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Client Alert

Unlocking Potential: Amendments to the Public Interest Corporation Act and Their Implications for Public Interest Governance in Japan

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Summary

The forthcoming amendments to Japan's Public Interest Corporation Act aim to unlock the potential of Public Interest Corporations (PICs) by introducing greater financial flexibility, streamlining administrative processes, and reinforcing governance and transparency requirements. These changes are designed to empower PICs to address diverse social challenges with enhanced agility and accountability. However, the amendments also introduce practical challenges, including the need for external directors and auditors, potential revisions to compensation policies, and compliance with forthcoming government guidelines. This column examines the key aspects of the amendments, their implications, and preparatory steps that PICs can take to ensure a smooth transition and maintain public trust in their operations.

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Introduction to Public Interest Corporations

Public Interest Corporations (PICs) in Japan, comprising entities such as Public Interest Incorporated Associations and Public Interest Incorporated Foundations, play a pivotal role in addressing social and public welfare needs. With over 9,700 organizations employing around 290,000 individuals, and contributing approximately 5 trillion yen annually in public-purpose expenditures,¹ these entities are powerful drivers of social change. However, under the current legal framework, some claim that stringent financial rules and administrative requirements impede the ability of PICs to maximize their potential in addressing evolving societal challenges.

The forthcoming amendments to the Public Interest Corporation Act aim to address these concerns by introducing more flexible financial rules, simplifying administrative processes, and enhancing governance and transparency measures. By implementing these changes, the Japanese government seeks to create an environment where nonprofit organizations can thrive while sustaining the public's trust and support.

The Public Interest Corporation Framework: Understanding the Legal Structure

To appreciate the impact of these amendments, it is essential to understand the foundational laws governing public interest corporations in Japan:

1. Act on General Incorporated Association and General Incorporated Foundation

Enacted in 2008, this Act provides the legal foundation for forming nonprofit entities without requiring them to pursue explicitly public-interest purposes.² These associations and foundations have considerable flexibility in their operations, though they do not enjoy the tax benefits that PICs do, nor are they held to the same standards of transparency.

2. Act on Authorization of Public Interest Incorporated Associations and Public Interest Incorporated Foundations (Public Interest Corporation Act)

This Act regulates the certification process for entities seeking “Public Interest Corporation” status, allowing associations and foundations with high levels of public-purpose activity to be recognized as PICs.³ Certified PICs enjoy tax benefits and a public status that reflects their societal value, but are also subject to higher standards for transparency, financial

¹ Summary of Amendments to the Act on Authorization of Public Interest Incorporated Associations and Public Interest Incorporated Foundations, Cabinet Office of Japan, available at <https://www.koeki-info.go.jp/regulation/kaisei.html>

² See, Article 1 of the Act on General Incorporated Association and General Incorporated Foundation

³ See, Article 1 of the Act on Authorization of Public Interest Incorporated Associations and Public Interest Incorporated Foundations

accountability, and government oversight to ensure that public funds are well-stewarded.

Key Features of the Amendments

The amendments to the Public Interest Corporation Act introduce several important changes:⁴

1. Flexible Financial Discipline

- **Balanced Budget Requirement Revision:** The longstanding requirement that a PIC's income not exceed its expenses has been relaxed. Now, PICs are expected to achieve financial balance over a mid-term period, allowing for more sustainable planning and investments.
- **Future Public Interest Project Funding:** PICs are now allowed to set aside funds for future public interest projects, with such funds classified as expenses. This change encourages strategic financial planning and reinforces PICs' commitment to addressing long-term social issues.

2. Streamlined Administrative Procedures

- Modifications in business activities previously required approval; however, after the amendments, PICs will need only to submit notifications, simplifying the administrative burden and allowing for quicker adaptation to societal needs.

3. Enhanced Governance and Transparency

- **Mandatory Segregated Accounting:** PICs are now required to implement three-category accounting, distinguishing between public interest activities, profit-making activities, and general operations. This shift promotes financial clarity and strengthens public trust.
- **New Certification Standards:** PICs must now avoid conflicts of interest by excluding individuals with special financial interests from director and auditor positions and are required to appoint external directors or auditors. Furthermore, annual reports must now cover governance practices and other measures to ensure operational integrity.
- **Government and Organizational Roles:** While the PICs are responsible for enhancing governance and transparency, the government has committed to supporting these organizations by gathering and disseminating information that could aid PICs in their public-benefit activities.

⁴ Comparison Chart Regarding Amendments to the Act on Authorization of Public Interest Incorporated Associations and Public Interest Incorporated Foundations, Cabinet Office of Japan, available at <https://www.koeki-info.go.jp/regulation/kaisei.html>

Implications of the Amendments

These amendments reflect a move toward a more dynamic role for public interest organizations in Japan. With flexible financial management, simplified administrative requirements, and strengthened governance, PICs are better positioned to pursue innovation in tackling social issues.

However, implementing these changes could present some challenges for organizations:

1. **Challenges in Recruiting External Directors and Auditors**

Many PICs may face difficulties in recruiting qualified individuals for the newly required external director and auditor roles. To avoid last-minute challenges, organizations should start their search early, ensuring they meet compliance requirements without disrupting operations.

2. **Remuneration for Board Members**

Currently, many PICs specify in their Articles of Association (AoA) that directors and auditors serve without compensation. However, external directors and auditors, who will bear significant responsibilities as board members, may be difficult to recruit on a voluntary basis. Offering remuneration could help attract qualified candidates, but many organizations may need to amend their AoA if it currently stipulates that directors and auditors are unpaid.

3. **Awaiting Government Guidance**

Although this amendment provides a clear framework, the government is expected to release more specific guidelines and regulations ahead of the implementation in April 2025. Monitoring these updates will be essential, as they may impact recruitment and other preparatory processes.

Conclusion

This legislative shift not only fosters an environment where PICs can operate with greater agility but also ensures that the public can trust in the accountability and transparency of these organizations. Ultimately, these reforms aim to create a society where private entities play an increasingly integral role in addressing public issues, contributing to a more resilient, inclusive, and socially responsive Japan. In the global context, many public interest sectors are moving toward models that emphasize transparency, fiscal responsibility, and public accountability. By requiring higher standards of governance and removing financial restrictions that previously hindered growth, Japan's PIC framework is aligning itself more closely with these international trends, potentially serving as a

model for other nations seeking to balance government oversight with public interest autonomy.

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