



Civil Society Monitor

Japan Center for International Exchange

No. 6 July 2001

New Tax Bill Gives Partial Victory to NPOs

THREE YEARS AFTER the enactment of the Law to Promote Specified Non-Profit Activities (the NPO Law; see *Civil Society Monitor* no. 4) in 1998, the Japanese Diet passed a second landmark legislation related to nonprofit organizations (NPOs). In March 2001, the Law Amending in Part the Special Tax

Measures Law was approved as the first legislation to address the eligibility of NPOs incorporated under the NPO Law to receive tax-deductible donations.

This legislation is the latest event in the movement toward establishing a more enabling environment for NPOs in Japan. The movement acquired momentum and national attention after some 1.2 million volunteers acted to aid the victims of the Great Hanshin-Awajishima Earthquake in 1995. The ineptness of the government bureaucracy to deal with the tragic situation and the impressive work of the volunteers and NPOs active at the scene of the disaster dramatized the need for a legal infrastructure that, by directly addressing the constraints against the activities of NPOs, recognized the valuable contribution of NPOs to society. The fight to ease rigid government control over incorporation of NPOs and to realize better tax treatment for them started receiving strong support from political leaders, business leaders, and the media, eventually resulting in the passage of the NPO Law. This law is significant because it makes approval of incorporation for an NPO contingent on certain objective criteria rather than subject to the discretionary powers of competent authorities of the central government.

While the passage of the NPO Law

represented a victory for the nonprofit sector in Japan, the law was unsatisfactory in that it did not address the issue of tax deductibility for NPOs. Instead, a Diet resolution was appended to the law stating that the issue of tax privileges would be reviewed within two years of promulgation. The Law Amending in Part the Special Tax Measures Law is the result of that review.

Philanthropic Giving and NPOs

Since the enactment of the NPO Law in 1998, some 4,200 NPOs have incorporated. This number of new NPOs is significant, given that 26,000 "public interest corporations" have incorporated since 1886, when Article 34 of the Civil Code was enacted. Yet this impressive emergence of civil society organizations that facilitate participation in sustaining and promoting the public good has not been accompanied by equally substantial philanthropic development.

Organized private philanthropy in Japan has not shown any significant growth in recent years, nor has corporate philanthropy registered much growth, though it has remained stable despite the recent economic stagnation. Individual giving, as has been the case over the years, has remained an insignificant factor in the

overall philanthropic landscape.

Most of the newly incorporated NPOs are in dire need of financial resources. According to a December 1999 survey by the Economic Planning Agency of newly incorporated NPOs, of the 663 respondents, more of these groups depended on fees (90.6 percent) and revenues from activities (73.6 percent) than on contributions (60.8 percent). According to a survey conducted by the Prime Minister's Office on NPOs in 2000, the breakdown of financial resources of these organizations is 34 percent from fees, 10 percent from revenues from services, 17 percent from government support, and 5 percent from contributions. These figures corroborate the findings of the Johns Hopkins Comparative Nonprofit Sector Project, undertaken between 1990 and 1996, which found the sources of revenues of NPOs in Japan to be 52.1 percent from fees and charges, 45.2 percent from government aid, and a meager 2.6 percent from private contributions.

The need for substantial growth of philanthropic support is obvious, because as civil society organizations are increasingly expected to respond to the diverse social needs in Japan, the gap between the "demand side" of civil society and the "supply side" in terms of financial resources can only widen.

(continued on page 2)

Toward a More Enabling Environment

The Fight for Tax Privileges for NPOs

A major factor inhibiting giving in Japan has been the lack of tax privileges for recipient organizations. The limited availability of tax privileges for NPOs, especially in terms of tax-deductible contributions, exemplifies the reluctance of the government bureaucracy to loosen its tight grip over national resource allocation. In order for Japanese NPOs to become eligible for tax-deductible contributions, they have to be authorized as a “special public interest–promoting corporation” by the Ministry of Finance and the government agency with jurisdiction over them. While the scope of organizations with this privilege has been widened since the late 1980s, of the total 26,000 public interest corporations incorporated under Article 34 of the Civil Code, only fewer than 1,000 are given this status. It is important to note that this special tax privilege must be reassessed every two years through a rigorous renewal process in which the decision to grant or renew this status rests entirely on the discretion of officials in charge at the Ministry of Finance. Moreover, it can be safely assumed that most of those 1,000 nonprofits with the tax privilege are de facto subsidiaries of government agencies with their top executive posts filled normally by ex-bureaucrats of these agencies. Aside from these 1,000 organizations that underwent the authorization process, 34 types of organizations, such as legal persons conducting scientific research and experiments, educational corporations, social welfare corporations, and corporations providing rehabilitation for criminal offenders, have been defined as special public interest–promoting corporations, and some 17,000 such organizations have been automatically given the privilege of receiving tax-deductible contributions.

