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### COMMENTS ON THE

### DRAFT CHARITY LAW<sup>1</sup>

Written comments on the Draft Charity Law (CL) have been invited by staff of the Ministry of Civil Affairs (MoCA) and the Ministry of Finance (MoF) to assist in further consideration and amendment of the draft of 15 September, 2006. After further revision, the draft law will be forwarded to the Legal Committee of the Standing Committee of the National Peoples' Congress.

#### **General:**

We are very honored to have been invited to participate in this process and to provide some suggestions about this legislation, which will establish the concept of charitable organizations in China. Some members of our group have been assisting MoCA and MoF for several years during the extensive revisions in the regulatory scheme for NPOs in China. All members of the group are familiar with the regulatory and tax regimes for charities in their own and other countries and thus bring comparative knowledge to the discussion. Our written comments are intended to provide a supplement to oral comments made during the Charity Law Salon held at Tsinghua University in November 2006, the Charity Law , Conference held in Beijing in October 2006, the conference held in conjunction with the University of British Columbia in July 2006, and other more informal

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<sup>1</sup> Internal Draft of 15 September 2006.

discussions with Ministry and State Council officials about improving the legal environment for charity in China.

We also appreciate very much the interactivity of this process. Our view is that the ministries are doing exactly as they should by preparing drafts and seeking a broad range of advice from both Chinese and foreign experts who have worked with these issues on academic and practical levels for many years. While the views presented by various commentators may differ and while the draft that eventually emerges will inevitably be a compromise, which takes into account a variety of concerns, there is no question that it will have benefited from this interaction. And those of us who have been involved with the discussions as foreign experts will have received immeasurable benefits as well.

CAVEAT: We must precede our comments with the following caveat. Because we were unable to obtain a complete English translation of the draft, these comments are not comprehensive and account should be taken of the fact that we did not have an opportunity to review the draft in its entirety. Therefore, we hope we will be forgiven for any lack of understanding of the draft, its language, or what it contains.<sup>2</sup>

### General Comments

Our general comments address five specific issues:

1. **Scope of the law.** As indicated below, we think that the law is too broad. It covers too many issues that should, in principle, be dealt with in separate pieces of legislation, which can address specific concerns about the relevant issues (e.g., volunteering and fund raising). Our substantive comments about the scope of the law are fueled by our conviction that no one piece of legislation can increase the public's interest in giving to charity or participating in charitable activities. A culture of philanthropy

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<sup>2</sup> Although ICCSL is responsible for the content of these comments, it would like to thank the following people who participated in formulating them or advising as to their content: Prof. Cole Durham, Brigham Young University School of Law; Dr. Michael Ernst-Pörksen, Cox Steuerberatung, Berlin; Dr. Leon E. Irish, Visiting Professor of Law Central European University (Principal Reviewer); Dr. Jia Xijin, Associate Professor, Tsinghua University NGO Research Center; Dr. Jin Jinping, Assistant Professor, Peking University School of Law; Dr. Berthold Kuhn, Visiting Professor, Tsinghua University NGO Research Center; Ms. Pei Bin, Senior Program Officer, Asia Foundation; Dr. Knut Pissler, China Specialist, Max Planck Institut für Internationales Privat-Recht, Hamburg; Prof. Karla W. Simon, Visiting Professor of Law Peking University (Principal Drafter); Dr. Wang Ming, Associate Dean, Tsinghua University and founding Director Tsinghua University NGO Research Center ; students at Peking University School of Law and at Tsinghua University's School of Public Policy. Ms. Li Jian, Director in the Legislative Affairs Office of the Ministry of Civil Affairs, attended a class taught by Prof. Simon at Bei Da, which provided a platform for good discussion, especially of the definition of "charity and public benefit." Prof. Simon also met with her and Mr. Wang Laizhu at the MoCA offices to discuss the provisions in the draft law.

and voluntarism needs to be fostered within Chinese society, and good laws are only a beginning. Thus, it might be better to let some of the issues ripen a bit more before legislating about them. That might be particularly true, for example, of the provisions on fund raising, which are likely to be very controversial in addition to being complex.

2. **The law's relationship to other regulations/legislation for not-for-profit organizations (NPOs).**<sup>3</sup> This needs to be more fully worked out in the next draft of the Charity Law.
3. **The definition of charity.** Our recommendation, discussed in detail below, suggests that this should be conformed to definitions in existing laws and regulations; there should be more clarity about the need for a charity to have both charitable purposes and charitable activities; and charities should be allowed to charge reasonable fees for their charitable work.
4. **The non-distribution constraint.** The provisions of the Charity Law that will enact this rule should be strengthened in the next draft.
5. **The process of becoming a certified charity.** This should be clarified and a "charity commission" should be considered as an alternative to the proposed process of decision-making by MoCA and MoF officials.
6. **The governance of charities.** Provisions should be included in the next draft that will strengthen governance, such as board composition rules, compensation rules, etc.

### Specific Comments

The comments are based on translated provisions of the draft law as described below. Issues presented by each chapter/article are discussed following the descriptions of what the draft law provides. The comments also include information about resources that may be of relevance to the Ministry officials as they work on the next draft of the CL.

The comments can be grouped roughly into three types:

- Substantive comments about the scope of the law and the definition of charity;
- Procedural comments about how an organization becomes a charity and/or a certified charitable organization; and
- Structural comments about the relationship of this law to existing laws (the Public Welfare Donations Law and the Trust Law) and regulations (on Social Organizations, Foundations, and Civil Non-commercial Institutions).

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<sup>3</sup> By using this term, we mean to suggest all current forms of not-for-profit organizations currently permissible in China. We also are aware that more organizations may become NPOs if the process of moving some public institutions (*shiyew danwei*) into NPOs is successful.

