FRONTIERS OF LAW IN CHINA
VOL. 10 MARCH 2015 NO. 1
DOI 10.3868/s050-004-015-0010-4

ARTICLE

AN EGG *VS.* AN ORANGE: A COMPARATIVE STUDY OF TAX TREATMENTS OF NONPROFIT ORGANIZATIONS

HU Tianlong [*]

This article focuses on the comparisons of the tax exemption schemes in the US and China through a three-fold discussion. Despite the tremendous development of China's nonprofit sector, not many comprehensive studies have been completed on such reforms. The tax treatment of Chinese nonprofit organizations, as a crucial component to constructing a nonprofit sector, is unsophisticated and short of practical significance. The expansion of the nonprofit sector in the past decades has resulted in many problems concerning its tax framework: incoherently defined public benefit or charity purpose of nonprofit organizations; the unavailability of an enforceable fiscal incentive system to promote charitable donations, arduous and discouraging administrative procedure of obtaining the tax exemption, burdensome requirements for the application and registration of nonprofit organizations, such as dual management, high threshold of capital endowment for foundations, and prohibition on cross-region development. Moreover, from a jurisprudential perspective, in the Chinese tax context two cautions are methodologically identified. First, the scarcity of decent comparative legal tax scholarship in general does not support quality comparison. A shortage of paradigmatic discourse shows the simultaneous existence of bluntly conflicting arguments, parallel courses, and irregularities in analysis. Second, the tax cultural traditions as well as social, political, and legal settings of a systematic tax governance framework should be included in tax comparatists' theorizations. A tax study ultimately has to be conducted from a "big-picture" perspective, in which a tax system is embedded. Otherwise, a comparative study may easily turn into a descriptive, mechanical, and perfunctory analysis. It argues that a comprehensive tax transplant effort of valued ideas and practices, although bold and uncomfortable for the recipient country at the beginning, is what China needs to build a robust nonprofit sector.

[*] (胡天龙) Associate Professor of Law and Mingde Youth Scholar, Renmin University of China Law School, Research Fellow, International Monetary Institute, Renmin University of China, Beijing 100872, China; S.J.D. (Michigan), LL.M. in International Taxation (Michigan), LL.M. (Michigan). The author thanks Professor Reuven S. Avi-Yonah and WANG Liming for encouragements and comments. This project is supported by the Fundamental Research Funds for the Central Universities, and the Research Funds of Renmin University of China (14XNJ002). The author takes all errors contained herein. Contact: hut@umich.edu

INTRODUCTION 163
I. OVERVIEW AND BACKGROUND OF NONPROFIT SECTOR LAWS IN CHINA 166
A. Historical Development 166
B. Summary of Current Laws and Regulations in China 168
1. Social Organizations 169
2. Private Non-Enterprise Unit 173
3. Foundations 174
4. Unregistered NGOs 175
C. Tax Treatment of Chinese NGOs 176
1. Tax Treatment of Charitable Donations 176
2. Procedural Reform for Charitable Tax Exemptions 180
II. CURRENT U.S. FEDERAL NGO TAX EXEMPTION SYSTEM — AN INSTITUTIONAL AND THEORETICAL ANALYSIS 182
A. The Exemption 182
B. Theories of Charitable Exemption 184
1. The Traditional Public Benefit Subsidy Theory 184
2. The Base-Defining Theory 185
3. The Capital Formation Subsidy Theory 186
4. Donative Theory 188
5. Summary 188
C. Overview of Financial Incentives in the NGO Sector 189
III. THE CHARITABLE TAX-EXEMPTION SYSTEM IN PRACTICE — A FURTHER COMPARISON 190
A. Formation and Registration 190
1. U.S. 190
2. China 190
B. Recognized Exempt Purpose and Definition of Charity 192
1. U.S. 192
2. China 193
C. Requirement of Operation for an Exempt Purpose 194
1. U.S. 194
2. China 194
D. Prohibition of Private Inurement 195
1. U.S. 195
2. China 196
E. NGO Asset Management upon Dissolution, Termination and Liquidation 197
1. U.S. 197
2. China 198
F. Tax Culture 198
1. U.S. 198
2. China 199
CONCLUSION 199

INTRODUCTION

This article focuses on a comparative study of the tax treatments for the nonprofit sector in the U.S. and China for three reasons. First, the development of China's nonprofit sector[1] has been tremendous in the past three decades, but few comprehensive studies have been initiated on reforming China's nonprofit organization tax system — a crucial component that binds nonprofit sector as a partner of the state. Echoing China's success in economic growth in past decades, literature on Chinese tax typically focuses on tax incentives for foreign direct investment and tax policies catering to economic development. Second, collaterally, the rule of law development in the past decade has motivated new scholarship regarding the modernization of China's charity sector with an "all-in" charity code[2] or cultivating expansive grassroots non-government organizations (hereinafter "NGOs"). These idealistic studies, however, suffer from a lack of focus on the tax treatment for the nonprofit sector and a consequently unrealistic understanding of the legal and political settings in which Chinese nonprofit organizations operate. Third, the studies of tax treatment of non-profit organizations share similar commercial implications with those directly related to tax incentives and trade-related tax studies. China's integration into the WTO and the global trade system has been met with complaints about national treatment and fair competition from both foreign and domestic enterprises. A key issue arising is the gradual downplaying and elimination of preferential tax treatment of foreign investment in China.[3] However, there is no substantially

[1] See generally, Evelyn Brody, *Institutional Dissonance in the Nonprofit Sector*, 41 Villanova Law Review, 433–440 (1996), discussing that the third sector often uses the terms "charity" and "nonprofit" interchangeably; see also generally D.B. Robertson, *Should Churches be Taxed?*, Westminster Press (Westminster), at 40–68 and Chapters II, III and IV (1968). The same problem exists in the limited research as to the definition or literal description of "*cishan*" or "*gongyi*," *i.e.* "charity" in China.

[2] See generally QIN Peihua, 中国慈善法草案雏形初具 让慈善回归民间定位 (*China's Draft Charity Law Is in Shape*), available at http://www.china.com.cn/news/gongyi/2010-08/02/content_20620246_2.htm (last visited Sep. 15, 2014).

[3] Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 Harvard Law Review, 1573 (2000), presenting the relationship between tax incentives and revenue; Professor Avi-Yonah examines the increased use of tax incentives as weapons in the international competition to attract investment. Professor Avi-Yonah argues that the establishment of tax havens allows large amounts of capital to go untaxed, depriving both developed and developing countries of revenue and forcing them to rely on forms of taxation less progressive than the income tax. Professor Avi-Yonah contends that both economic efficiency and equity among individuals and among nations support limits on international tax competition, and he presents a proposal that accommodates the competing concern for democratic states' ability to set their tax rates independently. He proposes the coordinated imposition of withholding taxes on international portfolio investment, with the goal of ensuring that all income may be taxed in the investor's home jurisdiction. Professor Avi-Yonah also proposes that multinational corporations be taxed initially in the jurisdictions where their goods and services are consumed. Professor Avi-Yonah outlines that, both developed and developing nations would be able to preserve the progressivity of the income tax and to broaden and stabilize their tax bases in time to stave off the fiscal threat to the welfare state.

meaningful tax law regarding the nascent NGO sector. Little thought has been given to the economic and fiscal potential of NGOs as foreign investment vehicles. Aiming to address concerns above through a comparative study,[4] this part proceeds cautiously along two distinct tracks.

First, modern tax studies are debated predominantly in Western terms such as progressivity, equity, and efficiency, but in general the scarcity of decent comparative legal tax scholarship fails to generate a "lively debate on comparative tax works and their methodologies."[5] Meanwhile, "a shortage of paradigmatic discourse in comparative tax invites the simultaneous existence of bluntly conflicting arguments, taking parallel courses, yet never engaging each other."[6] Although some frameworks of comparative tax studies have been proposed,[7] they are more theoretical than practical.[8] One pragmatic concern with these frameworks is that only very limited areas of tax are forcefully analyzable by tax corporatists. This embarrassment is particularly challenging to scholars in the Chinese tax context who want to further explore the "tax transplant" methodology.[9] In this connection, this article argues that a comparative tax study relating to China might be better achieved by focusing on a "tax law sub-discipline" rather than on a specific tax concept. One reason is that a tax concept, usually a transplanted vocabulary of western origin, is too narrow to substantiate a patulous, meaningful, and productive comparative analysis. The other reason is that specific tax provisions are contingent on their contexts and not easily extrapolated to others. For example, an international tax concept at the

---

[4] The literature on comparative tax and federalism is voluminous. *See* Reuven Avi-Yonah, *Preface to Comparative Fiscal Federalism: Comparing the European Court of Justice and the US Supreme Court's Tax Jurisprudence*, in R.S. Avi-Yonah, J. R. Hines Jr. and M. Lang, eds. xvii-xviii. EUCOTAX Series on European Taxation, (Kluwer Law International (Alphen aan den Rijn) (2007); Michael A. Livingston, *From Milan to Mumbai, Changing in Tel Aviv: Reflections on Progressive Taxation and "Progressive" Politics in a Globalized but Still Local World*, 54 American Journal of Comparative Law 555 (2006), Professor Livingston is one of the topmost contributors of the comparative tax literature and has conducted extensive research; see also Victor Thuronyi, *Comparative Tax Law*, Kluwer Law International (Frederick) (2004) for a detailed account of comparative tax methodologies and comparison of tax systems of over 20 countries.

[5] Carlo Garbarino, *An Evolutionary Approach to Comparative Taxation: Methods, and Agenda for Research*, 57 American Journal of Comparative Law 677, 684 (2009) ("[t]here are three aspects related to the peculiar nature of taxation that make comparative research particularly difficult: rapid legislative change; the complexity of tax systems; and the heterogeneity of local tax concepts"); see also, Omri Y. Marian, *The Discursive Failure in Comparative Tax Law*, 58 American Journal of Comparative Law, available at http://ssrn.com/abstract=1404323, at 1 (arguing that there have been several efforts at defining a theoretical framework for comparative taxation, but these efforts have been "largely ignored by everybody except their own authors" leading to an ongoing "non-discourse" that characterizes the field) (last visited Sep. 15, 2014).

[6] Id. Omri.

[7] Id.

[8] Id.

[9] See LI Jinyan, *Tax Transplants and Local Culture: A Comparative Study of the Chinese and Canadian GAAR*, 11 Theoretical Inquiries Law, Art. 8, (2010) arguing the issues arising as to comparing a westernized conceptions, available at http://www.bepress.com/til/default/vol11/iss2/art8 (last visited Sep. 15, 2014).

maximum can only throw in scrappy value to other major tax areas such as turnover tax or income tax.[10]

Second, the specific cultural, social, political, and legal roots and contexts of a tax governance framework usually are much less discussed or are even purposefully ignored by tax comparatists. This "snooping" methodology inevitably provokes abundant "contemptuousness" and skeptics from orthodox tax scholarship against tax comparative studies. A tax study ultimately has to pay attention to the general cultural, social, political and legal contexts in which a tax system is embedded. Otherwise, a comparative study may easily turn into a descriptive, mechanical, and perfunctory analysis. The practical and academic significance of comparative tax studies can hardly be achieved by a limited comparison of the technical elements of a tax concept without anything more. Such "big-picture" perspective nonetheless must be employed to conduct a comparative study as to the Chinese tax context. The same rationale applies to studies of the impact of both the rule of law development and China's assimilation to the World Trade Organization (hereinafter "WTO") system as well. Therefore, this article further discusses the role of philanthropic culture in its comparison between the U.S. and Chinese tax systems.

The development of China's nonprofit sector[11] has been marvelous, especially after recent natural disasters,[12] the 2008 Beijing Olympic Games, and various latest celebrities' donation scandals.[13] Regulatory deficiency in the treatment of nonprofit organizations has alarmed China's failure to maintain its tradition of state-centered social provision and the exacerbation of economic disparities between rural and urban citizens. Surges of grassroots NGO activity, millions of affectionate "netizens" during the natural disasters, and devoted volunteers for the 2008 Olympic Games and Paralympics Games have also exposed the malfunctioned administration and messed allocation of charitable resources. Meanwhile, the Chinese government has seriously identified the indispensable role played by the nonprofit sector in alleviating the bureaucracy, downsizing government, stimulating wealth mobility, reducing regional inequality, and, ultimately, promoting a harmonious society.

The current Chinese legal framework fails to establish an enabling and operative nonprofit sector. Mostly, the state fails to regulate it through a potent tax system, creating various tax preferences and ensuring no abuse of those preferences. Even if it had been

---

[10] Id.

[11] See Brody, fn. 1 at 436–37, discussing that the third sector often uses the terms "charity" and "nonprofit" interchangeably. See also generally Reobertson, fn. 1.

