

# **Present and Future Trends of NPOs in Japan**

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## **Nonprofit activities lagged behind in Japan**

One hundred and thirty-two years ago (1868), Japan assumed the form of a modern state and joined the ranks of the Western powers. Since then, it has endeavored to become a strong nation capable of competing on equal terms with the West. After its defeat in World War II, 55 years ago (1945), Japan made started afresh as a democratic nation. For economic recovery and the subsequent high economic growth, the state government guidelines and regulations naturally played a big role, but the role played by private enterprises was also important. Within the context of this recent history, centering on the state and private companies, private sector nonprofit activities received neither social nor institutional support.

The private sector pursues profit through its business activities and returns part of it to the government in the form of tax. Most people came to expect the government to use that tax revenue to engage in activities that do not yield any profit. Under these circumstances, private sector groups either became dependent on the government, made demands on it or opposed its policy. Consequently, they failed to develop a strong consciousness as independent entities that endeavored to solve social problems from an independent standpoint.

From around the 1970s, however, people using their own judgement began to engage in civic activities that grappled with social issues. This trend accelerated in the 1980s, reflecting a growing need to deal with the various problems inherent in a society that regarded economic growth as an absolute must. People also began to show interest in civic activities because, as the Japanese economy reached a certain level of growth, an increasing number of citizens began to seek a way of life that material wealth alone could not guarantee. This trend became more marked in the latter half of the 1980s when the Plaza Accord was signed. Also, the fact that many citizens and businesses had gained first-hand experience in private sector nonprofit activities in various Western countries no doubt contributed to this trend.

## **Creation of a new nonprofit corporate system**

Against this background, people began to point out the absence of a nonprofit corporate system that guaranteed the independence of citizens' activities. Then in the 1990s, efforts began to be made to establish a system that could deal with this problem. Those involved in civic activities and private sector research groups mainly studied this problem and made various concrete proposals. Civilian organizations were established to realize such a system.

It is in this context that many volunteers rushed to Kobe to help in the rescue efforts after the Great Hanshin Earthquake devastated that city in 1995. They also contributed in the post-quake rehabilitation of the stricken areas. Here, the importance of private sector nonprofit activities was driven home to the general public, prompting both the Administration and the Diet to seriously consider establishing a system for promoting such civic activities. Responding to these developments, civilian organizations held lively discussions in various parts of Japan.

As a result, the Diet passed, by a unanimous vote, the Law to Promote Specified Nonprofit Activities (the so-called NPO Law) in March 1998. The new law, which went into effect in December, promotes efforts by citizens to freely engage in activities that contribute to society. It does this by enabling citizen organizations to obtain nonprofit corporate status easily and without government offices dictating the kinds of activities they should engage in. It can be said that whereas the conventional public-service corporation system (public corporations and foundations) is premised on the relevant ministries' power to approve and supervise civic activities, the NPO Law paves the way for the removal of a significant number of official restrictions. As of December 1, 3021 citizen organizations have obtained corporate status since the NPO Law went into effect, and each has been actively promoting its activities.

## **Increasingly important role of NPOs**

The direct significance of the NPO Law is that by making it easier for many organizations engaged in civic activities to obtain corporate status, the law enables these organizations to enter into different contracts and arrangements. The further significance of the NPO Law is that under its provisions the activities engaged in autonomously by citizens are institutionally recognized as socially important. In fact, most of the activities will probably be undertaken by volunteer organizations that do

not require corporate status. Nevertheless, their importance to society is now recognized.

In the months and years to come, we expect more people to participate in private sector nonprofit activities. In addition to taking part in volunteer activities, people will have more opportunities to receive support as members of nonprofit organizations or to become full-time staff members of such organizations. Moreover, there will be more instances of people getting together to establish new NPOs. There is a possibility that, in tandem with these trends, various institutions that originally did not assume the importance of volunteer activities will now recognize their importance and transform themselves into institutions that nurture such activities and promote private sector nonprofit organizations.

