can be tax deductible. Thus, a company may claim that its involvement in preservation improved the public attitude towards the company and should, therefore, be recognized as advertising. Since the company will still have to prove the existence of a direct connection between the expense and its income, it may find itself, at the end of the day, with an expense not recognized by the tax authorities. Therefore, a company, or any other legal form of business, will probably prefer to invest in a different area of public benefit, such as sport or cultural activities sponsorship,where its expense is more likely to be tax deductible.

Third, according to the tax ordinance, contributing money to a non-profit organization is tax deductible. A few conditions limit this option:

1. The organization must be a separate legal entity. As we already mentioned, in relation to some buildings and sites which need preservation such a legal entity does not necessarily exist.
2. The legal entity, mainly the endowment or the *"Amuta"*, must be formed by private individuals, interested in promoting the preservation and creating the legal entity others can donate money to. There is no incentive for establishing such a legal entity, and no way to enforce the existence of one.
3. If the entity is established, it has to be recognized by the tax authorities as a non-profit organization. There are a few conditions the entity has to fulfill to get such recognition, some of which limit the scope of activities such an entity may exercise.
4. The amount one can contribute to a non-profit organization is limited, both by the total amount and by the percentage of the contributor's income, which may be tax deductible. These conditions vary from one legal form of the contributor to another.
5. The non-profit organization may not be involved in any "business-like" activity. If it conducts any activity which is done by business entities as well (such as selling products, tickets, etc.), it may lose its recognition. One of the outcomes of this rule is that, in general, the non-profit organization has no "V.A.T. income" from which V.A.T. expenses may be deducted or set off. Thus, the cost of the preservation itself, borne by a non-profit organization, is generally much higher.

Nevertheless, using a non-profit organization, mainly in the form of *"Amuta"*, is the most common way of enjoying private participation in the preservation of buildings and sites in Israel. Due to the fact that there are a few disadvantages to this form as well, new ways are being sought all the time.

This year another amendment to the Planning and Building Law is being prepared. It includes new ways to encourage preservation, with some emphasis on ways to encourage private participation in the preservation of buildings and sites.

Among the suggestions being discussed are the granting of an exemption from municipal taxes, reducing betterment taxes, recognition of expenses connected with preservation for deduction from land appreciation tax levied on the sale of a property and earmarking of building license fees collected for creating a special budget for preservation.

TOSHIYUKI KONO

The Public Benefit Corporation and Taxation in Japanese Law

I. The Public Benefit Corporation in Japanese Law

1. The principle of the Japanese Civil Code

Chapter 2 in the General Rules of the Japanese Civil Code (§§ 33-84) as the fundamental corporation law in Japan distinguishes two types of corporations. One is the "for-profit corporation" to which the Japanese Commercial Code is applicable (§ 35). The other is the "public benefit corporation" which is dedicated to public interests such as religion, charity,and science (§ 34). Most of the provisions in chapter 2 of the Japanese Civil Code are concerned with the latter type of corporation.

When one category is "for-profit", its counterpart should be "non-profit". However the Japanese Civil Code takes the position that only the public benefit organization among all types of non-profit organizations can be incorporated. In other words, Japanese Law does not know the non-profit corporation as a legal form. All other non-profit organizations therefore remain as unincorporated associations: These organizations cannot legally be the contract party, nor the owner of real estate. Although some provisions in the Japanese Civil Code could apply *mutatis mutandis* to these organizations, there is no appropriate legal framework for them.

The Japanese Civil Code distinguishes the public benefit corporation further into two categories depending upon the nature of the organization: "incorporated public benefit association" and "incorporated public benefit foundation". The core of the first one should be individuals or organizations that form a group of people for the same purpose, whereas certain assets for specific purposes is the essence of the latter.

Besides the public benefit corporations based on the Japanese Civil Code, there are several special laws such as the Religious Corporation Law, the Private School Law, and Social Welfare Law[1] which are the legal basis for specific types of public benefit corporations. In practice they are the majority. Public benefit corporations based on the Japanese Civil Code make up only ca. 10 % of 230,000[2] public benefit corporations in Japan.

2. How to incorporate the public benefit corporation

When one wants to incorporate a public benefit corporation, one must apply for the permission of the administrative organ in charge of the field to which the purpose of the corporation is related. For example, a public benefit corporation for the purpose of education must be permitted by the Ministry of Education[3], while a public benefit organization for safe traffic must be permitted by the Ministry of Transportation. If the purpose of a public benefit corporation covers these two fields, then it must be permitted by both. Giving

permission means that the administrative organ exceptionally allows incorporation. It shows that the administrative organ has very wide discretion and that it has strong influence on the incorporation procedure. The "public benefit" must be, for example, clarified in each case through discussion with the administrative organ. In practice, the incorporation procedure starts with an informal meeting with the administrative organ and the applicant must follow the instructions of the organ. This procedure usually takes one year. To get permission to incorporate, it is often recommended that the organization must have started public benefit activities two or three years prior to the informal meeting[4]. It is also required that the organizations have sufficient capital at the time of the application. For example, to incorporate an incorporated public benefit foundation, 500 million Yen (ca. US$ 4 million) is usually necessary.