The strong reluctance on the part of the government bureaucracy to readily be-

stow the tax privilege was demonstrated at the time of the passage of the NPO Law. In fact, the issue of tax deductibility for NPOs was a point of contention most vigorously fought over throughout the legislative process. When the NPO Law was finally passed in March 1998, tax deductibility was not one of its provisions. After a fierce debate, the Diet resolution mentioned earlier was attached to the bill. With the strong urging of NPO leaders, a nonpartisan Parliamentary Caucus on NPOs was formed in August 1999 to begin examining proposals for tax

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deductibility for donations to nonprofits. Representatives of the NPOs themselves formed a liaison council on reform of the tax and corporate system for NPOs. The council prepared a proposal on tax privileges in October 2000, as the tax revisions were to be debated in the Diet before the end of November 2000 for possible implementation in November 2001 under the resolution to the NPO Law.¹ The Parliamentary Caucus on NPOs held its fourth general assembly in August 2000 and confirmed that tax measures to support NPOs would be submitted to the Diet as a bill sponsored by the legislators.² After this assembly, the legislators, working with NPO leaders, held open forums throughout Japan with the participation of a large number of citizens. Each political party then started drafting tax

reform measures to support NPOs. One common feature of these legislative proposals by divergent parties was that they sought objective measures for achieving public benefits.

On December 1, 1999, one year after the enactment of the NPO Law, the Parliamentary Caucus on NPOs submitted the first draft of its proposal on tax privileges in connection with NPOs. On December 14, 2000, the tripartite ruling coalition finally decided on a framework for revision of the tax code for fiscal 2001. It clearly stated that tax measures to support NPOs should be introduced from October 1, 2001. This legislative proposal passed both Houses of the Diet without any revision in March 2001.

Stringent Requirements for NPO Tax Deductibility

Though the new tax legislation supplements the NPO Law enacted two years ago, there is heavy criticism of the conditions which NPOs must satisfy in order to gain the tax privilege. Several key provisions in the legislation inhibit NPOs from qualifying for tax-deductible contributions (for the complete text see the unofficial translation in this newsletter of “The Cabinet Order Amending in Part the Special Tax Measures Law”). These conditions include the following: (1) that 80 percent of total expenditures be spent on NPO-related activities; (2) that 70 percent of donations received be spent on NPO-related activities; (3) that more than one-third of total revenues come from donations and grants; (4) that single contributions of more than 2 percent of total contributions not be counted toward the amount of donations, that small contributions under 3,000 yen not be counted toward the amount of donations, and that contributions of more than 50 percent of total donations not be counted toward the amount of donations; and (5) that for NPOs to receive donations from more than one municipality they must perform a specific activity in more than one municipality, must have beneficiaries of

the specified nonprofit activity in more than one municipality, and specified nonprofit activities or their beneficiaries in one municipality must not exceed 80 percent of their total activities. The strongest criticism from NPOs concerns the requirement that donations and grants constitute one-third of the overall revenues but with many restrictions in computing the amount. According to an informal survey done by Cs (Coalition for Legislation to Support Citizens' Organizations), it is estimated that at the most 10 percent of NPOs will be authorized to receive tax-deductible contributions.

Despite these strict conditions, some NPO leaders acknowledge that the legislation contains certain elements which distinctly represent a major gain by NPOs as well as civil society in Japan in general. Specifically, determination of whether certain NPOs are qualified to receive the privilege for tax-deductible contributions will be made by the Director General of the National Tax Administration Agency solely on the basis of objective criteria set forth in the law, unlike the case of the Civil Code, under which such a determination is made at the arbitrary discretion of officials of the government agency in charge and the Finance Ministry. Once this barrier of bureaucratic intervention has been broken, it may be possible for NPOs, with the help of members of the Diet, to negotiate for less stringent conditions for tax privileges. One other major gain by the NPO side is that the new legislation allows individuals to donate assets for inheritance to the authorized NPOs by deducting the amount of donations from the amount of assets subject to the inheritance tax. Again, these provisions are not available to "special public interest-promoting corporations" incorporated under the Civil Code.