Today in Japan many social institutions are being reformed. The establishment of the NPO Law can be seen as part of this trend. The public nursing care insurance system, however, that came into force this April, and the Decentralization Promotion Act is particularly helping to expand the role of local governments. The Social Welfare Law, revised this June, will probably change the way social welfare is provided. Moreover, the reorganization of ministries and agencies that will take place in January and the Free Access to Information Law, that will probably be enacted after that, will gradually change the role of the central government. This movement toward reform will serve to increase the importance of NPOs.

Particularly, in local administration, the cooperation between NPOs and the government has increased in importance, and that trend is already becoming prominent. Many local governments are considering measures to promote such cooperation, and new efforts are being made in this area, and there is a good possibility that administrative reform may be promoted in local governments through these efforts.

Also, companies are beginning to take notice of the existence of NPOs and are aiming to join hands with them. Such a trend is observed not only in their efforts to contribute to society, but also in their business activities proper. Moreover, companies, as well as groups of companies or trade organizations, are engaging in social activities and establishing their own NPOs. Reflecting the current sluggish economic conditions, this trend has not yet picked up momentum, but there are many signs pointing in that

direction, so that in the future they will undoubtedly become brisk.

### **Problems facing NPOs**

While these trends are visible, the operating basis of Japan's NPOs has yet to be consolidated. Many problems have to be overcome before they can cooperate with the government and businesses as equals.

One of these problems is the absence of a tax system for strengthening NPOs' economic basis. A system of taxation needs to be established that will promote the flow of funds to NPOs. Under such a system, individuals and businesses will be able to donate to NPOs and receive tax incentives, and when an NPO engages in profit-making business activities, it will be entitled to receive corporate tax exemptions. The NPO Law stipulates that such institutional reform should be carried out within three years after it comes into effect. At present, advocacy groups in a federation of Parliamentarians and those in a federation of civilian organizations are actively promoting their respective causes. Expectations are high that a clear direction will be confirmed by December.

Even if a tax system favorable to NPOs is adopted, it will not mean that the economic strength of NPOs will be immediately enhanced. For that to happen, each NPO will have to strive to win the support of the public for its activities. The important thing is to create conditions in which the presence of many easily accessible NPOs will enable a person to have a real feeling that his or her life has indeed been enriched as a result of their presence. It is only when these efforts are properly coordinated that a new NPO tax system will begin to have any practical effect. And that will indeed mark the creation of a new nonprofit culture.

## **Addendum**

### **Future topics in revising the NPO Act**

One of the special characteristics of this NPO Act is the stipulation in the supplementary provisions section that states “revisions are to be made within 3 years following execution in accordance with the state of affairs of operation.” As is implied in the word *chôreibokai*,<sup>1</sup> the sudden changing of laws must definitely be avoided due to confusion that would be caused from the standpoint of both national and municipal citizens. However, when starting something new against the backdrop of an ever-changing society it is not easy to create something that will sufficiently satisfy everyone with all of the uncertain elements present. In this situation, it becomes necessary to first of all introduce legislation in a uniform range and employ methods that make gradual changes with various attempts aimed at social trends especially in this current era where we see society undergoing change at rapid pace/breakneck speed. For this reason, laws that include these types of “revision-oriented” provisions may become the standard fare. This will drastically stir up the interest of citizens regarding the law, because “law revision” will no longer be a special and major undertaking, but something familiar to all and sundry.

Under the influence of these provisions both the House of Councilors and the House of Representatives passed a supplementary resolution calling for the creation of revision proposals within two years following execution that would include preferential taxation measures. The said revision proposal was put together at the end of November 2000 and submitted to the Diet, and it will be finally established by the end of November 2001 following deliberation in the Diet. Due to the fact that this law will be established through legislation by House members who have close relationships with civilian groups, the role played by these groups will also take on importance in the revisions to follow. Thus, the sincerity of efforts made by these groups that have recently become NPO corporations under the influence of this law will come under question.

#### ***1. The first step regarding civil law revisions***

With that let’s go into what types of revision items there may be. First, it would be a good idea to consider what may happen in the near future. If we consider the

establishment of the NPO Act as a “Hop;” reforms made to the non-profit corporation system with civil law revisions would be a “Jump;” and the revisions of the NPO Act in three years time could be ranked in the middle position as a “Step.” In other words, when dealing with these revisions it will be necessary to hold discussions that take into consideration the drastic civil law revisions that will follow a few years after the establishment of the NPO Act. Also regarding the preferential taxation system it will be important to make considerations from the viewpoint of what to with the basic framework at the core of this absolutely new corporation system.

