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**China's Charitable Foundations: Development
and Policy-Related Issues**

By

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Abstract

As an innovative form of social organization, the charitable foundation is a new phenomenon in the People's Republic of China. Since 2004, when the new Regulations on Administration of Foundations were promulgated, the foundation sector has experienced rapid growth. However, compared to its potential and the important role the foundation sector can play in China's social development, a more favorable institutional and legal environment should be considered to boost its expansion. Since government policies are vital in shaping the landscape of the civil sector in China, this paper will focus on how government policies can help create a conducive legal and institutional environment for the expansion of private foundations. Specifically, administrative barriers and tax incentives are extensively discussed. In doing so, experiences from other countries, especially the US, will be discussed to serve as a reference as well as a model of best practice.

Keywords: Charitable contribution; Charitable foundation, Income tax deductible, Philanthropy; China.

JEL Classification No.: H21, L31, L38, O20.

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China's Charitable Foundations: Development and Policy-Related Issues*

I. Introduction

A foundation is a not-for-profit organization that promotes public benefit undertakings through grants and donations. Its assets come from individuals, legal persons or other organizations. Though, historically, a foundation is among the oldest existing social institutions in the world, it is, as an innovative form of social organization, a new phenomenon in the People's Republic of China. The first national charitable foundation, the Chinese Children and Youth Foundation, was set up in 1981. Six other foundations were set up in the same year. Most of the first-established foundations were public foundations, funded and managed by the government. Private foundations were almost non-existent until 2005, after China issued the Regulations on the Administration of Foundations (RAF) in June 2004. The RAF, for the first time, legally distinguished between public fundraising (hereafter "public") foundations (*gongmu jijinhui*) and non-public fundraising (hereafter "private") foundations (*feigongmu jijinhui*) and lowered barriers for the establishment of private foundations. Since then, the foundation sector has experienced rapid growth. By March 2013, the total number of foundations reached 3082, with 1753 private foundations and 1329 public ones.

During the past 20 years, due to the accumulation of private wealth and encouraging tax laws, aided by the increasing awareness of corporate social responsibility, private foundations have developed very rapidly and have started to play an increasingly important role in promoting China's social development. Their services cover a wide range of social fields, including education, health, poverty relief, public security, culture, environment and animal protection. Because of their formal, institutionalized status, private foundations have started to exert leadership influence in China's civil sector.

With the rapid development of the foundation sector after 2004, increasing research attention has been shifted to this area. Statistics and data are rare for this new sector though. In 2010, China Foundation Center, an information service platform that imitates the US Foundation Center, was launched to collect and publicize data on foundations. So far, the information and data have been quite limited and preliminary. Some important research has been done by civil study institutes at universities and research institutions, providing statistics and analysis on which other scholars base their work. The Blue Book Series of Philanthropy (Annual Report on China's Philanthropic Development), compiled by a team led by Yang Tuan at the Chinese Academy of Social Sciences, provides an overview of the whole philanthropic sector, with some discussion of the foundation sector. A more in-depth effort is the Green Book Series of Foundations (an independent report on Development of Foundations) by Kang *et al.* from the NPO Research Institute of Renmin University. It started in 2011 and publishes annual report specifically on foundations. Furthermore, from 2009, an annual forum on the development of China's non-fundraising foundations is held, which publishes an annual report, each year focusing on a specific subject. For example, the 2010 forum issued a report on internal governance and guidelines for information disclosure. The report issued by the 2012 forum focused on asset management and distribution.¹

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¹ A prominent feature of the development of China's private foundations is the pioneering role played by individual activists, some of whom are civil practitioners, like Xu Yongguang and Lu Dezhi; some are scholars, like Kang

Excluding the reports on the overall development of the foundation sector, published papers on private foundations are rare.² The few academic papers on this subject look at different aspects of foundation development, which can be categorized into two groups: the social and institutional environment of foundations and the internal governance and management of foundations. Some scholars (e.g. Wang, 2010) analyze China's ancient charitable tradition and argue that "individual charity" is a barrier to the modern concept of philanthropy; Liu and Zhang (2009) analyze the incentive mechanism of enterprises to engage in charitable activities and detail social pressure, public image building and social responsibility as key factors. Many of China's civil practitioners point out how "Chinese style philanthropy," the state-dominated charity system, has hindered the development of private foundations.³ Lin and Wu (2012), using survey data, argue that the state-dominated charity system is limiting the role of non-profit organizations (NPOs) to perform their charitable function. Tax policies are regarded as the most important institutional factors affecting foundations and are therefore among the most discussed topics. As early as in 2004, Irish *et al.* (2004) conducted a very comprehensive study of China's tax system and set forth a number of specific recommendations for improvements applicable to China's NPOs. Some of these suggestions were later echoed in an amendment of the enterprise income tax law promulgated in 2009, while others are still applicable today. In recent years, due to a series of scandals and misconduct in a few foundations, there is mounting distrust from the general public regarding the foundation sector as a whole. Discussions on how to improve a foundation's internal governance have raised the issues of accountability and transparency (Liu, 2012).

The foundation sector worldwide is regarded as one of the most important contributors to the success of the civic sector. Because of its endowment and the social aspiration of the donors, the foundation is "the operational secret of America's civic sector." Through "the priming role foundations play in starting new civic-sector organizations, they nurture them into self-sustainability, and provide a continuous supply of social venture capital to the civic sector" (Fleishman, 2007, p.25). The role of foundations as a social mediating force is especially important in China because the civic sector is generally very weak and needs support from a professional social engine. Therefore, the foundation sector is viewed by China's civil practitioners as the "hope of the third sector in China".

The research question of this paper is: how should China promote the development of the foundation sector given the important role it could play in the social development? This is a comprehensive subject because the development of foundations is a mixture of cultural, political, economic, and social phenomenon. It involves different actors (private citizens, enterprises, foundations, other organizations in the civil sector and government). Therefore, this research question can be pursued through many perspectives and is concentrated on the roles of different actors. One relevant area is how to create a favorable social and legal environment for the foundation sector; another line of thought is the development of foundations themselves, i.e. how to strengthen the

Xiaoguang, and Yang Tuan; some are government officials, like Wang Zhenyao, and some entrepreneurs, Chen Gungbiao and Feng Lun. They have a strong sense of social responsibility and deep understanding of China's charitable system. They utilize their social influence and spread their philanthropic idea through practices in NPOs, research and public discussions.

² A search in China's biggest academic journal network "China Academic Journals Network" using "private foundations" as key words only produced 38 articles, and most of the journals shown are not academic journals, but magazines for the general public.

³ Some famous practitioners in China's civil sector (eg. Yu Yongguang, Deng Guosheng) all voiced their concern that government dominance in the philanthropic sector leaves little space for private foundations.

foundations' accountability through better internal governance and transparency. Since government policies are vital in shaping the landscape of the civil sector in China, this paper will focus on how government policies can help create a conducive legal and institutional environment for the expansion of private foundations. The development of private foundations is an interaction between the demand and supply of charitable funds. China's charitable demand is huge at its current development stage with inadequate and low coverage of the social welfare system. Therefore, the development of foundations or other charitable organizations is largely determined by the supply of charitable funds, even though the general direction and focus areas of the foundations are affected by demand considerations. This article discusses the relationship between the government and the foundation sector, and how government policy can be adjusted to encourage more charitable contributions to foundations and help foundations achieve sustainable development.

This paper is organized into four sections. Section II offers a brief introduction on the evolution of policy along with an overview of the current situation of the foundation sector. Section III analyzes China's charitable fund supply and donor structure, emphasizing the role of private enterprises and wealthy individuals in the development of private foundations. Section IV is a comprehensive discussion of much-debated government regulations and tax incentive policies, which have the most direct and profound impact on the expansion and sustainability of foundations. In doing so, experiences from other countries, especially those of the US, will be discussed to serve as a reference point as well as a model of best practice. Section V concludes.