## Overview:

The four reasons for needing a charity law are listed on pages 19 and 20 of the explanation of the draft law (hereinafter “E”):

- (1) The number of charitable organizations in China is small, their internal organization is not standardized, and public confidence in these organizations is lacking;
- (2) The market for charitable fundraising is quite chaotic;
- (3) The support for charitable undertakings is inadequate; the tax advantages for charitable donations are not in place or are not implemented in practice; and
- (4) There are not enough activists from society for charitable undertakings; acknowledgment of charity is not strong.

References to corresponding legislation in the United Kingdom (UK), the United States (US), and Japan can be found in E, page 20; the legislation of those countries is said to be more supportive of charity.

The objective of the law is stated as follows:

“This Law is hereby formulated to protect the legitimate rights and interests of parties concerned in charity activities, promote healthy development of charity and cultivate a charity culture.” The legislative aims of the law are explained on pages 20, 21 of E.

## ISSUES PRESENTED

1. It is admirable to recognize the need for legislation to address all of the concerns stated on pages 19-20 of the Explanation. It is questionable, however, whether one piece of legislation can or should provide for all of the above-mentioned and very specific types of regulation. For example, the “Charities Act” in the UK, which became law on November 8, is 188 pages in length. It addresses principally the definition of charity, the re-organization of the Charity Commission, the regulation of charitable trustees, and the creation of a new administrative review body called the “Charity Tribunal.” Thus, it deals mainly with the substance of the definition and the procedure for acquiring status as a charity, leaving most other issues to other legislation. We address the UK Charities Act’s provisions with respect to fund raising below.
2. On balance, it might be better to have separate pieces of legislation to address the following:
  - Regulation of fund raising
  - Tax benefits (this has already been suggested in a report to MoCA-MoF on taxation of NPOs and charities/public benefit

organizations). The report can be found at [http://siteresources.worldbank.org/INTCHINA/1503040-1122886803058/20601839/NPO\\_tax\\_En.pdf](http://siteresources.worldbank.org/INTCHINA/1503040-1122886803058/20601839/NPO_tax_En.pdf).<sup>4</sup>

3. Legal issues affecting volunteers are quite complex and separate from the legal issues affecting charities. They must be handled with sensitivity in order to create a “culture of voluntarism.” Over-regulation can stifle what is seen as an important way of encouraging Chinese people to participate in solving social problems and creating a harmonious society (see below for suggestions). We therefore suggest that the legal rules for volunteers also be dealt with in separate legislation.

### **Contents of the Draft CL:**

The Draft CL includes chapters/articles addressing the following:

- Definition of charity (public benefit) (Chapter 1, Art. 3);
- Definition of the agencies involved in the oversight of charitable undertakings; requirements for becoming a charitable organization (contents of articles of incorporation, etc); defining the process of “voluntary charity verification” and what organizations may undertake such verification (Chapter 2);
- Fund raising regulations (Chapter 3);
- Rules for charitable trusts (Chapter 4);
- Rules for volunteers (Chapter 5);
- Relationship between social responsibility and charity (Chapter 6);
- Supportive mechanisms for charities, including tax benefits (Chapter 7);
- Legal responsibilities of charities (Chapter 8); and
- Other provisions (Chapter 9)

**1. Definition of “charity:”** According to the explanation of the law, Art. 3 incorporates a “medium” definition of charity by including a list of 4 general purposes:

1. Emergency and crisis relief for regions, individuals and groups in difficulties;
2. Relief for disadvantaged people;
3. Education, health, science, culture, sports for social benefit; and
4. Promotion of urban and rural community development and environment.

In addition to the specifically enumerated categories, Art. 3, para. 5 includes “other charitable activities,” which provides for future development of the concept of charity.

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<sup>4</sup> The Tax Report is also available in Chinese on the same World Bank website.

There is a discussion of the definition of charity (*cishan*) (whether the definition of charity should be large, medium, or small) on pages 20 - 22 of E. The discussion focuses on whether a broader (or larger, *da*) scope of charity as proposed by some “experts” should be adopted. These persons are said to have claimed that the scope of charity should be at least as broad as “public interest,” “public benefit,” or “public welfare” (*gong yi*), a term that is used in the foundation regulations as well as in the Trust Law and the Public Welfare Donation Law. Others (“experts” as well as “practitioners” from the MoF, the State Administration of Taxation (SAT), and MoCA) opposed making the definition of charity as broad as *gong yi*, by stating that because the management capacity of the government is “very limited,” a medium or small scope of charity should apply. The drafters finally decided to have the medium scope of charity (*zhong*) as the definition in Art. 3, by having a general and abstract definition of charity in Art. 3 (flush language), combined with the list of activities deemed to be charitable in 3.1 to 3.5.

The Draft CL thus differs to some extent from the definition of “public welfare undertakings” in Art. 3 of the Public Welfare Donation Law, which reads as follows:

“Article 3: The following non-profit activities shall be deemed public welfare undertakings to which the regulations apply:

- I. Disaster relief, poverty alleviation, and assistance to the handicapped, as well as activities for social groups [*shehui tuanti*] and individuals in straightened circumstances.
- II. Education, scientific, cultural, public health, and athletic undertakings.
- III. Environmental protection and construction of public facilities.
- IV. Other public welfare undertakings promoting social development and progress.”

The definition of charity also appears to differ from the definition of “public interest” for public interest trusts (*gongyi xintuo*) in the relevant article of the Trust Law (Art. 60), which is not mentioned in the draft CL. It is also said to be narrower than the “public benefit” terminology used in the Foundation Regulations.