Next let’s look into the non-profit corporate and public service corporation system and its taxation system that will need to be brought into existence hopefully within six to seven years (but possibly 10 to 20 years from now) through drastic revisions to the civil law. Here we will depict the following contents.

A “Non-profit corporation system (Non-profit corporations and non-profit foundations)” will be newly established through conformity to the law (a registration system). Competent authorities will not be needed if this is done completely with conformity to the law, while a system that conforms with the NPO Act would be sufficient when considering the public opening of information and other similar items. From the standpoint of the taxation system this non-profit corporation system would be roughly equivalent to voluntary groups.

A “Public service corporation system (Public corporations and public utility foundations)” will be established. The competent authorities system that had existed up to that point would be abolished and a jurisdiction system that conforms to the NPO Act would be introduced. This could either be regulated by civil law or be entrusted to special laws. Preferential measures such as supposed donation deductions from profit-making enterprises and tax exemption for interest will be established in the taxation system.

Fairly strict measures will also be needed for the public opening of information.

A “Public service corporation advancement” system that would demand public-oriented donation deductions for civilians over a wide range will be established through radical revisions to the Income Tax Act and the Corporation [Corporate?] Tax Act. A unified sanctioning organization such as the Public Service Corporation

Advancement Committee will need to be established and introduce strict public opening of information.

While it will be necessary from here on out to make well thought-out corrections and further bring these visions for the future into more concrete forms, without first determining a basic framework it will not be possible to come up with effective strategies and tactics to advance them. In order to realize their construction it will be necessary to restructure existing corporations and the non-profit corporations and public service corporations of existing foundations along with introducing system reforms through civil law revisions. Further, it will be essential to switchover from competent authorities to jurisdiction authorities which will demand a monstrous effort, as it will involve existing rights. Even though it will also be necessary to restructure NPOs and other corporations this should not require an undo amount of work. It will also be essential to bring about a taxation system that differs in very basic ways from the existing specific public welfare advancement corporation system. Taken from the current taxation philosophy this will require some extremely radical ideas.

When envisioning these forthcoming models it is advisable to consider the contents of the revisions and methods for this current NPO Act. The points for revision that need to be investigated can be divided roughly into revisions of the corporation system itself and taxation revisions. For a short time the latter was pointed to with an attitude of “Next we need to revise the taxation system,” while the corporation system has been left in an uncompleted state requiring further discussion and revision. The corporation system is a matter that should not be forgotten by any means and more future-oriented discussion will be needed, which will certainly attract the interest of a large number of civilians.

## ***2. Measures for realistically bringing about a better taxation system***

An attempt to identify issues that will arise in the future by comparing taxation related matters involved with NPO corporations with those of public service corporations revealed the following points:

1. There are no apparent problems with granting groups that do not perform, from the point of view of the taxation system, profit-making activities (33 occupational types in accordance with the Corporation Tax Execution Ordinance) and only carry

out non-profit activities with tax exemption rights that are identical with those of public service corporations.

2. When businesses are judged by the taxation system to be profit-making, these businesses shall be taxed in the same manner as other industries without the utilization of tax reductions that are used for public service corporations. However, since tax reduction rates would be the same if the annual income is 8 million yen or less, a large number of groups will not be effected by this measure.
3. Businesses judged to be profit-making from the viewpoint of the taxation system that will pose problems will be profit-making businesses that have been recognized as public service corporations that have not had "Supposed Donation" deductions approved for non-profit activities. This will develop into a major problem in the future as civilian operated groups develop into businesses.
4. While the financial gains of the funds of public service corporations are considered at present to be tax-exempt, this will not be approved. At the current time groups that possess a great deal of funds are still considered to be rather scarce and with the present development of an environment of super-low interest this will not pose much of a problem, but it will probably develop into one in the future. This will especially be a problem for corporations that have been recognized as being foundations.
5. The largest problem will be the lack of tax-exemption measures for individuals and businesses that have made donations to NPO corporations. At present, social welfare corporations and educational foundations receive preferential taxation measures for donors after being automatically recognized as being specific public welfare advancement corporations while these are granted for only a small percentage of corporations and foundations (slightly over 3 percent) following strict examination by the competent authorities or the Ministry of Finance.