II. China's Charitable Foundations: Current Situation and Characteristics

Although the concepts of charity and caring for others are embedded in Chinese culture and practiced throughout Chinese history, the formal philanthropic sector was banned after 1949, when the People's Republic of China was founded. Under the ideology of strong state political control and strict central planning of the economy, private entities and the civic sector had no place in the system. In fact, from 1949 until the late 1980s, all NPOs were part of the State and the Party, so they had neither independence nor a separate regulatory framework.⁴ Serious exploratory efforts in differentiating public service-providing NPOs and the State began in the mid-to-late 1980s after economic reforms were initiated.⁵ The General Principles of Civil Law (GPCL) of the PRC, adopted in 1986, divided legal persons into 4 categories: enterprises, government organs, public institutions and social organizations. For the first time, socialist China recognized that there existed a legal scope for private activities – either commercial or non-commercial. This set the stage for a private citizen's involvement in public affairs.

After the adoption of the GPCL, regulations were promulgated by the State Council in 1988 and 1989 that dealt with the registration and management of two types of NPOs – associations (SOs) (1989) and foundations (*jijinhui*) (1988)—with rather stringent government control and oversight. According to these regulations, a “dual management” process is required, with organizations required to have a sponsor organization (*yewu zhuguan bumen*) to assist the Ministry of Civil Affairs in the establishment and oversight of all NPOs (Simon, 2005).

⁴ For an overview of the policy evolution of China's NPOs, see Simon (2005).

⁵ Some progress was made earlier in separating NPOs and the public institutions, e.g. the creation of the Department of Social Organizations (*Shetuan Si*) in 1977-78 within the Ministry of Civil Affairs.

In 1998, regulations on the management of civil-non-enterprise units (*Minban Feiqiye*) were promulgated, showing that the government has accepted the notion that private citizens can form their own legal entities outside the commercial sphere. However, citizens or commercial entities were still not permitted to form foundations.

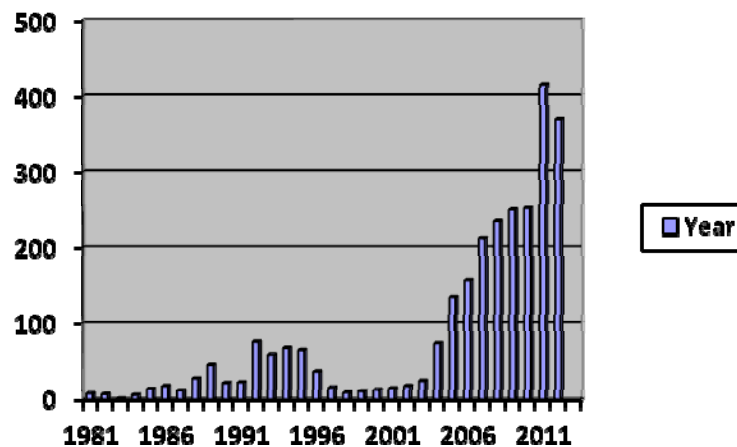
The Regulations on the Administration of Foundations (RAF) were finally issued in 2004. They clearly outline the requirements for: registration and management, governance structures, management and use of assets, and monitoring and supervision of the foundations. Specifically, they provide clear protection of the legal rights of foundations, their donors, and the beneficiaries. The assets of a foundation and its other sources of income are protected under the law. According to the RAF, the foundations, their donors, and the beneficiaries enjoy tax benefits as stipulated by legal and administrative regulations.

The RAF differentiates between public foundations and private foundations. The biggest distinction between these two categories is that the former is allowed to engage in public fundraising whereas the latter is not. Private foundations are generally funded by a major gift from a wealthy individual or corporation. In addition, the original funds required for setting up a private foundation (RMB2 million) is lower than setting up a public foundation (RMB4m).

The most important breakthrough of the RAF came in allowing private citizens or commercial entities to set up foundations. The promulgation of the RAF represents a watershed in the development of China's foundation sector. The following numbers exemplify how the issuance of the RAF boosted the development of foundation sector.

Before 2004, there were only 26 newly registered foundations each year; after 2004, over 100 new foundations were set up each year. Growth further increased after 2007, with over 200 new registrations each year (Figure 1).

Figure 1. New Registration of Foundations



Sources: Kang *et al.* (2011); China Foundation Center.

Before 2004, the dominating force in the foundation sector was government-initiated public foundations, accounting for over 80 percent of all foundations; after 2004, private foundations developed rapidly, with an annual growth rate in their number of 40 percent, while the number of public foundations grew a lukewarm 10 percent annually. The

number of private foundations overtook public ones in 2010. By Feb. 2013, the total number of foundations has reached 3070, with 1738 private foundations and 1332 public foundations (Table 1).⁶ While the numbers might be considered insignificant, the fact that the civil force has entered the public arena and started to play a leading role in the country's social progress is highly significant.

Table 1. Private Foundations vs. Public Foundations

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013. 2
Public		721	795	904	943	1029	1077	1218	1265	1332
Private		253	349	436	643	800	1098	1373	1696	1738
Foreign		1			11	14				
Total	892	975	1144	1340	1597	1843	2175	2591	2961	3070

Sources: Data of 2004–2010 are from Tao (2011); 2011--, media sources and China Foundation Center.

The foundation sector has developed rapidly and has gained recognition and trust from the general public as an important player in the public welfare field. Among China's major non-profit social organizations, the foundation sector became the biggest recipient of donations in 2011, accounting for nearly 40 percent of the total donations.⁷

Table 2. Donations: by Recipient Organizations (2011)

Types of Social Organizations	Donation (money and in-kind) (100m)	(%)
1. Department of Civil Affairs, all levels	111.	13.2
2. Party, government, Social organizations (exclude. 1)	71.	8.4
3. Foundations	337	39.9
4. Red Cross Association	20.	3.4
5. China Charity Federation	204.	24.1
6. Social Organization(Exl. 3.4.5)	11.	1.3
7. Public Institution	49.	5.8
8. Religious Group	8	0.9
9. Others	26	3.1
10. Total	837	100

Source: Zhongmin Donation Information Center.

⁶ The rapid increase of private foundations is attributable to the governmental policy favoring private foundations over public ones. According to an official from the Ministry of Civil Affairs, the government doesn't encourage an increase in the number of public foundations, because "too many public fundraising activities would discourage [the] general public's enthusiasm to donate." <http://baike.baidu.com/view/2680204.htm>. Although there are no explicit laws or regulations prohibiting private individuals or entities from setting up public foundations, in practice, it's very difficult for private individuals or enterprises to set up a public foundation. The Chinese government is wary of public fundraising activities because some philanthropic organizations are neither transparent nor strict in their information disclosure.

⁷ Compared to other years with serious natural disasters, such as 2008 and 2010, when emergency philanthropic funds were mobilized, 2011 was a relatively quiet year. Therefore, the donations and expenditures more or less reflect the normal trend.

Table 2 shows that the foundation sector received 39.9 percent of all donations in 2011, overtaken the 27.5 percent of donations received by the Red Cross Association and China Charity Federation combined. The Red Cross Association and the China Charity Federation are the two biggest government-run national non-profit public benefit social organizations. They are among the earliest foundations in China and have members and branches throughout the country.⁸

This demonstrates the phenomenal development of the foundation sector in attracting funds and the relatively important position of foundations in China's philanthropy. In the US, where the foundation sector has developed for over 100 years and is by far the most advanced in the world, foundations have received less than 10 percent of total giving each year.⁹

Because the American foundation sector has been at the forefront of organized philanthropy, it often serves as point of reference when analyzing foundations in other countries. However, the historical and legal development of the US foundation sector has been very different from experiences in other parts of the world, which raises the question of applicability when coming to terms with the foundation phenomenon in other countries. Even in advanced economies, the trajectory and current situation of foundations show notable differences. America's experience shows that the foundation is a naturally evolved form of civil organization and flourished with industrialization. However, in Europe, many countries kept a watchful, frequently distrustful, eye on foundations and, in France, foundations were banned until the twentieth century (Anheier and Toepler, 1999). Due to a different cultural and legal system, the term "foundation" can mean something very different from one country to another. In terms of public benefit foundations, the number of foundations in each country varies greatly. Germany has 19551 foundations, while France has only 2264. In terms of the social environment of the foundation sector, China and the US occupy two extremes. America has the most advanced civil society, which leads the social, economic and even political development of the country, while China's civil sector is in its infancy, so it struggles for more open space and encouragement from government policy. In the US, where civil sector plays a much more dominant role in shaping the country's social structure, the civil sector is supported annually by nearly 70 percent of Americans, with charitable giving of nearly US\$300bn, accounting for around two percent of the nation's GDP. (Fleishman, 2007). In China, the civil sector's involvement in the philanthropic activities is weak. Total donations in China in 2011 were RMB83.7bn, accounting for less than an 0.2 percent of GDP.