*Gong yi* (公益) is the term used in all three legal documents. It is defined in Art. 60 of the Trust Law in the context of “public welfare trusts” (*gong yi xintuo*, 公益信托) and in Art. 3 of the Public Welfare Donation Law in the context of “public welfare undertakings” (*gong yi shiye*, 公益事业). The Foundation Regulations include no definition of “public welfare,” but refer to the term (*gong yi shiye*, 公益

事业) in Art. 2 to define foundations. The word for charity (*cishan*, 慈善) has only been used one time so far in Chinese legislation/regulations, in Art. 10 para. 2 of the Public Welfare Donation Law for the definition of public welfare social organizations (*gong yi xing shehui tuanti*, 公益性社会团体).

#### ISSUES PRESENTED

One of the significant aspects of the decision to legislate a “medium” definition of charity is the extent to which the concept of charity in China will be narrower than the concept of charity in many countries, which tend to use public benefit as the guideline for defining charity. The choice to use a “medium” definition may make sense in the context of the capacity of the administrative (and tax?) authorities, but it will inevitably be confusing for them if different definitions are used in different Chinese laws. Despite the fact that there are concerns about the capacities of the small MoCA staff that must necessarily deal with verifying charitable status (unless an inter-ministerial charity commission is created, as suggested below), their job would actually be complicated by the use of different definitions in different laws. Given that the Public Welfare Donations Law (PWDL) has been around for many years, it might be preferable if the definition of “charity” in the Charity Law were the same as the definition used in that law (i.e., the PWDL), with Art. 3 para 5 (“other charitable activities”) remaining in the CL to provide for more flexibility in case new types of purposes arise that demand support. See below for a discussion of the conflict with the existing Foundation Regulations.

It needs to be noted, however, that the Ministry of Finance has stated that only when there is a charity law, would they be able to work out tax rules for charity organizations. MoF has been the principal Ministry objecting to the broader definition of charity; the SAT has also been objecting to a broad scope for the definition.

In E. on page 23, there is an interesting discussion about whether political and religious activities should be excluded from the definition of charitable undertakings. Both topics are sensitive ones. It is stated that, if necessary, prohibitions on such activities could be read into the general clause of Art. 3, para. 2 forbidding “activities not related to the goals of charity.”

#### ISSUES PRESENTED

1. Political activities: It is not uncommon for countries to limit the charitable sector to those organizations that do not have advocacy as their primary purpose. On the other hand, allowing charities to engage in a modest

amount of public advocacy that is related to their objectives is widely accepted (Germany, UK, US all allow for this).

For example, suppose a charity wants to educate the public about the health risks of smoking. It can certainly fund research and publish books on the subject written by well-known and well-credentialed scientists. But why should it be prevented from having a public awareness “Anti-smoking Day” once a year? Although this may have a political dimension, it should be permitted.<sup>5</sup>

2. Religious activities: Because religion is separately regulated in China, prohibiting religious charities would seem to be an appropriate restriction in the Chinese context. In other countries, however, promoting religion is a separate charitable purpose.

## 2. Chapter 2

Art. 5 of the draft CL provides that a number of government agencies are to be responsible for aspects of the administration of charitable undertakings. There is no clear distinction made about the responsibilities of the agencies involved: State Council, local governments, MoCA on the central and local levels, and other “functional departments” (line ministries) also on the central and local levels.

### ISSUES PRESENTED

1. Vague language in a law will undoubtedly create turf wars about whose job it is to regulate which aspects of charity activities. Thus, it would be much better for the CL to clearly define the roles of the following:
  - MoCA
  - MoF
  - Line ministries

It is also important to be quite specific as to the procedures to be followed in applying to become a “verified charitable organization.”

ICCSL’s suggestion, made in the past, is that MoCA, MoF, and SAT together agree to establish an inter-ministerial “charity commission” (see below) to make “certified charity” determinations and that the line ministries have the function they have in other systems, namely, to license charities to do their work and have some oversight responsibilities with respect to the work they do.

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<sup>5</sup> It would be easy enough to specify that only a very small part of a charity’s activities are permitted to be advocacy activities and they such activities must be related to the organization’s charitable purposes.

2. It will also be necessary to delineate which organizations are subject to national regulation and which to local regulation; we assume this will be done along the same lines as the existing regulations for the three types of NPOs.

Art. 7 of the draft (E. on page 25) states that there are three organizational forms available for charitable organizations: foundations, social organizations (associations), and civil non-commercial institutions, but it does not describe exactly how the CL will affect those organizations. This is a structural problem that needs to be addressed in the next draft.<sup>6</sup>

#### ISSUES PRESENTED

1. What is not clear from discussions with MoCA and State Council officials is the extent to which currently registered not-for-profit organizations of all types will need to go through another level of administrative applications and oversight processes in order to become “verified charities” and what exactly are the benefits they will obtain if they do so. In structuring the law it would be useful to clearly delineate that an organization is not a charity unless it is certified as such (see below, however, with respect to foundations). That way an organization that engages in some charitable activities but whose purpose is not exclusively charitable will know that it does not need to apply for charitable status (e.g., the All-China Lawyers Federation is a social organization, which engages in some educational activities, but it is clearly not a charity).
2. What is the structural relationship between this law and the regulations on social organizations, civil non-commercial institutions, and the two types of foundations (fundraising foundations and non-fundraising foundations)? Some have said that the CL stands on the “pillars” of those regulations, while others disagree.<sup>7</sup> It is clear that the Charity Law will deal with only a subset of the organizations permitted to be registered under those regulations – those that qualify as charities. This is especially relevant for social organizations, some

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<sup>6</sup> Chinese commentators have suggested that there be a “Comprehensive Law for NPOs,” which would apparently deal with all types of not-for-profit entities in China and would also contain the requirements for charity status. It would be good to have such legislation to ensure the continuity of treatment of NPOs in the future. Efforts to write such a law should clearly proceed as the Charity Law is also considered by the ministries, the State Council, etc. In principle, the efforts for both pieces of legislation should be coordinated.