A Two-Tiered Civil Society

The dichotomy within civil society organizations in Japan—namely, the existence of those established under Article

34 of the Civil Code and those established by the provisions of the NPO Law along with the new tax privilege available to some of these NPOs—has posed a basic question concerning the overall structure of civil society organizations. This two-tier structure became evident when the NPO Law was enacted, resulting in considerable easing of the incorporation process without the need for approval of the government agencies as against the traditional Civil Code public interest corporations which can be incorporated only after undergoing the rigorous process of government approval. Thus, an intense exploration has begun among some civil society experts, practitioners, and members of the Diet to review the entire structure of civil society, including Article 34 of the Civil Code, amendment of which requires constitutional revision.

When legislation on a new category of quasi-nonprofit corporations passed the Diet toward the end of May 2001, proponents of an overall review of the legal system pertaining to civil society succeeded in getting an amendment attached to the legislation. The amendment reads: "In light of the importance of and future prospects for the activities of nonprofit organizations, and in view of the need to fully adjust the legal system to the transformation of society, the Government should expeditiously review the legal system pertaining to the incorporation of nonprofit organizations under Article 34 of the Civil Code, particularly concerning ways to ascertain their adherence to the public interest" (unofficial translation). On the part of civil society, the Japan Association of Charitable Organizations, which consists mainly of nonprofit corporations under the Civil Code, has launched a major study with the participation of leaders in civil society, the legal profession, media, business, and other sectors to formulate recommendations on the legal system regarding the nonprofit sector and also to recommend ways for NPOs to improve their own governance with a special emphasis on their fiduciary responsibility.

It is ironic that just when NPOs are gaining strong public support, several scandals involving nonprofits under the Civil Code have tarnished the image of NPOs in general. The scandals are not unrelated to the fact that in Japan many of the traditional NPOs have had close relationships with the competent authorities through, for example, accepting former bureaucrats from the government agencies that have jurisdiction over their fields of activities to fill top executive posts. In the current political atmosphere in Japan where primacy is given, at least rhetorically, to the need for fundamental structural reforms limiting the power of bureaucracy, the traditional nonprofits are seen, at times, as players in the state-centric system.

The debate over the question of further tax incentives for financial contributions to NPOs will continue and intensify, and the struggle for a more enabling environment for nonprofits should be carried out in the overall framework of governance of society. The debate cannot shirk the fundamental questions of what is the public interest, who defines the public interest, who should serve the public interest, and whether civil society organizations are legitimate and effective actors promoting the public interest. Tax deductibility for contributions for NPOs, in this sense, has become a central focus of the debate.

Notes

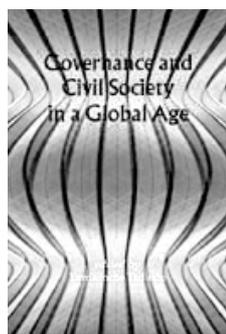
1. This section draws heavily on "Problems with Taxation on Donations in Regard to Taxation to Support NPOs," by Takako Amemiya. This piece is contained in the reference material for the House of Councillors Finance Committee Research Office in Diet Session No.151, March 2001.

2. Most legislative proposals in Japan are drafted by government bureaucrats, but the number of bills drafted and submitted by legislators has been increasing in recent years. ❀

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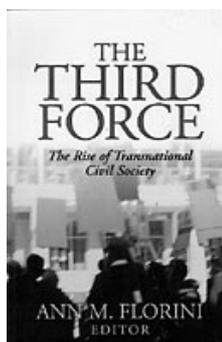
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Cabinet Order No. 141

The Cabinet Order Amending in Part the Special Tax Measures Law (unofficial translation)

In conjunction with the enactment of the Law Amending in Part the Special Tax Measures Law, etc. (Law No. 7 of 2001), the Cabinet shall institute this Cabinet Order to enforce the said Law on the basis of the supplementary provisions of the Law and the stipulations of the Special Tax Measures Law (Law No. 26 of 1957).

