



# Fact Sheet – Tax Guide for Charitable Institutions and Trusts of a Public Character

(UPDATED BY THE INLAND REVENUE DEPARTMENT IN APRIL 2020)

## 1. BACKGROUND

- 1.1. The Inland Revenue Department (the “**IRD**”) has updated its Tax Guide for Charitable Institutions and Trusts of a Public Character (the “**Guide**”) in April 2020, which was last revised and published in September 2019.
- 1.2. The purpose of this fact sheet is to provide non-governmental organizations an overview of the latest amendments made in the updated Guide. It also provides a recap of the key issues on the qualification requirements, formalities, and regulations concerning charitable institutions and trusts of a public character in Hong Kong.

## *Recap of Key Issues*

### 2. MEANING OF CHARITY

- 2.1. The IRD has long adopted the practice to refer to the four heads of charitable purposes:
  - (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.
- 2.2. Head (d) above will only be regarded as charitable if they are of benefit to the Hong Kong community whilst the first three heads may be in relation to activities carried on in any part of the world.
- 2.3. A purpose of an institution or a trust is not charitable unless it is for public benefit. There must be an identifiable benefit or benefits which are clear, relatable to its charitable purpose and be balanced against any detriment or harm.
- 2.4. An institution or trust cannot generally be charitable if it is in principle established for the benefit of specific individuals. Broadly speaking, the beneficiaries of a charity must not be defined by a personal connection such as family relationship or common employer. The benefit must be to the public in general, or to a sufficient section of the public without unreasonable restrictions by geographical or other restrictions. Any personal benefit must be incidental.

### 3. REQUIREMENTS ON CONSTITUTION OF CHARITY

- 3.1. A charity must be established by a written governing instrument which states precisely and clearly the purposes or objects for which it is established.
- 3.2. A majority of charities in Hong Kong are incorporated as companies limited by guarantee, with governing instrument being the Articles of Association. The Articles of Association should include objects clause, clause limiting application of funds towards the attainment of stated objects, clause prohibiting distribution of income and properties amongst members, clause prohibiting members from receiving remuneration (except for exceptional circumstances specified), etc.

### 4. TAXATION OF CHARITY

- 4.1. To put it simply, all profits derived in Hong Kong from trading or business activities are subject to profits tax.
- 4.2. A charity is exempt from profits tax subject to certain conditions being fulfilled under section 88 of the Inland Revenue Ordinance (Cap. 112) (the **"IRO"**) in relation to the trade or business carried on by the charity concerned:
  - (a) such profits are applied solely for charitable purposes;
  - (b) such profits are not expended substantially outside Hong Kong; and
  - (c) either (i) the trade or business is exercised in the course of the actual carrying out of the expressed objects of such institution or trust; or (ii) the work in connection with the trade or business is mainly carried on by persons for whose benefit such institution or trust is established.
- 4.3. A charity typically seeks recognition from the IRD of its tax exemption status under section 88 of the IRO<sup>1</sup>.

## Updates

### 5. "TRADE" OR "BUSINESS" – WITH UPDATED EXPLANATIONS

- 5.1. The updated Guide explains that the definitions of "trade" and "business" are not exhaustive. Each case should be assessed based on its fact. Whether an activity is considered as "trading" depends on a number of factors such as:
  - (a) the number and frequency of transactions;
  - (b) the nature of the goods or services being sold;
  - (c) the intention of the charity in acquiring the goods which are to be sold;
  - (d) whether the goods are capable of being used and enjoyed by the charity selling them;
  - (e) the nature and mechanics of the sales; and
  - (f) the presence or absence of a profit motive.
- 5.2. Elaboration on the concept of "business" is only provided in the updated Guide. The updated Guide sets out the key indicia in determining whether the activities carried on by an organization amount to the carrying on of a business:
  - (a) whether the organization intends to carry on a business;
  - (b) the nature of the activities, particularly whether they have a profit-making purpose;
  - (c) whether the activities are: (i) repeated and regular; and (ii) organized in a business-like manner, including the keeping of books, records and the use of a system;
  - (d) the size and scale of the organization's activities including the amount of capital employed in them; and
  - (e) whether the activities are better described as a hobby or recreation.