<sup>7</sup> While there is currently no “project” for MoCA to write a “comprehensive NPO Law,” that is being discussed both inside and outside the government.

of which are purely mutual benefit organizations (MBOs). Making a distinction between MBOs and charities is extremely important for the NPO sector in China, even if this current draft is a little confusing in how it does it.<sup>8</sup>

3. On the other hand as it stands now, all foundations must be for public benefit (*gong yi*), because the regulations establish this requirement. Will the CL now create “charitable” public benefit foundations as opposed to “non-charitable” public benefit foundations? This seems to be a confusing use of terminology, but perhaps that is the intent of the law.

Art. 8 provides a bit more clarity about the relationship between the CL and the existing regulations, with provisions for a “voluntary verification procedure” for charitable organizations. This verification procedure involves MoCA and the taxation departments (SAT) at the local level, which apparently means that a linkage is intended between “verified” charitable status and tax benefits, although that linkage is not fully spelled out.

#### ISSUES PRESENTED

The Tax Report ICCSL prepared for MoCA and MoF in 2004 (see [http://siteresources.worldbank.org/INTCHINA/1503040-1122886803058/20601839/NPO\\_tax\\_En.pdf](http://siteresources.worldbank.org/INTCHINA/1503040-1122886803058/20601839/NPO_tax_En.pdf))<sup>9</sup> proposed that a new “commission” be set up to determine “charitable” (“public benefit”) status. Such a commission could have staff who would become experts about the subject of charity or public benefit, and, if it were structured on an inter-ministerial basis, the views of each involved agency would be reflected. While it would take time to organize such a structure, this is becoming quite a well-accepted way to develop an expert body to deal with charity matters. There are now such commissions in Japan and New Zealand, along with the UK. Although they differ from the possible inter-ministerial commission suggested here in that they are public bodies with members appointed from the private sector, this is an idea whose acceptance seems to be growing.

One thing the legislation could do is require that MoCA, MoF, and SAT work to establish such a commission and create the procedures for verification as a charity within two years. That is similar to what the Japanese have recently done – the legislation passed by the Diet in May

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<sup>8</sup> This was proposed by ICCSL previously in the 2004 Tax Report.

<sup>9</sup> See note 2.

2006 calls for the Commission to be established 18 months later.<sup>10</sup> An outline of the provisions for the new Public Benefit Commission in Japan is attached. Consideration should be given to including some of these provisions in the draft CL.

“Certified charitable organizations” enjoy some unspecified rights (Art. 8 para. 2), and have the obligation to follow some additional requirements regarding their corporate governance (Art. 12). These include having not only a Board of Directors but also a Supervisory Board. The Board of Directors in a “certified charitable organization” is obliged to make “collective strategic decisions” (*jiti juece*), while the Supervisory Board is responsible for “supervision.”

Art. 12 para. 2 states that no more than one-third of the members of the Board of Directors and the Supervisory Board of a “certified charitable organization” may receive remuneration. There are, however, no standards set for remuneration of Board members nor are there clear conflict of interest rules or rules about related parties on the Board of Directors or Supervisory Board. See recommendations below.

Art. 12 para. 3 states that “certified charitable organizations” should provide the directors and supervisors with the necessary provisions to fulfill their tasks. What this means, however, is unclear.

#### ISSUES PRESENTED

1. It remains unclear what constitutes a “collective strategic decision.” Does “collective” indicate that the Board of Directors must decide on “strategic” matters by unanimous vote or by a supermajority (e.g., 2/3’s)? The latter is more typical.
2. The obligation of the Supervisory Board to supervise as well as the rights of the Supervisory Board to fulfill this task should be clarified. It should also be discussed whether a Supervisory Board is necessary for every certified charitable organization. Especially for smaller organizations such a complex structure seems to impose an unreasonable burden.
3. There should be more clarity about Board remuneration standards.
4. There should be rules about Board composition. For example, South Africa is considering legislation that will require the Board of any charity

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<sup>10</sup> The Japanese Commission will be a private body, composed of members appointed by the Prime Minister. It will also have a staff.

to consist of five or more people, no more than 2/5 of whom can be related by blood or marriage.

5. All of the additional governance requirements could be useful, but unless clear benefits result from the process of becoming a “verified charity,” it is very unlikely that organizations will undertake the verification procedures.

Arts 13 to 23. From the wording of Arts. 13 to 23, it seems that these provisions might apply to all charitable organizations and not only to the ones that underwent the certification procedure for charitable organizations. If the legislation intends to apply Arts. 13 to 23 only to “certified charitable organizations,” this should be clarified. The provisions in Arts. 13 to 23 repeat many of the requirements already in force for NPOs in China (e.g. requirements for contents of the articles of association, Art. 13).

Art. 14 includes a list of “income” (*shouru*, 收入) of charitable organizations:

- (1) funds provided by the originator (*chuangshi ren*, 创始人 (the term used here is different from the term usually used for founder (*faqiren*, 发起人), see e.g. Art. 6 para. 2 No. 3 Foundations Regulations);
- (2) membership fees (*huifei*, 会费);
- (3) donations and financial aid from the society (*shehui juanzeng, zizhu*, 社会捐赠, 资助);
- (4) government subsidy (*zhengfu butie*, 政府补贴);
- (5) “other legal income” (*qita hefa shouru*, 其他合法收入).

It is unclear whether charities are going to be permitted to charge fees for services they render and goods they sell. In the definition of charity (Article 3 Paragraph 1) the draft suggests that natural persons, legal entities or other organizations should conduct charitable activities voluntarily and free of charge. The decision whether or not to allow charitable organizations to charge fees is apparently left to subordinate legislation on the different types of charitable organizations (foundations, SOs and CNIs). It seems clear that charities should be permitted to charge reasonable fees for their services/goods. However, setting the level of permissible fees is a complex issue. We have included a suggestion as to fee-setting below, but other formulations are available, and we would be happy to provide them.