[12] See China Daily, Aug. 18, 2010, listing recent natural disasters that involving high casualty and economic loss including the 2010 South China floods & Yushu Earthquake, Sichuan Earthquake in May 2008, the southern China snowstorm crisis in early 2008, etc.

[13] See *ZHANG Ziyi Began to Address Quick Scandal*, available at http://www.hollywoodreporter.com/hr/content_display/world/news/e3i4fe3d67e44c8b3addc7a3a9589c41c58 (last visited Sep. 15, 2014).

suggested that a comprehensive charity law should be enacted, the existing charity tax laws and regulations sojourn discordant, anachronistic, and inoperative. What makes it worse is that certain bureaucratic management and unprofessional administration have jeopardized the incentives for and confidence in reforming the nonprofit sector.

The U.S. system on tax treatment of nonprofit organizations has been a well-established and sought-after model for decades. It is regarded as particularly appropriate for emerging NGO sections. This article proffers special emphasis on China's tax reform for the charity sector, which has expanded as a result of remarkable economic growth and legal system reform. Although there is no single pattern fitting in various global needs, the U.S. model provides quite established principles of federalism, fiscal incentives and economic adaptability makes it a powerful system. This article compares current nonprofit tax rules in China and those in the U.S. in practice and highlights suggestions that may benefit charity tax law reform in China.

Following this introduction, Part II presents a brief overview of China's current charity laws and regulations, the historical development of charity tax laws and those in practice, especially charitable tax exemptions. Part III outlines a number of institutional and theoretical backgrounds of the current U.S. charity tax exemption systems. Part IV highlights the institutional and practical similarities and differences between the China and U.S. systems. Part V concludes with major findings by commenting on potential nonprofit tax law reform in China.

I. OVERVIEW AND BACKGROUND OF NONPROFIT SECTOR LAWS IN CHINA

A. Historical Development

China runs according to a complex party-state system in a struggle within itself to find its way to modernize the nonprofit sector. In 1950, China adopted its first law[14] to manage societal organizations; however, pre-Deng (pre-1978) social organizations are government operated non-governmental organizations ("GONGOs") and not "true" NGOs based on the western definition. Those GONGOs[15] are established and absorbed into the party-state system as part of government branches. Leaders of those organizations are either current or retired senior government officials and their staff enjoy the same benefits and privileges of government officials. Apparently, GONGOs are exempt from registration and administration requirements that are required of China's NGOs.

The 1980s witnessed the development of a plethora of various forms of NGOs surging

[14] See 社会组织注册暂行条例 (*Provisional Procedures on the Registration of Social Organizations*), the first law governing social organizations and it remained effective until 1989.

[15] Mostly, those organizations are semi-government entities, such as "the Chinese Communist Youth League," "the China Writers' Association," "the All-China Workers' Union," and "the All-China Women's Federation."

from economic "reform and the open-up policy." In response to liberalization in economic development and the state-owned enterprises (SOE) modernization reforms, the state has realized its shortage of capacity and resources to provide all necessary social services to function as a rapidly reforming society. In the 1990s, the central government proposed a "small government, big society" policy, transferring part of service responsibilities that had come from the government to private or nonprofit sectors. Following the party-state tradition, private and nonprofit sectors have consistently been treated as auxiliary and subordinate agents of the state in bridging the gap between the state and the people, especially in areas like poverty relief, elementary education support, aging population welfare, and environment protection. Although the first authentic civil society organizations debuted in somewhat embarrassed way in the early 1980s, they have since shown remarkable potential to outshine the government as a major platform of raising critique and promoting social welfare and justice. However, in sensitive areas such as human rights, political reform, and religion, the government has territorially maintained a very strict practice in monitoring related activities and did not likely allow private sector or nonprofit sector to step into such realm.

In the second half the 1980s, the government was confronted by a clear and sweeping economic development needs coupled with a rudimentary and obsolete system of NGO management. In particular, the late 1980s witnessed a speedy promulgation of the new Regulation on Registration and Management of Social Organization. Not surprisingly, practical yet firm measures, such as dual management system, approval and management of supervisory unit and membership requirements, all have been established since 1989, and the scale of the NGO sector has risen and fallen according to rounds of re-registration hurdles.

Despite the fluctuating[16] numbers of registered NGOs, legislation has been unexpectedly friendly to the nonprofit sector in general. Coupled with the establishment of specific government branch to manage societal organizations,[17] the Article 35 of the 1982 Constitution recognizes the right to freedom of association and the General Principles of Civil Law (GPCL) has categorized social organizations together with government organs and public institutions that are different from commercial enterprises. This tolerance continued for over 15 years and led to the 1998 promulgation of two important pieces of legislation, most importantly the 2004 Regulation for the Management of Foundation (hereinafter "Foundation Regulation," or *Jijinhui Guanli*

[16] MA Qiusha, *The Governance of NGOs in China since 1978: How Much Autonomy?*, 31 Nonprofit & Volumtary Sector Quarterly, 305–306 (2002); see also 取缔非法民间组织暂行办法 (*Provisional Rules Banning Illegal NGOs*) (promulgated by the Ministry of Civil Affairs, effective as of Apr. 10, 2010), targeting mostly at illegal grass-roots based Qi-Gong movements.

[17] For details of the nonprofit organizations management and government apparatus, available at http://cszh.mca.gov.cn/ (last visited Sep. 15, 2014).

Tiaoli), which even permits entry of foreign foundations.[18] However, quantification of growth of the nonprofit sector in China has always been difficult. A majority of NGOs remain unregistered, or registered as for-profit entities' to evade arduous administrative proceedings, and many even dissolve before any formal registration procedure is taken or completed.

B. Summary of Current Laws and Regulations in China

In China, NGOs[19] are classified into three major categories: social organizations (SOs or *shehui tuanti*), private non-enterprise units (PNEUs or *minban feiqiye danwei*), and foundations (*jijinhui*), according to three important NGO legislations — the Regulations on Registration and Management of Social Organizations (hereinafter "SO Regulation" or *Shehui Tuanti Dengji Guanli Tiaoli*); the Provisional Regulations on Registration and Management of Private Non-Enterprise Units (hereinafter "PNEU Regulation" or *Minban Feiqiye Dengji Guanli Zanxing Tiaoli*); and the Foundation Regulation. In particular, Chinese citizens may incorporate, manage, and participate in SOs and PNEUs, while foreign citizens may only act as the legal representatives of a foundation as permitted.[20]

The Bureau of Administration of NGOs (*minjian zuzhi guanli ju*) within the Ministry of Civil Affairs ("MCA") (previously the Department of Social Organizations or *Shetuan Si*) is the primary official agency in charge of nonprofit organization and is responsible for the registration and filings, detailing implementation rulings and interpretation of laws and regulations in the nonprofit sector. Likewise, other government agencies join in regulating NGOs in certain areas. Under appropriate delegation of authority, State Administration of Taxation (SAT) and Ministry of Finance (MOF) have issued regulations and rulings on the tax-deductibility of donations, tax exemptions or preferences, and internal governance;[21] the State Administration for Industry and Commerce (SAIC) coordinates non-public fund-raising foundations and certain for-profit

---

[18] See Part I (B)(3): Foundation in this article.

[19] See MA, fn. 16, the term civil society organizations ("CSOs") is *minjian* or popular organizations. It is also interchangeably be referred as NGOs. See Na La, 中国草根 NGO 的问责现状与问题 (*Analysis and Problems on the Development of Grassroots NGOs in China*), discussing the literal meanings of NGO, CSO, NPO, SO and Foundation (in Chinese), available at http://www.nporuc.org/ html/achievements/20090907/ 167.html (last visited Sep. 15, 2014).

[20] See Art. 24 of 基金会管理条例 (*Regulations on Management of Foundations*) (promulgated by the State Council, Mar. 8 2004, effective Jun. 1, 2004), available at http://news.xinhuanet.com/zhengfu/2004-03/18/content_1372870.htm (last visited Sep. 15, 2014).

[21] See Art. 29, 社会团体登记管理条例 (*Regulations on Registration and Management of Social Organizations*) (promulgated by the State Council, Oct. 25, 1998, effective Sep. 25, 1998) (hereinafter "SO Regulation"), available at http://www.cnca.gov.cn/rjwbgs/ztxx/ldgzhbz/4570_4.shtml (last visited Sep. 15, 2014).

activities conducted by NGOs; and the Ministry of Public Security may police NGOs for certain criminal disobedience relating to national security.[22] In addition, local MCA at the provisional or city levels and other administrative branches promulgate various region-oriented or industry-specific rules and regulations to manage local NGOs.[23]

1. Social Organizations

● Dual management requirement

The SO Regulations, PNEU Regulations, and the Foundation Regulations all require a dual management structure. Each type of organization for nonprofit purposes, before it files registration at the national or local level office of MCA, must first seek a professional supervisory unit (*yewu zhuguan danwei*) to review (*shencha*) and approve (*pizhun*) such registration, which later monitor NGOs' operation, governance and finances, etc. after its establishment.[24] Although any government agency at the national, provincial, or city level, or any certified GONGO,[25] can act as an NGO sponsor, NGOs, especially grassroots NGOs, do not have much luxury to select appropriate supervisory sponsors.[26] In reality, many SOs remain unregistered or even underground simply because the potential supervisory units deny such sponsorship or the NGO's proposed major purposes and activities do not fall within sponsor's scope of duties,[27] and operative unregistered SOs risk criminal liability.[28] Therefore, granting approval by supervisory

---

[22] Id. Art. 35.

[23] Beijing is considered to be the most conservative in NGO registration and management due to its political sensitivity, while other provinces such as Yunnan and Guangdong take a relatively more liberal approach toward NGO management.

[24] See Arts. 6–9, 27–28, 民办非企业单位登记管理暂行条例 (*Provisional Regulations on Registration and Management of Private Non-Enterprise Units*) (promulgated by the State Council and effective as of Sep. 25, 1998) (hereinafter "PNEU Regulation"), available at http://www.ha.xinhuanet.com/fuwu/kejiao/2004-03/29/content_1869912.htm (last visited Sep. 15, 2014).

[25] See Art. 6 SO Regulation.

[26] See generally Na La, fn. 19; see also, HE Pengyu and Jillian S. Ashley, *Opening One Eye and Closing the Other: The Legal and Regulatory Environment for "Grassroots" NGOs in China*, 26 Boston University International Law Journal, 29 (2008) (hereinafter "HE and Ashley"). In practice, the dual management requirement has proved to be the most difficult hurdle for grassroots NGOs to surmount in gaining legal status. In order to secure the support of a government supervisory agency, the founders of an NGO must cultivate personal relationships with government officials to develop trust and connections. From a government agency's perspective, acting as a sponsor to a grassroots NGO creates many new duties, responsibilities, and political risks, but reaps few benefits. The extreme difficulty of finding a government sponsor is widely considered to be the major reason why over 90% of NGOs in China are either underground and unregistered or registered as commercial enterprises.

[27] See SO Regulation, Art. 6.

[28] See Art. 35 SO Regulation, stipulating that an unregistered NGO operating in the name of an SO could be subject not only to civil, but also to criminal liability. According to Art. 54 of the Law on Public Security Administrative Punishments, a person convicted under this provision could be subject to up to 15 days in prison and a fine of up to RMB1,000. Given that many NGOs across China are not officially registered, this provision could be viewed unfriendly to NGOs.

units is utterly discretionary,[29] and there is no standard filing paperwork requirement on obtaining sponsorship by an SO.[30] Potential government supervisory sponsors may ostensibly stretch the approval process[31] or demand unnecessary paperwork maliciously.

The dual management requirement creates several layers of problems reflective of historical reasons for monitoring development. First, it may help offering Chinese citizens reasonably accessible venues to the constitutionally protected rights to form all kinds of associations.[32] The nature of the supervisory units, however, usually dominates the scope of the activities to be conducted by the application organizations or NGO candidates.[33] Second, the dual management structure inhibits the dynamic development of responsive associations for emergency situations.[34] This drawback is particularly evident during the time of emergent natural disasters. Many volunteers have to establish *ad hoc* NGOs to conduct relief activities and they were not even able to find supervisory units within a tight timeframe. Third, it prohibits NGOs from engaging in activities across multiple sectors[35]. Usually, a supervisory unit is risk-averse and thus prefers approving NGO sponsorship within its scope of designated responsibilities and very reluctantly oversees NGOs that carry out unfamiliar activities. For example, a healthcare supervisory unit usually would refuse supervising NGOs in the education area. Therefore, NGOs have to be solely focused or functioned and are not flexible to receive donations from diversified sources. Fourth, quite often NGO is manipulated as a vehicle during government internal reshuffles to retain their redundant staff or retirees.[36] Fifth, government agencies also often set up GONGOs to raise external sources of funding[37] and to disqualify private applicant organizations.

