

# CHINA MATTERS

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## What's Next for Foundations in China?

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*Lack of transparency and the wait for new regulations have some companies looking for other options to broaden their social impact in China.*

### Quick Glance

- Though the need for foundations is great in China, PRC regulations on charitable giving are underdeveloped, making it difficult for foreign foundations to give away money.
- Until new regulations are issued, foreign companies and foundations can apply to set up a foundation in China after finding PRC sponsors and jumping through hoops.
- Many foreign companies resort to establishing a special fund to operate under the auspices of an existing PRC foundation.

Many multinational corporations (“MNCs”) aim to develop a well-crafted corporate social responsibility plan as part of their standard operating procedure worldwide. Having a local charitable foundation or nonprofit entity in China can help a foreign-invested enterprise (“FIE”) deepen its ties with the community, develop goodwill with local authorities, extend a philanthropic hand toward projects the FIE feels are most urgent, and enjoy modest tax breaks. A few long-established foreign

foundations that focus on education, healthcare, environmental issues, and other concerns also have been looking to establish a foothold in China as part of their global approach to solving problems that affect populations worldwide.

Giving away money in any country should be a relatively easy task. In China, however, many of the laws and policies that govern charitable activities remain under development, leaving gray areas and barriers for foreign companies or international foundations looking to take their first philanthropic footsteps there. MNCs or international foundations that seek to engage in philanthropic activities in mainland China should understand current PRC laws and where the policies are headed.

### The Guidelines

Though China in theory allows foreign entities to establish foundations, in practice the procedure is not so straightforward. The principal piece of PRC legislation that guides the creation of foundations is the State Council's Administrative Regulations on Foundations, which took effect June 1, 2004. The regulations allow only domestic entities or PRC nationals to establish a foundation in the Mainland. According to Article 2, an overseas entity must use its PRC subsidiary as the donor to set up a PRC

foundation provided certain conditions are met, including

- The funds of the proposed foundation meet the minimum capital requirements: ¥8 million (\$1.2 million) for a nationwide public foundation, ¥4 million (\$590,000) for a regional public foundation, or ¥2 million (\$295,000) for a private foundation;
- The applicant (such as an FIE) must first obtain approval from a government “business supervisory unit” (for instance, the PRC Ministry of Health) that is in charge of the public sectors that the applicant’s philanthropic activities target and is willing to sponsor the proposed foundation;
- The proposed foundation is established for a specific purpose that promotes the public welfare in China. The PRC Ministry of Civil Affairs (“MCA”) and the proposed foundation’s government business supervisory unit must confirm that the foundation falls within the definition of “PRC public interest domain”;
- The proposed foundation’s desired name, articles of association, and list of personnel responsible for conducting its planned scope of activities must be submitted to and approved by MCA and the proposed foundation’s government business supervisory unit; and
- The proposed foundation has a registered office address in China.

Without the approval of a business supervisory unit, the FIE cannot file an application to register a PRC foundation with MCA. In practice, however, it is difficult for an FIE to locate a government business supervisory unit willing to support its activities, as some PRC ministries seem to view this role as carrying only risk and no reward (see the *CBR*, May–June 2009, p.34). To date, it is unclear whether any

foreign company or its PRC subsidiary has successfully established a foundation in the Mainland.

### **Foreign Foundations Face Similar Struggles**

Though the regulations permit foreign foundations to set up a representative (“rep”) office in China, doing so requires the cooperation of a “sponsor,” which must be a PRC government business supervisory unit, and the foundation must comply with a few specific procedures. First, like a foreign company that wants to establish a China-based foundation, the foreign foundation must obtain approval from a PRC government business supervisory unit that is in charge of the public sectors in which the applicant’s philanthropic activities aim to engage. Under Article 7 of the regulations, this government unit could be any one of the relevant authorized departments of the State Council or organizations authorized by the State Council to act as a supervisory unit for overseas foundations, such as the ministries of Education or Health.

After obtaining this preliminary approval, the applicant must submit evidence of the approval, a completed application form, and other materials to MCA, which will then review the application. The regulations require MCA to announce its decision within 60 days of receiving all required documentation. Once it receives MCA approval to set up a rep office, the overseas foundation will be granted a formal registration certificate, at which point its rep office will be successfully incorporated. With this PRC legal status, the rep office can arrange visas for foreign employees, hire local employees, open a PRC bank account, and initiate other steps to implement foundation projects.