Art. 15 states the purposes for which charitable organizations may use their “income” (*shouru*): First, it must be used only for the specific aims of the respective charitable organization. Art. 15 para. 2 then incorporates a non-

distribution constraint by stating that “besides remuneration and welfare cost for employees and other necessary administrative costs, income of the charitable organization must not be distributed by any means to the members of the charitable organization.”

## ISSUES PRESENTED

It should be discussed whether such a formulation of a non-distribution constraint is specific enough that it cannot be avoided. It might be better to provide as follows:<sup>11</sup>

### **Non-Distribution Constraint**

A charity organization is prohibited from providing special personal benefits, directly or indirectly, to any person connected with the organization (e.g., founder, officer, board member, employee, or donor) or from distributing or using assets or income other than for its charitable purposes.

Another way to approach this with regard to employees is to forbid the payment of unreasonable compensation by referring to a standard for compensation with reference, e.g., to the salary for comparable work by a government official

The Japanese legislation provides examples of alternative wording with regard to providing a non-distribution constraint for public benefit organizations, which are available below.

Art. 16 provides for a basic system of auditing. However it is not clear whether financial reports of all certified charitable organizations must undergo examination by external auditors. This should be clarified, and special rules should exist for small organizations.

Art. 17 of the draft provides a 10% ceiling for administrative costs of charitable organizations (see also E. page 27). A corresponding requirement is found in the Regulation on Foundations (2004) Art. 29. For social organizations and civil non-commercial institutions there are no current limits. Apparently this requirement is being reconsidered.

Art. 19 of the draft extends some of the disclosure requirements for foundations to social organizations and civil non-commercial institutions (see E. pages 27, 28). Art. 19 para. 4 mentions an annual activity report, a financial statement and an auditing report, which must all be disclosed. The public disclosure of reports is a good example of ways to inspire transparency and accountability.

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<sup>11</sup> This language is adapted from the Open Society Institute Guidelines on Laws Affecting Civic Organizations.

Art. 21 of the draft provides that “upon termination of the charitable organization its assets (*caichan*, 财产) shall be used for charitable aims in accordance with the articles of association; if it is impossible to treat the assets in accordance with the articles of association than MoCA will “organize” that the assets are donated to a charitable organization with an identical (*xiangtong*, 相同) charitable aim and disclose this to the public.” This provision is modeled after Art. 33 of the Foundation Regulations.

#### ISSUES PRESENTED

**Another possible formulation of the non-distribution constraint upon dissolution would be as follows:**

No charity organization is permitted to distribute assets to its founders, officers, board members, employees, donors, or members upon its liquidation. It must distribute any remaining assets (after payment of creditors) to a charitable organization with similar purposes or to the state.

Art. 22 of the draft also mentions the requirement for a “*zhuguan bumen*” (competent business unit or line ministry) to be involved with certified charitable organizations in addition to MoCA and the SAT. The line ministry appears to be responsible for supervision of “internal governance,” financial administration, and the development of charitable activities. The extent to which this will add to the obligations of the sponsoring organizations is unclear, but it may make them even more hesitant than they already are to take up sponsorship.

#### ISSUES PRESENTED

Again in this regard, it would be useful to look at the provisions of the recently passed Japanese legislation, which describes in great detail the additional governance requirements for the new form of Public Benefit Corporation, which are much stricter than the language of the draft CL. These are also included below.

It would also be useful to include a requirement of fiduciary duties and the establishment of a conflict of interest policy in the CL. A suggestion would be as follows:<sup>12</sup>

**Duties of Loyalty, Diligence, and Confidentiality**

Officers and board members of a charity organization are to exercise loyalty to the organization, to execute their responsibilities to the organization with care and diligence, and to maintain the confidentiality of nonpublic information about the organization.

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<sup>12</sup> These are adapted from the Open Society Institute Guidelines on Laws Affecting Civic Organizations.

### **Prohibition on Conflicts of Interest**

Officers, board members, and employees of a charity organization must avoid any actual or potential conflict between their personal or business interests and the interests of the charity organization.

### **3. Chapter 3 – fund-raising.**

Art. 24 para. 2 states that only organizations with a “Certificate of the certification for charitable organizations” may engage in fundraising activities from the general public (*shehui gongzhong*). This does not apply “if laws or administrative regulations provide otherwise.” It is useful to limit public fund raising in this way at the present time, as it gives MoCA control over the organizations that raise money from the public.

The various rules with respect to permits for fund raising (Arts. 26-27) and the rules with respect to public fund raising (Art. 28) are really not detailed enough to protect the public. In addition, it would be useful for fund raising legislation to deal with the issue of professional fund raisers. The recently enacted Charity Act in the UK provides some useful examples of how such regulations should be developed.

Art. 25 of the draft sets up a license requirement for fundraising. Arts. 26, 27 of the draft outline the licensing procedure: “certified charitable organizations” must apply at the MoCA offices of the people’s governments above the county level (县级以上人民政府民政部门).

### **ISSUES PRESENTED**

It is also not clear whether the license requirement for fundraising includes fundraising activities “from the general public” under Art. 24. Does the law intend to make a distinction between fundraising (e.g., through personal contacts with individuals or companies) and fundraising activities “from the general public?”

It is not clear what this means for fundraising foundations and non-fundraising foundations under the Regulation on Foundations (2004). Can non-fundraising foundations that are charities and that obtain such a certificate engage in fundraising? Probably not, but the law does not say so in a clear fashion.

Regulation of fund raising is quite a complex subject and deserves its own legislation. For example, the 2000 Charitable Fund-Raising Act of the Canadian Province of Alberta contains more than 57 articles, which discuss such subjects as when public solicitations can be made, when a

fund raising enterprise may work for a charity, etc. See <http://www.canlii.org/ab/laws/sta/c-9/20060926/whole.html>.