Special Cases of Tax Write-off for Donations to Approved Specified Nonprofit Corporations

1. The requirements specified by Cabinet Order as stated in Article 39.22.2 and Article 66.11.2.(b) of the Law shall be as follows:
 - i. That the amount described in (b) shall make up more than one-third of the amount described in (a) during “the preceding two fiscal years, etc.”
 - a. Amount remaining after subsidies from the national or local governments, extra income, and other gains specified by ordinance of the Ministry of Finance have been deducted from the total amount of income.
 - b. Amount remaining after the amount that exceeds the standard limit per donor (which means the amount of one donor’s total donations exceeding two (2) percent of the total amount of donations received) and the total amount of donations specified by ordinance of the Ministry of Finance have been deducted from the total amount of donations received.
 - ii. That the percentage under one of the following items in the preceding two fiscal years, etc. is less than eighty (80) percent.
 - a. The percentage in the total amount of donations received of the total donations from individuals residing or maintaining an office, place of business, or other premises (hereafter “office, etc.” in this Sub-section ii and in Section 2) in the same city, township, or village (ward in Tokyo, or ward in any of the cities specially designated under Article 252.19.(a) of the Local Government Law; the same applies in this Sub-section and in Section 2) as well as from corporations that have an “office, etc.” in the same city, township, or village.
 - b. The percentage, as specified by ordinance of the Ministry of Finance, of the said corporation’s specified nonprofit activities (those activities specified in Article 2.(a) of the Law to Promote Specified Nonprofit Activities [Law No. 7 of 1998]; the same applies in this Sub-section and in Section 5) in the same city, township, or village in the specified nonprofit activities conducted by the corporation.
 - c. The percentage of individuals residing or maintaining an “office, etc.” in the same city, township, or village, and corporations that have an “office, etc.” in the same city, township, or village in the total number of individuals and organizations directly from which the said corporation has received the transfer or loan of their assets or the provision of their services (referred to as “transfer of assets, etc.” in Sub-section iii and Sub-section vi, following) pertaining to its specified nonprofit activities.
 - iii. That activities under each of the following items, as specified by ordinance of the Ministry of Finance, make up under fifty (50) percent of activities over the preceding two fiscal years, etc.
 - a. Activities consisting of transfer of assets, etc. (excluding what has been provided in exchange for nothing, and what is specified by ordinance of the Ministry of Finance) targeted at member(s) or such others specified by ordinance of the Ministry of Finance (referred to as “members, etc.” in this Sub-section), as well as intercourse among members, etc., communications, exchange of views, and other activities targeted at members, etc.
 - b. Activities (excluding transfer of assets, etc. to members, etc.) that benefit specific persons, including members, etc. of the said corporation, members of specific organizations, people engaged in specific occupations, and people who live or maintain an office, etc. in places specially designated by ordinance of the Ministry of Finance.
 - c. Promotional, advertising, research, information-providing, and other activities concerning specific publications or persons.
 - d. Activities that call on specific persons against their will to do, or not to do, something.
 - iv. With regard to administrative organization and accounting, the following requirements shall be fulfilled.
 - a. Persons such as those described below make up less than one third of the number of officers and the number of employees.
 - (i) Relatives and those with special ties specified by ordinance of the Ministry of Finance (referred to as “relatives, etc.” in (ii) below).

