

**Conclusions**  
**International Symposium on NPOs**  
**December 14, 2007 in Peking**

Within the scope of the further development of the legal and organizational system for non-for-profit organizations (NPO) in the PR China, the China National Bureau of Administration of Non-governmental Organizations of the Ministry of Civil Affairs and GTZ jointly hosted the "International Symposium on NPOs" on December 14, 2007 in Beijing.

At present, NPOs need to meet new requirement to keep pace with the fast development of China's society in the fields of politics, culture, economy, healthcare and education. The Chinese government sees NPOs therefore as an important factor in accelerating modernization and building a harmonious society. But the legal framework for them continues to be inconsistent and the total number of NPO as well as their operational capability cannot satisfy the needs of modern society, especially in the fields of healthcare, welfare, and education.

One focus of the Chinese efforts in enhancing the NPO system is the improvement of the internal structure and constitution of NPOs as well as their ability to attract and manage donations and funds to meet the present social demands - including the set-up of respective public monitoring systems. Another aim is the establishment of a complete and comprehensive finance and taxation system to enable them to have clear and consistent rules for tax exemptions and the deductibility of donations. The existing laws and regulations on these matters are still scattered and inconsistent or at least not clear.

The December symposium was attended by Chinese experts, including officials from the Ministry of Civil Affairs and the Legislative Office of the State Council. Foreign experts from Germany and the United States made comments on the problems and questions raised during the course of the symposium.

The following is a summary of the discussions during the symposium, including conclusions and recommendations for consideration are set out below by the German and American experts.

#### **A. Legal Issues**

From a legal comparative perspective regarding not-for-profit organizations (非营利性组织, NPOs), one should differentiate between three groups of legal

consequences that were discussed at the symposium: (1) Organization Law, (2) Tax Law, (3) Other legal matters (e.g., fundraising). The most important aspects of these legal consequences for Chinese law are discussed in this report.

## **1. In general.**

### **a) Different issues regulated by different laws.**

The legal consequence of organization law is that the organization receives its legal personality. The legal consequences of the tax laws are that the organization and its donors receive several specific tax benefits. The legal consequences of other legal matters depend on the specific issue being regulated: for example, in the case of fundraising, the question is the extent to which the law permits public fundraising.

In the German law and the laws of other countries (e.g., the United States) these three groups of issues are treated separately. There are different tests to determine whether a specific organization meets the specific requirements of organizational law, tax law, and fundraising law – but these are different requirements and they are generally contained in different laws. Further information about the different specific requirements can be found in the essays to topic 1, topic 2, and topic 5.

It is, of course, possible to combine different legal consequences in one particular legal form. For example, a Spanish foundation is automatically entitled to receive tax benefits when it is established, making an additional test of the requirements for tax benefits unnecessary. This is true because the pre-conditions of the organizational law and the tax law are similar (e.g. the organization must be established for public benefit).

Another example of a combination of different legal consequences can be found in the Chinese Foundation Law. This law combines the pre-conditions for organization law with the pre-conditions for the permission to raise funds from the public (for public-fund-raising foundations, 公募基金会). This is an uncommon linkage from the perspective of other countries, which treat the issue of fund-raising as a separate matter from either organizational form or tax benefits. In general various organizational types of NPOs are permitted to engage in public fund-raising provided that the legal requirements for such fund-raising are met.

From a legal comparative view one can ask whether the Chinese Foundation Law, having a combination of organizational form with permission to fund raise, can be compared with the German Foundation Law, which does not address this issue. In our opinion, it is possible to compare “foundations” under German law and under Chinese law, despite the failure of the German Foundation Law specifically to address fund-raising. This is so because in Germany there are almost no specific pre-conditions for the right to raise funds (see below). On the

other hand, the more meaningful comparison is relevant: both Chinese and German foundations are premised on the notion that they are non-member organizations that are organized around assets (an endowment) and that they are subject to the non-distribution constraint.

## b) Governance

### aa) Explanation

The governance structure for NPOs and in particular public benefit organizations (公益组织, PBOs) is important because the roles of the officers and members of the board of directors are one of the keys to effective provision for good overall management and development of the NPO sector. In China considerable reliance is placed on the regulatory oversight of the “sponsoring organization” (主管单位) within the government to ensure that the NPO/PBO does not engage in improper activities. While the state’s attorney in other countries may have regulatory oversight, the first oversight mechanic is within the organization – it is the board of directors (and the supervisory body, if there is one) that ensures proper behavior by the NPO/PBO.