● Constraints on repeated and cross-regional subsidiaries

A derivative of the dual management requirement is the "non-repetition" constraint. In particular, the supervisory unit or MCA may deny the registration of a NGO if "in the same administrative area there is already a social organization active in the same or

---

[29] See generally GE Yunsong, *On the Establishment of Social Organization under Chinese Law*, 2 International Journal of Not-for-Profit Law (2000), available at http://www.icnl.org/knowledge/ijnl/vol2iss3/art_2.htm (last visited Sep. 15, 2014); see also generally HE and Ashley, fn. 26, discussing a case study of establishment of an eye care center.

[30] Id. GE.

[31] Id.

[32] Karla Simon, *Regulation of Civil Society in China*, 32 Fordham International Law Journal 964 (2008–2009). Professor Karla Simon is a major contributor in the field of non-for-profit organization studies. (hereinafter "Simon").

[33] Id., discussing that scholars complain about not being to form appropriate organizations for academic studies.

[34] Id.

[35] See Na La, fn. 19.

[36] Id.

[37] See *e.g.* Simon, fn. 32 and HE and Ashley, fn. 26.

similar area of work."[38] Taking SO as an example, the non-repetition provision stipulates that in a particular area of activity, such as elementary education, only one SO in service is allowed to operate in a given geographical region (city, provincial, or national),[39] although the definition of "area of activity" is quite discretionary. It is well argued that the non-repetition requirement has the merit of avoiding too many organizations "developing without planning," and possibly potential "malicious competition" among nonprofit organizations.[40]

A further ramification of the non-repetition constraint is that an SO has to be real name identification member-based and therefore often subjects its members to surveillance.[41] In addition, the SO Regulations prohibit cross-regional branching.[42] For instance, the administrative hierarchy of the supervisory unit delineates the geographical application within which an SO can operate. If an SO wishes to reach out its registered geographic region and branch a subsidiary or representative office elsewhere, it has to obtain an approval in advance from its own supervisory sponsor and even the permission of local MCA in the desired subsidiary location that oversees similar areas of activities.[43] Literally, national SOs cannot establish branches in different provinces, although they are merely permitted to conduct activities across the country.[44] Moreover, SO subsidiaries cannot set up second-tier subsidiaries and an SO legal representative (*fading daibiaoren*) must not at the same time act as a legal representative for another SO.[45]

The non-repetition constraints coupled with branching restriction discourage locally-registered NGOs to conduct activities across China, and suppress networking and resource sharing among SOs. Moreover, an SO must not endanger or be in conflict with the interests and safety of the state and the unity of all ethnicities, and must not violate the

---

[38] See generally GE, fn. 29, citing The Interpretation of the Regulation on the Registration and management of Social Organization and the Interim Regulations on the Regulation and Management of Private Non-enterprise Units 36 (The Department of Politics and Law of the State Council & The Bureau of Administration of Non-governmental Organizations of the Ministry of Civil Affairs eds. (1999).

[39] See HE & Ashley, fn. 26 at 44–45, noting an example that, if there is already a national AIDS NGO, a similar organization could register only at the provincial or city level. This limitation reflects the Party's corporatist view of the state-society relationship, considering SOs' purpose to be to serve as a bridge between the state and society by representing the interests of various constituent groups — for example, those with AIDS or, more traditionally, women or the disabled — at a given administrative level.

[40] See GE, fn. 29.

[41] See SO Regulation, fn. 21.

[42] Id.

[43] For instance, a city-level SO can branch within the city, but cannot conduct activities outside of its registered city. If an SO wishes to conduct activities in multiple cities of the same province, it has to seek a provincial-level government sponsor and register at that level. And if an NGO wants to conduct activities in cities outside its home province, to apply the language of the regulation literally, the NGO would have to seek a ministerial-level sponsor and register a national NGO to legally carry out its mission.

[44] See SO Regulation, Arts. 12 and 13.

[45] Id. Arts.14 and 19.

state interests, public interests, or public morals.[46] Those requirements again reinforce the deeply rooted concern to foster meaningful and controllable non-profit organizations.[47]

● Exempted Organizations

Some organizations are exempted from the registration requirement according to Article 3 of the 1998 SO Regulation. These organizations include those that participate in political consultative meetings, such as the Chinese Communist Party-sanctioned eight political parties and nine other associations including the All-China Federation of Industry and Commerce, the Communist Youth League, and the All-China Women's Federation. Other exempted organizations include 14 well-known GONGOs, such as the China Writers' Association, the SONG Qingling Foundation, and the Red Cross Society of China,[48] just to name a few. These GONGOs are usually considered to have the same status as administrative branches and are often viewed as part of the government bureaucracy.

What is more interesting is the third clause of Article 3, which states that any organization that is set up by a government entity or a GONGO and that conducts its activities within such entity is exempted from registration. In practice, many NGOs exploit this provision and struggle to gain semi-legal status by attaching themselves to a governmental or semi-governmental entity that holds more liberal attitudes toward NGOs. Higher educational institutions are a common example of such liberal entities that shelter and sponsor NGOs[49] and nonprofit organizations of a research and academic nature.

The legal status of a GONGO is a precious resource. Some GONGOs find it in their financial interest to offer shelter to NGOs in exchange for membership fees and management dues. The sheltered NGOs are thus exempted from registration. Sometimes, GONGOs may even formally sponsor NGOs with a second-tier SO status by acting as their supervisory units and allowing them to register with the MCA or its local bureau. A nonprofit organization may take advantage of such an affiliation with and supervision under GONGOs and gain legitimacy and important governmental connections, though often at a high financial stake. For example, one GONGO under the MCA sponsors a nonprofit organization and charges them annual membership fees as high as

---

[46] Id. Art. 4.

[47] See Na La, fn. 19, discussing that the highly restrictive provisions against pluralism, branching, and networking are based on government concerns over an SO becoming a rival power and thus threatening the reign of the Chinese Communist Party. For instance, national-level NGOs are presumably not able to register at all and usually the most closely monitored and controlled by the central government.

[48] A complete list of these exempted GONGOs is available at http://www.mca.gov.cn (last visited Sep. 15, 2014).

[49] See *e.g.* Jude Howell, *New Directions in Civil Society: Organizing around Marginalized Interests*, in Jude Howell eds. *Governance in China*, Rowman & Littlefield (Maryland), at 143, 155–65 (2004).

RMB200,000.[50]

2. Private Non-Enterprise Unit. — The Private Non-Enterprise Unit (PNEU) vehicle, first created by the 1998 Provisional Regulations on Registration and Management of Private Non-Enterprise Units (PNEU Regulation), is a special NGO category in the Chinese context. By definition, a PNEU is a privately-run noncommercial unit, and its main purpose is to provide social services,[51] mainly in the fields of education, public health, technology, and sports. These facilities historically have been almost entirely owned and operated by the state. Ever since the economic reforms starting in the late 1970s, private institutions have gradually proliferated and replaced government agencies in running related organizations and PNEUs thus have come into the picture. The 1998 PNEU Regulation formally recognizes the legal status of these then state-operated now privately-run entities and grants them nonprofit status. In practice, a majority of PNEUs are for-profit entities in the areas of education and healthcare. The PNEU sector has grown very rapidly since the promulgation of the PNEU Regulation. As of December 31, 2006, a total of 159,000 PNEUs have been registered,[52] accounting for about 46% of all registered NGOs in China, and roughly half of these PNEUs are private schools.[53]

Many key provisions of the 1998 PNEU Regulations mirror those in the SO Regulation, such as the dual management system, non-repetition within the same administrative region restriction,[54] and not surprisingly, similar broad and vague languages subject to discretional interpretation by the state power.[55] One additional restriction imposed on PNEU is that a PNEU may not set up branches even within administrative region in which it is registered.[56] As difficult as it is to substantiate, this provision is suspected to envision the disadvantaged position of state-run noncommercial organizations (*e.g.* schools and hospitals) in competition against PNEUs.

Traditionally, PNEUs aim to provide social services and thus are less politically sensitive to the government. PNEUs are even encouraged and fostered as stated in a recent MCA work report,[57] and adopted by grassroots NGOs as a good vehicle to obtain the nonprofit status and the associated legitimacy. Noticeably, the PNEU Regulation casts

---

[50] See HE & Ashley, fn. 26 at 46.

[51] See PNEU Regulation, Arts. 1 and 2.

[52] See 孙伟林局长在全国民间组织管理工作视频会上的讲话 (*Speech at the National NGO Management Conference by SUN Weilin, Head of National Bureau of NGO Management*), (Jan. 31, 2007), available at http://www.mca.gov.cn (last visited Sep. 15, 2014).

[53] ZHAO Yong, 民办非企业单位有关法律问题之思考 (*Thoughts on the Legal Issues of PNEUs*), in WEI Dingren eds. 中国非营利组织法律模式论文集 (*Collected Essays on the Legal Models of Chinese NPOs*), China Fangzheng Press (Beijing), at 220 (2005).

[54] See PNEU Regulations, Arts. 5, 8, and 13.

[55] See SO Regulations, Arts. 4 and 35.

[56] See SO Regulations, Arts. 4, 13, and 27.

[57] See fn. 52.

out sincere efforts by the government to fashion a tiered-management structure for NGOs and diversify NGO categories.

3. Foundations. — The 2004 Foundation Regulations marked a major step forward for China's NGO legal framework. Noticeably, for the first time, a foreign NGO, other than a chamber of commerce,[58] could legally establish its presence in China as a nonprofit entity.[59] A foreign citizen, subject to a three-month residency requirement for certain key management personnel, is able to incorporate and participate in domestic private foundations.[60] Foreign foundations are not allowed to raise funds inside China.[61]

Superior to the 1998 SO Regulation and PNEU Regulation, the 2004 Foundation Regulation features some modern NGO prerequisites and standards — in particular, management appointments, internal governance, donation and financial management. Not surprisingly, the Foundation Regulations disappointed observers by keeping the dual management,[62] and a provincial level of government sponsor is required, which is more restraining than the SO and PNEU regulations.

● Categories of Foundations and Capital Requirements

The Foundation Regulation elaborates separate treatment for domestic foundations and for representative offices of foreign foundations.[63] A domestic foundation is further classified geographically as a national foundation and a regional (provincial) foundation, and also classified either as a private or public foundation based on the sources of its funds and donations.[64] A national foundation, the representative office of a foreign foundation, or any foundation whose legal representative is not a citizen of Chinese mainland has to register with the MCA and secure the backing of a ministerial-level government supervising agency or a sponsor recognized by the State Council.[65]

The minimum capital threshold to set up a private foundation is RMB2 million (about $295,000),[66] RMB8 million (about $1.18 million) for a national foundation, and RMB4 million (about $590,000) for a regional foundation.[67] Local MCAs may at their discretion impose higher initial capital requirements. The initial capital is presumably kept on book

---

[58] See 外国商会管理暂行规定 (*Provisional Regulations on Management of Foreign Chambers of Commerce*) (promulgated by the State Council, Jun. 14, 1989, effective Jul. 1, 1989).

[59] See 2004 Foundation Regulation, Arts. 6, 13, and 14.

[60] Id. Art. 24.

[61] Id. Art. 25.

[62] Id. Art. 7.

[63] Id. Art. 13.

[64] Id. Art. 8; see also Na La, fn. 19, Chapter III.

[65] Id., Art. 7. In particular, a foreign citizen may serve as a legal representative or Chairman of the Board for a domestic private foundation, though it is yet to be seen whether this will be allowed in practice. At a minimum, foreign citizens or citizens from Hong Kong, Macau, or Taiwan can assume important management positions of a foundation and thus potentially control its operations in significant ways.

[66] Id. Art. 8.

[67] Id.

and thus cannot be used for programming activities.

● Constraints on Cross-Regional Subsidiaries and Standards for Internal Governance

A foundation may set up branches upon approval of the MCA or its provincial branch, and the civil affairs bureaus have the discretion to deny the application.[68] The 2004 Foundation Regulation requires particular internal governance requirements,[69] such as the board of directors formation,[70] appointment of a supervisory official, [71] and a legal representative.[72] Moreover, the Foundation Regulation also elaborates financial management standards, such as annual expenditure restraints,[73] and capped management compensation and capped overhead fees.[74]

4. Unregistered NGOs. — The taxing registration requirement, especially the difficulty of searching for a "supervisory or administration unit," encourages the establishment of many de facto NGOs, including grassroots NGOs in China that do not seek registration. In fact, the unregistered NGOs that operate openly and legally may well outnumber registered ones.[75] As mentioned above, a social organization can operate as an internal organization of another enterprise and social organization without registration.[76] Some *de facto* social organizations incorporate themselves as corporations and are treated the same way as a normal commercial enterprise. If a NGO can demonstrate its nonprofit nature to the local governmental and tax authorities, even though it is hard to prove, there might be some flexible and compromised accommodation can be reached between NGOs and local MCA and SAT.