Even if this is utilized for NPO corporations it will be almost void of significance as only a very few corporations could be targeted with a system that does not use a competent authorities system.

6. From the point of view of preferential taxation measures for donors there is a

system for specific donations other than those of the specific public welfare advancement corporation system for public service corporations and tax-exemption regulations involved in inheritance. Making it possible to apply these for NPO corporations (even if the number of applications is small) will be greatly wished for in the future.

7. A corporate resident tax (*per capita* rate) will be applied to corporations that have earned corporate status in the realm of local taxes. Generally speaking this comes to ¥70,000 for urban and rural prefectures and cities and towns, which would be a bit of a strain for small-scale groups. Almost all urban and rural prefectures and some cities and towns have stipulated tax-exemption measures regarding this with most of them adding that profit-making activities are not carried out as one of its requirements. As stated earlier, it is believed that there will be an increasing trend toward groups forming into businesses in the future, and thus this will certainly not be very effective. Currently tax reduction for local taxes involving donations is only applied to community chest associations and the Japan Red Cross. However, in the light of the fact that the majority of NPO corporations carry out most of their activities within their respective local areas it would be advisable to look into this problem.

The items mentioned up to this point are the main topics regarding the taxation system and we are not prepared at this time to point out all of the areas that need to be revised. However, it would be beneficial to explore the topic noted in number 5 a bit which is perhaps the most serious problem, namely, how to set-up a donation deduction system of a framework that differs from the current specific public welfare advancement corporation system.

Making NPO corporations also into the subject of the current specific public welfare advancement corporation system is, from the point of view of system revision, actually the easiest to understand and its procedures would also be quite simple. On the other hand, it may be felt that this is not enough to solve all problems. However, as was stated previously, with approval being limited to only a very few corporations the system works basically in form only and has almost no effect in actual operations. For this reason a donation deduction system that differs completely in structure from the specific public welfare advancement system must be established.

In order to solve this problem it would be advisable to establish a philosophy of “Civilian interest” that differs in its nature from “Specific interest” which is determined by the competent authorities and the Ministry of Finance and set-up a “Civilian public welfare advancement corporation” system. Although the conception of this system has not yet been made in concrete terms, it would be necessary to create a framework in which it would be possible to make judgements concerning public welfare properties with the support of a large number of civilians. Preferential tax measures serve in the role of substituting for tax payment. At present there is a demand by the taxpayers for system that they can accept and that would work in harmony with the existing one. Based on the premise that “Specific interests” will continue to exist, it will be important to advance the concept of “Civilian interests” which differ in its very nature with this. Along with establishing a “civilian” philosophy that can withstand the legal system using the wording of “Civilian interests” it will be important to secure a “Public interest” philosophy that will substitute the traditional government-based image of interest with one that is more socially oriented.

It is hoped that these drastic revisions of the civil law to be implemented in the future will bring about a unification of the traditional specific public welfare advancement corporations and these civilian public welfare advancement corporations. We are not too sure how appropriate it is to unify the two, then label it a “public welfare advancement corporation” system. The current specific public welfare advancement system is extremely limited and is quite transparent with the authorities possessing a great deal of power. However, unifying this with the newly established civilian public interest advancement system will have to make it more transparent and more applicable over a wider range of issues. This civilian public interest advancement system takes on the significance of being a model experiment in order to achieve this. The question is just how well this experiment will be understood and evaluated by the taxpayers.

What is being demanded at the present time is a long-term approach toward the construction of a systematic foundation to support Japan’s civilian [or civil] society and a practical way of dealing with the changes taking place in this era.

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<sup>1</sup> *chôreibokai* is a Japanese proverb, which literally means, that which was ordered in the morning is changed in the evening. i.e. an unsettled course of action.