Therefore, simple comparison is not only improper but also misleading. Here, we list the basic statistics of foundations in the US and in China not to compare, but as a point of reference, in an attempt to show where China's foundation sector is situated, and what could be expected for China's future development.

Although the number of foundations and scale of their assets are not comparable between China and the US, the simple statistics from Table 3 shows that in the US, private grant-making foundations typically dominate the foundation sector. This is a very distinctive feature of the US foundation sector compared with foundations in other countries (Anheier and Toepler, 1999). In China, private foundations overtook public

⁸ The sharp decline in donations to the Red Cross Association and China Charity Federation was partly due to the scandal in June 2011 related to the Red Cross: A girl showing off her extravagant life-style on internet claimed herself a manager with the Red Cross Foundation. This fueled the public suspicion over the in-transparency and mis-management of the Red Cross in particular and all public foundations in general.

⁹ According to Giving USA 2012, total estimated charitable giving in the US in 2011 amounted to US\$29 bn in contributions. Giving to foundations totaled US\$26bn, accounting for 8.7 percent of all donations.

ones by 2010 in number, but in terms of the assets and use of charitable contributions, the public foundations still take the lead. And public foundations are mostly founded and run by the government, a legacy from the state controlled social structure. This issue will be further discussed in the following section.

Table 3. US Foundations vs. Chinese Foundations: Basic Statistics

		Number 2008	Assets 2008	Giving 2010	Income 2010
US Private foundations	independent	67379	US\$456bn	US\$33.1bn	
	corporate	2745	US\$39bn	US\$5.2bn	
	operating	4762	US\$20bn	US\$4.4bn	
US Public foundations	community	709	US\$50bn	US\$4.2bn	
US Total		75,595	US\$565bn	US\$46.9bn	US\$25.8bn
China Private		1373	RMB33.9bn	RMB7.3bn	RMB17.4bn
China Public		1218	RMB44.6bn	RMB21.7bn	RMB27.3bn
China Total		2591	RMB78.5bn	RMB28.0bn	RMB44.7bn

Sources: Data for US: US Foundation Center; Data for China is for 2011, from Yang (2013).

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In addition to their expansion, foundations in China have increasingly realized the importance of being open and accountable to the general public through strengthened internal governance and information disclosure. Through monitoring at the sector level, China's Foundation Center started in 2012 to compile the "China Foundation Transparency Index," calculating each foundation's index according to its information disclosure on the four categories of information (basic, accounting, projects and donations). This list is published on the Foundation Center's website and updated weekly.

Generally, China's foundation sector is at its initial stage of development. Specifically, this stage has several characteristics:

- (1) Small in scale for most foundations and emergence of large foundations

China's foundations are generally small. Apart from the national private foundations registered with the Ministry of Civil Affairs, which required a minimum initial capital of

RMB20m, especially after 2000, over 85 percent of foundations have been registered with an initial capital falling into the 2–4million and 4–8million categories (Table 4). This reflected the new capital requirements of the RAF. According to the RAF, the threshold capital for creating a private foundation at the local level is RMB 2m, and, for a public foundation, RMB 4m. In addition, due to the RAF requirement that the foundations have to spend at least 8 percent of surplus assets from the previous year for charitable purposes, some donors choose to give the minimal capital required when creating the foundation and inject money at a later stage as per the project requirement.

Table 4. Scale of Foundations

Initial fund	1980s		1990s		After 2000	
	number	%	number	%	number	%
<2m	7	5.1	10	2.8	12	1.0
200≤--<400	22	16.3	77	21.3	522	43.8
400≤--<800	70	51.9	162	45.0	488	40.9
800≤--<1000	22	16.3	36	10.0	27	2.3
1000≤--<2000	9	6.7	38	10.6	56	4.7
≥2000	5	3.7	37	10.3	87	7.3
Total	135	100	360	100	1192	100

Source: Kang *et al.* (2011).

On the whole, the foundation sector's income was RMB45bn in 2011, with a rather high average income of RMB17m. However, the mean is skewed because nearly half of foundations have an income less than RMB2m. Due to their limited income, most foundations spend less than RMB5m, with more than half expending less than RMB 1.6m.

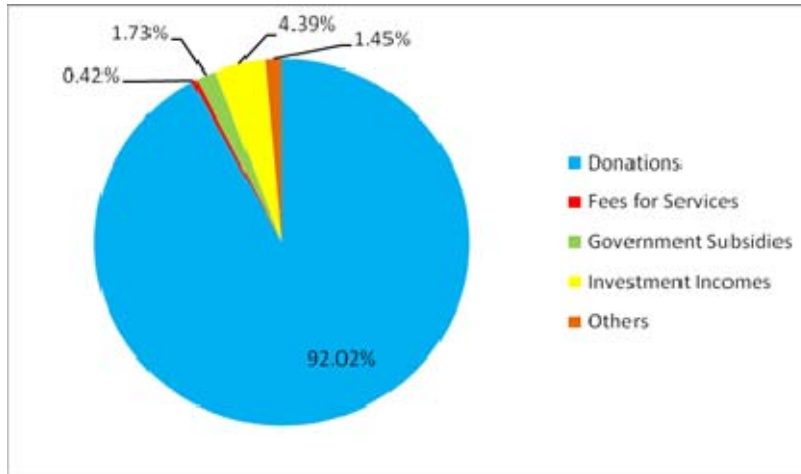
Similar to the US foundation sector which is notable for the large scale of its foundations (the top 25 foundations provided 21 percent of total giving in 2008), there have emerged large foundations in recent years, some with assets of more than RMB100m. The divide is quite prominent in both donation income and charitable giving. In 2011, the top 20 percent of foundations received over 90 percent of donations and made 87 percent of charitable spending of the sectors. Most of the large foundations are university foundations. For example, Tsinghua University Education Foundation and Peking University Education foundation have assets of over RMB1bn.

(2) Source of funds are narrow.

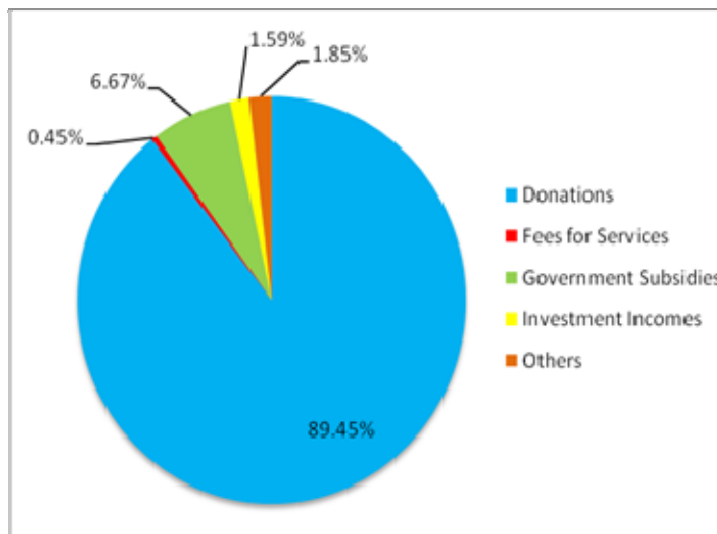
Foundation revenues come primarily from 4 sources: donations, income from invested assets, fees for services rendered, and subsidies from the government.

