

Public Governance Guidance Note

Tax-exempt charities: Introduction to the revised tax guide on national security concerns issued by the Inland Revenue Department

Introduction

One of the important aspects for an NGO which carries out charitable objectives¹ is to be recognised as a tax-exempt charity by the Inland Revenue Department (IRD) under section 88 of the Inland

Revenue Ordinance (IRO). A tax-exempt charity will not need to pay profits tax. This status will also provide other exemptions from business registration fees and certain stamp duty transfers².

Section 88 IRO is convoluted in its drafting. To assist you to understand the section, the exemption from paying profits tax by charitable bodies applies where (1) the profits, for example: donations and investment income, are applied solely for charitable purposes, and (2) the expenses are not substantially expended outside Hong Kong. The IRD can ask for details of the underlying activities from the trade or business that generates the profits, to see if these are consistent with the charitable objects, or the persons they intend to benefit. For example, a charity with the object to protect children that auctions violent comics for fundraising may find itself in trouble with the IRD, if not the public also, in our social media age.

- 1 Also, trusts of a public character are more likely to be well-established names and which this guidance note will not focus on.
- 2 As set out under paragraphs 20 to 35 of the IRD's 'Tax Guide for Charitable Institutions and Trusts of a Public Character' https://www.ird.gov.hk/eng/pdf/tax_guide_for_charities.pdf.

Gratitude is expressed to Chee Weng Lee, Global Head of Tax, Tricor Group, and Mohan Datwani FCG HKFCG(PE) as authors of this guidance note. Also, Ms Edith Shih FCG(CS, CGP) HKFCG(CS, CGP)(PE) Past International President, The Chartered Governance Institute and Past President, The Hong Kong Chartered Governance Institute, and Executive Director and Company Secretary, CK Hutchison Holdings Limited for her inputs in finalising this guidance note. The members of the Public Governance Interest Group are April Chan FCG HKFCG (Chairman), Lau Ka Shi BBS FCG HKFCG, Margaret Yan, Natalia Seng FCG HKFCG(PE), Rachel Ng ACG HKACG, Samantha Suen FCG HKFCG, Stella Ho and Stella Lo FCG HKFCG(PE). Mohan Datwani FCG HKFCG(PE), Institute Deputy Chief Executive also serves as Secretary to the Institute's Interest Groups. If you have any comments and/or suggestions relating to the Institute's thought leadership, please contact: mohan.datwani@hkcgi.org.hk.

Importantly, donors' donations to a section 88 charity may qualify for tax deductions³. In fact, in difficult times, the availability of tax deductibility may well influence whether a donor makes a donation. It is therefore important for a charity to make it, and stay on the list on the IRD's webpage for section 88 charities⁴.

The IRD explains that individual and business donors whose donations are chargeable to salaries tax, personal assessment or profits tax can claim deduction for the aggregate of approved charitable donations up to 35% (up to 25% for the years of assessment 2004/05 to 2007/08) of the assessable income or profits, as the case may be, in the basis period of a year of assessment. Such aggregate must not be less than \$100. (Sections 16D and 26C of the IRO).⁵

The NSL

On 30 June 2020, the Standing Committee of the National People's Congress (NPC) promulgated the '*Law of the People's Republic of China on Safeguarding National Security in the Hong Kong Special Administrative Region*' (NSL). The NSL has 66 articles, contained in six chapters, covering namely general principles, duties and the Government bodies of the HKSAR for safeguarding national security, offences and penalties, jurisdiction, and applicable law and procedure⁶. A charity must not violate law, and most certainly not the NSL⁷.

By September 2021, the HKSAR Government publicly announced that although promoting charitable work should be encouraged, this cannot endanger national security in the name of charity⁸. Also, the 'Tax Guide for Charitable Institutions and Trusts of a Public Character' (**Tax Guide**) was updated in the same month to address national security concerns following the enactment of the NSL⁹. This Guidance

Note is intended to provide a broad overview of the additional requirements under the Tax Guide relating to national security, as well as a simplified health check for tax deductibility. This is kept at a basic level to raise awareness of the issue, and in case of doubt, professional advice should be sought, as appropriate.

The Tax Guide

Paragraphs 5 to 11 of the Tax Guide explains the meaning of 'charity'. The following are the headings of these paragraphs, and you are encouraged to read the Tax Guide for details:

- Charity is not equivalent to voluntary or non-profit-making organisation
- Charity must be established exclusively for charitable purposes
- Charitable purposes are classified into four heads (a) the relief of poverty, (b) the advancement of education, (c) the advancement of religion, and (d) other purposes of a charitable nature beneficial to the community not falling under any of the preceding heads (which must be of benefit to the Hong Kong community unlike those under headings (a) to (c)), and
- Charity must be established for public benefit.

Additionally, because of national security concerns, paragraphs 12 to 15 of the Tax Guide now state that a charity should not engage in or support any acts or activities which are unlawful or contrary to the interests of national security. The point here is that in carrying out your charity's objects, you need to make sure that you know that you are not supporting activities that potentially violate NSL. In most cases, there should be no issue, for example, if you pay

3 For example, if the donor is an individual, and gives to a charity, the donor may fall into a lower tax bracket, which may be important to the donor, especially for significant donations.

4 https://www.ird.gov.hk/eng/tax/ach_index.htm

5 <https://www.ird.gov.hk/eng/tax/ach.htm>

6 <https://www.info.gov.hk/gia/general/202006/30/P2020063001015.htm>

7 We are not in a position to provide any advice on the NSL which is a new law and in case of doubt, professional advice needs to be obtained.