---

[68] Id. Art. 12.

[69] The SO and PNEU Regulations, in contrast, have almost none.

[70] See 2004 Foundation Regulation, Art. 20, stipulating that the board must have between 5 and 25 members, for private foundations established using the assets of a private individual, no more than a third of board members may be close relatives of that individual, and for other foundations, close relatives may not serve simultaneously as directors no more than a third of a foundation's board members may receive financial compensation from the foundation.

[71] Id. Art. 22, providing that the official cannot be a member of the board, a close relative of a board member, or on the financial staff of the foundation.

[72] Id. Art. 23, providing that the legal representative of the foundation may not concurrently represent any other organization and a public or private foundation's legal representative should be a citizen of Chinese mainland if the foundation's original funds are of domestic Chinese origin.

[73] Id. Art. 29, stipulating that the amount of money spent annually by public foundations on public benefit activities must not be less than 70% of the previous year's income, and private foundations' annual expenditure must not be less than 8% of the surplus from the previous year.

[74] Id. a foundation may not allocate more than 10% of its total expenditure to cover staff wages and benefits and other overhead costs.

[75] This article excludes secret, underground organizations that operate illegally for discussion for two reasons: (1) The numbers are not collectable or verifiable in any official means; and (2) illegally operated underground organizations are loosely associated and sometimes at best are motivated gatherings for spiritual pursuit.

[76] Often, those organizations reach beyond the scope of serving the affiliated enterprise or organization. For example, in many universities, the affiliated social organizations are also serving the society in general and the government will often just turn a blind eye to these types of activities.

Many NGOs, especially grassroots NGOs, simply do not exist as legal entities because they never seek to register. However, some of these NGOs operate openly (acknowledged by some governmental entities and officials) and are generally accepted by the community. Since Chinese tradition favors a connections between people (*guan*xi) and flexibility in resolving problems when relevant official process is burdensome and costly, unregistered but well-connected NGOs will likely continue playing an important role and leading to many administrative discrepancies and uncertainties.

C. Tax treatment of Chinese NGOs

China does not have a comprehensive tax code governing various forms of NGOs. Charitable tax exemptions from major Chinese taxes are mostly based on the "nonprofit" concept,[77] which is prescribed and interpreted by scattered provisions within the various tax laws and regulations. The China Trust Law (on charitable trust) and the Public Benefit Donation Law (hereinafter "PBDL") are a couple of laws passed by the National People's Congress governing NGOs.[78]

1. Tax Treatment of Charitable Donations. — As noted above, rules about income tax treatment of donations scatters in various laws and regulation as shown below (see Table 1).

Table 1 Legislations on Tax Treatment of Donation

Date of Enactment	Legislation	Description
January 28, 1994	Article 24 Regulations for the Implementation of the Individual Income Tax Law of the PRC	"Individual income donated to educational and other public welfare undertakings" refers to the donations made by individuals who have used their income for educational and other public welfare undertakings, and in areas suffering from serious natural disasters or poverty, through social organizations or government agencies in the People's Republic of China. The part of the amount of donations that does not exceed 30 percent of the amount of taxable income declared by the taxpayer may be deducted from his amount of taxable income
February 4, 1994	Article 6(4) Provisional Regulations of the PRC Enterprise Income Tax	Donations for community benefits and charitable donations by a Taxpayer in a year are deductible up to 3% of the Taxable Income.
September 1, 1999	Articles 24 and 25, Chapter IV Preferential Measures, PBDL	Article 24 When donating property for public welfare undertakings according to the provisions of this Law, corporations and other enterprises may be given preferential treatment in enterprise income tax according to the provisions of laws and administrative regulations. Article 25 When donating property for public welfare undertakings according to the provisions of this Law, natural persons, individual businesses of industry and commerce may be given preferential treatment in individual income tax according to the provisions of laws and administrative regulations.

(*To be continued*)

[77] See 2004 Foundation Regulations, Art. 2; SO Regulation, Art. 2; PNEU Regulation, Art. 2.

[78] See generally in Leon Irish, JIN Dongsheng & Karla Simon, *China's Tax Rules for Not-for-Profit Organizations*, at 12–16 (2004), and in practice, registration with the MCA or its local branch in one of the three recognized NGO forms guarantees exemption, even the local bureau of industry and commerce may consider NGOs as for-profit commercial enterprises on a case-by-case basis and apply normal business tax rates.

(*Continued*)

Date of Enactment	Legislation	Description
July 12, 2000	Joint Notice on Income Tax Treatment of Donation by Enterprises to the Red Cross (SAT and MOF)	Donations made to non-profit social organizations and state apparatus (such as the Red Cross) by enterprises, social organizations, and individuals should be fully deducted from taxable income.
March 8, 2001	Joint Notice on Income Tax Policies as to Perfecting Experimental Works for Urban Social Securities System (SAT and MOF)	Charitable donations made to charitable organizations, foundations, or non-profit social organizations by enterprises, social organizations, and individuals should be fully deducted from taxable income.
September 22, 2003	Joint Notice on Income Tax Deduction as to Donations to Five Foundations Including the China Health Vehicle Project (SAT and MOF)	Charitable donations made to China Health Vehicle Foundation, Sunzhifang Economic Science Foundation, China Charity Foundation, China Legal Aid Foundation and China Justice-Upholding Foundations by enterprises, social organizations and individuals should be fully deducted from taxable income
February 5, 2004	Article 8, Joint Notice on Education related Tax Policy (SAT and MOF)	Donations made to the educational institutions by taxpayers through non-profit organization and state apparatus in China should be fully deducted from taxable income.
March 16, 2007	Article 9, Enterprise Income Tax Law	In relation to the expenses from charitable donations incurred by Enterprises, the portion within 12% of the total annual profit may be deducted from the taxable income.

Individuals and corporations can deduct their charitable contributions with some constraints in China. For individuals, "personal contributions to educational and other undertakings for public welfare shall be deducted from the taxable income in accordance with the relevant regulations by the State Council."[79] The regulations there under define donations as "donations by individual[s] of their income to educational and other undertakings of public welfare, and to areas suffering from serious natural disasters or poverty, through social organizations or government agencies in the People's Republic of China."[80] The regulations further limit the deduction to 30 percent of taxable income.[81]

According to the recent unified Enterprise Income Tax Law, which took effect on January 1, 2008 and unifies the treatments between foreign and domestic enterprises, enterprises are allowed to deduct up to 12 percent of taxable income for contributions to causes for "public benefits and social welfare."[82] As stipulated in the Provisional Rules and Regulations there under, causes for public benefits and social welfare are defined in almost the same way as the Regulations for the Implementation of the Individual Income Tax Law. The Enterprise Income Tax Law of the PRC (hereafter EIT Law) explicitly states that donations directly to individual donees are not deductible. As of July 2006, the MOF and SAT had only approve tax deductions for donors to sixty-two organizations,[83]

[79] See The Individual Income Tax Law of the PRC, Art. 6.

[80] See The Regulations for the Implementation of the Individual Income Tax Law of the PRC, Art. 24.

[81] Id.

[82] See Enterprise Income Tax Law of the PRC, Art. 9 (promulgated by the National People's Congress, Mar. 16, 2007, effective Jan. 1 2008).

[83] See 慈善捐赠优惠政策 (*Preferential Policy for Charitable Donations*), available at http://www.juanzhu .gov.cn (last visited Sep. 15, 2014).

most of which are GONCOs. Donations to these twenty-six organizations are fully deductible, but for the other thirty-six organizations, individual donors can deduct up to 30% of taxable income, and corporate donors up to 12% under the recently revised Enterprise Income Tax Law, which increases the permissible charitable contribution deduction for both domestic and foreign companies corporate donors from 3% to 12%.[84]

The Chinese tax laws and regulations require that for charitable contributions to be tax-deductible, they must meet both a specific "cause" requirement and an organizational prerequisite, *i.e.* to be tax deductible, such contributions have to cater certain causes as well as to pledge (through) certain organizations. However, there is serious doubt about how important a role the tax benefit consideration plays in individuals' or corporations' donation considerations.[85] First and foremost, the MOF and SAT stipulate only a few organizations that are eligible for receiving tax deductible charitable contributions. Donations made to non-certified NGOs are not tax deductible. Second, due to the high volume of activities in times of emergency, eligible organizations might have insufficient human and financial resources to collect and manage donations. Third, the infrastructure connecting individual income tax reporting and charitable deductions is weak.[86] Finally, the complicated administrative procedure may thwart taxpayers to claim such deduction, the nominal value of which is insignificant in most cases.

In addition, although recent natural disasters in China have stimulated a round of personal charitable donations, such economic endowments remain infrequent in China for various reasons. First, the feeling of distrust still occupies minds of individual donors regarding the likelihood of a reasonable and fair allocation of charitable donations. Second, the absence of an estate or gift tax in China reduces the motivation for making donations. Third, the government adopts an unsympathetic controlling practice toward unregistered NGOs, which mostly are underground churches, religious groups, and elderly care centers. Finally, corruption by government officials overwhelmingly impairs their capacity to request further donations.

According to the PBDL, qualified public welfare organizations are allowed to receive public welfare donations under the following conditions:[87]

i) activities carried out by social bodies and individuals to provide disaster relief, aid for the poor, and giving support and assistance to the physically disabled;

---

[84] See the EIT Law of the PRC, Art. 9.

[85] See generally, 中国税务学会《关于进一步扩大内需的税收政策研究报告》 (Chinese Taxation Institute, *Report on Tax Policy Studies for Promoting Domestic Needs*), available at http://www.chinatax.gov.cn/n480462/n7921376/n7921576/n7921766/n7921902/8800885.html (last visited Sep. 15, 2014).

[86] See generally Na La, fn.19.

[87] See 中华人民共和国公益事业捐赠法 (*Public Welfare Donation Law of the PRC*), Art. 3 (effective as of Sep. 1, 1999), available at http://www.gqb.gov.cn/node2/node3/node5/node9/userobject7ai1270.html (last visited Sep. 15, 2014).

ii) educational, scientific, cultural, public health, and sports undertakings;

iii) construction of environmental protection facilities and public utilities in society; and

iv) other public and welfare undertakings in society that aim to promote social development and progress.

Noticeably, the donations have to be made to certified public welfare social organizations and public welfare private non-enterprise units under the Public Welfare Donations Law. Therefore, the importance of achieving registration with the MCA as a gateway to receive various benefits is foremost over other considerations in establishing an NGO. The 2001 Trust Law provides for the first time some promising support to the establishment of a public (charitable) trust (with certain limitations). In particular, the purpose of trusts for charity and public interests should include poverty relief, emergency relief, assistance to the disabled, development of education, science and technology, culture, and sports, medicine and health welfare, and environmental protection. However, the establishment of a public trust and trustee appointments for a public trust are all subject to the approval and oversight of MCAs.[88]

As part of friendly legislations to the NGO sector,[89] in January 2007, the MOF and SAT jointly have released encouraging measures and rulings for promoting tax exemption and deductibility. "All public benefit social organizations or foundations established upon approval of the civil affairs administrative department" would be eligible to receive tax-deductible donations, subject to a review conducted by MOF and SAT and is designed to confirm the organization's public benefit nature.[90] Therefore, the category of organizations eligible for charitable tax exemption or deduction expanded to include charities such as aging people care centers, ethnic minority education programs, and

---

[88] See 中华人民共和国信托法 (The Trust Law of the PRC), Arts. 62, 64, 65, 67, and 70, which stipulate that public trusts shall establish a trust supervisor. The trust supervisor is prescribed by the trust documents or appointed by the public welfare authorities if there is no such prescription in the trust documents. The trust supervisor has the right to file an action or establish other legal activities in his own name for the benefit of the beneficiary. The duties of the trustee of a public trust have been enhanced. The trustee must make a report about the disposition of the trust business and the status of the trust assets at least once a year. If the public trust expires, the trustee must report the cause and date of the expiration to the public welfare authorities within 15 days of the occurrence of the event forming the reason for expiration of the trust.

[89] See generally Simon, fn. 32, noting that a comprehensive Charity Law is under discussion and is intended to address multiple aspects of the regulation of charities in China, including tax deductibility of donations. The MCA and MOF have sought broad input on the law, a draft of which was circulated for comment in Sep. 2006. See also, International Centre for Civil Society Law, *Comments on the Draft Charity Law for the PRC*, 5 International Journal of Civil Society Law 12, (2007) (Hereinafter the Simon: Comments).