Figure 2. Income Structure of China's Foundations (2010)

a. Private Foundations



b. Public Foundations



Donations account for the lion's share of income, amounting to around 90 percent for both public and private foundations. The government subsidizes more for public foundations than for private foundations (6.67 percent vs. 1.73 percent). Few foundations in China earn much income from providing services (about 0.4 percent). Notable are the low levels of investment income, 4.39 percent and 1.59 percent for private and public foundations in 2010, respectively (Yang, 2012). It's standard practice for US foundations to invest in the capital market and some large foundations fund their giving solely through investment income, essential if a foundation is to last indefinitely. Chinese private foundations vary greatly in their management of capital. Some large foundations, for example, many university foundations, operate like foundations in the US. They have investment committees that comprise financial professionals and have a clear investment strategy. However, a majority of foundations rely on their initial capital to conduct

welfare activities and don't engage in any investment at all, or only invest a small portion of their capital. According to Kang *et al.* (2011), about 80 percent of private foundations in 2008–2009 had no investments at all. Another report by Yang (2012) shows that, in 2010, less than one-third of foundations made investments. When they do invest, they mostly invest in government bonds or bank deposits, not a well-chosen portfolio due to a lack of financial personnel. Because of the underdevelopment of China's capital markets, seeking investment income is unattractive. Among the foundations that invested, 40 percent had near zero returns. Only 9.4 percent of foundations have investment committees. For most, the accounting and bookkeeping staff makes investment decisions. And, to make matters worse, there are usually only 1 or 2 accounting staff in a foundation.¹⁰

Private foundations are not allowed to raise funds from the general public, so they base their activities on private gifts. Because the scale of these foundations is usually small, their survival relies on the continuous injection of capital and investment income. According to a survey, 62 percent of income came from the original donors of the foundations. Other sources are limited.¹¹

This raises another issue: many foundations lack independence, especially those set up by enterprises. Some foundations don't have full time staff and even their offices are borrowed from enterprises. According to a survey, only 34.9 percent of all foundations paid their full-time staff, 11.7 percent paid their part-time staff. The salaries and benefits of other foundations are paid by the enterprises that launched them.¹² Therefore, these foundations are not operated as independent entities, but instead as social responsibilities for the public relations department.

In terms of philanthropic giving, due to limited funds most private foundations spend less than RMB5m each year. Half of these foundations spend less than RMB2m. Only university foundations spent more than RMB10m. Unlike independent American foundations, which usually have a large endowment to begin with,¹³ private Chinese foundations generally have a small asset base, so their capacity for philanthropic activities is limited.

(3) Focused areas and grant-making: need for clearly defined roles

The areas that the foundations target have expanded from human services, which fulfilled immediate needs in the 1990s, to human and social development areas such as culture and research. The hierarchy of focus areas measured by the number of participating foundations is education, research, medical assistance, culture, poverty alleviation, children, safety and disaster relief, and the elderly.

Education is the most common focus of the foundation sector. By the end of 2011, there were 1380 out of 2591 foundations including education as one of their focused areas, representing 53 percent of all foundations. Specifically, there were 422 education foundations, with the net assets, income and charitable spending all accounting for nearly half of the total of the private foundations (China Foundation Center, 2013). In contrast to education, art is a less attractive area to foundations because most enterprises think that education and support for the poor would generate more social benefits and positive public attention than donations to art foundations. Therefore, there are only a few art

¹⁰ See speech by Zhu Jiangang, <http://gongyi.sina.com.cn/gyzx/2013-01-08/150640368.html>.

¹¹ See speech by Zhu Jiangang, <http://gongyi.sina.com.cn/gyzx/2013-01-08/150640368.html>.

¹² See speech by Zhu Jiangang; <http://gongyi.sina.com.cn/gyzx/2013-01-08/150640368.html>

¹³ In 2011, the Bill and Melinda Gates Foundation alone gave over US\$3.2bn. The second largest foundation gave US\$605m.

foundations, most of which are founded by the artists and receive follow-up, often contingent, funding from the artists themselves and their families and friends, posing serious problems for their continued survival and development.

While US foundations are typically grant-making, private Chinese foundations act like social organizations with an endowment as most operate their own projects. Although many practitioners believe “private foundations to be the hope of China’s third sector,” (Xu, 2004), very few foundations mainly engage in making grants to other non-profit organizations. According to a study that sampled foundations, 43.5 percent provided some grants to grassroots organizations, but only 9 percent are solely grant-making foundations.¹⁴ There are two reasons for this. First, the foundation sector is in a fledging stage, lacking sufficient funds and personnel, and second, grassroots organizations are weak, so most don’t have the capacity to undertake required projects. But then, these two reasons could be motivation for the foundation sector to clearly define its role, distinguishing itself from other types of charitable organizations and, thus, really serving as a “social venture capital” intermediary between donors and operating grassroots organizations.

(4) Lack of professional personnel

The foundation sector has not yet developed into a socially acknowledged profession that attracts real talent. According to the latest report of the Chinese Academy of Social Sciences (Blue paper, 2013), by the end of 2011, the foundation sector employed 8532 full time staff and spent only 2.07 percent of their total expenditure on staff wages and benefits and other overhead. This ratio is far below the 10 percent allowed by the government.¹⁵ Foundations are professional social organizations and need capable and sufficient human resources to carry out their mission. The extra low spending on staff wages and benefits reflects the serious shortage of human resources. In 2011, the average number of full-time staff in private foundations was 3.6 persons; there were no full-time staff in 17 percent of foundations. And to make matters worse, most of these foundations’ staff are just accountants. The sector lacks professionals who have expertise in public welfare activity management as well as investment. Some enterprise-endowed private foundations “borrow” their staff and offices from the enterprises, while others rely on volunteers for help. The absence of professional philanthropic personnel has become a constraint on the further development of private foundations (Tao, 2011).

III. Supply of Charitable Funds and Donor Structure of Foundations

Supply of Charitable Funds for Foundations

The development of foundations is a cultural, political, economic, and social phenomenon. It involves different actors (private citizens, corporations and government). Cultural and political systems have long-term effects on the philanthropic sector, but they are not policy issues, so this article will take the cultural and political systems as a given, instead focusing on the institutional and legal environment of the foundation sector.

The function of the philanthropic sector is defined as the “third income distribution,” after the first distribution through the market by factors of production, and

¹⁴ See speech by Zhu Jiangang, <http://gongyi.sina.com.cn/gyzx/2013-01-08/150640368.html>.

¹⁵ According to Regulation, article 29, a foundation may not allocate more than 10 percent of its total expenditures to cover staff wages and benefits and overheads.

the second by the government through tax and welfare transfer. As an effect of the income distribution, the development of the philanthropic sector, specifically foundations, is tied to economic growth. This correlation is significant in China. A simple correlation analysis of new foundation registrations between 1981 (when the first foundations were established) and 2010 reveal that the increase in new registrations parallels GDP growth. Also, the numbers of registrations with local departments of civil affairs (provincial, autonomous regions, and directly administrated municipalities) reflects the development levels of the region—the higher the local GDP, the more foundations registered.

While economic development promotes the philanthropic sector as a whole, the accumulation of private wealth and the increase in income inequality would benefit the sector as well. There was clear evidence of this correlation in the US. Between 1969 and 1991, the Gini coefficient measuring US income inequality jumped by about 10 percent from 0.39 to 0.43 and the share of national income earned by the top 10 percent of earners increased by 18 percent in the 1980s. During this period, the US foundation sector experienced rapid growth. China's experience also demonstrates this relationship. Though a new sector, the foundation sector has become the fastest growing sector in terms of assets and donations received. In 2011, it received a growing share of donations, overtaking other charitable organizations, such as China Red Cross and China Charity Association, which rely on donations from the general public.

If this relation holds, then China's private foundations will sustain their growth. Rapid economic growth in the past 30 years has led to a huge accumulation of private wealth. However, the wealth has been distributed unevenly and inequality in China has become a serious social issue. The Gini index stood at over 0.5 in 2011, higher than most developing countries. The top ten percent of households have more assets than the bottom half.

The other side of the story is that China continues to produce increasing numbers of billionaires. The 2010 Huren Report on China's wealthiest people says that the country accommodates more than 55,000 RMB billionaires and that the number of Chinese millionaires has reached 1,020,000. Under social pressure and influenced by a global corporate focus on ethical and philanthropic development, there is increasing awareness of one's social responsibility and the need to share prosperity among enterprises and the burgeoning newly rich. According to a survey from Huren, paying taxes and donating to charity are considered the best ways for entrepreneurs to demonstrate social responsibility. Over half of China's millionaires prefer to donate through a charitable foundation. There are 100 members on the Hurun Philanthropy List 2012, with charitable donations totaling RMB10.1bn, five times more than that in 2004. Individual donations have increased noticeably, with over 50 percent of the listed philanthropists giving last year. The average donation accounted for 1 percent of the philanthropist's total wealth. Another encouraging feature of the 2013 list is that, among the 100 on the list, 64 were first timers. Furthermore, 35 percent of philanthropists on the list have set up their own charitable foundations.