Current Chinese law hardly addresses the ways in which boards of directors of PBOs should work to ensure that the organization behaves properly. For example, the law does not deal generally with fiduciary duties of PBOs. Nor does it deal at any length with potential conflicts of interest between the organization and its board members, employees, founders, etc. In the Foundation Regulations there is a provision that no more than one-third of the directors may be paid,<sup>1</sup> which is helpful although it allows perhaps too high a percentage to be paid. In the Implementing Regulations for the Enterprise Income Tax, there are signs that a requirement exists that donors are not permitted to be involved in the grant-making of a “charitable social organization,”<sup>2</sup> which would preclude certain conflicts of interest.

### bb) Suggested legal reform

Chinese law with regard to all forms of legal entities that would like to achieve PBO status should provide for fiduciary duties (such as the duty of care and the duty of loyalty). There should also be provisions in the law (perhaps in the tax laws) providing that all forms of self-dealing and conflicts of interest are prohibited.

## 2. For-profit activities of nonprofit organizations

<sup>1</sup> Art 20 Foundation Regulations (基金会管理条例).

<sup>2</sup> Art 52 (8) Implementation Regulations EIT (中华人民共和国企业所得税法实施条例): “Donors are not involved, in any form, in the distribution of assets of the organization”.

In order to discuss the question it is useful to differentiate between different types of activities and to assess what other rules should apply.

a) For-profit activity

As already stated in the essay for topic 2, a for-profit activity of an NPO is an economic activity (delivery of goods or services for a fee on a market), with the aim to generate profits (a surplus).

b) For-profit activity and not-for-profit purpose

It may seem odd that an NPO is permitted to conduct for-profit activities. However, the “not-for-profit” character of an NPO does not follow principally from its activities but also from its purposes. This means in part that an NPO may not have commercial purposes even though it may conduct some for-profit activities. Moreover, an NPO is primarily defined by the non-distribution constraint, not by whether or not it raises money through its for-profit activities.

c) Non-distribution constraint

aa) Explanation

In German law as well as in the laws of other countries with respect to NPOs, the most important feature distinguishing an NPO from a business entity is the requirement that a PBO may not distribute its earnings or assets to anyone either in the form of current distributions or upon dissolution of the organization.<sup>3</sup> The legal rules regarding the application of the “non-distribution constraint” can be found either in civil law<sup>4</sup> or in tax law<sup>5</sup> or both.

The rule has the following consequences:

- A PBO may earn a surplus from its activities (including unrelated business activities to the extent it is permitted to carry out such activities under the applicable law);<sup>6</sup> it is not, however, permitted to distribute the surplus.
- A PBO may also not distribute the surplus indirectly. In other words, the payment of reasonable remuneration for services is permitted, while

<sup>3</sup> There is no limitation on the distribution of assets to members at the time of the dissolution of a non-public benefit organization, as long as the entity has not received tax or other benefits consistent with status as a PBO.

<sup>4</sup> Art 21 of the German Civil Code (GCC) says that a nonprofit association must not have a commercial business as its purpose; on the other hand, noncommercial activities are permitted if they are subordinate to the nonprofit activities. See below. The same rule applies in common law countries.

<sup>5</sup> Both German law and U.S. law provide for this in the tax law. Art. 55 ¶ 1 No. 1-4 of the General Fiscal Law in Germany, and §501 (c)(3) of the Internal Revenue Code in the United States.

<sup>6</sup> English law provides, for example, that “trading” activities must be conducted through a taxable subsidiary

- unreasonable salaries or other indirect payment of the surplus to employees, board members, etc., is not allowed.
- Upon the dissolution of a PBO, its assets must be distributed to another PBO or, in some cases, the state.
  - A best practice is to provide for the application of the non-distribution constraint in the governing documents of the organization.