- (ii) Officers or employees of the said corporation and those of a specific corporation (including a corporation whose stocks or investment funds held directly or indirectly make up more than fifty (50) percent of the total number of stocks issued by the corporation or the total investment in the corporation, and other corporations with special ties specified by ordinance of the Ministry of Finance), and their relatives, etc.
 - b. Accounts are audited by a certified public accountant or an approved auditing firm, or the said corporation records its accounts in ledgers and other documents as specified by ordinance of the Ministry of Finance and maintains said ledgers and documents.
 - c. No expenditures of unclear purpose or other inappropriate accounts as specified by ordinance of the Ministry of Finance are made.
- v. With regard to the said corporation's activities, the following requirements shall be fulfilled.
- a. The following activities, as specified in Article 2.(b).(2) of the Law to Promote Specified Nonprofit Activities, are not conducted.
 - (i) Activities for the purpose of propagating religious teachings, performing ceremonies, or educating or cultivating believers.
 - (ii) Activities for the purpose of promoting, supporting, or opposing a political principle.
 - (iii) Activities for the purpose of recommending, supporting, or opposing a candidate (including a prospective candidate) for a specific public office (public office as specified in Article 3 of the Public Offices Election Law [Law No. 100 of 1950]; the same applies elsewhere in this Sub-section), or those in public positions, or political parties.
 - b. Activities do not yield special benefits to the said corporation's officers, employees, or other workers, or to the donors, or their relatives, or to those with special relations with these people, as specified by ordinance of the Ministry of Finance. The requirements that no special relations are formed with other specific persons, as specified by ordinance of the Ministry of Finance, shall be met.
 - c. Operating expenses related to specified nonprofit activities make up more than eighty (80) percent of total operating expenses.
 - d. More than seventy (70) percent of the total amount of donations received are allotted for specified nonprofit activities.
 - e. When the said corporation provides grants or subsidies, it submits beforehand, to the director general of the National Tax Administration Agency by way of the superintendent of the tax office with jurisdiction over the place of its tax payment or the location of its main office, documents describing the methods of inviting and selecting applicants and the content of the grants or subsidies, and, after the providing of grants or subsidies, documents describing the results, without delay.
 - f. When the said corporation remits or transfers money overseas, it submits beforehand, to the director general of the National Tax Administration Agency by way of the superintendent of the tax office with jurisdiction over the place of its tax payment or the location of its main office, documents describing the amount of money, the purpose for which it is to be spent, and the planned date of provision. (When it is difficult to submit such documents beforehand because of emergency, as in the case of aid extended to a disaster-hit area, documents describing the amount of money, the purpose of use, and the date of its provision shall be submitted without delay.)
- vi. When a request is made for perusal of the following documents, perusal shall be granted unless there is good reason for refusal of the request.
- a. The "report of activities, etc.," "list of officers, etc.," and "articles of incorporation, etc.," as specified in Article 28.(b) of the Law to Promote Specified Nonprofit Activities.
 - b. Stipulations concerning the payment of officers' or employees' salaries.
 - c. Copies of the documents submitted in accordance with the stipulations of items (e) and (f) of the preceding Sub-section.
 - d. Documents explaining the details of income and other fund-related items, the items concerning the transfer of assets, etc. and donations, and other items specified by ordinance of the Ministry of Finance.
 - e. Documents described in Sub-section iv, Section 4.
- vii. No facts show that the corporation has ever violated the law, obtained or attempted to obtain gains through fraud or any other illegal activity, or engaged in any activity detrimental to the public interest.
- viii. On the starting date of the fiscal year of the said corporation including the date of its submission for the written application as specified in Section 3 (if the fiscal year is not fixed, the starting date shall be January 1st of the year that includes the date of its submission of the application), more than one year shall have passed since the date of its founding. (If the said corporation is a corporation approved under Article 66.11-2.(b) of the Law [the Law Amending in Part the Special Tax Measures Law and Others], more than two years shall have passed either since the starting date of the fiscal year that follows the final year of the preceding two fiscal years, etc. pertaining to the