[90] See 关于公益救济性捐赠税前扣除政策及相关管理问题的通知 (*Notice Concerning Policy and Related Questions on the Pre-Tax Deduction of Public Benefit Relief Donations*) (promulgated by the MOF and SAT jointly and effective on Jan. 8, 2007) (hereinafter "the 2007 Notice").

health care centers for the treatment of specific diseases.[91] Moreover, in 2008 the MCA upgraded its operations dealing with charity statistics and other charity activities from a semi-independent "bureau" to a Ministry Department.[92]

A further reading of charitable tax exemption laws and regulations reveals that passive investment income (interest and dividends earned on investments) of NGOs is still subject to tax.[93] Investment income has always been one of the major sources of revenue for all NGOs, especially for NGOs in the U.S. However, interest income realized by Chinese foundations, which are established with a high permanent capital requirement, mostly end up being subject to EIT in the course of an NGO's operation and existence.[94] Therefore, the fragile availability of NGO revenue resources again will be hijacked, resulting in actual reductions in charitable finances and low capital mobility. Although this problem has not emerged severely within the SO and PNEU sectors, a responsive ruling from the SAT should likely remove their fears in this connection.[95]

2. Procedural Reform for Charitable Tax Exemptions. — Messy and sometimes opaque procedural practices are not foreign to the tax law field in China, and charitable tax exemption is not an exception in this regard. In the 2007 MOF and SAT joint ruling, a procedural scheme is provided but is too advanced to fully implement comparing with existing tax administrative capacities. Still, smaller sized and more independent charities all expect to see an easier fundraising. The murky procedure in this connection may also challenge the domination of fundraising by the large government related charities such as GONGOs and the municipal charity foundations.

According to the 2007 Ruling, tax deductible donations may be made to all public "welfare social associations or foundations established upon approval of the department of civil affairs of the State Council."[96] Apparently, this welcoming gesture of the government comforts donors in many ways, especially when deductions are permissible for donations made to pass-through organizations[97]. Given the enormous economic interests such as commissions or management fees available in pass-through

---

[91] See 慈善捐赠优惠政策汇编 (*Collection of Preferential Policy for Charitable Donations*), available at http://www.juanzhu.gov.cn (last visited Sep. 15, 2014).

[92] See, *China Adds Government Department for Charity Activities*, People's Daily Online on Sep. 11, 2008, stating that, in China, such escalation of administrative hierarchy means a lot in terms of management authority, resources allocation and enforceability of NGO administrative regulations.

[93] See fn.91.

[94] See, *e.g.* WANG Biqiang, *A Taxing Time for China's Non-Profits*, The Economic Observer Online on Feb. 19, 2008.

[95] See Simon, fn. 32, raising that the SAT has taken this issue under advisement and may soon release new policies with regard to tax exemption of revenues earned on funds held by CSOs. A change to reflect the recommendation in the Tax Report would be welcome.

[96] See 2007 Notice, fn. 90.

[97] For example, the All-China Charity Federation and the China Red Cross Society.

organizations, such procedures for qualifying the organizations that are permitted to receive tax deductible contributions are unlikely to be implemented in the near future.

Furthermore, to qualify as a public welfare organization to enjoy deductible contributions, a confirmation letter from appropriate level of tax authorities is required.[98] To obtain such recognition letters, an application should be filed with evidence that the organization, *inter alia*, is non-profit, is established and managed consistently with the law, may not distribute any surplus upon dissolution or termination,[99] may not engage in business activities unrelated to its public welfare purposes, has an oversight body that is not "aimed at making private profits," has an internal financial and accounting management, and has a charter.[100]

The 2007 Ruling also stipulates instructions on handling donations and communicating with its donors. Those instructions include that (1) No donor may participate in the asset distributions or take ownership to such assets; (2) organizations eligible for donation-based pre-tax deductions shall use public welfare relief for specific purposes;[101] and (3) a special voucher for public welfare relief donations must be used.[102] The 2007 Ruling also prescribes procedures for donors to follow to claim deductions on their tax returns. For instance, the donor must submit the certification by the authorities of the donee organization; the original receipt received from the donee organization; and other materials as required to be submitted.

The discussion of Charity Law again becomes indispensable. Many scholars have expressed deep interests and completed extensive work toward the promulgation of a comprehensive or "all-in" charity law[103], which aims to embrace all valid factors involving nonprofit organizations. For instance, the draft Charity Law provides that current tax laws and regulations fail to detail the approaches by which nonprofit organizations obtain licenses to engage in public fundraising. Article 24, Paragraph 2 of the draft Charity Law[104] states that only organizations with a "[c]ertificate of the certification for charitable organizations" may engage in fundraising activities from the

---

[98] See 2007 Notice, fn. 90.

[99] Id.

[100] Id.

[101] For example, education, civil affairs, other public welfare undertakings, or for the districts that suffer from natural disasters or the poverty-stricken districts. Moreover, the non-profit public welfare social associations and foundations, as well as the people's governments at or above the county level and their departments."

[102] The organizations must "separately use the vouchers for public welfare relief donations as uniformly printed under supervision of the central or provincial public finance department according to the financial affiliation, and affix their respective special financial seals; and shall issue receipts if any individual asks for it for his donations."

[103] Rebecca Lee, *Modernizing Charity Law in China*, 18 Pacific Rim Law & Policy Journal 347 (2009).

[104] See Simon Comments, fn. 89.

general public (*shehui gongzhong*). This does not apply "if laws or administrative regulations provide otherwise." Limiting public fund raising in this manner gives the MCA control over the organizations that raise money from the public. This should generally be seen as an important consumer protection, and thus it would be important to enact similar rules in the draft Charity Law.[105]

As criticized by Professor Simon, the various other rules with respect to permits for fundraising in the draft Charity Law (Articles 26 and 27) and the rules with respect to public fund raising (Article 28) are, however, not detailed enough to protect the public at the present time.[106] While Articles 26 and 27 of the draft outline the licensing procedure: "Certified charitable organizations" must apply at the MCA offices of the people's governments above the county level, it is unclear as to what information will be required for a license, etc. In addition, it is important to note that in times of natural disaster, the need for a license may inhibit some fundraising — this may prove to be problematic if there are no organizations that have sufficient public trust to collect and disburse the massive funds needed in cases like the one presented by the Sichuan Earthquake. It is going to be important to put the Charity Law in place quickly so as to allow more independent nonprofit organizations to obtain charity status and fundraising licenses.[107]

II. CURRENT U.S. FEDERAL NGO TAX EXEMPTION SYSTEM — AN INSTITUTIONAL AND THEORETICAL ANALYSIS

The U.S. federal law of tax-exempt organization derives its authority from the taxation powers of the Congress, and related tax provisions are codified in the Internal Revenue Code (hereinafter the "IRC"). In general, a charitable organization is defined as one that "pays no tax on its income and whose donors derive a tax benefit as a result of their donations.[108] The U.S. system adopts a classification method that lists objective standards for qualifying organizations exempt from federal income tax.

A. The Exemption

The current language on NGO tax exemption appeared first in Section 501(c)(3) of 1954 IRC. The charitable income tax exemption refers to the statutory relief from the obligation of certain nonprofit entities to pay income tax. Pursuant to IRC Section 501(c)(3), such relief is automatically offered to entities that are granted tax-exempt charitable status upon application and approval. A variety of non-charity entities are also entitled to income tax exemption.[109] Moreover, charitable nonprofit organizations, unlike

[105] Id.
[106] Id.
[107] Id.
[108] See Besty Buchalter Adler, Rules of the Road (1999), at 3.
[109] Other forms include social welfare organizations, labor organizations, business leagues and social clubs.

practically all other tax-exempt nonprofit organizations, are the only tax-exempt nonprofit organizations that are also eligible to receive charitable donations from the public, entitling the donor to federal income tax benefits. The IRC provides that individuals and corporations that donate money or property to charitable entities may be entitled to receive a tax deduction when computing their own tax liability. The potential savings can be quite significant depending on the amount of the donation, the type of property donated, the income of the donor, and the type of charity to which the donation is given. This ability to receive tax deductible donations from the public is the key federal tax law distinction between charities and other tax-exempt nonprofit organizations.[110]

An interested nonprofit corporation should file an application with the IRS to obtain the tax-exempt charitable status. Not surprisingly, such complex paperwork demands accurate and ample information concerning organizational structure, principal activities, financial assets, expected and past revenue streams, internal policies, and much more. The IRS evaluates the information provided to determine if such proposed activities and organizational structure are deemed "charitable." Noticeably, the IRS, subject to later judicial review, has sole discretion as to whether to grant or deny the applicant tax-exempt charitable status based if the information provided on the organization's forms do not adequately comply with the law. The IRS may even revoke the "charitable" status if the charitable entity does not operate in compliance with federal law. Accordingly, a charity must often also update annual information reports to the IRS about its operative activities after initial filings.

These extensive requirements on obtaining and maintaining tax-exempt charitable status are only a few of the many aspects of the charitable tax exemption, including but not limited to not paying federal income tax. Under the requirement of filing specific forms to obtain the tax-exempt status, the forms required for tax-exempt charitable status are much more complicated than those required for other tax-exempt nonprofit organizations. Such added complexity is mostly due to the additional financial impact on tax revenues because charities are also eligible to receive tax deductible donations from the public.[111] The IRS, by granting an organization tax-exempt charitable status, not only saves the organization from the requirement to pay federal income tax, but also communicates assurances to potential donors that donations will be used for charitable purposes.

---

[110] IRC Section 501(c)(3).

[111] See David Brennen, *A Diversity Theory of Charitable Tax Exemption — Beyond Efficiency, Through Critical Race Theory, Toward Diversity*, 4 Pittsburgh Tax Review 1, 3–5 (2006) (discussing that the added complexity could be related to something that has nothing to do with dollars, or perhaps the added complexity has something to do with the nature of charities in a market society, and the reason charities are eligible to receive tax deductible contributions is that they are required to use these monies for charitable purposes, as opposed to mutual benefit purposes as is the case with other tax-exempt nonprofit organizations.)

B. Theories of Charitable Exemption

Traditional theories of the charitable tax exemption are principally based on concepts of economic efficiency. These efficiency-based theories explain the charitable tax exemption as either a subsidy by government for public goods, a necessary result of using net income to define tax liability, or a means of compensating charities for capital constraints. Other efficiency-based theories contend that the charitable tax exemption is either a payment for an entity's ability to garner donations or a means of compensating charities for the risk they assume in providing public goods. Each of these economic theories for the charitable tax exemption has its strengths and its weaknesses. They are also useful in establishing the contours of the charitable tax exemption. However, these traditional theories may contain less significant non-economic considerations, which, ultimately, make them incomplete. This explanatory deficiency also means that these efficiency theories cannot fully guide us in establishing the contours of charitable tax exemption law.[112]

1. The Traditional Public Benefit Subsidy Theory. — The public benefit subsidy theory views the charitable tax exemption as an approach whereby the government pays organizations consistently engaged in providing public goods. In other words, charitable tax exemption is offered essentially to "pay" or "compensate" private entities that supply public goods and services as noted in *Bob Jones University vs United States*.[113] The theory fundamentally assumes that the government subsidizes certain "goods" or "services" that the government either cannot or will not supply on its own due to various constraints, such as constitutional constraints as to religion and political constraints as to campaign support. Another assumption underlies this theory is that government, under neutral principles, can determine what constitutes a public good or service for purposes of the charitable tax exemption. Therefore, the government somehow takes exemption as a form of financial support for charities.

The traditional subsidy theory alone does not fully validate the charitable tax exemption. One problem with the theory is that it fails to justify why governmental

---

[112] Rob Atkinson, *Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis and Syntheses*, in Paul Bater, Frit Hondius & Penina Kessler Lieber eds. *The Tax Treatment of NGOs: Legal, Fiscal and Ethical Standards for Promoting NGOs and Their Activities*, Kluwer Law International (Frederick), at 253–83 (2003).

[113] See Brennen, fn. 111 at 68, arguing that charitable exemptions are justified on the basis that the exempt entity confers a public benefit-a benefit which the society or the community may not itself choose or be able to provide, or which supplements and advances the work of public institutions already supported by tax revenues. History buttresses logic to make clear that, to warrant exemption under Section 501(c)(3), an institution must fall within a category specified in that section and must demonstrably serve and be in harmony with the public interest. The institution's purpose must not be so at odds with the common community conscience as to undermine any public benefit that might otherwise be conferred.

financial support for charities has to be a tax exemption rather than a direct grant or privileged access to resources. Meanwhile, this theory does not identify a coherent protocol as to what goods and services are for the public benefit. For this instance, although the neutral market principles might drive the process of deciding what benefits the public,[114] the "neutral" efficiency principle alone does not substantiate a basis for understanding how a public benefit is determined.

