demonstration, to form associations in accordance with the law of the country."
- Law No. 102–SL 1957 is on the right to establish associations.
- Decree No. 258 is on detailed regulations guiding the implementation of Law No. 102-SL 1957.
- Directive No. 01, dated February 5, 1989, of the chairman of the Minister Council (now the prime minister) concerns the management of the organization and activities of mass organizations.
- Circular No. 07, dated January 6, 1989, of the Government Committee on Organization interprets Directive No. 01, and it also concerns the management of the organization and activities of mass organizations.
- Directive No. 202, dated June 5, 1990, of the chairman of the Minister Council on the implementation of state regulations concerns the establishment of associations.

Together, these regulations contain the legal rules for associations and funds (foundations).

REGISTRATION

According to Article 3 of Law No. 102–SL 1957 on the right to establish associations, the establishment of an association requires prior permission. Any citizen who wants to establish an association must form a preparatory committee, which is called a pro-tem committee. This committee prepares and writes a draft statute of the association, which includes the following: the name of the association, its objectives and purposes, the scope of its activities, the activities of its association, and the form of organization. The committee is also responsible for mobilizing members and appointing a central committee of the association.

Representatives of the pro-tem committee send an application form to the competent state agency for permission. The application form must include the name, objectives, purposes and scope of activities of the association; the location of the head office; the number of members; the sources of funding and assets of the association; the drafted statute of association; a list of the founding members and their curriculum vitae; a list of nominees to the central committee; and the procedure for terminating the association and disposing of its assets.

Finally, the application must also include the recommendation of the state agency that is in charge of the field in which the association operates. For associations operating nationwide, the recommendation shall be made by the relevant line ministry. For associations operating within a province, the recommendation shall be made by the relevant authority. It should be noted that these recommendations are important but not decisive.

The government office authorized to permit the establishment of associations (the competent authority) is as follows. The prime minister is responsible for granting permission for establishing associations operating nationwide or in several provinces. The chairman of the People's Committee of the province is responsible for granting permission for establishing associations operating in the whole province or several districts within the province. The chairman of the People's Committee of the district, commune, or town is responsible for issuing permission for establishing associations operating within his or her constituency. In the case of an association that has been granted permission to establish and operate in a province but wants to expand the scope of its activities nationwide, it shall apply for an establishment of a new association rather than for expanding its scope of activities.

After receiving permission, the pro-tem committee is responsible for preparing the documents required to hold the congress of the establishment of the association and for reporting to the competent authorities as to the content, agenda, time, and location of the congress.

The association is officially established with the formal proclamation of its establishment. The congress is responsible for proclaiming the establishment of the association according to the permission granted by the competent authority, for adopting the statutes of the association, for adopting the program of actions, and for electing the board of the association.

The leaders of the association must complete all documents of the congress and report the result to the competent authorities. The statutes of the association shall come into effect upon the approval of the competent authorities.

The current laws and regulations do not provide any maximum time limit for considering the application. Nor do they provide for appeal in case permission is refused. However, a petition can be addressed to those who issued the denial. If the relevant authority refuses to change its decision, a petition may be filed at the higher administrative level.

The laws protect the right to establish an association. Article 7 of Law No. 102–SL 1957 stipulates that anyone violating the right of others to establish an association or to associate or withdraw voluntarily shall be warned, sued, or sentenced to a one-month to twelve-month term of imprisonment. Article 24 of the Criminal Law provides that it is a criminal offense to obstruct a citizen's right to meet and associate, as follows: "Those who obstruct a citizen in the exercise of the following rights of freedom shall be warned or fined, or sentenced to a twelve-month detention or to a three-month to twelve-month term of imprisonment . . . the right of freedom of meetings, the right to establish an association in conformity with the interest of the state and the people."

The laws also contain provisions applicable to an association that violates the regulations. Article 6 of Law No. 102-SL 1957 provides that if an association has been formed without permission or its activities do not conform to its statutes and the current laws and regulations, the responsible persons shall be warned or sued, the association shall be dissolved, and the assets of the association shall be confiscated.

Recommendations

The following changes should be made to the laws and regulations pertaining to procedures for establishing an association:

- The law should specify the minimum number of founding members and association members and the scope of the association's activities.
- The law should place a limit on the amount of time that a competent authority may take to consider an application form from the date of receiving a complete set of documents.
- The law should allow a right of appeal to an administrative court when permission to establish an association is denied.
- The law should be revised so that the prime minister is relieved from the obligation to serve as a competent authority and is replaced by another minister, perhaps the chairman of the Government Committee for Organization and Personnel.