Charitable causes are divided into seven categories: education, social welfare, poverty alleviation, cultural heritage, disaster relief, environmental protection and public health. This echoes the focus areas of the foundation sector. Education, often involving donations to one's alma mater, is the cause most widely supported and accounts for 36 percent of donations.

Huren started to publicize the Top 100 List each year from 2004. The list's publication has been encouraging for charities and foundations operating throughout China, for a few reasons. First, many of the donors have continuously remained on the

list since its publication, now setting up private foundations to further their work. Second, over half of the listed philanthropists are newcomers, i.e. 71 on the list in 2011, 69 in 2012 and 64 in 2013. This demonstrates broader participation of the rich in philanthropy. Third, the average age of the lists ranges from 40 to 53. Over half of the billionaires on the 2012 list are under the age of 32. “Doing good before you die” now becomes “doing good while being young.” This new trend echoes the changes globally. Young, well-educated entrepreneurs are more receptive of new ideas of philanthropy and social innovation.

Donor structure of China’s charitable funds

Compared to other countries, the percentage of US civic-sector support coming from voluntary contributions is unusually high. In fact, since the 1950s, private giving by individuals, foundations, and corporations has represented about 2 percent of America’s GDP, about 3 times as much as the next closest country, the United Kingdom. In comparison, Chinese charities’ funding pool is rather small. In 2011, total giving was RMB84.5bn, accounting for just 0.18 percent of GDP. Even 2008, the year regarded by many as the “prime year of China’s philanthropy,” because of national enthusiasm for donations to the Wenchun Earthquake recovery, saw donations total RMB86.2bn, accounting for 0.22 percent of the same year’s GDP, albeit a 198 percent jump from the previous year. After that, charitable giving decreased to its normal level below 0.20 percent of GDP (Table 5). After all, private individuals and enterprises only started to accumulate wealth after Deng Xiaoping’s southern tour in 1992. The social security system is still in the making. Available charity funds are limited. Still, an encouraging development has been the increase of the general public’s philanthropic awareness and involvement through micro-public-benefit activities via internet donations.

Table 5. Donations (2007-2011)

Year	Donation (RMBbn)	Annual increase (%)	% of GDP	year	Donation (RMBbn)	Annual increase (%)	% of GDP
2007	25.5	123	0.09	2010	87.1	84	0.22
2008	86.2	198	0.27	2011	68.6	-21	0.18
2009	47.4	-45	0.14				

Source: Zhongmin Donation Information Center and author’s calculation.

In the US, the civil sector is supported by nearly 70 percent of Americans of all socioeconomic circumstances. Total giving by individuals comprises the dominant share. Take 2011 as an example, when giving by individuals totaled US\$217bn, accounting for 73 percent of all contributions, followed by foundations (14 percent), bequests (8 percent) and corporations (5 percent). Giving by individuals, bequests, and family foundations amounted to 88 percent of all donations in 2011(US Foundation Center, 2012).

The story in China is quite different. If we look at the donor structure of charitable funds, we find that enterprises are the main donors of charitable funds, accounting for more than half of total giving. Giving from individuals are half of those donations given by enterprises.

Table 6. Donations by Donor Type in 2011**unit: RMBm**

Donor type	Inside China	Overseas	Total	Percent
Individual	9285.	655	9940	31.6
Enterprise	16219	1851	18070	57.5
Government	1235.	78	1313	4.2
Social Organizations	668	853	1522	4.5
Other NPOs	589	2	590	1.9
Total	27995	3439	31434	100.00

Source: Zhongmin Donation Information Center.

Notes: 1. Figures are based on a RMB31.4bn sampling monitor database collected from media and those who applied for China's Philanthropic Awards. 2. Social organizations include: Social associations, civil non-enterprise institutions and foundations. Other NPOs include: People's associations (Communist Youth Associations, All-China Women Federation, Trade Unions, China Disabled Person's Federations and All-China Federation of Industry & Commerce), and public institutions.

Table 6 is a sample structure of donor types based on a sampling monitor database. It shows that individuals and enterprises are the main supply of charitable funds, accounting for nearly 90 percent. Of the two, enterprises are the main donors, accounting for 57 percent of total giving. The role of private enterprises in charitable contributions is quite notable. According to Zhongmin Donation Information Center, private enterprises have been the leaders of philanthropy, accounting for more than half of total enterprise donations since 2007 when national data was first collected. In 2011, private enterprises' donations accounted for one third of the national total (Yang, 2012).

Individual donations have increased significantly in recent years, which is a good sign of increased public philanthropic awareness. However, if one looks further into individual donations, one finds that a large percentage of individual donations have come from the owners of private enterprises. Donations from the general public have yet to indicate regular, active participation in philanthropic activities. Also to be noted is several big gifts from entrepreneurial donors. The top ten domestic individual donors in 2011 contributed RMB6bn, accounting for 22 percent of total individual giving. Among them, Cao Dewang donated RMB3.5bn from his 300 million equity shares to the Heren Charity Foundation, a private foundation he set up in 2010.

So we can see that private enterprises and wealthy individuals are now playing a dominant role in China's charitable contributions. With heightened social responsibility and growing aspirations for social change, they will assert more influence on social development. There are two ways for a wealthy donor to give: donating assets outright to an operating charity or creating a foundation. The increasing number of private foundations shows that more and more enterprises and wealthy people choose to set up their own foundations as a channel for charitable giving. There are several reasons for this. In the US and other countries with heritage and gift taxes, tax considerations involved in estate planning are a strong motivator. Charitable gifts during the lifetime of a donor can diminish tax liability, while gifts to establish a foundation upon death can

significantly diminish or even eliminate estate tax liability.¹⁶ However, in China, there is no heritage and gift tax, so this motivation doesn't hold. In some cases, donors are simply uncertain about how and where to give. Sometimes, donors have trouble finding organizations that are large enough, focused enough, or effective enough to pursue the specific goals they favor. In China, due to the state dominance of the philanthropic sector and a general lack of transparency of charitable organizations, many donors worry about how well and how faithfully charitable organizations would steward their philanthropic assets. Many, having observed or heard of the misuse and lack of disclosure of how the funds were used, figure that they can assure themselves of their money's being well spent in society's interest only if they can monitor the funds. Thus, a fear of having their hard-earned wealth squandered or ineffectively spent may tempt donors to establish foundations rather than giving the money outright to other organizations.¹⁷ Another more overarching motivation for most donors is the desire to create a vehicle for effectively helping the less fortunate, i.e. promoting lasting social change. Enterprises have an incentive to launch a foundation to fulfill their social responsibility and improve their public image (Liu and Zhang, 2009)

IV. Government and the Foundation Sector: Regulations and Tax Incentives

Chinese style philanthropy: General social environment

China's charitable fund supply and donor structure show that the foundation sector, especially private foundations, has great potential for development. However, behind this rosy picture of private donations, there is involuntary and reluctant giving, which could hurt philanthropy in the long run. As we know, modern philanthropy with the full participation of general civic society is a rather new concept in China where only 30 years ago there was no room for private social organizations and the government used to be the sole provider and manager of social services. This institutional legacy still has its influence on China's philanthropic sector, as some term it "China style philanthropy."¹⁸ It offers one explanation for the unusually high percentage of donations coming from corporations and rich individuals and the relatively weak participation of the general public. It refers to the involvement of the government in the philanthropic sector.

China's philanthropic system is dominated by charity organizations that were either created by the government or continue to maintain close ties with government agencies. There are three groups of NPOs that can raise funds from general public: the Chinese Red Cross system,¹⁹ China Charity Organization system,²⁰ and public charitable

¹⁶ Some great foundations, such as the Rockefeller Foundation and the Carnegie Corporation of New York were established before the charitable contribution deduction was created. The Bill and Melinda Gates Foundation appears to have been created with little income tax deduction motivation (Fleishman, 2007).

¹⁷ Cao Dewang is a devoted philanthropist. In 2010, he donated RMB100m to the disaster-ridden area of China's southwest through China Poverty Alleviation Foundation. To ensure that the fund was safely distributed to 100 thousand poor families, he signed a strict contract, requiring that the fund was dispatched within 5 months with an error rate of less than 1 percent and a management fee of 3 percent rather than the 10 percent normally applied. He was personally involved and set up a supervisory committee while using media to report on the whole process. This was a successful practice of transparent and efficient philanthropy, but it was a time and energy consuming process. In 2010, he launched his own private foundation, the Heren Charitable Foundation.