3. Advantages and disadvantages

When a non-profit organization is incorporated as a public benefit corporation based on the Japanese Civil Code, it will enjoy the following advantages:

a) High social reliability – It is shown in the fact that the presidents of many public benefit corporations are well-known artists or business people. The social reliability may increase the chances to receive donations from the private sector or subsidies from the State or local governments.

b) Juridic person – The public benefit corporation can register properties with its own name and become a contract party. The only exception in this context is the Code of Civil Procedure. Even an unincorporated association can sue and can be sued (§ 29 Code of Civil Procedure).

c) Tax privileges – This will be described in the following chapter of this paper.

On the other hand, the administrative organ controls not only the incorporation procedure, but also its public benefit activities after being incorporated. The public benefit corporation must annually produce for the administrative organ a plan of its activities and budget for the coming year, and a report of its activities and finances for the previous year. In addition, it will be inspected by the officers of the administrative organ every two or three years[5].

II. The Public Benefit Corporation and Corporate Tax

Public benefit corporations enjoy several tax privileges such as limitation of taxable income, lower tax rate, exemption from property tax, consumption tax, and resident tax. This paper focuses on tax privileges in the Japanese Corporate Tax Law.

1. Not taxable income

For certain types of organizations the Japanese Corporate Tax Law imposes corporate tax only on "for-profit business income", which is practically equivalent to "unrelated business income[6]" in the US law (§§ 4, 7). These organizations must be listed in the Appendix List No. 2 of the Japanese Corporate Tax Law. Even if an organization carries on public benefit activities, it cannot enjoy this tax privilege unless it is listed. If it is listed once, however,it enjoys the tax privilege, even if it is doubtful that the organization's activities are really for the public benefit[7]. The incorporated public benefit association and the incorporated public benefit foundation based on the Japanese Civil Code are included in the list. The income from public benefit activities is therefore not taxable.

The same rule applies also to foreign public benefit corporations which have been incorporated according to foreign laws (§ 10): When a foreign corporation is equivalent to one of the listed organizations in the Appendix List No. 2, and when the Minister of Finance appoints it as being eligible for the tax privilege, it enjoys the same privilege.

Under the current rules of the Japanese Civil Code, many non-profit organizations remain as unincorporated associations. The Japanese Corporate Tax Law, however, considers these organizations as "incorporated", as long as they determine their representative or administrator (§ 2, 8). In this case, their for-profit business incomes are taxable.

2. For-profit business income

Until the corporate tax was imposed on the for-profit business income of religious corporations in 1920, any kind of income of public benefit corporations was not taxable. After WW II, the situation of public benefit corporations was investigated for the reform of the entire taxation system. A report of this investigation says "many public benefit corporations make profit through for-profit business and compete with for-profit corporations and individuals ... The income from for-profit business is spent for developing the business or having fun... The for-profit business income shall be taxable."[8] According to the legislator's explanatory note, due to the drastic inflation after the War many public benefit corporations had to start or enlarge their for-profit business. Although this type of business is inevitable for them, if any income of public benefit corporations were not to be taxable, it would be too unfair for for-profit corporations. To avoid such a situation and to adjust the for-profit business of public benefit corporations and the normal business activities of for-profit corporations, the corporate tax should be imposed on the income of public benefit corporations. Due to practical reasons, however, the tax office does not check activities of each public corporation. Instead all public benefit corporations must pay corporate tax for the income from their for-profit business.[9] Since this business has a different nature from the regular business of normal for-profit corporations, a lower tax rate is applicable. This lower tax rate is 27 % since 1990, while the tax rate for for-profit corporations is 37.5 % (§ 66).

According to § 2 no. 13 of the Japanese Corporate Tax Law, "for-profit business" is defined as the business which is "listed in an ordinance" and "regularly carried on" at its "place of business". § 5 of the Execution Ordinance for Corporate Tax Law lists up to 33 kinds of business[10]. Every for-profit business must be checked as to whether it falls under one of the 33 types[11]. "Place of business" could be an already

existing facility. Also a touring theater company has a place of business.

"Income" from a for-profit business includes not only active income from business activities, but also passive income like interests from savings accounts or dividends. Only passive income from a for-profit business is taxable.