<sup>1</sup> The list of charitable institutions and trusts of a public character, which are exempt from tax under section 88 of the IRO as at 30 April 2020, available at: [https://www.ird.gov.hk/eng/pdf/s88list\\_emb.pdf](https://www.ird.gov.hk/eng/pdf/s88list_emb.pdf).

## 6. NEW EXAMPLES ILLUSTRATING VARIOUS SCENARIOS AND THE RESPECTIVE TAX TREATMENTS

TYPES	EXAMPLES	POSITION
Primary purpose trade/business (i.e. profits contribute directly to an expressed object)	<ul style="list-style-type: none"> <li>The sale of products made of recycled materials by an environmental protection charity</li> <li>The provision of medical consultation by an elderly care and welfare charity in return for consultation fees</li> <li>The provision of training courses to children with special education needs by a children's charity in return for course fees</li> <li>The provision of low-priced meals to the poor by a poverty charity</li> <li>The provision of a residential care home for the elderly by an elderly care charity in return for fees</li> </ul>	Can be exempted from profits tax
Ancillary <sup>2</sup> trade/business (i.e. profits contribute indirectly to the furtherance of an expressed object)	<ul style="list-style-type: none"> <li>The sale of food, drink and snacks to patrons of an art charity or museum charity</li> <li>The provision of childcare services in a church to parents who attend church services</li> <li>The sale of vegetarian food by a religious charity in a temple (e.g. Buddhist temple) built for the advancement of religion</li> <li>The provision of study tour to children by an education charity</li> <li>The provision of pilgrimage tour to believers by a religious charity</li> </ul>	Can be exempted from profits tax
Trade/business where work mainly carried out by the beneficiaries	<ul style="list-style-type: none"> <li>The sale of artwork produced by elderly persons as part of their rehabilitation by an elderly care and welfare charity</li> <li>The operation of a restaurant mainly by the deaf as part of a training programme run by a hearing loss charity to facilitate the integration of the deaf into the community</li> <li>The provision of car-beauty services by the ex-mentally ill as part of an on-the-job training programme run by a rehabilitation charity</li> </ul>	May be exempted from profits tax
Trade/business involves charging for services or facilities of public benefit	<ul style="list-style-type: none"> <li>Reduced entry fees to art galleries and museums for an art charity or museum charity</li> <li>Scholarship funds provided by others for a school or college or university</li> </ul>	May be exempted from profits tax
Investment in trading company	<ul style="list-style-type: none"> <li>Investment in a trading company that operates a hotel or restaurant</li> </ul>	Not exempted from profits tax

<sup>2</sup> The updated Guide highlights that trade/business with the purpose to simply raise funds for charity would not be regarded as "ancillary". There must be a connection with the expressed object of the charity.

<b>Financial investment</b>	<ul style="list-style-type: none"> <li>Investment in surplus fund that is not needed in the short or medium term in a diversified investment fund designed for long term investment Provided that:             <ul style="list-style-type: none"> <li>The charity itself does not engage in trading of investment fund or financial securities</li> <li>The investment is appropriate and in line with its investment policy provided in the governing instrument</li> <li>Any conflict of interest has been disclosed and managed</li> <li>Any personal benefit has been identified and is acceptable due to the reasonableness, necessity and in the interest of the charity</li> </ul> </li> </ul>	May be exempted from profits tax
<b>Property letting not exercised in the course of actual carrying out of expressed objects</b>	<ul style="list-style-type: none"> <li>A charity set up for promotion of religion leases out property at market rent without specific target group of tenants Provided that:             <ul style="list-style-type: none"> <li>Rental income is applied solely for its charitable objects and is not expended substantially outside Hong Kong</li> </ul> </li> </ul>	Not exempted from profits tax
<b>Property letting exercised in the course of actual carrying out of expressed objects</b>	<ul style="list-style-type: none"> <li>A charity set up for the relief of poverty lets out apartment units it owns at below-market rent to the poor Provided that:             <ul style="list-style-type: none"> <li>Rental income is applied in Hong Kong solely for its charitable objects</li> </ul> </li> <li>An environmental protection charity leases a function room when it is not reserved for holding activities related to environmental protection to other charities at a rent Provided that:             <ul style="list-style-type: none"> <li>Rental income is applied solely for its charitable objects and is not expended substantially outside Hong Kong</li> </ul> </li> </ul>	May be exempted from profits tax