#### bb) Current Chinese law

While the application of the non-distribution constraint is quite clear in civil law countries such as Germany and in common law countries such as the United States, it is not so clear in China. Thus, this report recommends that the application of non-distribution rules be made clear both in applicable regulations and in practice.<sup>7</sup> Looking at Chinese law, one can find the following with respect to the three relevant organizational forms:

1. The Foundation Regulations (2004) provide as follows: Art 27 contains the requirement that “A foundation should use its assets in accordance with its mission as stipulated in its charter and within the scope of public benefit activities so laid down.” In addition Art 33 requires that “Monies left over when a foundation is wound up should be used for public benefit ends as stipulated in the foundation’s charter; funds which cannot be used in this way will be donated by the organ in charge of registration to another public benefit organization with similar aims and objectives to the original foundation. Any such action will be made public.” These rules come the closest to a complete statement of the non-distribution constraint as any that apply to the various forms of legal entity in China
2. With respect to Social Organizations, Art. 29 of the 1998 Regulations provides as follows: “A social organization’s resources, and income lawfully obtained from activities carried out in accordance with its charter and in accordance with relevant regulations, must be used for the area of work as defined by the organization’s charter and must not be distributed to the membership.” In addition, both Art. 33 of the Regulations and the Model Statutes for SOs stipulate that “under the supervision of the sponsor organization and the registration and administration authority,” remaining assets must be used for the development of undertakings with similar aims to the original SO.<sup>8</sup>

<sup>7</sup> This is particularly true because of the response of many of the practitioners (representatives of SOs) attending the symposium, who seemed to be unaware of the importance of the rule.

<sup>8</sup> Art. 45, Model Statutes for SOs (社会团体章程示范文本).

3. With regard to organizations categorized as civil non-business institutions (民办非企业单位, CNI), Art 21 of the Temporary Regulations from 1998 provides as follows: “A CNI’s capital resources must be lawfully obtained; no institution or individual may seize, secretly divide or divert the CNI’s capital. A CNI’s legal income must be used for activities stipulated by the charter of the unit.” This statement does not really embody the non-distribution constraint, and there are some indications that at least some CNIs are to be permitted to pay “reasonable rates of return” to “investors.”<sup>9</sup> Those organizations would not be PBOs in the classic sense.

It is also important to look at other legislation to determine whether the application of the non-distribution constraint is addressed there, as it is in the United States, and Germany. The relevant laws are the Public Welfare Donations Law (中华人民共和国公益事业捐赠法) (1998) and the Enterprise Income Tax Law (中华人民共和国企业所得税法, EIT) (2007, effective 2008). With respect to the former, the provisions are not very clear; Art 17 says only that “Public welfare social organizations should make use of donations and financial aid in activities and undertakings that conform with the specified purpose [of the organization].” With respect to the EIT, the provisions regarding non-distribution are far better developed, at least in terms of administrative guidance as to how Art 9 (allowing the deduction of “donations for public interest”) is to be applied.

In an administrative directive issued on 8 January 2007, the Ministry of Finance<sup>10</sup> made clear that one of the requirements of deductibility of donations to public welfare organizations is that “[the organization’s] surplus cannot be attributed to any individual or for-profit organization when it is terminated or dissolved.” In addition, Art 52 of the Implementation Regulations for the Enterprise Income Tax Law<sup>11</sup> requires that:

- The earnings and surplus of an organization that is qualified to receive deductible donations must be “mainly used” for the organization’s purposes;<sup>12</sup> and

---

<sup>9</sup> Art. 51 Law of the People’s Republic of China for the Promotion of Private Education (中华人民共和国民办教育促进法) 2002.

<sup>10</sup> 财政部 国家税务总局关于公益救济性捐赠税前扣除政策及相关管理问题的通知 财税[2007]6号 [Notice of the Ministry of Finance and the State Administration of Taxation on the Policies and Related Administrative Issues Concerning Pre-tax Deduction of Public Benefit Relief Donations, Caishui (2007) Nr. 6 (Taxation Notice 2007)], issued on January 8, 2007, effective from the date of its issuance.

<sup>11</sup> See supra note 2.

<sup>12</sup> This language of the Implementation Regulations echoes the language of the January Guidance.

- “Upon termination, any assets remaining shall not belong to any individual or profit-making organization.”

While it would be useful if the issue of non-distribution of current earning were better clarified, certainly the requirement that an organization not distribute assets improperly upon dissolution is absolute.

#### cc) Suggested legal reform

It might be useful to strengthen and clarify the non-distribution constraint applicable to PBOs under Chinese laws and regulations by providing uniformly as follows:

##### **Non-Distribution Constraint**

A charity organization (or public welfare 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 at any time, whether during the organization’s lifetime or upon its dissolution.

A comparable result could probably also be achieved, if the non-distribution constraint rule would be added to the model statutes for CNIs, at least for CNIs that receive tax benefits or conduct fundraising. This is due to the fact, that the non-distribution constraint is already part of the foundation law and the law of SOs and that the tax law provisions are limited to the three legal forms foundation, SO, and CNI.