2. The Base-Defining Theory. — By pointing out the insufficiency of the public benefit subsidy theory, Boris Bittker and George Rahdert proposed the base-defining theory, which essentially states that charities (and many other nonprofit organizations) are not suitable targets of the income tax and thus should be exempt from income tax. Specifically, Bittker and Rahdert argue on the economic aspects of the exemption:

> *"...[Charities] should be wholly exempted from income taxation, because [(1)] they do not realize "income" in the ordinary sense of that term and because, [(2)] even if they did, there is no satisfactory way to fit the tax rate to the ability of the beneficiaries to pay."*[115]

The base-defining theory explains that measuring the income of a charity is a conceptually difficult, if not impossible, task.[116] By analyzing the sources of a charity's typical revenues such as interest on endowment, funds, membership dues, and gifts/donations, Bittker and Rahdert summarize that, with the exception of interest on endowment funds, charities simply do not realize revenues in of the type that constitute taxable income[117]. Membership dues, gifts, and donations to the charity preferably would be categorized as excludable gifts from members or donors. Moreover, the charitable entity itself behaves as a mere conduit for passing the economic enrichment, which may be viewed as excludable gifts to the charity's beneficiaries.[118]

Another complicated factor necessitates counting deductible expenses incurred in acquiring revenue. Bittker and Rahdert identified charitable expenditures as potentially

---

[114] Id., Brennen presents that, in Bob Jones University, a private university was identified in the charitable tax exemption statute as a public benefit-education, yet the Court held that the education in that case was not entitled to exemption due to the presence of invidious racial discrimination. Brennen further argues that efficiency analysis alone does not provide a rationalization for this aspect of charitable tax exemption.

[115] Bittker & Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 Yale Law Journal 299 (1976).

[116] Id., measuring an entity's income by a determination of the entity's gross income in excess of expenses incurred in acquiring the income. Gross income is generally any economic enrichment that is not excluded from income by Congress, and one common Congressional exclusion from income is gifts, money or property given with "detached and disinterested generosity" is not usually treated as taxable income.

[117] Id. at 301–302.

[118] Id. at 303.

including items such as staff salaries and medical welfare programs for indigents. Firstly, considering a deductible expense as an "ordinary and necessary expense incurred in carrying on a trade or business" activity is self-contradictory because this treats mission-focused charitable activity as a "trade or business."[119] Further, even if the definition of "business" includes providing charitable benefits, since ultimately all revenues are committed to charitable purposes, leaving no revenue to insiders as profits, a charity would essentially have no tax liability.[120] Moreover, treating the expense as eligible for the charitable contribution deduction is arguably unrealistic because either structural impediments in the statute authorizing the charitable deduction or the necessary zeroing out of income prohibits such deduction. Base-defining theory also concerns applicable appropriate tax rates.[121]

Although the base-defining theory centers on an economic explanation[122] of the charitable tax exemption, it fails to address a few non-economic aspects aside from the elimination of a financial obligation, such as justice and fairness in resource allocation and opportunities for societal enhancement and betterment. More precisely, Bittker and Rahdert's thesis fails to fully address a few issues including the difference between a zero or near-zero tax liability and a tax exemption, political activities and lobbying, the definition of "charitable," and private foundation rules.[123]

3. The Capital Formation Subsidy Theory. — In response to the base-defining theory, Professor Henry Hansmann proposes his capital formation subsidy theory on charitable tax exemption.[124] Professor Hansmann explains that the rationale for the charitable tax

---

[119] Id., see also Brennen, fn. 111 at 12–15, briefing that base-defining theory may well explain a few inherent controversies with charities' operation.

[120] Id., net income-save for some instances of multi-year accumulations for specific purposes-would always equal zero, resulting in no tax liability.

[121] Id., Bittker and Rahdert argues that tax rates implicate conceptions of efficiency related to either the "benefit" or "ability to pay" theories of taxation; and a charity's income should be imputed to its beneficiaries for rate determination purposes since it is most likely the beneficiary who would bear the burden of any tax on the charity's income.

[122] See Brennen, fn. 111 at 12–15, presenting that, throughout their base-defining theory, Bittker and Rahdert explain that, even if the federal income tax were to apply to a charity's income, it is quite likely that no tax revenue would result. See also generally Brody, fn. 1, however, Evelyn Brody explains quite well in her sovereignty theory of charitable tax exemption: while most observers have described tax exemption as a subsidy, a zero rate of tax differs qualitatively, not just quantitatively, from a one-percent rate of tax. Tax exemption maintains an independent distance between charities and the state. Similarly, exemption differs in an important political way from an equivalent system of direct grants.

[123] Id., presenting that Bittker and Rahdert's base-defining theory uses a similar type of non base-defining (non-economic) analysis to fully account for the educational exemption for museums, colleges, and orchestras.

[124] H. Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 Yale Law Journal 54, (1981).

exemption concerns the access of charities to capital markets.[125] Professor Hansmann argues that the tax exemption compensates charities for the lack of access to capital markets, and such "capital subsidy" promotes "efficiency especially for industries where nonprofit firms serve consumers better than their for-profit counterparts." If markets operate at optimal efficiency, and if nonprofit organizations are the most efficient producers of "contract failure" goods and services, nonprofit organizations should be subsidized to grow and expand as a societal unit.

A key to Professor Hansmann's capital subsidy theory is the notion of contract failure which "derives from the inability of some or most consumers to make accurate judgments concerning the quality, quantity, or price of services provided by alternative producers." Professor Hansmann typically uses the American Red Cross[126] to exemplify contract failure in that nonprofit firms are more efficient than for-profit firms in circumstances of contract failure.[127]

Professor Hansmann explains that constraints on the ability of nonprofit organizations to obtain capital make their income tax exemption appropriate. With the three major sources of funding for nonprofit organizations being debt, donations, and retained earnings, unlike for-profit firms, charities do not have access to equity capital and cannot issue shares. Nonprofit organizations also simply fail to obtain appropriate debt capital due to high bankruptcy rates and operative risks involving loans, and donations are tricky due to uncertainties and insecurities. Therefore, nonprofit organizations roughly should rely entirely on retained earnings to operate and develop.[128] Professor Hansmann further argues that the exemption is necessarily based on the lack of access to capital and contract failure experienced by nonprofit organizations. Similar to the base-defining theory, the capital formation subsidy theory fails to articulate a few issues that have no necessary connection to economic efficiency, such as exemption to commercial nonprofit organizations[129] that produce simple standardized services, and the assertion that

---

[125] Id., Professor Hansmann explains: [T]he best justification for the exemption is that it helps to compensate for the constraints on capital formation that nonprofit organizations commonly face, and that such compensation can serve a useful purpose, at least for those classes of nonprofit organizations that operate in industries in which, for various reasons, nonprofit firms are likely to serve consumers better than would profit-seeking firms.

[126] See Brennen, fn. 111 at 19–20, arguing that, Professor Hansmann thinks nonprofit firms are more efficient than for-profit firms in providing certain types of contract failure services because of the non-distribution constraint. Consumers are not as concerned with nonprofit firms as they would be with for-profit firms about donations being diverted to shareholders because nonprofit firms do not have shareholders.

[127] Id. at 19–21.

[128] Id.

[129] Id., Brennen points that Professor Hansmann's view is the statement that "[t]here would obviously be little point…in granting the exemption to a nonprofit hardware store." Further, Professor Hansmann misses that even a hardware store might provide the type of benefit, under certain circumstances, that society wants, needs, or otherwise values.

nonprofit hospitals should not be eligible for tax exemption.[130]

4. Donative Theory. — Mark Hall and John Colombo have developed the donative theory of tax exemption.[131] Tax exemption is considered a subsidy, which is justified where neither the government nor the private market effectively provides a service that is demanded by a significant number (but not a majority) of citizens.[132] In order for the government to assume a duty, there must generally be majority support. In the absence of such support, the needs of significant sector of society may not be met.[133] A tax exemption thus provides a way for the government to subsidize important services without the necessity of majority support or the ability to control the organizations that provide the services.[134] Voters support tax subsidies for services provided by minority-supported organizations in which they have no interest because they, in turn, receive tax subsidies for services provided by other minority-supported organizations in which they do have an interest.[135]

Hall and Colombo use donations as a proxy for public support.[136] For instance, an organization taking enough public support may be viewed as important to a significant segment of society, and such segment is not provided by the government or the private sector.[137] As such, the organization is entitled to tax exemption. The use of donations as a measure of exemption-worthiness separates traditional nonprofit organizations from for-profit institutions, which may also benefit society without receiving donations.[138]

5. Summary. — As the above rationales underlying the tax exemption have revealed,

---

[130] Id., Brennen further argues that Professor Hansmann's articulated reason for this assertion is the lack of contract failure or need for capital evident in the hospital industry. It is important to realize-and this is a point that Professor Hansmann and many others miss-that the value inherent in a particular form of charitable organization may not be readily apparent by means of traditional efficiency analysis. Brennen also refers to Professor Jill Horwitz's empirical research concerning hospitals. Professor Horwitz concludes that-despite the myriad of calls for ending tax exemption for hospitals that do not serve the poor-empirical research shows that tax-exempt nonprofit hospitals provide societal benefits that for-profit hospitals simply do not provide. The special benefits of nonprofit, as compared to for-profit and government hospitals include the provision of "more profitable services than government hospitals and more unprofitable services than for-profit hospitals." Brennen posits that, though Professor Horwitz does not conclude that these unique benefits of tax exempt nonprofit hospitals are caused by tax exemption, Horwitz does acknowledge that this connection has not been disproven.

[131] See generally, M. Hall & J. Colombo, *Donative Theory of the Charitable Tax Exemption*, 52 Ohio State Law Journal 1379, (1991).

[132] Id. at 1398.

[133] Id. at 1422–23.

[134] Id. at 1426 and 1437, arguing that public policy limitation may help voters to accept subsidized undersupplied goods.

[135] Id. at 1437.

[136] Id. at 1447.

[137] Id. at 1411 and 1437.

[138] Id. at 1443.

there is no generally accepted theory explaining the existence of tax exemption. Scholars have different perspectives in explaining tax exemption for nonprofit entities. When a state designs nonprofit tax exemption laws and policies, it is inevitable to include all possible theoretical reasoning for more open and inclusive discussions and hearing. It is notable that those theories do not explain the rationales for giving tax deductions for charitable contributions made to nonprofit entities.

C. Overview of Financial Incentives in the NGO Sector

Central to the NGO tax exemption system is the incentive under IRC Section 170 — the tax deduction for charitable contributions. Sections 501(c)(3) and 170 of IRC stipulate an objective formula with measurable standards for exemption and deductibility, and 28 categories of nonprofit organizations are eligible for exemptions from federal income tax. However, only those that qualify under Section 501(c)(3) are entitled for the "most favored" treatment *per se*. While charitable organizations enjoy the generous tax benefits, they are, at the same time, subject to the most stringent monitoring.

A quantitative measurement of public support is to label a public benefit or "charitable" organization based on the extent and type of public support it receives. Section 501(c)(3) classifies public support organizations into "public charities" and "private foundations." Public charities are further categorized into three types: donative charities under Section 509(a)(1); service provider charities under 509(a)(2); and supporting organizations under 509(a)(3). Each type of pubic charity has its respective tax treatment based on the extent and nature of their public support. A donative charity must raise at least one-third of its total eligible revenues from a combination of gifts, grants, and contracts from the public sector. A service provider charity must raise at least one-third from a combination of revenues derived from fees, admission sales, and revenues from the sale of related products, as well as from public gifts and grants. A supporting organization does not need to raise funds from the public because of its unique affiliation with another publically supported charity.

A charitable organization has to pass the "organized" and "operated" tests under Section 501(c)(3), and certain objective standards are applied in this connection. A nonprofit organization is recognized as exempt if it is organized for a recognized exempt purpose and is operated in service of such exempt purpose. Since subjectivity and discretion play an insignificant role in these determinations, the analysis and test procedures are ascertainable and standardized. Any organization soliciting exemption should affirmatively seek recognition of its exempt status from the IRS. On the other hand, IRS merely performs the role of applying and recognizing exemptions according to the objective standards.

III. THE CHARITABLE TAX-EXEMPTION SYSTEM IN PRACTICE — A FURTHER COMPARISON

After briefly evaluating fundamental features of China and U.S. NGO tax treatment systems, some important provisions in both systems are worthy of detailed comparison. This part explores the details of the differences between the American and Chinese systems. Again, this comparison is selectively oversimplified to embrace concepts are that interpreted differently in the U.S. and Chinese tax contexts. Therefore, the goal is to exemplify in which settings those terms are introduced or interpreted rather than focusing on the technical meaning of elements involved.