3. Several problems under the current system

a) Public benefit corporations are non-profit organizations and therefore the lower tax rate is applicable. In practice, misusing this privilege, public benefit corporations sometimes make large profits and distribute them to their members. For example, the president of a private college received ca. US$ 1.5 million when he resigned his post due to his scandals.[12] Neither the corporation law nor the tax law has any provisions to check such cases.

b) The lower tax rate is applicable to all public benefit corporations. The size or the content of activities is not taken into consideration. In practice therefore a small publishing company has to pay tax based on a higher tax rate than the publishing department of a large size religious corporation.

c) The financial and fiscal situation of public benefit corporations is not well disclosed, especially because passive income is not transparent. In one case a foundation whose main purpose is granting research scholarships offered less than US$ 100,000 in scholarships as the total. But this foundation had more than US$ 100 million in its fund[13]. This example suggests that an appropriate disclosure procedure is necessary.

III. Donations to Public Benefit Corporations and Tax

In this chapter I will briefly explain the tax imposed on the donor who makes donations to public benefit corporations. We have to distinguish the following two cases.

1. Corporations as donors

In this case we need to check the Japanese Corporate Tax Law. This Law classifies two types of donations – regular donations and specific donations – and allows tax deduction.

a) The limit of the tax deduction in the case of a regular donation is 0.5 x (the amount of the donor's capital x 0.002 + its annual income x 0.025).
For an enterprise whose capital is US$ 3 million and income is US$ 1 million, donations up to US$ 15,500 are tax deductible.

b) The limit of the tax deduction in the case of a specific donation:
- Donation to the State: the whole amount of the donation;
- Donation to public charities: this specific donation can be made besides a regular donation, i.e. in the abovementioned example, US$ 15,500 can be tax deductible. Public charities are corporations which make special contributions to the promotion of public benefits (§ 37, 3 no. 3). Originally it was intended to support research in the field of natural science through giving more generous tax deduction to donors. If a corporation wants to enjoy this privilege, it must be listed in § 76 of the Execution Ordinance for Corporate Tax Law. Now this list covers not only research institutes for natural science but also various fields such as support of international students, protection of cultural heritage, and legal aid. This system encourages philanthropy in Japan[14].

In this context, I would like to mention a special rule for public benefit corporations. When a public benefit corporation has a for-profit business and makes an expenditure for its own public benefit section from its for-profit business section, this expenditure is considered as a donation and is tax deductible up to 50 % or 20 % of its annual income (§ 37, 4).

2. Individuals as donors

In this case there are two possibilities of tax deduction.

a) The first possibility is based on the Succession Tax Law. When somebody obtains assets through a succession or a testamentary gift, and he donates the assets to public charities within 6 months, the whole amount of the donation is tax deductible.

b) The second possibility is based on the Income Tax Law. Regular donation by individuals is not tax deductible at all. Only the specific donation to the State or public charities is tax deductible up to the limit, i. e. the annual income of donor x 0.25 – 10,000 Yen. When an individual donates real estate, or sells it for less than half of its market value, this transaction is considered as a sale with the market price. These rules do not encourage donations by individuals.

IV. Recent Movements in Corporation Law

The 1995 earthquake in Kobe caused tremendous material and mental damage to the residents of the Kobe – Osaka area. However there was one pleasing phenomenon: A large number of volunteers gathered in Kobe from all over the country and helped damaged residents for weeks. Since then, many volunteer groups raised their voices requesting the creation of an appropriate legal system for them. As already mentioned, under the current system for non-profit organizations only one legal form is available, i.e. public benefit corporations based on the Japanese Civil Code or special laws. Due to the strict control of administration, and due to the amount of required capital, many non-profit organizations cannot or do not want to become public benefit corporations. The volunteer groups, however, want to enjoy tax privileges and have social reliability by being incorporated. With this background, the coalition of the three governing parties[16] made a Draft of the so-called Non-Profit Organization Law[17]. During the Diet session which is currently running, this Draft will be subject to debate. And hopefully it will pass the Diet. The earthquake pushed not only the land in Kobe, but also the Diet in Tokyo. The following is a summary of the contents of this Draft with some comments.

The purpose of this Draft is to support citizen activities through incorporating citizen activity organizations and to contribute to public interest (§ 1). The citizen activities shall be voluntary and non-profit activities to promote public in-

terests. Anybody shall be able to participate in these activities (§ 2, 3). To incorporate a citizen activity organization, certain documents for application shall be produced for the administrative office in charge. And the incorporation shall be authorized by the office. In principle it shall be authorized within three months after the application. After being authorized, it shall be registered (§ 5). The incorporation procedure is completed with this registration. After being incorporated, the corporation for citizen activities shall disclose the information on its activities and financial situation and report it to the administrative office in charge (§ 9). If the report is not made within three years, the authorization shall be annulled. The administration office can control the corporation to some extent (§ 10). The income of the corporation is not taxable except for the income from its for-profit business (§ 13).