#### d) Legal consequences of for-profit activities

##### aa) Organizational law

As already stated in topic 2, in Germany and the U.S. the organizational law permits as a rule all legal forms of NPOs to conduct for-profit activities. There is only one exception, with respect to the German Association, where economic activities (where there is no for-profit purpose) are restricted by the so-called “privilege of subordinate activities” (“Nebentätigkeitsprivileg”). The main reason for that limitation is creditor protection. For China we would not recommend that such a limitation be included in the Social Organizations Regulations, because the aim of creditor protection could also be reached by other means. Thus, the Chinese organizational law should continue to permit an NPO to conduct for-profit activities, particularly as this may be important for its financial support.

##### bb) Tax law

As regards tax benefits the usual solution is the following: tax exemption is allowed for “purpose-related” for-profit activities (e.g., fees at hospitals), but not for “purpose-unrelated” for-profit activities (e.g., a shoe factory owned by an NPO). The reason for that is to ensure a fair competition in the field of commercial activities. This solution is used in both German and U.S. tax law. As regards China there seem to be a difference between the different tax benefits: As regards the Enterprise Income Tax for NPOs, the implementation regulations state that income derived from engaging in profit-making activities is not exempt from taxation.<sup>13</sup> Comments from Chinese participants of the symposium suggest that this provision is to be read in a way that China also differentiates between related and unrelated activities. However, this should be clarified by the legislator. As regards the tax benefits for donors, the implementation regulations for the EIT state in Art. 52 No. 6 that a qualified NPO must not be “engaged in business activities not related to its purposes.” It is questionable whether such a rule is reasonable.

#### cc) Suggested legal reforms/clarifications

For-profit activities should be generally permitted for NPOs, and unrelated for-profit activities should be taxed. NPOs that qualify for donations deductible from taxable income should be permitted to carry out unrelated for-profit activities.

### 3. Fundraising regulation

In fundraising regulation for PBOs (charities) one can differentiate between different means of regulation: for example, the legal consequences of regulation can include restrictions on the right to raise funds in public and the need to acquire permission to raise funds.

#### Solicitation Regulation

##### a) Permission

As already stated in the essay to topic 5 the traditional solution in Germany is the requirement of permission by the competent state authority if an organization wants to raise funds publicly. If the state authority has issued a permit for the solicitation, the legal requirements are fulfilled.

According to fundraising regulations, the permission will not be granted in the following cases:

---

<sup>13</sup> Art. 85 Implementation Regulations EIT (supra note 2).

- the fundraising activities, reaching the aim of the fundraising activities or the usage of the funds raised endangers the public order;
- there is no appropriate guarantee that the fundraising activities are conducted in an orderly manner and that the funds raised are used for the purpose they were raised for;
- it is to be expected that there is an apparent disproportion between expenses and funds to be raised; or
- in the case of the sale of goods for public benefit or charitable purposes if it is not guaranteed that at least one quarter of the sales price set aside for public benefit or charitable purposes.

Moreover, the granting of permission is subject to the discretion of the competent authorities only in the following cases:

- there is an accumulation of fundraising activities in the same district, especially if this influences the fundraising of other “welfare associations” (like the Red Cross) or fundraising by the federal states; or
- the fundraising activities, reaching the aim of the fundraising activities or the usage of the funds raised could influence the relations of Germany with other states.

The above listed reasons for declining the permission for fundraising of NPO are said to be in accordance with the German Basic Law, but so far they have seldom been tested by parties in court proceedings as to whether they restrict free speech rights.

#### b) Another approach (U.S.)

United States law, consistent with the First Amendment to the Constitution, permits states to establish “time, place, and manner restrictions” on public fundraising. This is because fund-raising restrictions are viewed as having important consumer protection consequences for the general public. “Time, place, and manner” restrictions are only allowed to be applied if the rules for applying them are clear and are not within the discretion of the state agency granting the permits. This is to ensure that there is no discrimination among charities permitted to fund-raise. For example, it would be allowable to provide that no organization may go to a person’s home to solicit funds after 8 PM and before 7 AM. But it would not be allowable to provide, for example, that only religious organizations are permitted to fund raise at airports.

There is also a state interest in protecting both the public and the charity itself from fraudulent practices by paid fund-raisers. Thus, paid fund-raisers are required to disclose the fact that they are paid as well as the proportion of the funds raised that will actually go to the charity.