## 7. DUTY TO INFORM CHANGE IN CIRCUMSTANCES

The duty to inform change in circumstances of a charity has not changed substantially. If there is (a) a change of its correspondence address, (b) alteration to its governing instrument, (c) termination of its subsidiary body<sup>3</sup>, or (d) cessation of its operation, dissolution or winding up, it is obliged to inform the IRD within 1 month, or else the IRD may cease accepting its tax-exempt status.

## 8. DUTY TO INFORM CHARGEABILITY TO TAX

8.1. The duty to inform chargeability remains the same. If a charity has (a) ceased to be a charity with chargeable profits which were previously exempted under the proviso

to section 88 of the IRO, or (b) commenced to derive chargeable profits, other than profits which were previously exempted under the proviso to section 88 of the IRO, it is obliged to inform the IRD of its chargeability to tax for a year of assessment not later than 4 months after the end of the basis period for that year of assessment.

8.2. The updated Guide flags that if a charity fails to inform chargeability to tax (hence commits the relevant offence) and upon prosecution, the Commissioner may “compound” the relevant offence (i.e. accept a monetary settlement instead of sanctioning the institution of a prosecution) in lieu of penal action. The Commissioner may also impose additional tax.

<sup>3</sup> The updated Guide clarifies the meaning of “subsidiary body”, referring to a body which is not an entity distinct from the charity and is governed by the charity’s governing instrument under the charity’s sole ownership and control.

## 9. DUTY TO REPORT REMUNERATION PAID TO EMPLOYEES OF THE CHARITY

Similar to all other employers' obligations, a charity has a duty to report details of remuneration made to its employees for each year of assessment and to report the employees' commencement/cessation of employment and departure from Hong Kong.

## 10. CONCLUSION

The IRD provides helpful clarifications on the definitions of "trade" and "business". The new examples also give more specific and comprehensive guidance on the conditions that organizations should be aware of when claiming for tax exemption.

## Pro Bono Practice of DLA Piper

*“Pro bono is a core part of our business, and the team is staffed by professionals at the top of their game.”*

– Simon Levine, Managing Partner & Global Co-CEO of DLA Piper

At DLA Piper, we have a dedicated team of lawyers carrying out innovative and effective pro bono programs worldwide. In 2019, 175 of our lawyers in Asia provided over 6,000 hours of award-winning pro bono services to over 100 individual and NGO clients.

We are keen to give back to the local community who has been supporting our business development.

We value our partnership. We provide various types of service to our pro bono clients, including:

- Legal clinic;
- Legal advice on governance and other internal issues;
- Tax/charitable status advice;
- Co-organizing legal education workshops/ seminars; and
- Legal research.

Your suggestions help us to understand the local needs.

## Meeting our people

If you have any questions on the above or would like to obtain further legal advice, please feel free to reach out to Anderson Lam (anderson.lam@dlapiper.com), our Partner and Co-Head of Tax, Asia or Samantha Mak (samantha.mak@dlapiper.com), our Associate.

If you are interested in partnering with us and building pro bono projects together, please feel free to reach out to Aaron Chan (aaron.chan@dlapiper.com), our Pro Bono Associate.