REQUIRED PURPOSES AND ACTIVITIES

Each and every association pursues a certain objective. The state authorizes the establishment of associations based on the consideration of the purposes of the associations. The test is this: how do the purposes of the association meet the requirements of social development and of the regulations?

Article 3 of Law No. 102-SL 1957 stipulates that to ensure the legitimacy of the objectives of associations and to protect and strengthen the People's Democracy, applications for establishment of associations shall be submitted to authorized state agencies for permission. At that time, the social system was the People's Democracy. But times have changed, and the current social system is the socialist system.

Business activity necessary to sustain the operation of the association should be permitted and distinguished from business activities conducted for profit. As mentioned earlier, one of the organizational and operational principles of associations is self-support. Membership fees are insufficient to cover the cost of operations. Therefore we suggest that associations be authorized to do business, with the profit generated to be used to sustain the operation of the association but not divided among the members. Those profits should be subject to income tax.

The competent authority considers and decides whether the objectives of an association under application for permission are legitimate or not. The purposes of the association must be clearly stated in the association's statutes. Based on the stated statutes, an association must carry out its activities, which normally includes furthering the purpose of the association, admitting and expelling members, protecting its members' legitimate interests, and educating its members.

TAX EXEMPTION

Under current laws, no taxes are imposed on associations, except for taxation of business income. NPOs are exempt from paying a corporate income tax and a corporate profits tax, under the rationale that both taxes apply only to a business enterprise. This exemption is the result of an informal understanding rather than a formal ruling.

TAX DEDUCTION

Present laws also do not provide tax deductions for contributions to associations by individuals or organizations. Research should be conducted on adopting regulations allowing tax deductions to those who contribute to associations, to encourage them to fund NPOs, especially NPOs operating on community-based objectives.

CAPITAL FORMATION

The sources of capital of an association are membership dues, funds provided by domestic and foreign sources, profits from business activities, and income from other activities, such as consultation services.

There are currently no specific laws that authorize an association to invest for profit, but most associations deposit their funds in banks, although the interest rate is not high.

According to Article 11 of Decree No. 258, apart from membership dues, any fund donated to an association must be approved by the competent state agencies. In practice, however, associations often receive assistance in cash and in kind without prior permission.

INTERNAL GOVERNANCE

An association is legally responsible for its activities. Associations are usually structured in the following forms: general congress and congress of representatives. Associations with small memberships must have a congress. Members of larger associations participate in a congress of representatives. The congress is the highest authority of the association. It meets every five years. It approves the report of the central committee.

It decides the policies, orientation, tasks, and structure of the association. It decides whether to amend or modify its statutes. It elects the central committee.

The central committee is the highest governing body during the period between meetings of the congress. It is elected by the congress for a term of five years. The central committee holds regular meetings every six months and extraordinary meetings if needed. It issues guidelines on the implementation of general congress resolutions. It approves annual and biannual action plans of the association. It approves the working report of the standing board. It elects and removes members of the standing board. It decides to form or dissolve special commissions. It sets the membership fee. It convenes the general congress. The central committee includes the chairperson, the vice chairperson, the secretary general, and other members.

A standing board of the central committee is used if the central committee is too large. It has the function of administering the activities of the association between meetings of the central committee. The standing board, with a mandate of five years, has the following rights and obligations. It decides concrete working programs for implementing the general congress and central committee resolutions, and it provides guidance for their activities. It admits new members. It organizes and administers the office of the association. The standing board includes the chairperson, the vice chairperson, and other members.

Special commissions are also formed around the concrete needs of the association. Examples are the Commission for Organization, the Commission for Foreign Affairs, the Commission for Fundraising, and commissions to implement particular projects.

REPORTING OBLIGATIONS

The standing board is responsible for preparing and submitting biannual and annual reports on the activities and financial state of the association to the competent state agencies.

The amendment of the statutes of the association shall be approved by the authorized bodies. The association shall report to the authorized bodies when changing the members of the standing board or electing a new standing board of the association. The standing board of the association shall inform the authorized bodies and the People's Committee in advance of the new location when moving the head office. The list of full names, ages, occupations, addresses of members and branches of the association, and financial statements and records of the association and branches, together with the meeting minutes of the standing board, shall be filed in the head office or branches of the association. These records and documents shall be checked by the authorized bodies if required. Fifteen days after the congress, the standing board shall send to the authorized bodies the copies of the meeting minutes, the resolution of the congress, and the reports on activities and financial statements of the association.

DISSOLUTION

Voluntary Dissolution

Voluntary dissolution occurs when the association itself decides to end its existence. The most common reasons for voluntary dissolution are that the association has fulfilled its purpose or mission or that the period of time for which it was established has expired.