¹⁸ Deng Guosheng, a professor from Qinghua University, used this term first. Also see (Lin and Wu, 2012).

¹⁹ The Chinese Red Cross has branches in 31 provinces and in HK SDR and Macao SDR. It has more than 20 million members nationwide. The Chinese Red Cross enjoys special status and is governed by the China Red Cross Law

foundations. They are typical bureaucratic organizations with the top managers, usually former officials from the department of Civil Affairs, designated by the government. Large foundations are also government run. Shown by their names, they are allowed to raise funds from general public, while private foundations are not allowed. And it is very difficult for private individuals or enterprises to create fundraising foundations.

Because of the governmental background and relations with the local government, these charity organizations used administrative measures to raise funds by allocating certain quotas and issuing official documents. They usually target enterprises because this was more cost-effective than raising funds from individuals. Sometimes, enterprises are forced to involuntarily donate. This goes against the basic principle of China's Public Welfare Donation Law, the leading law governing charitable fundraising activities, which states that "donations should be voluntarily and freely given. It is forbidden to forcefully or covertly extract donations, or to use the name of the donor in a for-profit enterprise" (Article 4). For example, according to the Public Welfare Donations Law, local government departments above the county level are allowed to receive donations during natural disasters. However, in practice, some local governments abuse this right by pressing enterprises to donate, which have to cooperate to maintain a good relationship with the local government in question.²¹

Administrative Barriers in Government Regulations

Institutions in the foundation sector are concerned with the following regulations, which constrain the establishment and sustainability of foundations.

(1) Dual management requirement

According to the RAF, the Ministry of Civil Affairs under the State Council and its departments at the provincial, autonomous region and directly administered municipality levels are the organs responsible for the registration and management of foundations. However, the applicants must have a supervising government department or government authorized organization before they can register with the Ministry of Civil Affairs or local civil affairs departments. This regulation was carried over from the 1998 version of "Regulations for registration and management of Social Organizations." The government set up this dual management system out of concern that civil affairs departments were not capable of managing highly diversified non-public organizations.

Many government departments are reluctant to shoulder the responsibility of supervising private organizations. On the other hand, many activities of the NPOs have to be approved by supervising organizations, depriving the NPOs of their independence. As a result, many non-public charitable organizations are registered as corporations, or have never registered. Because of the difficulty of registration, there is a large gap between registered NGOs and the actual number of NGOs. According to the statistics report of the

²⁰ China Charity Association was founded in 1994 by the Ministry of Civil Affairs. It is the national NPO, with 333 members around the country.

²¹ Although China-style philanthropy was criticized by many and voluntariness was regarded as the essence of charitable conduct, some local governments still pressure enterprises for donations. A recent newspaper headline, documenting a local scandal, reads "Shenmu 10bn philanthropic funds programme." The county government mandated local enterprises to donate RMB10bn in 5 years to achieve "sharing development." The Shaanxi Shenmu Charity Foundation for People's Well-Being was registered in June 2011, with an initial fund of RMB4.3bn.

Ministry of Civil Affairs, as of the end of 2011, excluding foundations, there were 492 thousand registered social organizations. However, the estimated number of grassroots social organizations might fall into the range of 2 to 4 million, most of which unregistered.

In practice, supervising organizations have become a rubber stamp, and, thus, are not strictly required. Many scholars argue that the registration requirement should be simplified; on the other hand, the government should strengthen supervision to prevent private foundations from misusing resources or attempting to profit from their public benefit status. In the draft of the new amendment to the RAF, this regulation is expected to be revised. In the future, for the establishment of foundations, applicants need only register with the local civil affairs departments.

(2) Initial endowment requirement

The RAF requires private foundations to have an endowment of as high as RMB20 million for registration with the Ministry of Civil Affairs and RMB2m for the local department. Further, the regulations do not permit that the value of the initial endowment be reduced at any time.

Another issue is that, in the current regulations, only monetary assets are allowed to form the initial endowment of a foundation. But some entrepreneurs would prefer to donate in the form of equity. For example, Caodewang of Yaofu Glass announced in April 2011 that he would donate 400m shares of his stock holdings of Yaofu Glass (with a market value of RMB3.5bn at the time) to Heren Charity Foundation, a private foundation set up by his family in June 2010. The rationale behind donating stock, according to Cao, is that the stock itself is an investment and can increase in value. The dividend of the stock can be the main source of the foundation's income that also sustains its development.

In the US and other countries, charitable gifts take the form of cash and property (in kind, stocks, real estate, etc.). China should relax this requirement to take into consideration all kinds of charitable fund supply.

(3) Requirement for payout:

According to RAF, Article 29, the amount of money spent annually by public fundraising foundations on public benefit activities stipulated in their charter must not be less than 70 percent of their previous year's income; non-public fundraising foundations' annual expenditure on the public benefit activities stipulated in their charter must not be less than 8 percent of their surplus from the previous year. If a foundation fails to meet the public benefit expenditure level, it will receive a warning from the civil affairs department and its registration may be revoked in serious cases.

In order to avoid an unreasonable accumulation of earnings by endowed organizations, many countries, including the United States, Canada, and Germany, adopt a tax rule that requires minimum spending of earnings. Such rules generally impose a penalty tax from 30 to 200 percent of the shortfall if the earnings are not spent within a specified time. In the US, private non-operating foundations are required by law to distribute 5 percent of their investment assets annually for charitable purposes. By

tracking payout practices of the largest US foundations, the American Foundation Center revealed that during the period 2007-2009, the largest share of endowed foundations (46 percent) reported payout rates in the range of 5 to 5.9 percent, on average. Nearly one-in-five foundations had payout rates at or above 10 percent (Renz, 2013a).

Compared with the US, China's requirement for expenditure of 8 percent is even higher because the amount a foundation spends on staff, overhead, and other program-related administrative expenses is included in the calculation of its qualifying distributions each year in the US, but not in China. In fact, payout levels are hotly debated by legislators and the media in the US. Foundations have been urged to raise annual payout levels by those who advocate faster distribution of their resources to meet today's pressing social needs. Against calls for higher payout levels are most investment advisors, who argue for the need to assure the preservation and growth of foundation funding capacity in the long term. In China's case, considering existing funding difficulties and inexperience in other sources of income for private foundations, a lower payout requirement could be a feasible option to help sustain foundations.

There are also complaints over the requirement that a foundation may not allocate more than 10 percent of its total expenditures to cover staff wages and benefits and overhead. However, at least for the present, the average administrative expenditures of all the foundations stand at only 2.07 percent of their total expenditure on staff wages and benefits and overheads. This ratio is way below the 10 percent cap set by the government. It is difficult to decide which level of expense is appropriate because expense patterns vary dramatically between foundations with differences in giving levels, assets, operational styles, geographic reach, and programs. According to a recent report on American foundations' administrative expenses (Renz, 2013b), foundations that employed staff had median expense ratios of nearly 8 percent compared with less than 1 percent for those without staff. International grant-making, direct charitable activities, and grants-to-individuals programs are strongly associated with higher expense ratios. Foundations undertaking direct charitable activities incur higher administrative expense ratios than foundations that only make grants. In China's case, the foundation sector is at its initial stage and most foundations have few full time staff, so this requirement is easy to meet. However, as more professionals are introduced into this sector, and considering that many foundations are operating their own projects, many of which targeting people in remote and poor areas, a reasonably high administrative expense ratio should be expected.

Tax Incentives: Income Tax Deductibles for Donors

This is the most discussed area of government policy that might support the foundation sector. Research concerning tax policies abound. Irish *et al.* (2004) have done a very comprehensive study on China's tax system and set forth a number of specific recommendations for improvements in the tax system applicable to China's NPOs. They advocate the adoption of the concept of "public benefit organizations," which includes foundations. They suggest that PBOs should be exempt from enterprise income taxes on all their net profits from gifts, grants, and membership dues, on all their income from investments (i.e., dividends, interest, rents, royalties, and capital gains), and related business activities. As to the tax deductibility of charitable contributions, it suggests an

increase to 10 percent for enterprises (from 3 percent) and 50 percent (from 30 percent) for individuals.