Indeed, the Charity Commission, which is charged with administering the new and complex provisions of the UK Act, has stated as follows with regard to fund raising:

### **Public charitable collections**

The Act provides for a new system for licensing charitable collections in public. It applies to all such collections, including face-to-face fundraising, involving requests for direct debits.

There is a new role for the Commission in checking whether charities and other organisations are fit and proper to carry out public collections and we will be responsible for issuing public collections certificates, valid for up to five years.

We need to develop the right regulations and guidance so that we can take on this new role. We also need the necessary resources to set up the new systems and this will take time to set up. We don't envisage taking on this function for a few years yet.

4. **Chapter 4 – charitable trusts.** In this chapter on charitable trusts (*cishan xintuo*) it becomes clear that a charitable trust is supposed to become one form of a “public interest” trust (*gongyi xintuo*) in the Trust Law (2001).<sup>13</sup> But there is a problem here – the Trust Law refers to public interest trusts as having the following purposes: the relief of poverty; assistance to victims of natural calamities; assistance to the disabled; the advancement of education, science and technology, culture, arts and sports; the advancement of medical and hygiene business; the advancement of environmental protection to maintain or protect ecological environment; and the advancement of other public interests. Does the proposed CL mean that there will be public interest trusts that are not charities? If so, this will be very confusing.

The charitable trust law (in Art. 72) also provides for the application of the *cy pres* doctrine. This is useful, and it might also be good to include it in the CL and make it applicable to all charities.

### ISSUES PRESENTED

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<sup>13</sup> Some commentators believe that the enactment of the Trust Law was aimed in part at regulating charitable activities. See Charles Zhen Qu, “The doctrinal basis of the trust principles in China’s trust law,” *Real Property, Probate, and Trust Journal* summer 2003, available at [http://www.findarticles.com/p/articles/mi\\_qa3714/is\\_200307/ai\\_n9294180/pg\\_1](http://www.findarticles.com/p/articles/mi_qa3714/is_200307/ai_n9294180/pg_1).

Chapter 4 is the only place in the draft CL or the explanatory materials that charitable trusts are mentioned, and it is not entirely clear what this means.<sup>14</sup> It is a little surprising to find no mention of the Trust Law in the explanation on the draft, but just a reference to charitable trusts (*cishan xintuo*) in the draft law itself. This needs more development.

Treating charitable trusts as part of the same regulatory regime for charities as social organizations, foundations, and civil non-commercial institutions make sense, and it follows the manner in which this issue has been dealt with in Japan.

There are few, if any, charitable trusts in China even though the Trust Law was enacted in 2001. Perhaps the problem lies in the insufficiency of the tax benefits that can be received by creating charitable trusts.<sup>15</sup>

With respect to *cy pres*, it is clear that as to charitable assets generally, there needs to be more clarity. It is not clear who is held to be responsible for the management and protection of charitable assets. What seems to be missing in the management of charitable assets in the Chinese context is the court system. Social assets are neither public nor private, and this needs clarification. The clarification of charity assets also relates to the drafting of the Property Law, currently under discussion.

5. **Chapter 5 – volunteers.** Dealing with charitable volunteers, which is a new concept in Chinese NPO law, this chapter begins to set out a framework for volunteer work.<sup>16</sup> The definition in Art. 39 of the draft seems to make it clear that volunteers are not to be used by charitable organizations in fundraising, but there is no general description of what a volunteer is and what other things volunteers may do for an organization. Further, in many other countries a great deal of charitable fundraising is done by volunteers (e.g., USA, UK).

The law permits registered charitable volunteers (under Art. 41 of the draft) to work for

- charitable volunteer organizations (*cishan zhiyuan zuzhi*, see Art. 40) and

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<sup>14</sup> In the recent Japanese reforms, the new laws on public benefit corporations (PBCs) with respect to granting PBC status are also applicable to charitable trusts. See M. Miyakawa, *The Outline of the Three PBC Related Reforms*, in 4 INT'L J. CIVIL SOC. L. 4 (October 2006).

<sup>15</sup> Prof. Nomi, of the University of Tokyo, was asked to comment on the Trust Law as it was evolving in China; he also make the point that tax benefits must be provided if people are to be encouraged to give large sums of money for charity. See <http://www.ju-tokyo.ac.jp/~nomi/ENGLISH/chinatrustsym2000.htm>.

<sup>16</sup> We understand that MoCA has a new Bureau on Volunteers.

- those charitable organizations that underwent the “verification” procedure

and “to enjoy the rights” mentioned in Art. 42. All volunteers have the duties mentioned in art. 43.

#### ISSUES PRESENTED

1. What roles are volunteers to play in charitable organizations? It would be good, for example, to clarify that unremunerated members of the Board of Directors and Supervisory Board are volunteers.
2. In today’s China many volunteers are students or retired persons. What responsibilities does a charitable organization have for its volunteers? Suppose, for example, that a volunteer is injured while carrying out a charitable relief mission. Does the organization have to pay for the injury?
3. What if a volunteer hurts someone in the course of carrying out his volunteer duties? Can he be sued for this, and is the organization additionally or alternatively liable? This issue is addressed in legislation from various countries. See, for example, the South Australia Volunteer Protection Act, available at <http://www.ofv.sa.gov.au/pdfs/Volunteer%20Protection%20Act.pdf>.
4. In what ways does this legislation relate to labor legislation? For example, will it exempt volunteers from minimum wage laws?
5. How does this legislation relate to regulations that have been developed at the city and provincial level? Apparently, five Chinese provinces and four cities have enacted laws or regional regulations on volunteer work, including Guangdong, Shandong, Fujian, Henan, Heilongjiang, Ningbo, Hangzhou, Yinchuan and Chengdu. Beijing is now considering such regulations as well.