A. Formation and Registration

1. U.S. — In the U.S., an organization must be "organized" for exempt purpose. The IRS has no discretion to approve or deny exempt status based on subjective factors, provided the applicant organization can demonstrate that it has been properly formed under state law and that its charter contains the appropriate language required by federal law. The process is straightforward and predictable. The applicant organization submits an "Application for Recognition of Exempt Status under Section 501(c)(3)" (IRS Form 1023) supported by a conformed copy of the Articles of Incorporation, corporate bylaws, various financial schedules and a narrative describing current, and planned activities programs and contemplated fundraising strategies. An applicant organization satisfies quite easily the organizational tests if the governing documents articulate the organization's exempt purpose.

2. China. — In China, almost every law student studying NGO laws knows about the difficulty of establishing and registering a NGO. As discussed in Part II above, there are several issues central to the registration and application of NGOs China.

● Dual Management

The dual management requirement forces many NGOs to remain unregistered or even operate subversively because the potential supervisory agencies probably refuse to oversee applicant organizations. What makes it worse is that there may be even no appropriate supervisory agency willing to take on such a role.[139] Although unwillingness to perform supervisory duties may result in a judicial review, obtaining approval for registration from government branches or GONGOs that are sought as sponsoring organizations does not appear to require them to act at all — the granting of permission

[139] See Simon, fn. 32, suggesting only those SOs that choose to be and are defined as charity organizations, would be subject to strict scrutiny under the drafted Charity Law. If this were to be done, the new Charity Law would contain the provisions to accomplish the type of organizational integrity and the institutional oversight necessary for organizations operating for public benefit.

is entirely discretionary on the part of supervisory agencies. Additionally, even a tentatively complete list of required documents for submission to obtain supervisory sponsorship by an appropriate entity does not exist. This is but one of the reasons potential supervisory sponsors can ostensibly prolong the application process by imposing unreasonable paperwork requests.

In this manner, the dual management requirement offers the government the ability to manipulate the number of organizations that can be registered in a given territory. Moreover, the Ministry of Civil Affairs may deny registration if "in the same administrative area there is already a social organization active in the same (*xiangtong*) or similar (*xiangsi*) area of work, there is no need for a new organization to be established." On one hand, this provision helps to create an orderly situation that avoids organizations with duplicated purposes and to eliminate malicious competition for limited social resources. On the other hand, however, this also allows the government, if it desires to control certain areas of social services, to establish an NGO beforehand or during the application process so as to rule out the possibility of the registration of a real NGO applicant seeking to do the same work.

The dual management system deserves further debates in terms of removing barriers to establish NGOs. Advantages of removing the dual management structure are obvious. Many temporarily formed NGOs have made great impacts during early stages of natural disaster relief and rescue activities. The government has been intentionally silent and permissive of those activities conducted by unregistered NGOs, and it has thereby *de facto* eliminated unnecessary administrative barriers. Arguably, a revised provision as to dual management is more desirable because it allows special or emergent formation of NGOs. This solution has also been implemented well in other countries such as Japan.[140]

● High Endowment Requirement for Foundations

The 2004 Foundation Regulation provides two different types of foundations: private foundations (formed by individuals or private businesses) and public-fundraising foundations. The former foundation is intended to encourage affluent individuals and corporations to establish their own foundations to carry out charitable activities. There has clearly been a positive response in that regard, as indicated by the giving statistics from 2007 and press reports regarding new foundations.[141] Public fund-raising foundations in practice are mostly institutions organized nationally and staffed throughout

[140] Id., drawing an interesting comparison between the China and Japan NGO management system similarly preserving the fundamental freedom of association, which the Chinese constitution guarantees the Chinese people. Only those SOs that choose to be and are defined as charity organizations, would be subject to strict scrutiny under the new Charity Law. If this were to be done, the new Charity Law would contain the provisions to accomplish the type of organizational integrity and the institutional oversight necessary for organizations operating for public benefit.

[141] Id.

the country by the party-state itself.[142] For instance, a public benefit purpose is required for a public fund-raising foundation, and additional review as to formation and registration of such fund-raising foundations is validated and expected in the application process.

Admittedly, the requirement that foundations have to maintain high endowments or capital reserves needs further deliberation. As illustrated in Part II, a national private foundation is expected to keep at least RMB2 million as a permanent endowment; a local private foundation that does not engage in fund-raising is expected to invest at least RMB2 million as permanent endowment. As to public fund-raising foundations, a local one should invest at least RMB4 million as permanent endowment, and a national one should invest at least RMB8 million. Notwithstanding the legislation goal of nurturing solid and well-standing foundations, these thresholds are somewhat haughty and may discourage interested parties from forming and developing fund-raising foundations.

B. Recognized Exempt Purpose and Definition of Charity

1. U.S. — Under IRC Section 501(c)(3), there are seven purposes listed in the U.S. law as recognized exempt purposes,[143] and the list is inclusive and intentionally broad. Among the seven purposes, treasury regulations mostly interpret three purposes comprehensively: charitable, educational, and scientific purposes. In the meantime, the U.S. system has adopted extensive flexibility in interpreting the other four purposes according to social realities and economic development initiatives.[144] As a result, the U.S. system has bolstered the nonprofit sector by enabling creativity, such as through joint ventures between the enterprise and government to meet the investment capital needs and

---

[142] Id., Simon further argues that the regulations appear to permit the Ministry of Civil Affairs to act as the registering and oversight agency with regard to large national private foundations, and the experience of the Narada Foundation offers proof that MCA will assume this role. The language of the regulations also opens the possibility that as a practical matter MCA may not necessarily enforce the dual management requirement of the 2004 regulations with regard to smaller foundations when it chooses not to.

[143] I.R.C. Section 501(c)(3) stipulates "Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office."

[144] See GCM 36993 (1977), providing that innovative enterprises qualify under Section 501(c)(3) for passing the organization test as long as they (1) lessen burdens of government; (2) promote community welfare by lessening neighborhood tensions; (3) eliminate prejudice and discrimination, and (4) defend human and civil rights served by law or (5) combat community deterioration and juvenile delinquency.

encourage continued commitment to public benefit.[145] As to the educational and scientific areas, the Treasury has expanded the original tax treatment by providing a mechanism for accommodating distance learning technologies and unconventional classrooms along with interactive internet activities.

2. China. — The exempt purpose determination usually depends on the definition and coherency of the term "charity" in China. A careful reading of current laws and regulations can reveal several different definitions of "charity." In practice, the adoption of the concept "public benefit" to define charitable organization is widely accepted by many jurisdictions. For example, the English Charities Act 2006 clarifies the definition of "charity" by emphasizing that public benefit is created.[146]

The definition of charity also appears to differ from that of "public welfare" for public welfare trusts (*gongyi xintuo*) stipulated in the Trust Law, while the "public benefit" terminology used in the 2004 Foundation Regulation and the tax rules defines charity with broader scope. *Gong yi* is the term used in almost all of these legal documents. It is defined in Article 60 of the Trust Law in the context of "public welfare trusts" and in Article 3 of the Public Welfare Donation Law in the context of "public welfare undertakings" (*gongyi shiye*). The Foundation Regulations include no definition of "public welfare," but refer to the term public welfare institutions (*gong yi shiye*) in Article 2 to define foundations. And the language in the new tax rules with regard to entities qualifying to receive donations is that they must use the money "for education, civil affairs, other public welfare undertakings, or for the districts that suffer from natural disasters or the poverty-stricken districts." In fact, the word for "charity" (*cishan*)[147] has only been used one time, at the time of this writing, in Chinese laws and regulations. In Article 10, Paragraph 2 of the PWDL, there is a reference to the regulations of social organizations being established "with the principal aim of developing charities."

According to Professor Karla Simon, the definition of "charity" in the draft Charity Law incorporates certain enumerated purposes in Article 3 of the PWDL:[148]

> emergency and crisis relief for regions, individuals, and groups in difficulty;
>
> relief for disadvantaged people;
>
> education, health, science, culture, sports for social benefit; and,

---

[145] See Rev. Rul. 98–15, 1998–12, I.R.B. 6.; see also *Redlands Surgical Services vs Commissioner*, 242 F. 3rd 904 (9th Cir. 2001), both of which determined that a nonprofit hospital and a for-profit healthcare company could form an LLC to benefit both parties, on the conditions that the nonprofit serve as the general partner and that the exempt purpose drive the enterprise. Furthermore, the LLC's board would be required to reflect the majority interest of the exempt organization and retain its control over the nonprofit hospital.

[146] See generally Na La, fn. 19.

[147] Id., stating that there has been some consideration in the Chinese literature of whether the meaning of the two terms is actually the same or different.

[148] See Simon, fn. 32 at 946.

promotion of urban and rural community development and environment.

In addition to the specifically enumerated categories above, Article 3, Paragraph 5 also includes the term "other charitable activities," which provides for future development of the concept of charity.

Therefore, an expansive definition of "charity" should be considered and adopted. As Lee has proposed, a charity should be regarded as an eligible charity so long as it: (1) is organized and operated exclusively for public benefit purposes by engaging in public welfare activities (including emergency relief, relief for the poor, education, health and social benefit, promotion of community development, etc.); (2) contains restraints on distribution of profits, dividends, or assets to its members (non-distribution constraints) and (3) is required to spend its remaining assets on charitable purposes after its termination[149].

C. Requirement of Operation for an Exempt Purpose

1. U.S. — The operational test in the U.S. system views the organization's financial and program activities as indicators of its operations, and such review is monitored on an annual basis.[150] Usually, the IRS waits and sees how newly formed and approved nonprofit organizations operate and behave by issuing a provisional "advance ruling" for a four year period, in which the organization can demonstrate its operations in a more concrete manner. At the end of the four-year period, the IRS assesses the organization's level of public support and makes a final determination as to exempt status.

Admittedly, the operational test has been quite flexible over decades of development and practice. It recognizes the importance of monetary resources for the nonprofit organizations. Mostly, it enables the organization to charge fees for services and general dues and non-dues-based revenues without compromising its exempt status.

An exempt organization needs to file an annual information return (Form 990) to the IRS if it receives more than $25,000 in annual revenues and is not a church. The Form 990 asks pointed questions about the organization's program, activities, contributions, grants, compensation and administrative expenses. Moreover, the U.S. system recently improved accountability of exempt organizations by posting all related available information online to promote visibility and exposure. Undoubtedly, this practice ensures that the exempt organizations continue to operate in the interest of their initial exempt purpose.

2. China. — Monitoring the operation of nonprofit organizations in China presents one of the crucial problems in the development of nonprofit sector. It is not even clear the extent to which currently registered nonprofit organizations of all three types need to go

[149] See generally Lee, fn. 103.

[150] See Brennen, fn. 111 at 6–8.

through administrative applications and supervision processes in order to become "verified charities" or the exact benefits if they get verified.

A primary problem is to determine institutionally which government organ is the supervisory authority as to the activities of nonprofit organizations. Given the dual management requirement for nonprofit organizations, it appears that an additional layer of supervisory authority is necessary, however burdensome this might be. It has been suggested that a new agency should be created to oversee all the aspects of institutional development, transparency, and accountability (reporting requirements) without involving a sponsoring organization in the formation process.

Unlike the IRS in the U.S. system, the Chinese MCA and SAT most likely involve the verification process of all nonprofit organizations. However, due to the intergovernmental conflicts and staffing problems, nonprofit organizations are not able to manage the administrative reporting procedures to two departments, especially for deciding the exempt status in a cost-effective manner. As evidenced in the 2007 Ruling, there are very weak connections between MCA accreditation and SAT approval of tax exempt status. Therefore, scholars have proposed a separate "Public Benefit Commission" to supervise the charitable status of all nonprofit organizations. However, due to the infrastructure complexities in the party-state China, this proposal is too ideal to be implemented[151].

In addition, due to the blurred boundaries among the three types of nonprofit organization in China, a standard reporting form like the U.S. Form 990 is neither wise nor feasible. On the other hand, if each form of nonprofit organizations has its own reporting structure, the administrative costs can limit the government's ability to adopt further monitoring and verification procedures.

Finally, many nonprofit organizations in China may even want to register as a commercial enterprise for its exempt purpose. This is especially true for a few foundations set up by foreign individuals or international philanthropic organizations. These foundations still benefit from taxpayer friendly provisions to enjoy tax holidays while avoiding arduous NGO registration and operative process.

D. Prohibition of Private Inurement

1. U.S. — The IRS historically adopts a zero tolerance policy for personal benefits inuring to any person with influence over the decision-making affairs of a charitable organization. The IRS used to have to revoke the exempt status after it identifies a violation of this rule. However, to balance the IRS and charitable community, the Congress added a new provision IRC Section 4958, *i.e.* the Intermediate Sanction clause, to the IRC. The Intermediate Sanctions focuses on "excess benefit transactions" by disqualified persons and enacts a two-tier excise tax designed to punish the wrongdoer

[151] See Simon, fn. 32 at 946.

while spring the charity. Under this rule, it is unjust enrichment transactions and their perpetrators that are sanctioned, but not the charitable organizations.