As an international practice, the governments of most countries provide tax incentives to support the development of NPOs. Generally, the tax benefits include exemptions for civic organizations themselves and deductions for the charitable contributions that support them. The former is usually applicable to all NPOs, while the latter can only be enjoyed by public benefit organizations. A foundation is a specific form of public benefit organization and, thus, enjoys both tax incentives. In terms of specific taxes, three categories are most relevant to the development of foundations: heritage or gift tax, donations, subsidies, investment and other forms of income tax exempt for foundations, and donors' tax deductions for charitable giving.

In China, the importance of NPOs is recognized and tax incentives are granted. According to the Public Welfare Donations Law, the "state encourages the development of public benefit undertakings, and grants support and preferential treatment to public benefit social organizations and public benefit nonprofit institutions."

However, China doesn't have a comprehensive and coherent tax system tailored specifically to NPOs. Tax incentives for charitable contributions are scattered through many different laws and regulations. In addition, the current tax system is not particularly encouraging for potential donors. For example, there is no estate tax or gift tax in China. The estate tax and gift tax are important drivers of charitable giving in many developed countries. In the US, for example, bequest giving alone accounted for 8 percent of total donations in 2010/2011.

In China, foundations, like other NPOs, enjoy tax exemptions for incomes coming from donations, subsidies and other forms of income tax. However, the invested income of donated funds, except for interest income earned on bank deposits or Treasury bonds, is subjected to a 25 percent enterprise income tax, the same as for-profit enterprises.²² Any income derived from securities such as stock shares, bonds (excluding Treasury bonds), and other income, including capital gains, is to be included in one's taxable income ; any returns on business activities are also subject to the enterprise income tax. The taxation authority created this regulation to ensure fair competition between the business activities of NPOs and for-profit enterprises. However, it has certainly discouraged the development of private foundations. For private foundations, which cannot raise funds from the general public, their sustained development relies mostly on investment returns. Taxing invested income especially discourages large-endowment private foundations since large foundations have to spend more than average foundations under the 8-percent requirement on public benefit expenditures.

Although each country differs in how they treat investment returns of NPOs, most countries with advanced civic sectors provide preferential tax policies. The criterion is whether the invested income is used for their chartered mission. In the US, foundations pay no tax on their income or appreciation and, depending on their certain characteristics,

²² The Regulations for Management of Foundations (Article 28) clearly stipulate that "A foundation should employ legal, safe and effective means to ensure that their original funds maintain their value or grow." This is a typical problem in China's tax system: general principles are set in some regulations, but the specifics in other regulations sometimes don't support or even contradict with the set principles.

are required to pay only a modest annual federal foundation tax, approximately 1 to 2 percent of their assets.

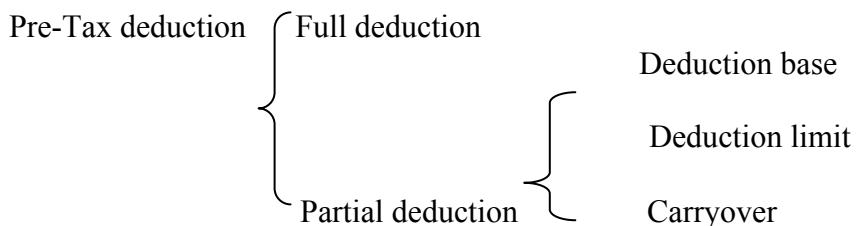
Donations from enterprises and individuals are the major source of funding for private foundations in China. In the current tax system, donations are largely affected by income tax, i.e. the tax deductions that donors enjoy for their charitable contributions. In discussing China's situation, tax deduction incentives in several countries in various stages of development are compared to figure out where China's policy should be directed in the future.

Though most countries offer tax deductions for charitable contributions, the extent of these benefits vary depending on the deduction base, the deduction limit as well as whether the deductions are carryovers and, if so, for how long (see Graph 1). For example, in the US, individual donors can deduct up to 50 percent of their taxable income with carryovers for 5 years.

In addition, many countries apply different degrees of tax benefits according to the types of donors, beneficiary organizations, and philanthropic undertakings. For example, in the US, individual donors can deduct up to 50 percent of taxable income, while corporate donors can only deduct up to 10 percent. The tax benefits for individuals are higher than those for corporations. This is probably due to the predominance of charitable contributions by individuals, which account for 75 percent of all giving. This differential deductible rate shows the policy preference.

In China, tax deductions enjoyed by donors are broadly stipulated in the New Regulations on Enterprise Income Tax [Art. 9], and Individual Income Tax [Art. 25], but the specifics of the exemptions are set forth in other laws and regulations. Through donations, enterprises can deduct up to 12 percent of the same year's accounting profit. For individuals, up to 30 percent of taxable income can be deducted before taxation. No carryovers are allowed.

Graph 1: Tax Incentives for Charitable Contributions



As for the pre-tax deduction, there are 3 choices. First, no deduction is allowed. Only very few countries, such as Italy, offer no incentive at all. Second is full deduction, which offers the largest incentive, but substantially reduces the tax base, so only a few, small countries, e.g. New Zealand, adopt it. The third category is partial deduction, which provides certain incentives for charitable contributions and, at the same time, guarantees the government's tax base. Most countries in the world adopt partial tax deduction.

In calculating the tax, different countries use different deduction bases. Some countries use one's contribution amount as the deduction base. For example, South Korea and Czech Republic allow taxpayers to deduct up to 10 percent when calculating personal income tax. Other countries, such as the US and Japan, calculate the tax deduction based on a certain proportion of one's taxable income. China uses taxable income in

determining the tax deduction for individual donors. For enterprises, China used taxable income as the deduction base before 2008 when the new income tax law for enterprises was implemented. In China's new enterprise tax law, a variation, the annual accounting profit, is used instead. Compared to charitable contributions as the deduction base, taxable income (or profit) relates the tax incentive to an enterprise's donation as well as its financial soundness.

While most countries adopt partial deduction, the deduction limit and carryover rules vary greatly. Table 7 shows the combinations employed by different countries in granting their tax deduction incentives.

In the US, all private foundations are eligible for this tax benefit. There are 3 categories of deduction limits: (1) 50 percent for all public charities, private operating foundations, and certain private foundations, the contributions of which are distributed to public charities or private operating foundations; (2) 30 percent limit for all other private foundations; (3) up to 10 percent of taxable income for a corporation for that tax year. A corporation can carry over to each of the subsequent 5 years any charitable contributions made during the current year that exceed the 10 percent limit.

In Canada, individuals are entitled to a tax credit (as opposed to a deduction) for contributions to certain charitable organizations, referred to as qualified donees. Corporations, however, receive a tax deduction for their donations to qualified donees. As of January 1, 2012, in addition to being qualified donees, most organizations must be listed by the Canada Revenue Agency (CRA) before providing charitable receipts. This listing may be found on the [CRA web site](#).

In Canada, charitable giving is categorized into 4 groups: ecological sensitive land gifts, cultural gifts, charitable donations and government gifts. A different deduction limit is applied to each category. Donors can claim gifts up to a limit of 75 percent of their net income. For gifts of certified cultural property or ecologically sensitive land, donors may be able to claim up to 100 percent of their net income. Canada also has a carryover policy of 5 years.

In Japan, the ability to deduct contributions to Japanese NPOs depends on whether the recipient organization has received specific authorization from the appropriate tax authorities. The largest group of NPOs eligible to receive tax-deductible donations is "Special Public Interest Promoting Corporations." SPIPCs must satisfy heightened requirements. This status, however, is effective for 2 years and renewable, requiring organizations to go through the same rigorous screening process as before. A foundation can qualify as an SPIPC.

Contributions of individuals to SPIPCs are deductible up to 40 percent of their annual income beyond a base of 2,000 yen. The contributions of corporations are deductible up to a limit (1.25 percent of income plus 0.125 percent of paid-in capital). In addition, bequests to SPIPCs are deductible from inheritance taxes.

In Germany, the tax allowance is limited to 20 percent of yearly income for individuals and 4 percent of the sum of gross revenue and salaries per annum for enterprises. Donations exceeding the deductible limits may be carried forward to subsequent fiscal years.