Though establishing a rep office clearly facilitates an overseas foundation’s efforts to conduct business in China, there has not been a substantial increase in the number of foundation rep offices. (According to MCA statistics, only 14 overseas foundations had successfully registered their rep offices in mainland China as of June 2010.) The chief obstacle seems to

be locating a PRC government business supervisory unit willing to oversee and support the activities of a foreign foundation. Like FIEs, many foundations appear to have trouble convincing a PRC government business supervisory unit to support their activities in China. Moreover, having a rep office does not allow an overseas foundation to conduct the full range of foundation activities. Most notably, a rep office of an overseas foundation cannot raise funds in China for its China-related activities.

PRC officials acknowledge the practical obstacles to the development of FIE-sponsored foundations in China and fully operational arms of existing foreign foundations, but officials state that many of these concerns will be addressed when China releases the revised guidelines on charities. A draft of the new Law on the Promotion of Charities, which will likely contain stricter legislation over fund management, is expected to be released in 2011. The new law reportedly includes provisions that enhance government control over charitable organizations, including tighter registration requirements for individual volunteers.

Stricter PRC government controls have also been issued for donations from overseas sources. Under new State Administration of Foreign Exchange regulations that took effect in March 2010, FIEs, foundations, or other organizations that accept donations from overseas donors face more scrutiny than ever. The new regulations increase controls over foreign funding, while adding more paperwork and splitting formalities among a number of governmental authorities so that recipient groups in China may find it harder to obtain funding.

#### **Moving to “Plan B”: Using a Special Fund**

Given these uncertainties and the current difficulties in securing official registration to operate as a charitable organization in China, another option has emerged as a way for foreign companies or foundations to pursue their charitable goals in China. An increasingly popular option is for

overseas entities or their PRC subsidiaries to establish a special fund (*zhuanxiang jijin*) to operate under the auspices of an existing domestic PRC foundation.

Companies can set up a special fund to target specific goals, such as promoting education for migrant workers’ children. The special fund monies are deposited into an account opened in the name of the host PRC foundation. An example of such a fund is the BMW Excellent University Students Award Fund, which was established under the China Soong Ching Ling Foundation in January 2006 by the BMW Group and BMW Brilliance Automotive Co., Ltd. From 2006–10, the BMW Excellent University Students Award Fund provided awards annually to 100 science and engineering students from 10 leading Chinese universities to promote the spirit of innovation among college students.

The State Council regulations and the Working Guidelines for Foundations, issued by MCA’s Bureau of Administration of Civil Organizations, govern the registration of special funds. To establish a special fund, an overseas entity (which can be a foreign company, a foreign foundation, or its Chinese subsidiary) must first locate a suitable PRC foundation whose scope of work is in line with the goals of the proposed special fund. Then the overseas entity must negotiate and conclude with the PRC foundation a donation agreement, which should include detailed plans for the composition of the special fund’s management committee. Once these steps are complete, the PRC foundation must file an application with and obtain approval for the special fund from its business supervisory unit within the relevant PRC government agency, as well as from MCA. The application process generally takes several weeks, though no statutory rules regulate the duration of the review and approval process. When all the required approvals are granted, the special fund is officially established.

Strictly speaking, the special fund is not an entity “incorporated” in the Mainland unless the host PRC foundation obtains approval from its supervisory unit and from MCA to establish the special fund as a

branch of the PRC foundation. In most cases, the special fund is an account established in the name of the host PRC foundation that receives funds for a specific project mutually agreed upon by the host foundation and the foreign foundation or corporate entity that donates the funds into the account.

#### ***Advantages of a special fund...***

Compared with registering a foundation or setting up a PRC rep office of a foreign foundation, a special fund is relatively less complicated to establish, chiefly because the foreign entity is not required to gain the support of a PRC government business supervisory unit and register with MCA. Usually, the overseas entity relies on its host PRC foundation to work with the relevant government authorities to obtain approval and complete the required registration procedures. In contrast, establishing a China-based foundation or foundation rep office requires the foreign entity to forge its own high-level connections with PRC government authorities to obtain support from a government business supervisory unit.