- said approval, or since the date of January 1st of the year that follows the final year.)
- ix. By the time it applies for approval under Article 66.11-2.(b) of the Law, the said corporation shall have received a certificate from the competent agency specified in Article 9 of the Law to Promote Specified Nonprofit Activities that testifies that there is not a good reason to suspect the said corporation's violation of law, administrative punishment based on law, or violation of the articles of incorporation.
 - x. The requirements stated in Sub-section iv, (a), (b), (c), and (d) of Sub-section v, Sub-section vi, and Sub-section vii (excluding the requirements in Sub-section vi if approval specified in Article 66.11-2.(b) of the Law pertaining to the said corporation is the first approval obtained) shall be fulfilled over the preceding two fiscal years, etc.
2. If the said corporation's main office is located on a solitary island (except for the case in which the said island has two or more villages, townships, or cities) and if the corporation has no office, etc. in the cities, townships, or villages other than the said island (or in the districts outside the island that are under the jurisdiction of the city, township, or village in which the main office is located), the stipulation in the beginning of the preceding Section 1 that "The requirements . . . shall be as follows" should be "The requirements (excluding the requirements stated in Sub-section ii) shall be as follows" when the stipulations in Article 66.11-2.(b) of the Law are applied here.
 3. A corporation which seeks to obtain approval specified in Article 66.11-2.(b) of the Law shall submit a written application describing the following items to the director general of the National Tax Administration Agency by way of the superintendent of the tax office with jurisdiction over the place of its tax payment or the location of its main office.
 - i. The applicant's name, the location of its main office, and the place of tax payment
 - ii. The name of its representative
 - iii. The date of its founding
 - iv. Overview of activities/programs currently conducted
 - v. Other items for reference
 4. To the written application in Section 3, the following documents shall be attached:
 - i. Activity reports, etc. specified in Article 28.(a) of the Law to Promote Specified Nonprofit Activities for the preceding two fiscal years, etc.
 - ii. "List of officers, etc.," and "articles of incorporation, etc.," as specified in Article 28.(a) of the Law to Promote Specified Nonprofit Activities.
 - iii. Document explaining that the requirements specified by the Cabinet Order as stated in Article 66.11-2.(b) of the Law are met.
 - iv. Document enumerating the details of programs to which donations will be allotted.
 - v. The certificate issued by the competent agency, as specified in Sub-section ix of Section 1.
 5. The preceding two fiscal years, etc. as specified in Sections 1 and 4 means the fiscal years that ended within two years from the starting date of the said corporation's fiscal year that includes the date of the submission of the application described in Section 3.
 6. The requirements specified by the Cabinet Order as stated in Article 66.11-2.(d) are those spelled out in Sub-sections iv to vii of Section 1 in case it may later be found that the corporation that received approval under Article 66.11-2.(b) had not fulfilled the requirements specified by the Cabinet Order as stated in Article 66.11-2.(b) at the time of the said approval, and in case false information has been given in the application submitted in accordance with the stipulations of Section 3 (including the attached documents as stated in Section 4), in the documents submitted in accordance with the stipulations of Section 8, or in the documents mentioned from (a) to (e) in Sub-section vi, Section 1.
 7. The corporation whose approval was cancelled on the basis of the stipulations of Article 66.11-2.(b) of the Law shall not be able to submit an application stated in Section 3 unless after the passage of two years from the next day of the date of the said cancellation.
 8. A corporation that has received approval under Article 66.11-2.(b) of the Law shall submit, within three months from the day following the final date of each fiscal year (each calendar year if the fiscal year is not fixed; and this should be the fiscal year, or the calendar year, that includes a date within the valid period of the said approval), to the director general of the National Tax Administration Agency by way of the superintendent of the tax office with jurisdiction over the place of its tax payment or the location of its main office, the corporation's activity report of the said fiscal year, and documentation concerning the amount of donations received, as well as other documents specified by ordinance of the Ministry of Finance.
 9. When a request is made for perusal of the written application under Section 3 (including the attached documents under Section 4), or the documents specified under (e) and (f) of v, Section 1, or the documents specified by ordinance of the Ministry of Finance as mentioned in the preceding Section, which were submitted by a corporation that received approval under Article 66.11-2.(b) of the Law, the director general of the National Tax Administration Agency shall have them perused in accordance with stipulations by ordinance of the Ministry of Finance.
 10. When changes are made concerning the items announced as specified in Article 66.11-2.(g) of the Law or in other cases where something occurs that falls under the provisions of ordinance of the Ministry of Finance, the specified nonprofit

corporation approved under Article 66.11-2.(b) of the Law shall report such changes or occurrences to the director general of the National Tax Administration Agency by way of the superintendent of the tax office with jurisdiction over the place of its tax payment or the location of its main office.

11. In addition to the stipulations in each of the Sections above, items as necessary shall be stipulated by ordinance of the Ministry of Finance concerning the application of the stipulations in Article 66.11-2 of the Law as well as the application of the stipulations in Section 1 when the said corporation is a corporation founded through merger and one year has not passed since the date of its founding as of the starting date of its fiscal year under which it submits a written application under Section 3.

Supplementary Provisions

(DATE OF ENFORCEMENT)

Article 1 This Cabinet Order shall come into force on April 1, 2001.

Supplementary Notes

Tax Incentives for Donations to Specified Nonprofit Corporations

- a) Donations of individuals to specified nonprofit corporations:
25% of income – 10,000 yen = the maximum amount of income deduction
- b) Donations of for-profit corporations to specified nonprofit corporations:
Capital, etc. x 0.125% + income x 1.25% = maximum amount counted as write-off
- c) Inherited property of individuals donated to specified nonprofit corporations:
Not included in taxable amount subject to inheritance tax.