#### c) What is an appropriate limit for fund-raising expenses?

In practice the most important question is how to determine an appropriate limit on fund-raising expenses. In Germany this means ascertaining the meaning of the phrase “an apparent disproportion between expenses and funds to be raised”. Experience shows that it is very difficult to decide this question by a fixed percentage limit. It is apparent, that the expenses (administration costs) depend on the reputation of the organization and on whether the donors are first-time donors or established donors for a given organization.

If an unknown organization begins a fundraising campaign addressing unknown persons, the experience show that the expenses can easily be higher than 90% or even higher than 100% of the raised funds. So it is problematic the proportion between expenses and funds as an “apparent disproportion” in such a case. If an organization with a good reputation continues its fundraising campaign with established donors, expenses of only 30% of raised funds might be regarded as an “apparent disproportion”. This is why the German courts have accepted comparatively high expenses for fundraising campaigns, especially if the campaign is conducted by a new established organization in its first years.

d) A fund raising campaign with a specific purpose produces a surplus  
A fundraising campaign can lead to the result that the collected funds are greater than needed to fulfill the purpose of the fundraising campaign – in other words, it produces a surplus. In Germany and the United States it is important to interpret the will of the donor in order to decide what to do with the surplus. If the donor would be satisfied with the promotion of another comparable purpose the donation can be used for that purpose. If the donor only permits his/her funds to be applied to the specific purpose of the campaign, it is necessary to give the money back. The intention of the donor can be unclear, if s/he has not uttered a specific intention. In some cases, the practical situation requires an inference to be made that the charity is permitted to use the money for other comparable purposes. This will be true, for example, in large-scale giving for natural disasters.

e) Public fund-raising in China

It is surprisingly not conclusively established to what extent a social organization (SO) may undertake public fund-raising. Because the Foundation Regulations 2004 allow public fund-raising only by selected foundations with a high initial endowment it would seem to be consistent that other NPOs (e.g., SOs) are equally subject to this comparatively strict requirement for fundraising. The regulations on SOs and CNIs are silent on the entire issue of public fund-raising, suggesting an inference that they are not permitted to do so. On the other hand, as a practical matter, many SO's do engage in public fund-raising, and if they

meet the requirements of the EIT, they are permitted to receive tax deductible donations. As there is no clear rule, there is no legal certainty on this.

It is also not clear what rules apply if there is a fund-raising surplus from a specific campaign, such as a natural disaster.

#### f) Recommendations regarding fund-raising

- (1) There should be a clear rule whether other organizations -- in addition to fund-raising foundations -- are entitled to raise funds publicly. This matter should be clarified in the upcoming SO regulations and SO's should unequivocally be permitted to engage in public fund-raising. It does not seem useful to restrict the right to raise funds only to fund-raising foundations, as funds raised from the general public can be a useful source of support for SO's. With regard to CNIs, these organisations should also be allowed to conduct fundraising, if the non-distribution constraint is applicable.
- (2) There should be separate rules established with regard to the entire matter of public fund-raising,<sup>14</sup> and several models of legal structures should be examined in establishing the rules. Examples for such procedures can be found both in Germany and in the US.
- (3) It would be useful to have a comparatively quick procedure for processing fund-raising permits in cases of sudden disasters, emergencies, etc.
- (4) It may be useful to have a clear rule for a case when the collected funds are greater than needed to fulfill the purpose of the fundraising campaign. It should be the rule that the funds must be used for another comparable public benefit purpose. The decision could be made by the directors of the organization or by a state authority. A third alternative would require the directors to apply to the state authority for a grant of permission to carry out the decision of the directors of the organization. A corresponding rule should also apply in a case when the purpose of the fundraising campaign is fulfilled without applying the funds at all (e.g., ill children are cured naturally after funds were raised for their cure) and in the case when it is impossible to fulfill the purpose (e.g. ill children die after funds were raised for their cure).
- (5) Government should consider - and probably require - a self-regulatory certification process for fund-raising NPOs based on self-evaluation of the NPO and leading to a "Fund-raising Certificate." This could be used by the NPO to show that it is fulfilling certain requirements important for donors.

## B. NPOs in Welfare, Healthcare, and Education

---

<sup>14</sup> We are unclear to what extent progress has been made on this subject in the context of the Charity Law. We would be happy to review the latest draft language and make suggestions as to content.

## 1. Background, functions, and scope of the sector

NPOs in welfare, healthcare, and education in Germany have a long tradition; some of them – primarily NPOs founded by the Catholic Church or the protestant churches -- date back to the Middle Ages.