When this Draft passes the Diet, we will have a new legal form for non-profit organization, in which the procedure is easier, the administration office controls only in certain circumstances, and the requirements for the incorporation are much more generous. The Draft requires, however, "public interest" as the purpose of the activities; it would be difficult to explain why the Draft could offer the tax privilege without any public interest related requirement, as long as the Japanese Corporate Tax Law gives the same tax privilege only to public benefit corporations. On the other hand it should not be interpreted as narrowly as "public benefit" in the Japanese Civil Code. Otherwise the Draft would not bring anything new. The requirement "public interest" must be rather loosely interpreted. This is the reason why I translated this requirement not as "public benefit", but as "public interest", although the Draft uses the same Japanese word *"koeki"* as that in the Japanese Civil Code and the Japanese Corporate Tax Law.

Summary

In Japanese law the most popular legal form for non-profit organizations is the public benefit corporation under the Japanese Civil Code and several special laws. When an organization is incorporated as a public benefit corporation, it always enjoys tax privileges. This formal and inflexible system sometimes causes unfair results. To create a new type of corporation for non-profit citizen activities, the so-called NPO-Draft was made and may pass the Diet during the current session.

Footnotes

1 Medical corporations based on the Medical Corporation Law are also public benefit corporations. In the Corporation Tax Law, however, they are treated as a type of for-profit corporation.

2 Public benefit corporation based on the Japanese Civil Code: 25,605 (1994); School Corporation: 7,583 (1996); Social Welfare Corporation: 15,210(1996); Religious Corporation: 184,021 (1995).

3 When the activity of an organization is limited to one prefecture, the governor of the prefecture gives the permission.

4 Takako Amamiya, The Incorporation and the Management of the Public Benefit Corporation (1994), pp. 52-54.

5 Supra. p. 246.

6 The Japanese Corporate Tax Law distinguishes the for-profit business activities of public benefit corporations from their activities for public benefit. The for-profit business activities are restrictedly listed in an ordinance. The Japanese Corporate Tax Law does not examine in each individual case if a business is "unrelated" to the original purpose of the corporation.

7 This is the difference between "unrelated business income" criteria in US law and the Japanese system.

8 Cited in Koji Ishimura, The Comparative Study of the Public Benefit Corporation Taxation Structure in the US and Japan (1992), p. 205.

9 Supra note, pp. 208-209.

10 (1) Sale of goods, (2) sale of real estate, (3) finance, (4) lease of goods,(5) lease of real estate, (6) manufacturing, (7) communication, (8) transportation, (9) storage, (10) contract for work and service, (11) printing, (12) publishing, (13) photograph, (14) lease of space, (15) hotel, (16) restaurant, (17)arrangement, (18) agency, (19) broker, (20) factor, (21) mining, (22) collecting stone and sand, (23) bathhouse, (24) barber, (25) beauty salon, (26) entertainment management, (27) playground, (28) amusement park, (29) medical care, (30) teaching or examination, (31) parking, (32) guarantee of debts, (33) offering intellectual property. In addition to these, some business accompanying one of the 33 types of business is considered as a for-profit business. For example, the organization of lectures by a publishing company is considered for-profit business, as long as the lectures are related to the publications of the company.

11 There are some exceptions. For example, the medical care of the Japan Red Cross is not considered as for-profit business.

12 A case cited in supra note (7), p. 108.

13 Cited in supra note (7), p. 254.

14 The Japanese Corporate Tax Law knows also specific charitable trusts (§ 37, 5 cf. charitable trust in general § 66 of Trust Law). § 77-2 of the Execution Ordinance for Corporate Tax Law lists only 11 types of specific charitable trusts, while 74 types of public charities are listed in § 77 of the Execution Ordinance for Corporate Tax Law. It shows that charitable trust is not popular in Japan. One of the reasons is the lack of interest of legislators: There was no provision on charitable trust in the draft of Trust Law, when the draft was made in 1919. Then some provisions were inserted in the last moment without enough discussion at the Diet. In addition, neither the administrative organ nor the trust bank was interested in promoting this system. Also the tax privileges of charitable trust are much smaller than those of public benefit corporations. See Minoru Tanaka, Public Benefit Corporations and Charitable Trust, p. 18, p. 22.

15 50 % applies to school corporations and social welfare corporations, while 20 % is applicable to all other corporations.

16 Liberal Democratic Party, Socialist Party (at that time, now Social Democratic Party), and Pioneer Party.

17 Its provisional title is the Draft of Citizen Activity Promotion Law.