



## China Tax Treatments for Charitable Donations

A massive earthquake hit China's Sichuan Province recently causing the loss of lives of tens of thousands people and destruction to a lot of properties in the affected areas. In response to the Nation's call for contribution to the relief effort, a huge number of companies and individuals in China have made or pledged donations to support the disaster relief.

Soon after the devastating earthquake, the Ministry of Finance ("MOF") and the State Administration for Taxation ("SAT") jointly issued the circular Caishui [2008] No.62 ("Circular 62") dated 19 May 2008 addressing various tax treatments for those quake-affected enterprises and individuals. Circular 62 also broadly addresses the tax treatments of charitable donations made by enterprises and individuals.

We discuss below the tax treatments for charitable donations from both Corporate Income Tax ("CIT") and Individual Income Tax ("IIT") perspectives based on Circular 62 as well as the existing and previous tax laws and regulations.

### CIT treatment for charitable donations

#### 1. How much is deductible?

According to the CIT Law and its Detailed Implementation Regulations ("DIR"), Enterprises are allowed to deduct eligible charitable donations up to a limit of 12% of their total annual profits calculated in accordance with the Chinese Accounting Standards.

#### 2. What are eligible charitable donations?

Under the CIT Law and its DIR, only donations made through charitable social organizations or governments at or above the county level are eligible tax-deductible charitable donations. The DIR has outlined the basic criteria for qualified charitable social organizations but has left certain conditions to be prescribed by the Ministry of Civil Affairs, the MOF and the SAT separately.

So far the MOF and the SAT have not released a list of approved charitable social organizations under the CIT regime. However, there is no reason to believe that those charitable social organizations approved under the previous tax regimes would not qualify under the CIT regime. These major charitable social organizations include the Red Cross Society of China, China Charity Federation and China Youth Development Foundation, etc.

#### 3. What are the administrative requirements in claiming CIT deduction?

Generally the donating enterprise should obtain a special official charitable donation receipt ("official receipt") from the charitable social organization as a supporting document for claiming CIT deduction. In the meantime, as indicated in a circular jointly issued by the MOF and the SAT in January 2007 (CaiShui [2007] No.6), the charitable social organizations are also required to issue the official receipt to the donors.

#### 4. What about donation in kind?

According to the DIR, where an enterprise uses its goods, property or labour for donation purposes (among other purposes), it shall be deemed to have sold the goods, transferred the property or provided labour

services, unless otherwise prescribed by the MOF and the SAT. This provision stipulates that the enterprise shall be deemed to have received income in respect of its in-kind donation.

The DIR does not clarify whether the deemed income should be based on cost or market value. It also does not mention whether there should be a "deemed cost" or "deemed expense" available to offset this additional "deemed income". One possible interpretation is that the "deemed income" provision could lead to an increase in the taxable income of the donating enterprise.

However, the "deemed income" clause in the DIR has provided a leeway for the MOF and the SAT to formulate separate rules for exceptional situations. Since there is a need for all kinds of donations for the Sichuan earthquake, it is hoped that the policy makers could consider waiving the "deemed income" rule for in-kind donations made for the purpose of the Sichuan earthquake, even if this will not be a general policy to exclude charitable donations of all kinds from the "deemed income" provision.

#### 5. What about donations made by Foreign Company-Representative Offices ("RO")?

For ROs which are subject to China taxes on a cost-plus basis, there is an issue on whether charitable donations made by the ROs would be treated as the operating expenses of the RO in calculating the deemed turnover of the RO for CIT and Business Tax purposes. There was a previous tax circular Guoshuifa [1998] No.63 ("Circular 63") issued by the SAT which states that monetary charitable donations made by ROs for domestic charitable and relief purposes are allowed to be excluded from the operating expenses of the ROs in determining the deemed turnover amounts.

Technically, this circular issued under the Foreign Enterprise Income Tax ("FEIT") regime should have been automatically annulled when the new CIT regime has become effective January 2008. However, the Chinese authorities may be inclined not to change the overall tax policies for ROs on the ground that there is no major difference in the taxation principles for ROs between the FEIT regime and the CIT regime. It is likely that even if the Chinese authorities would reform the RO taxation policies in the future under the CIT regime, any changes would likely be prospective and not retrospective.

In view of the above, ROs may still rely on Circular 63 for the tax treatment of their charitable donations. Before the SAT (and MOF) releases a formal clarification in the policy for this tax treatment issue, it is advisable for the donating ROs to seek the position of their local in-charge tax bureaus.

### **IIT treatment for charitable donations**

#### 1. How much is deductible?

According to the IIT Law and its implementation rules, individuals making charitable donations to domestic social organizations and government agencies for the relief of education, public welfare and disaster/poverty are entitled to claim a deduction up to 30% of the taxable income.

In addition, for donations made to certain designated charitable organizations such as the Red Cross Society of China and China Charity Federation, etc., the 30% limit is waived.

#### 2. What are the administrative requirements in claiming IIT deduction?

Normally, the individual making the charitable donation should obtain an official receipt from the charitable social organization as a supporting document to claim IIT deduction. Where the IIT is withheld by the employers, the employee should provide the official receipt to its employer who would reflect the deduction of charitable donations on the monthly IIT withholding return.

In response to the appeal for donations for the Sichuan earthquake, many employers have voluntarily collected the donations from their employees and make the donation directly to the charitable social organizations on behalf of their employees. Very often, the official receipts will be issued in the name of the employer rather than in the name of the individual employees. The Beijing Local Tax Bureau recently issued a notice in its website advising that, under such circumstance, they will accept the official receipt issued by the charitable social organizations to the employer as supporting documents to the individual

employees' claims for deduction of charitable donations provided that there is a detailed breakdown showing the amount contributed by each individual employee concerned.

Although we are not aware that similar notice is issued in other locations, it is expected that other local tax authorities will possibly follow the arrangement in Beijing. Enterprises are, however, suggested to check with the specific requirements imposed by the respective local tax authorities, so as to ensure the donations are rightly tax deducted for the relevant parties.

### **PwC Observations**

It should be noted that Circular 62 mainly reiterates that the deduction for charitable donations should be in accordance with the existing tax laws and regulations. It does not contain any additional tax relief to encourage people to donate more to support the disaster relief.

As discussed above, there are still uncertainties in respect of charitable donations under the CIT regime. The "deemed income" provision could have a negative impact on enterprises that wish to make in-kind donations. We hope that there would be future circulars to mitigate such impact on these enterprises who are truly acting for the benefits of the Nation.

Further, as a wishful thinking, the Chinese central authorities may consider lifting the 12% and 30% deduction cap and allowing eligible charitable donations to be deducted in full in computing the taxable income of enterprises and individual donors. This would hopefully encourage enterprises to donate more to the disaster relief.

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