NPOs in welfare and healthcare gained importance during the industrialisation of Germany in the late 19<sup>th</sup> century, when the protestant churches founded the interior mission (“Innere Mission”) to fight poverty and alleviate the social situation of the working class. At the same time, in the context of conflicts between the Catholic Church and the Prussian state (“Kulturkampf”), the Catholic Church enforced the development of Caritas, the social work of the Church. In the aftermath of the First World War, the “Arbeiterwohlfahrt” (Workers’ Welfare) developed out of the working class movement. As a nondenominational alternative with no political affiliation the Parity Group (“Deutscher Paritätischer Wohlfahrtsverband”) was founded in 1924 as an umbrella welfare organisation. The German Red Cross started to develop welfare and healthcare activities. Together with the Central Welfare Agency of the Jewish Community these are the major NPOs in welfare and healthcare today.

After the Second World War these organizations profited from the discrediting of the state because of Nazism, thus successfully re-establishing their importance. They grew rapidly with the “Economic Miracle” of Post-War-Germany. In welfare NPOs the “principle of subsidiarity” was successfully introduced, giving priority to NPO welfare activities over public services and obliging government to finance NPO services; the principle of subsidiarity was abolished in the late 1990’s, but could serve as model for the promotion of NPOs in China.

Today, NPOs in welfare and healthcare are an important part of German civil society. They serve to significant roles 1) as providers of services as well as 2) pressure groups lobbying for the social and healthcare interests of the German population in general as well as of specific groups (see below for more discussion). In terms of approach to services, a typical trait of welfare and healthcare in Germany is the “welfare mix” – the coexistence and cooperation of public services and NPO services with a growing percentage of for-profit activities (especially in hospital care and care for elderly).

The turnover of NPOs represents approx. 15% of the social budget of Germany (100 billion € of 735 billion €). In certain areas NPOs provide almost 100% of the services (e. g. for handicapped persons), and in many other areas around 50% (care for elderly, hospital care, kindergartens etc.).

Education in Germany is considered to be primarily a public domain: With the exception of kindergartens (out of 48,000 approximately 30,000 are operated by

NPOs – or 63%). In primary and secondary education, on the other hand, private organisations (most but not all of them NPOs) operate only 10.5 % (4,600 of 44,000, educating only 873,000 of 9.82 million students representing 8.9%). In higher education out of approx. 350 institutions approximately 120 are private organisations – and approximately 2/3 of them are NPOs. Although private organisations operate 34.5% of all institutions of higher education in Germany, they educate only 3% of the student population. There is a focus among the private institutions on business administration, where they educate 25% of the students at universities of applied sciences. Another focus of confessional NPO institutions of higher education is social work and nursing. Especially in higher education the importance of private organizations – especially NPOs – is growing rapidly; the majority of them were founded in the last 15 years and their number is increasing rapidly.

## 2. Functions and possible conflicts

A major function of NPOs in Germany is their participation in the development of civil society and of a democratic culture. In welfare and healthcare another major function of NPOs is to lobby and fight for the social interests of the population in general and of specific groups in particular (e. g. handicapped persons, poverty-stricken and/or unemployed people, children and youths, elderly, migrants). NPOs are either acting as advocates for the interests of others or are self-help organisations, recruiting members affected personally by specific social problems (e. g. war veterans, parents of mentally handicapped children, elderly people). Other NPOs are umbrella welfare and/or healthcare organisations, lobbying for the interests of their NPO members in politics and/or the general public (e. g. lobbying for certain privileges for NPOs, e. g. the principle of subsidiarity or for more and higher government subsidies). NPOs are acting in the general public interest recruiting volunteers and raising funds for social and/or healthcare activities. Finally an important function of NPOs is to operate and manage services like hospital care, care for elderly or handicapped persons, neighborhood centers, kindergartens, or offering counsel and advice to individuals and/or groups with social/health problems. In education NPOs lobby for the influence of parents in the education of their children and/or for alternative educational concepts. They are “agents” of a specific mission, e. g. of the churches. They raise funds and support institutional educational activities (e. g. schools) or they finance the individual education of students by scholarships, or they operate and manage educational institutions. It is important to define clearly the functions of a NPO and to differentiate between the different functions in order to avoid conflict of interests and problems of legitimacy. Conflicts might arise, for example, if a self-help

organisation of parents of handicapped children that is lobbying for adequate legislation and government subsidies, begins providing services for handicapped children. The NPO might be expected to make improvements in its services although it may not have the financial means to do so unless its lobbying is effective. Another conflict might arise because competences in lobbying do not necessarily correspond with the skills necessary to manage a service. A NPO primarily lobbying for elderly people probably should not operate services for elderly because it might be suspected that it is not lobbying primarily for improving the situation of elderly people, but for the operation of its services – the interest not always is identical. If an NPO is serving different functions it is important to realize that and in case of potential conflicts at least to differentiate between them and to develop adequate organizational structures making clear that the different divisions of an NPO are serving different functions.