8 <https://news.rthk.hk/rthk/en/component/k2/1610338-20210913.htm>

9 Supra note 2.

volunteers for meals when they help clean homes for the aged, there is probably no NSL violation. But, please do conduct a risk assessment as to where there are potential weaknesses in your operations which could be exploited for violation of the NSL. In fact, you can manage the risks by designing an appropriate system of controls. For example, it is good to have two persons, who do not previously know each other to keep check on each other.

You should also have a document signed by your volunteers for them to agree to comply with 'all applicable Hong Kong laws and regulations, including the NSL¹⁰. This statement should also be incorporated into your operational manuals and documents, especially those that you distribute to your volunteers. You should also consider conducting spot or undercover checks of the operations of your charity. Please take this issue seriously, and do not 'turn a blind eye' meaning not caring as to what happens.

Fundraising and use of funds

Also, there can be national security concerns for both fundraising and the use of your charity's funds.

In this connection, a tax-exempt charity should avoid receiving anonymous donations, aside from say public fund-raising, for example from selling flags. There should be some basic identification information for record keeping. In respect of significant donations, whether one-off or over a period of time, these should not be accepted without appropriate background check of the donor's source of funds¹¹. Further, if a charity is directed that a donation is to be used for a specific purpose, there may well be red flags raised. The question is why are the funds not directly provided to the intended recipient? Is it for tax evasion or to shield some illegal activities, including those specified under the NSL? Please document any justifications, which need to be strong ones for directed donations.

Continuous compliance requirements

The IRD may call for accounts, annual reports or other documents under paragraphs 65-67 of the Tax Guide. Where the IRD considers, after taking a holistic view, that a charity seriously contravenes its charitable objects (for example, use of funds not in furtherance of the charity's charitable objects, a serious breach of the charity's governing instrument, or engaging in or supporting acts or activities which are unlawful or contrary to the interests of national security) and hence fundamentally changes its charitable status and is not a genuine charity, the IRD may withdraw the recognition of tax exemption status of the charity concerned and raise tax assessment where appropriate.

Further, under paragraph 68 of the Tax Guide, a tax-exempt charity needs to notify the IRD within 1 month of the changes to its Articles of Association. The IRD should also be notified with regard to following matters: (a) change of its correspondence address, (b) alteration to its governing instrument, (c) termination of its subsidiary body (that is, a service unit or time-limited project) separately disclosed on the list of tax-exempt charities, or (d) cessation of its operation, dissolution or winding up.

For completeness, in relation to any proposed changes of the articles of association as the governing instrument of a Hong Kong incorporated charity, the consent of the IRD and the Companies Registrar should be sought beforehand to ensure the acceptability of the proposed changes and the retention of charitable status. This would extend, for example, to a change of name, or the desire to incorporate a subsidiary, the ability of which is not automatically available under the standard form of articles of association of a company limited by guarantee. Any approved changes along with the special resolutions will need to be filed with the Companies Registry and the IRD within a prescribed period.

10 For example, this can be contained in the document or questionnaire that you get from volunteers when they provide you with their personal information including their name, identity information and addresses.

11 As to what is significant depends on the charity, in business type situation, the amount is HK\$120,000. See, for example, paragraph 5.2. https://www.tcspl.gov.hk/tcspls/portal/guide/62/eng/TCSP_G2-e.pdf. However, this depends on what in effect the donation means to the charity from a risk-based approach and it may be safer to take a much lower threshold, for example, HK\$10,000. On background checks, there should be identity information, as with all donations, and a general understanding of how the donor made his money, and why does he want to contribute to the charity.

What Next?

We, therefore, recommend that all charities undertake a 'health check', and, in this regard, the following should be reviewed, and amendments made where needed.

- To begin with the health check please ensure that you and those involved in running your charity have read the Tax Guide and the NSL. If necessary, arrange for training on these documents.
- Review the constitutional documents of your charity, including the objects of your charity and to whom it benefits. Please make sure that this is clear and consistent with the definitions of a charity under the Tax Guide.
- You may also want to consider being clear on how funds are applied and distributed under your constitutional documents. There should be standard prohibitions against payment of remuneration to members of the governing body and the need for compliance with the law (which includes the NSL).
- In terms of operations, ensure that the trade or business generating the income, for example, fundraising, charitable sales, etc., are consistent with the charitable objects and benefit those intended under the charity. Also, the expenses of the charity must not be substantially expended outside of Hong Kong.
- Be mindful that your activities might be hijacked by subversive agents carrying out activities that violate the NSL. You need to make a risk assessment. Spot or use of undercover checks may be useful.
- From risk assessment, design questionnaires and systems of controls, for example talking to the people intending to benefit from your charities for feedback, to assess that everything is in order from time to time.
- Please keep all paper trails and documents in case of an IRD audit. These may include organisation charts, details of fund-raising activities, investments and use of resources of your charity.
- Please ensure continuous compliance with the Tax Guide, and have policies and procedures that reflect these requirements. That means you need to go through the Tax Guide, paragraph-by-paragraph, and consider what needs to be done by your charity to comply with the Tax Guide, who should be doing this, and by what time. You will then write these out as part of your policies and procedures.
- Generally, review from time to time the operations and usage of donations to ensure that your charity complies with the Tax Guide and hence, continues to be a tax-exempted charity consistent with section 88 of the IRO.