A number of recent unofficial inquiries to Chinese public foundations reveal that most are willing to cooperate with MNCs to establish special funds. There is no statutory minimum capital requirement to set up a special fund, but, in practice, most PRC foundations have their own thresholds that range from ¥1–3 million (\$147,600–\$442,700). The Chinese foundations surveyed noted that they have foreign currency accounts and are willing to accept contributions from overseas donors in foreign currencies.

Unlike a PRC rep office of an overseas foundation, which cannot conduct fundraising activities or receive donations in China, a special fund can solicit donations in China subject to the agreement and administrative supervision of its host foundation. In particular, if the special fund is established under a nationwide public foundation, the special fund may receive funding from the general public in China through and under the administrative supervision of its host PRC

foundation. A special fund set up through a local public foundation can raise funds only within the province where the local foundation is incorporated. A nonpublic foundation (*feigongmu jijin*), on the other hand, is prohibited from raising funds in China, so an FIE looking to establish a special fund with this type of PRC host should bear this fact in mind.

In addition, with appropriate tax authority approvals, PRC tax benefits may be available for the money contributed to the establishment or operation of a special fund. A PRC foundation certified by the PRC Ministry of Finance and the State Administration of Taxation as a tax-exempt charitable organization can issue charitable donation receipts to donors. With such receipts, a donor, whether a PRC-incorporated entity or an individual in China, can obtain PRC tax benefits for donations made to the foundation.

#### ***...and a few shortcomings***

There are, however, a few caveats. Since a special fund is not an independent legal person or legal entity, it must operate within the parameters prescribed under the charter of its host PRC foundation. The operation of a special fund is closely monitored and supervised by its host foundation, which must follow instructions from its business supervisory unit to use the special funds. Similar to a PRC foundation, a special fund is also subject to ongoing PRC compliance requirements. A special fund is required to have its own annual inspection, submit its financial report, and fulfill other compliance obligations together with its host foundation. Also, informal surveys with a number of Chinese nationwide public foundations reveal that the special fund registered by a foreign entity under a PRC foundation may be ineligible to arrange for visas for overseas employees, employ PRC citizens, or open PRC bank accounts in the name of the foreign entity.

Further, with a few exceptions, most PRC host foundations usually charge an annual management fee for a special fund. The amount of the fee varies and the percentage is negotiable, with a cap of

10 percent of the special fund's annual expenditure. For instance, if a special fund is established to award annual scholarships to college students and has an annual scholarship budget of ¥100,000 (\$14,760), then the annual management fee for this special fund would be no more than ¥10,000 (\$1,476)—10 percent of the special fund's annual expenditure on its philanthropic activities.

More important, upon registration, a special fund established under a host PRC foundation must establish a management committee, the composition of which is not subject to any PRC statutory requirement and can be decided jointly by the overseas entity and the Chinese foundation. To ensure the effective operation of the special fund, it is important for the overseas entity to negotiate and document all the details of the fund's management and goals.

#### **Getting Better at Doing Good**

A special fund may serve as a practical option for an MNC or an overseas foundation to implement its goals in China. A special fund enables such entities to channel funds into philanthropic activities in China, as well as tap into donations from Chinese sources. To make the most of its charitable goals, however, an FIE or overseas foundation should locate a suitable PRC host foundation and protect its interests with detailed documentation.

There are clear signs that China is balancing the need to encourage the development of charitable organizations against broader concerns that these organizations are run in a legal and orderly manner. In July, PRC officials met with representatives of international foundations to announce the establishment of a new China Foundation Center, which will provide an online database on foundations in China, with details on their

operations and disbursement of funds. Looking to its own newly emerging entrepreneurs, former MCA official Wang Zhenyao recently challenged each of China's billionaires to pledge ¥1 million (\$147,600) in charitable donations each year.

In the interim, there is no shortage of worthy causes in China—or of potential host foundations for special funds. According to the MCA's Bureau of Administration of Civil Organizations website ([www.chinanpo.gov.cn](http://www.chinanpo.gov.cn)), as of June 2010, there were more than 130 registered nationwide public foundations in China, providing assistance in healthcare, education, child welfare, environmental protection, and other areas. This large pool of foundations provides overseas donors and FIEs with several potential hosts for special funds.

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