### 3. Form follows function

German law offers a great variety of legal structures for not-for-profit activities as discussed in the essay for topic 2 and as discussed above. The choice of form should be made according to the function of the NPO, because certain structures are thought to fulfill certain functions. If the main function of an NPO is to organize members to lobby for their interests or to organize the competences of its members for other reasons, a registered association is an adequate structure. If the operation of major services is intended (hospitals, residential care centers for elderly, services for handicapped persons, etc.), a company with limited liability and/or a stock company should be considered, because both offer professional structures for the management and the governance of such services. If the primary function of an NPO is to raise and manage major funds and investments according to the will of the founder, a foundation is indicated. The flexibility of the laws regulating the association, the foundation, and the company with limited liability allows adaptation of the structures for an NPO to fit the intention and the requirements of the founders.

The functions of an NPO should also determine whether the organisation is to be highly centralized or decentralized. NPOs networking and/or organizing personal engagement and competences might prefer a decentralized structure, while effective lobbying might need a more centralized structure. Grassroots activities need a highly decentralized structure with a focus on the local area. But lobbying for the interests of grassroots activities in politics and fighting for legislation and government funding might require more centralized structures and a focus on the provincial or even the national level. Whether an NPO is acting nationwide, is focusing on a region/province, or on a local authority

depends on its function and its strategies and the form must be decided accordingly.

#### 4. Funding follows function

NPOs are financed from revenues from different sources. They receive fees for their services (especially for hospital care, care for elderly, care for handicapped persons). In Germany these fees – although there are no exact statistics – amount to 70% to 80% of all revenues. Other sources of funding include membership contributions, revenues from the management of assets, income from sponsoring activities, government subsidies, and revenues from commercial activities. German tax law allows commercial activities by NPOs, but taxes them differently according to their purpose as discussed above.

If an activity is intended to serve the principal purpose of the NPO, it is considered as a related purpose and it is tax exempt. Examples of this can be found in the healthcare and welfare fields. If a hospital is operating a cafeteria exclusively to serve food to its patients, employees, and the families of patients, this activity is closely related to the principal purpose of the hospital to treat its patients and the revenues are tax exempt. If the hospital is operating a cafeteria open to the general public, serving persons unrelated to the hospital (those other than patients, etc.) this activity is not related to the principal purpose of the hospital, and the cafeteria is a competitor to other cafeterias. It is thus taxed like a normal cafeteria. Similarly, if an NPO for handicapped persons is operating a restaurant in order to create jobs for handicapped persons, revenues from the restaurant are tax exempt. If a similar NPO is operating a restaurant in order to earn money for its activities, the revenues from the restaurant will be taxed.

Donations and inheritances are an important source of income for NPOs, although they represent only 5% of the overall turnover of NPOs in welfare and healthcare (approx. 5 billions €; data on revenues from donations in education were not available). Some NPOs have developed professional fund-raising strategies and are financing a major part of their budget by successfully raising donations and other revenues. In Germany national television chains organise successful lotteries to raise funds and invest these in services, e. g. for handicapped persons and/or for elderly people. A major part of the income from regional lotteries is also used to finance not-for-profit activities in welfare, healthcare and/or education. Approx. 1 billion € is raised annually by lotteries. Various foundations set up by German companies like the Deutsche Bank and other banks, by Volkswagen, by Bosch, by Bertelsmann provide also funds for educational, welfare, and healthcare activities.

The funding of an NPO should correspond to its functions and should offer incentives for efficient and high quality services. An NPO lobbying for its members should primarily be financed by contributions of its members. This ensures that the NPO is orientating its activities according to the interests of its members – if it does want to lose its members. A NPO offering services to clients (e. g., a hospital for patients) should primarily be financed by fees from its clients. This forces the NPO to fulfill the needs and the wishes of its clients. If NPOs receive government subsidies or other funds, the government or a donor should grant the funds in such a way as to support and promote the function of the NPO. For example, if the government is subsidizing care for elderly people or handicapped persons, the subsidies probably should not be paid as a “lump” sum to the NPO, but as an individual subsidy to the client/patient thus enabling him/her to pay it as part of the service fee to a NPO offering him/her services according to his/her needs.