Article 20 of Decree No. 258 stipulates that in case of voluntary dissolution, liquidation of assets and property and financial disposition shall be approved by the authorized bodies and shall be done in accordance with its statute. Article 21 stipulates that within ten days from the date of deciding voluntarily to end its existence, the central committee must announce the decision of voluntary dissolution in a daily newspaper. If there is no local newspaper, the notice must be delivered to the People's Committee where the head office of the association is located. Within ten days from the date of termination of the time limit for liquidation of assets and financial disposition of the association, the central committee must submit all related records and documents of the association to the competent body that issued permission to establish the association.

In fact, there have been no voluntary dissolutions in recent decades. In past decades, many issues have not been included in the regulations. For example, what is the solution for liquidation of assets and financial disposition if not stipulated or clearly stated in the statute of the association? Session 2, Article 107 of the Civil Code provides that before being dissolved, a legal entity must fulfill all property-related duties, the completion of which will be certified by the competent state authority.

Involuntary Dissolution

Grounds for involuntary dissolution are set forth in Article 8 of Law No. 102-SL 1957: "Those who abuse the right to establish associations to act harmfully to the interest of the state and of the people and to oppose the laws, the people's democracy system, to drive a wedge between the peoples, to harm the fine custom, to damage the cause for peace, reunification, independence, democracy of the nation, to sabotage the friendship between the people of Vietnam and the people of other nations, and to propagate war shall be punishable according to the current laws, the association shall be liable to dissolution, and its assets could be subject to confiscation."

An association shall be dissolved by the competent state bodies in the following cases: establishing an association without permission; operating in violation of the statute of the association; violating existing laws and regulations; renewing operations or reorganizing the association without permission after dissolution; operating against the interests of the state and the people, such as violating laws, acting against the regime, sabotaging the friendship between Vietnam and other countries, or promoting war; or serious loss of public credibility.

Within ten days from the date of receiving the decision of the state authority on the dissolution of the association, the central committee shall publish the decision of dissolution of the association in the newspaper, and all and every activity of the association must be stopped immediately. At least one month from the date of receiving the decision of dissolution, the central committee must complete its disposition of the association's assets and transfer the property to the state in accordance with the guidelines of the financial management agency, and it must deliver all documents, files, and seals of the association to the competent authorities.

In the case of involuntary termination, an association has the right to lodge a letter of reconsideration or complaint with the senior authorities. But it must cease all activities while it waits for the resolution.

The abovementioned regulations have never been used in practice. No association has ever been dissolved by the state authorities. Those regulations should be reviewed and amended so that reasons are set forth for termination, for appeal, and for property dispositions upon dissolution.

CONCLUSIONS AND RECOMMENDATIONS

More than forty years have passed since Law No. 102–SL of 1957 was enacted, and many provisions are no longer suitable to the current situation. Moreover, the law regulates associations only, and other laws are required to address other organizations. It would be more useful and therefore preferable to have separate laws to regulate associations and foundations.

A foundation is a new type of organization in Vietnam. Most of the existing foundations are established and managed by state agencies. These foundations are quite different from those formed and contributed to by individuals, families, or organizations. Any foundation law should take these differences into consideration.

NPOs should be authorized to engage in business activities so long as the profits are used for the purposes of the NPO. The only prohibition would be that NPOs could not distribute profits to their members.

Laws should be enacted to permit tax exemptions. Tax deductions should be available to benefit individuals and organizations that contribute to NPOs.

Regulations on accounting systems, disclosure of documents, and financial reports of NPOs to the state authorities should be clearly stated.

In the years since the renewal policy, Vietnam promulgated the new Constitution of 1992 and the Civil Code in 1996. We have amended, revised, and enacted many important legal documents, undertaken initial measures of reform of the state administrative system, and continued our efforts to build and better the law-governed state of the Socialist Republic of Vietnam. New laws have been promulgated or are under discussion, such as a commercial law and laws on banking, customs, post and telecommunications, electricity, construction, science and technology, environment, and water resources.

The state recognizes the need to revise laws at all levels and to abrogate regulations issued by executive agencies and localities that run counter to current laws promulgated by the National Assembly and the government.

The legal structure of the nonprofit sector should also be revised and streamlined. However, we are facing more urgent needs in other sectors, especially in the economic sector, and legislative reform of the nonprofit sector cannot lead the priority list. A more realistic estimate would look to the year 2000 as the date to expect drafts of a comprehensive law regulating the entire nonprofit sector.

Meanwhile, proceeding by the issuance of decrees governing the activities of the different forms of nonprofit organizations is probably the best way to respond to the realities of this important sector.

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