We understand that providing separate legislation for volunteers is currently under consideration, and we think that such a method of dealing with this sensitive subject would be wise.

#### 6. Chapter 6 -- social responsibility.

The various provisions on social responsibility (Arts. 47-51) deal generally with the question of how to instill in the Chinese people a sense of responsibility for the support for the poor and underprivileged. There is no question that the Chinese people already have such a sense, as they contribute readily to various social causes. It will be useful, however, to have some clearer guidance for public officials, teachers, and business executives as to how they may encourage greater participation in charity activities.

Pages 23 and 24 (E) discuss chapter 6 of the draft law on social responsibility (*shehui zeren*). This seems to be designed to make the Charity Law attractive to

the political leadership by linking it to the social responsibility discussions in the PRC (especially in the context of the new Company Law). Art. 47, para. 2 of the draft CL provides: “Enterprises must actively fulfill social responsibility by way of charitable activities,” but no details are provided.

#### ISSUES PRESENTED

How is the requirement that enterprises engage in social responsibility through charities activities to be enforced? Would it be enough, for example, if an enterprise set up a charitable company foundation? Is MoCA intending to develop an index “on social responsibility” of companies? Or will the current services (e.g., [www.chinacsr.com](http://www.chinacsr.com)) be used?

7. **Chapter 7 -- support of charitable activities.** In Art. 53, there is a provision that in case a charitable organization is not able to find a sponsor organization, MoCA may become the sponsor organization. This new provision is very welcome, as there has been a problem arising from the fact that many NPOs have in the past been unable to find a sponsor organization (which has resulted in large numbers being unregistered). It should be clarified, though, that MoCA can, when necessary, act as the sponsoring organization when the organization is being formed and long before it can become a certified charity. Hopefully the State Council and the legislators will not eliminate this provision, because it will solve a significant problem - that of the huge number of unregistered organizations operating in China at the present time.

There are also some general rules on tax advantages, advantages relating to customs duties, and exemptions from fees in Arts. 54 to 57, but nothing very specific.

#### ISSUES PRESENTED:

The Tax Report delineates a number of tax benefits for charities, which include

- Making it easier for donors to take tax deductions (especially the corporations that are trying to comply with social responsibility requirements)
- Making it possible for tax deductible donations to be made directly to charities instead of having only a list of specific charities that can receive such donations.<sup>17</sup> It should perhaps be clarified whether this extends to all charities or only to verified charities.

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<sup>17</sup> This is likely to engender some hostility from organizations that currently serve as pass-throughs for charitable donations. They will not enjoy giving up the fees they charge for those services.

- Since most Chinese citizens do not file tax returns, instituting a tax designation scheme like that available in Hungary. This is discussed in the tax report presented to MoCA and MoF. See references above.
- Permitting in-kind contributions<sup>18</sup> and carryovers.

MoCA should work with MoF to ensure that tax reforms providing these benefits are created together with enactment of the CL; otherwise no organizations will have an incentive to become “verified charities.”

8. **Chapter 8 -- legal responsibilities.** The articles of Chapter 8 contain the administrative sanctions for not following the provisions of the Charity Law,, and they were not translated for us. In general, there should be a clear linkage between the fiduciary responsibilities of Board and Supervisory Board members and the penalties for improper behavior. In addition, the sanctions should be graduated, with only limited sanctions applying in the event of minor violations of the law, such as a one-time failure to file reports on time. More comments on sanctions will be made available in a later paper, which the Ministry officials have asked us to prepare.

9. **Chapter 9 - delegation of responsibilities.** Art. 67 of the draft authorizes the State Council to formulate provisions to concretize this law and the (people’s congresses or the governments?) Provinces, autonomous regions, and municipalities are to formulate implementation provisions.

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<sup>18</sup> This appears to have been taken up by the CL, because it deals with the valuation of in-kind contributions in Art. 32.

## JAPAN<sup>19</sup>

### I. CHARITABLE STATUS RECOGNITION ACT (§§ 1 - 66)

This law describes requirements and procedures necessary for a general incorporated association or foundation that applies to obtain its charitable status. For this purpose, the Charitable Status Recognition Committee, which might be a Japanese version of the Charity Commission for England and Wales in the U.K., will be inaugurated within 18 months from the promulgation of this Act.

#### A. Charitable Status Recognition Committee

1. The Committee is an Executive Agency belonging to the Cabinet Office, and it is under the control of the Minister in charge of the matter (The Prime Minister).
2. The Committee consists of 7 committee members, who are appointed by the Prime Minister and approved by the Diet, and also a Chief Executive and his/ her staff. The term of committee membership is three years, but the committee members can be reappointed for a second term.
3. In each of the local Prefectural Governments, an organization of a similar type will be established for the purpose of recognizing charitable status at the prefectural level.
4. Any Incorporated Charitable Association or Foundation, which has offices or is conducting activities in two or more prefectures, will be under the jurisdiction of the National Committee. All others are under the jurisdiction of each of the Prefectural Committees.
5. The Committee has the legal power to make an inquiry into the management and activities of any Public Benefit Corporation (not-for-profit incorporated association or foundation with charitable status) and to make an inspection at the office of PBC. When the Committee has some suspicion about misconduct, mismanagement or disqualification of a PBC, it will give an instruction or an order to rectify the problem within a fixed time period. However, if the problems are not rectified and remain still unsettled at the end of that time, the Committee has the legal power to revoke the recognized charitable status of the PBC in question.

#### B. Requirements of Charitable Status

1. An Incorporated Association or Foundation should be established for such charitable purposes of Education and Science, Arts and Culture, Religion, and so forth, as indicated in the list of public benefit purposes attached to the Act (list omitted). It must also be established for the purpose of

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<sup>19</sup> Excerpt from article cited in note 1.

promoting public benefit for a number of unidentified people in the society.