Especially in the area of funding the unintended consequences of funding in general and of the forms of funding have to be studied continuously. “Strings” attached to funding may unintentionally have negative results. In Germany government requires NPOs to pay their employees no higher salaries than government employees. The result in many cases is that NPOs have adapted the salary scheme of the public administration, thus developing slowly into “quasi-governmental” organisations.

## 5. Challenges for NPOs

NPOs have to be aware of their specific roles and functions. Their structures and their funding should correspond to their functions and should promote efficient and high quality activities according to their roles and functions.

NPOs – like for profit companies – need strategies and strategic planning. They have to integrate trends and developments into their strategies as well as future challenges.

NPOs need a competent and efficient management – but the requirements for a manager differ largely from NPO to NPO. To manage a major hospital care NPO competing with other for-profit and not-for-profit hospital care companies, skills like human resources management, quality management, organizational development, finance management are required. To manage a lobbying NPO, skills like communication, networking, political experience, and good relations to politicians might be more important. Requirements for the management of NPOs might change with changes in trends, strategies, and environment. In Germany the political framework for NPOs in hospital care and social services changed fundamentally in the early ‘90s. In the past the development and success of a hospital depended largely on political decisions – when and which

government subsidies a hospital would eventually be granted depended on how many beds it had and in which specialties it had them – it had effectively become part of public hospital care program. Hospitals did not really compete for patients. Therefore an influential and experienced politician was considered to be a good manager for a hospital for a long time. With the introduction of prices for the treatment of a patient and with a growing competition among hospitals for patients, management skills like finance management, quality management, human resources management, and controlling became necessary instead of the skills of a politician. Today the management of not-for-profit service organisations like hospitals or care centers for elderly or handicapped persons needs managers with skills similar to these of for-profit service providers. This includes needing to overcome and/or to avoid civil service attitudes, which were previously widespread among NPOs in welfare and healthcare, and staying independent of government, and safeguarding this independence.

While in welfare and healthcare NPOs traditionally play a major role, their importance in education is still low, although the number of NPOs in education is increasing as well as their influence. NPOs in education have to overcome the public attitude that education is a predominantly public domain and that this should stay so.

Last, not least NPOs have to modernize their strategies to recruit volunteers and to raise funds.

## 6. Summary and suggestions for China's NPOs regarding part B

- The development of NPOs in welfare, in healthcare, and in education is a long-term process needing patience and the power to overcome eventual set-backs, but needing also impatient actors pushing for the establishment of a NPO sector systematically and stubbornly.
- Government can develop strategies, steps, and instruments promoting the foundation and the establishment of NPOs like introducing instruments similar to the German "principle of subsidiarity".
- Government should proceed with the transformation of the public service units into NPOs, but allowing time for the newly independent NPOs to develop expertise in operating the public services
- Government should focus on promoting the foundation of NPOs that are easier to establish and to be successfully managed. It might be easier to motivate people to engage in lobbying for the interests of elderly and/or handicapped persons rather than assume the challenging task of operating a complicated service like a residential care center for such groups.

- Legislation should allow organisational flexibility for different functions of NPOs. It should leave a certain freedom of choice among different organisational structures to the founders of NPOs according to the functions.
- Grassroot activities and self-help groups very often do not need subsidies, but an infrastructure for their activities which in general is easier to provide. They need rooms in the neighborhood for meetings and administrative work, they need access to telecommunication (telephone, fax, internet) and office equipment (copier, etc.). In many cases local authorities are able to provide this infrastructure. Subsidies to train members of such groups and/or support by professionals are helpful, but not obligatory in the first step.
- When granting subsidies, government should analyse thoroughly the possibility of unintended negative consequences of “strings” attached to such grants. Subsidies should be granted in a way that they offer incentives to NPOs to perform their functions as well as possible e. g. a subsidy to a membership-based NPO should probably not be granted as a “lump”-sum to the NPO, but as a subsidy of the fee of the individual members in order to strengthen their influence. A subsidy for the operation of a residential care center for elderly persons should rather be granted to the elderly persons to pay their fees.
- Government should consider the establishment of study programs such as “NPO-Management”, “Healthcare Management”, “Social Management”, and “Management of Educational NPOs”.