Table 7. Tax Deductibles: A Country Comparison

	China	US	Canada	Germany	France	Japan
Individual						
Deductible base	Taxable income	Taxable income	Tax credit Net income	Yearly income	Taxable income	Annual income
Deductible limit	30%	50%, 30%	75-100%	20%	20%	40%
carryover	No	yes	yes	yes	Yes	No
Enterprise						
Deductible base	Net profit	Taxable income	Net income	Gross revenue and salary	Revenues	Income, capital
Deductible limit	12%	10%	75 – 100 %	4%	0.5%	1.25% +
carryover	No	yes	yes	yes	Yes	No

In France, private persons may deduct 66 percent of their donations to public utility foundations from their income tax up to 20 percent of their taxable income. Companies can deduct 60 percent of their donations, but not more than 5% of their revenues. Excess amounts can be carried forward for five financial years, if applicable (Farny *et al.*, 2009)

In the US and Canada, tax authorities apply different deduction limits to various organizations or undertakings. In US, a 50 percent limit is set mainly for contributions to public charities, while 30 percent is used for the majority of private foundations. In Canada, more deductibles are set for certain types of public benefit areas that the state regards as having the highest value for society.

China has similar tax incentives for contributions to specific charitable organizations and for some special events. They are called designated contributions. Designated contributions enjoy full tax deductibility. They are used to meet urgent needs in the promotion of the public good, such as furthering education, science, culture, and welfare services. From 2000–2007, China used a differential policy for NPOs tax status. The Ministry of Finance and the State Administration of Taxation reviewed each NPO and determined its deduction limit. A list of 22 NPOs including the Chinese Red Cross, China Charity Federation and some public foundations, such as Songqingling Foundations and China Education Development Foundation, enjoy full deduction for contributions.²³ A total of 69 NPOs registered with the Ministry of Civil Affairs enjoyed tax deduction benefits of varied levels. Apparently, designated contributions to these listed public foundations have crowded out donations received by private foundations, putting private foundations at a disadvantageous position.

With the rising importance of private foundations in the civil sector and increasing appeals from those foundations for equal treatment, the government adopted a general

²³ The full deduction also applies to charitable contributions in certain cases, such as severe natural disasters, important national events, e.g. the Olympic Games, Shanghai Expo, etc. The tax benefits designed for specific events would usually expire after a certain period.

review procedure at end -2008. Starting from 2009, all public benefit NPOs, including foundations, file applications for tax deductible organization status. The Ministry of Finance, State Administration of Taxation, and the Ministry of Civil Affairs review each application and twice a year publicize a list of approved organizations, which are registered as national foundations and qualified for enjoying tax deductions. This list covers nearly 70 percent of all foundations. There were 85 foundations on the list in 2009 (vs. 137 total), 100 in 2010, 138 in 2011, and 140 in 2012. For those foundations that are registered locally, their respective local departments of finance, the administration of taxation and the civil affairs ministry are responsible for reviewing their credentials and publicizing a list of qualified organizations. This is a big step forward to providing equal tax incentives for all foundations.

Table 7 shows the combinations used by different countries in granting tax incentives. China's tax deductible benefits for individuals and enterprises are comparable to international practices. In terms of the deductible limit for enterprises, China's rate is actually higher than that in most of the countries documented. Empirical studies show that few business entities contribute more than 1–2 percent of their income in any given year to public benefit organizations. Therefore, a deduction of up to 10 percent of income should provide a sufficient allowable limit to accommodate those businesses that regularly or occasionally give substantially more (Leon, 2004). Considering this rate was increased in 2008 from the previous 3 percent to 12 percent, the government's policy intention to promote enterprise giving is quite obvious. In terms of individual tax deductions, the current limit is 30 percent. Since China has no inheritance tax or gift tax, the government should consider increasing the cap to 50 percent, providing a greater tax incentive for charitable contributions, especially for wealthy individuals. This should be an easy decision for policymakers because, before 2008, some designated social organizations and over 20 public foundations enjoyed full tax deductions, demonstrating the government's willingness to give up some tax revenue to encourage civil charitable contribution.

Furthermore, to encourage large donations, China should adopt the common practice of most developed countries to allow tax deductible carryovers. This allows enterprises and wealthy individuals to adjust their charitable contribution in response to operating conditions and social demand. For example, in special circumstances, such as severe natural disasters, enterprises or individuals are willing to make large donations. With carryover, they will be more reactive and don't have to worry about paying taxes on the donation they make in excess of the limit.

China lacks a comprehensive and integrated tax law specific to NPOs or foundations with clearly defined terms and implementation procedures. This leads to a lack of awareness and comprehension of the tax incentives by the general public. It also creates difficulties in tax benefit claims. One problem with the existing implementation is the acceptance of donation receipts from other regions. Regional competition for charitable contributions leads to local protection. For example, local public foundations are certified by their respective localities. One local tax authority might not accept the receipt of contributions issued by a certified foundation from another locality. Very recently, the One Foundation faced this problem. During Ya'an earthquake, the One Foundation received many donations. But when some enterprises provided receipts of donations to the Beijing Tax Bureau for tax deduction, these receipts were denied because the One

Foundation was not on the list of national or Beijing certified NPOs. The issue was eventually resolved, but it did exemplify the need for a unified certification system.

A more pressing problem is related to the tax benefit claim procedure. Both the enterprise income tax law and the individual income law offer tax benefits for donations. However, in practice, it is difficult to claim a deduction. In China, there is no social security number that is tied to each individual and the tax is deducted automatically by his/her employer before paying one's salary. Each individual doesn't fill any form to report taxable income or deductible income from donations. Therefore, when a person makes a donation, he has to go through a very tedious procedure to claim the deduction. When one does apply, it takes several months and a dozen administrative stamps to get the work done.²⁴ For enterprises and individuals to fully enjoy the tax benefit, a standard and simplified procedure for tax claims should be designed and publicized in the near future, or ideally, a new institutional arrangement for philanthropy related taxation ought to be created in the long term.

V. Conclusion

Since 2004, China's foundation sector has experienced rapid growth. Not only have the size and scale of foundations expanded, the internal governance of foundations has greatly improved and its influence in civil society is now well recognized. However, the state-dominated institutional environment and administrative barriers have hindered the development of the foundation sector. Since government policies are vital in shaping the landscape of the civil sector in China, this paper focuses on how government policies help create a conducive legal and institutional environment for the expansion of the foundation sector. Specifically, administrative barriers and tax incentives are extensively discussed. In doing so, experiences from other countries, especially the US, serve as a reference as well as a model of best practice.

As early as 2005, the Ministry of Civil Affairs began drafting the Philanthropic Law. Since then, the Philanthropic Law has been included in the working agenda of the People's Congress legislative committee. Also, revisions to the Regulations on Administration of Foundations and the Public Welfare Donation Law are underway, hopefully incorporating issues raised by the philanthropic sector's practice. According to experts, the upcoming Philanthropic Law will address the following issues we have discussed in the paper.

First, registration procedures will be simplified and the dual management requirement will be dismantled. In the future, for the establishment of foundations and other non-profit organizations, applicants need only register with the civil affairs departments as no supervising organization is needed.

Second, the relationship between the government, enterprises and civil society are expected to have a clear definition. The government should withdraw from direct involvement in philanthropic activities. The government will be responsible for policymaking and supervision of social organizations, as well as the purchasing of social services from those institutions. However, the local government will not be allowed to

²⁴ Having heard so many complaints over the tedious procedure for claiming tax deductions, Wang Zhenyao, a former official from the Ministry of Civil Affairs conducted an experiment by donating RMB 500 to the China Charity Federation. After 2 months and going through 10 procedures, he finally received his tax deduction.

raise funds from enterprises using social development propaganda. Philanthropy should be voluntary and based on civil participation.

Third, the tax incentive system will be modified, especially at the implementation level. As we have discussed, tax deductibles in China are comparable to international practices. However, there are too many ambiguous and seemingly random procedures for the general public, making it difficult to claim tax benefits. The Law is expected to stipulate a unified, open, and transparent implementation mechanism. Also, investment income exemptions for charitable organizations will be considered.

Hopefully, the Philanthropic Law will be passed this year and give a real boost to the sector in general and foundations in particular. It will be a milestone in China's social development.

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