2. The details of the list of 18 basic requirements for qualifying as a PBC are as follows:
  - a. The mission should be to carry out principally the charitable purposes through activities as described in (1).
  - b. The corporation should have the necessary and sufficient financial and technical capabilities of realizing the relevant charitable purposes.
  - c. Special private benefits should not be afforded to association members, councilors, trustees, auditors, employees of the charitable corporation or any other persons described in the regulation who have special interests therein.
  - d. Any giving of other special benefits to private companies and other for-profit organizations or any other persons described in the regulation who will act for the purpose of giving profits or special benefits to a specified individual or a specified organization is forbidden. It is, however, permissible to provide other special benefits for the purpose of supporting the charitable activities carried out by any other public benefit corporations with a recognized charitable status.
  - e. Any risky and speculative transactions, usurious loans and other activities, which are prohibited under the regulation due to the potential risks of causing the loss of or damage to the social trust, and/or any activities which offend the public order or the good morale, should not be conducted by a PBC.
  - f. The income to be delivered from the charitable activities should not be expected consistently to exceed the necessary expenditures on charitable activities.
  - g. In the case of a PBC that is conducting the additional non-charitable activities in addition to charitable activities, they should not disturb or harm the sound operation of the primary charitable activities.
  - h. The operational expense ratio for charitable activities as opposed to non-charitable activities should be expected to be over 50% of the total expenses incurred in a year.
  - i. Retention of any idle and dormant assets or properties, for which there is no plan for usage scheduled in the near future, must not exceed the maximum limitation of an amount of expenditure which will be expected to be incurred in the following year in carrying out the same type and size public benefit activities conducted during the current year.
  - j. The total number of related trustees, including trustee(s) of his/her spouse, and trustee(s) of his/her other next of kin, must not exceed one third of the total number of all trustees. The same limitation is to be applied to any case where auditors are required.

- k. The total number of trustees who are trustees of another organization (except for other public benefit corporations), employees thereof, and other persons closely related therewith, must not exceed one thirds of the total number of all trustees. The same limitation is to be applied to any case where auditors are required.
- l. In case of a large PBC, an accounting auditor must be appointed and retained for auditing service every year.
- m. Any remuneration of trustees, auditors, and councilors, if any, must be at the reasonable level and not be unduly excessive, in comparison with the general tendency of officers and employees of private businesses. The general conditions and standard level of payment must be subject to disclosure to the public.
- n. In case of a membership association, the below-mentioned conditions should be applied:
  - i. There may be no discriminatory treatment or other unduly strict conditions for membership;
  - ii. There may be no discriminatory treatment in exercising voting rights of the members, particularly in terms of the amount of money or the value of property paid into the PBC; and
  - iii. The establishment of the board of trustees is essential.
- o. The holding of a controlling interest in a going business concern is prohibited.
- p. If there are any specific assets or properties that are indispensable to carrying out the charitable activities of a PBC, the relevant provisions of the governing documents must state their special character as well as the way in which they are to be maintained and they must include restrictions on their disposal.
- q. The charter of the PBC must contain relevant provisions stating that in case of de-recognition of the charitable status or merger by absorption into another organization that is not a PBC, any residual assets must be contributed to public benefit corporations with similar purposes and activities, or specified type of not-for-profit corporations described in the Act, or to national or local governments.
- r. In the case of liquidation of a PBC, any residual assets must be contributed to the public benefit corporations with similar purpose of activities, or specified type of non-profit corporations prescribed in this Act, or national or local governments.

**Charging Fees**  
**“Model” Provisions on Public Benefit Organizations**

2.4 Factors to be taken into account in determining that an NPO is organized and operated to engage principally in Public Benefit Activities generally include:

That the NPO provides significant benefits

to the public-at-large, or  
to a targeted class of beneficiaries, where

the class is disadvantaged relative to the population as a whole, or

there is a significant value to the community in providing special benefits to the targeted class.

*Note that this factor constitutes a significant limitation on what constitutes a PBO. This factor means that it is not sufficient for an organization to engage in a Public Benefit Activity as listed in Article 1. It should also provide significant benefits, either to the public at large or to a targeted group under the conditions specified above. Thus by combining this article with Article 1 (x), for example, the Public Benefit Commission should determine that an organization that promotes economic development only in a prosperous area would not qualify as a PBO. One that promoted economic development in a disadvantaged region of a country, however, or even in a whole country if the entire population can be deemed “disadvantaged,” would be eligible for PBO status.*

That the NPO provides significant goods and services at or below cost;

All other factors indicating that the NPO is organized and operated principally to engage in Public Benefit Activities.

Factors to be taken into account in determining that an NPO is not organized and operated to engage principally in Public Benefit Activities generally include:

That the NPO targets a closed or otherwise limited class of beneficiaries, particularly one that includes persons affiliated in some way with the organization or its staff;

That the nature and extent of the NPO’s economic activities indicate that the NPO is not merely advancing its not-for-profit purposes but is

instead organized and operated principally for a commercial purpose;

*The purpose of this factor is to ensure that what is essentially a commercial business not be afforded the protection of PBO status. If the economic activities advance the public benefit purposes of the NPO, however, they should not be deemed a negative factor. See Article 13 and the accompanying note.*

That the NPO regularly engages in the sale of goods or services at a price above cost; and

*Selling goods and services in substantial amounts at prices that exceed cost is often an indicator that an NPO is in reality a commercial business.*

That the NPO provides unreasonable compensation or other special benefits to its employees or other persons affiliated with the organization.

*The terms "reasonable" or "unreasonable," or their functional equivalent, are often defined in other laws. For example, in a specific country "unreasonable compensation" might mean "compensation that is more than 30% above the average compensation paid in that country to people who have similar jobs."*