By adopting the Intermediate Sanctions, the U.S. scheme again exhibits its flexibility in balancing interests and competing tensions. The U.S. Congress admits that most charitable organizations behave properly; the Intermediate Sanctions creates a safe harbor for the majority of nonprofit organizations and their volunteers, staff, and directors. Under Section 4958, an organization is compliant with Section 501(3)(c) if it i) maintains proper records, ii) obtains comparability data regarding compensation arrangements, and iii) has a conflict of interests policy.

2. China. — The nonprofit sector has been infected with accountability issues from the every outset. In particular, the efficient and responsible use of the funds is now a public concern. A challenging accountability problem relates to corruption. China's notorious corruption on using donation makes it more questionable whether charitable donations can reach the hands of those most in need and that no personal interests of management personnel are involved. Widespread fears of misappropriation of donated funds even have to some degree prevented the general public from donating or induced the public to switch to foreign nonprofit organizations, which presumably have less accountability issues.

A frustrating observation as to China's nonprofit organizational scheme is that the values of accountability, transparency, and performance evaluation are so downplayed in practice. Not surprisingly, the immature practice of non-observance and lax implementation is displayed here. Article 21 of the Public Welfare Donations Law provides for the donor's right to access information about the use and management of the donations. The Foundations Regulations has similar provisions. All current laws contain regulations on submissions of annual reports to the relevant administrative authority. However, only the Foundation Regulations contains a duty of disclosure of information, requiring foundations to make the relevant annual reports public through media channels to provide for public enforcement of accountability. Thus, compared to information disclosure requirements of for-profit listed companies, disclosure requirements for charitable organizations are still quite primitive and under-developed.

The misalignment of interests and information provides charity management with great decision-making discretion. In order to prevent abuses, appropriate checks and balances must be put in place to protect charity assets and ensure the accountability of persons who control them. Appropriate use of checks and balances to improve governance would be beneficial to the charitable sector as a whole. Well-governed charitable organizations are more likely to enjoy greater public confidence, which is critical for fund-raising. Conversely, ineffective charitable governance may reduce the

ability of the charitable organizations to carry out their missions.[152]

Another aspect deserving attention is that internal government and financial management remains under-regulated. For example, Article 15 of the Social Organizations Regulations requires that a social organization set out the qualifications, powers, and duties of its members. However, the Regulations provide insufficient guidance. For example, the SO Regulations does provide that the highest authority rests with the members, but does not specify the authority scope. The SO Regulations should clearly delineate the powers and authorities that members can exercise at their meetings, including the power to amend the organization's constitution, appoint or remove directors, and dissolve the organization. The Regulations should also include procedures for calling meetings and passing resolutions.[153]

Regarding the duty of loyalty, only the Foundation Regulations prohibit a director and the director's associates from engaging in "self-dealing" with their foundation. This approach must be amended so that all senior officers and board members of a charitable organization are subject to duties of care and diligence, as well as a fiduciary duty of loyalty that prohibits them from having actual or potential conflicts of interest. Guidelines on how to deal with board conflicts would help the management understand their responsibilities. At the same time, because a voluntary board of trustees usually governs charitable organizations, the law should provide that they may be relieved from personal liability for breaches of certain duties if the court believes they have acted honestly and reasonably or in "good faith."

E. NGO Asset Management upon Dissolution, Termination and Liquidation

1. U.S. — The U.S. scheme requires that charitable assets remain within the charitable sector. An exempt organization may not dissolve, terminate, or liquidate without insuring that assets remaining after paying outstanding liabilities remain within the charitable sector. The board of directors of a dissolving organization may select an appropriate charitable recipient with a similar mission; however, under no circumstance can those assets be diverted to non-charitable recipients or for no-charitable purpose. This rule was tested repeatedly in the 1990s when nonprofit organizations, usually community

[152] Id., suggesting that ninety-nine percent of corporations in China did not engage in any form of charitable donations. While this may be explained partly by the fact that any concept of corporate social responsibility is still embryonic among Chinese corporations, it also partly reflects the lack of efficiency and accountability, and in turn, the lack of public confidence in the charitable sector.

[153] See fn. 103, stating that good governance starts with the ability to recruit and retain an effective governing board. This requires clear rules on the procedures for the appointment and removal of directors, the qualifications and number of directors, the duration of their appointments, and the terms of remuneration. The Regulations should also specify the duties and the potential liabilities of the board. While all laws currently governing the main types of charitable organizations prohibit misappropriation of the organization's funds, they fail to stipulate any duty of care for directors respecting their management duties.

healthcare institutions, merged with for-profit hospital chains. As a result, foundations were set up to administer charitable assets after closing, and this situation prompted various states' Attorneys General to implement protocols to govern such transactions and to seek court approval for the allocation of the assets before the transaction was completed.[154]

2. China. — The treatment of dissolved or liquated NGOs is a big loophole in China's NGO legislation. Provisions on termination and liquidation of three forms of NGOs in China are scattered over various laws and regulations, and most of them are hard to implement or lack specific guidance in practice. For example, Chapter 6 of the Trust Law stipulates the definition, creation, and termination of a trust. However, there are no delineated rules on how to treat the assets after paying all liabilities. Moreover, as discuss in part II[155], the 2007 Ruling by MOF and SAT stipulates that exempt organizations "may not distribute any surplus upon dissolution or termination," but this requirement is vague. Typically, the 2007 Ruling does not establish any detailed procedures to handle assets after dissolution and termination.

F. Tax Culture

1. U.S. — The divergence between the nonprofit tax exemption in practice in the U.S. and that in China can be attributed to the significant distinctions in the tax cultures of the two countries. First, the U.S. tax exemption scheme has evolved through a long process, by balancing social needs and economic development, as well as bridging the gap between the Congress, the IRS, and the nonprofit sector. In China, the first law dealing with a rudimentary form of nonprofit organizations of modern conception was not adopted until 1989. The development of nonprofit tax exemption scheme in China has been a long, painful process; even there are quite many transplantable values and principles underlying modern tax law, such as the rule of law, the ideology of freedom of association and cohesive legal infrastructure. While the SAT and MCA have conducted good preparations by inviting leading scholars and legislation consultants to design the charity law and related lessons from other countries, the gap between the law on paper (which has been borrowed from the West) and the law in action (which is defined by local conditions) is still huge.

Moreover, the U.S. scheme is created in a federalist system, which has two levels of sovereign governments — state and national — each has its own authority on the nonprofit sector. China, in contrast, is a party-state system that one central government has formal authority over administrative subdivisions that promulgate and implement the law. This may lead to the low efficiency in China in carrying out and designing detailed

---

[154] Id.
[155] Id.

rules for specific questions, let alone the huge disparity as to the development level among different localities in China. In addition to an established system of financial incentives including tax exemption and tax deduction, U.S. history has created a culture of giving and philanthropic activities, especially those associated with church and healthcare institutions, which are protected by the constitutional right of freedom of religion.

2. China. — The Chinese style of tax law drafting makes it difficult for nonprofit organizations to engage in the charity sector and related tax planning common in the U.S. To begin with, the text of the law is unclear in many respects, such as the definition of charity, the regulations on internal governance, the registration process, judicial review, and administrative processes. While the U.S. scheme mostly rests on Sections 501(c)(3) and 170, the IRS has promulgated various regulations, rulings, and notices to guide the practice, and case law also makes up a substantial part of the content of the existing scheme. In China, however, the situation is almost the opposite of its U.S. counterpart. The scattered regulations regarding tax exemptions and tax deduction are vague and subject to too much discretional review of MCA and SAT. The "opaque" nature of tax legislation also fails taxpayers in following the laws and drives applicant organizations into lengthy process of application and registration.

Another important point is that the general public in China has a long tradition of philanthropic and charitable giving. However, the distrust or fears for unreasonable usage and corruption do inhibit charitable giving even after more functional tax laws and regulations are promulgated in the future. This concern in return leads to the formation of many grassroots or underground NGOs, which sometimes again deepen the insecurities of donors of their charitable giving or donations.

CONCLUSION

This article focuses on the comparisons of the tax exemption schemes in U.S. and China in a three-fold structure. First, given the tremendous development of China's nonprofit sector, not many comprehensive studies have been completed on reforms regarding this issue. The tax treatment of nonprofit organizations, as a crucial component to construct a nonprofit sector, is unsophisticated and short of practical significance. Echoing China's success in economic growth in the past decades, literature on Chinese tax typically focuses on tax incentives for foreign direct investment and tax policies catering to economic development. This lack of research and study shows the prejudice against the nascent nonprofit sector as a partner of the state. Second, under the rule of law constructed in the past decade, some scholars suggest that China might modernize its nonprofit sector through an "all-in" charity code or unrealistically cultivate expansive grassroots NGOs. The study of the nonprofit sector has to embody a down-to-earth understanding of China' legal and political settings. Third, commercial implications of the

nonprofit sector invite studies of its tax treatment. Given China's integration into the WTO and heightened complaints over national treatment and fair competition, a key issue arising is that the profitability of foreign investment shrinks as the tax preferential treatment is gradually discounted. The profitable potential of nonprofit organizations as foreign investment vehicles may induce inappropriate tax planning activities. Therefore, it is never too late to develop a tax framework for the nonprofit sector.

The expansion of the nonprofit sector in the past decades has resulted in many problems associated with its tax framework. Doubting the suggestion of promulgating a comprehensive charity law, this article does not suggest any unrealistic idea of transplanting all valid and enabling values under the U.S. tax exemption system to China. The prime incentive for the tax deduction has not been solidly rooted in the general public. There is a lack of stimulating push for the tax authorities and MCA to adopt systematic, responsive reform measures. However, some positive reforms, especially on the tax exemption and tax deduction in the nonprofit sector, are more implementable and manageable. A comparison of tax treatment in the U.S. and China on nonprofit sector reveals the following observations.

First, the public benefit or charity purpose of nonprofit organizations has not been coherently defined. This confusion predictably inhibits the development of the nonprofit sector by stalling interested corporate and individual donors to take exemption and tax deduction.

Second, China has not set up an enforceable fiscal incentive system to promote charitable donations. The administrative procedure of obtaining a tax exempt certificate is arduous and discourages donors from donating or causing them to abandon obtaining the certificate, which worsens the efforts to modernize the scheme.

Third, there are still burdensome requirements for the application and registration of nonprofit organizations, such as dual management, high threshold of capital endowment for foundations and prohibition on cross-region development.

Fourth, the administration and supervision on the internal management, human and resource, and financial and accounting management of nonprofit organizations are very weak. China's complex administrative system for the nonprofit sector, including the MCA, MOF and SAT, is extremely inexperienced with managing fund raising, appropriate usage of donations, and profiteering from donations. Corruption has also been a major concern of the general public, discouraging them from making donations.

Fifth, the determination of tax-exempt status and review of such status is *ad hoc* and different from locality to locality. Such irregularities on one hand invite unethical manipulation of tax preferential policies, and create resistance to making donations through locally available venues on the other.

U.S. tax system for the nonprofit sector arguably embraces maturity, objectivity,

flexibility, and accountability. Evolving throughout the course of the American history, the U.S. scheme relies solidly on regulatory authority, government authority checks and balances, and confidence in the rugged individualism of American democracy. The qualification requirement to enjoy benefit of tax exemption is objective and is subject to minimum level of discretional review. Meanwhile, as an outcome-based set of measures, it enables the nonprofit sector to adapt to new economic development and strike a continuous balance between external regulations and internal governance.

From a jurisprudential perspective, in the Chinese tax context two cautions are methodologically identified. Firstly, the scarcity of decent comparative legal tax scholarship in general does not support comprehensive comparison. A shortage of paradigmatic discourse shows the simultaneous existence of bluntly conflicting arguments, parallel courses, and irregularities in analysis. Although some comparative tax frameworks have been proposed or compiled, their value to the Chinese tax context is not self-evident. For this reason, this article argues that a comparative tax study relating to China might be better achieved by focusing on a full "tax law sub-discipline" rather than on a specific tax concept. One reason is that a western-originated tax concept might be too narrow to meaningfully inform a Chinese policy orientation. The other reason is that it lacks geneyality necessary to be applicable to other subsidiaries of tax law.

Secondly, the tax cultural traditions and social, political and legal settings of a systematic tax governance framework should be included in tax comparatists' theorizations. A tax study ultimately has to be conducted from a "big-picture" perspective, in which a tax system is embedded. Otherwise, a comparative study may easily turn into a descriptive, mechanical, and perfunctory analysis. The practical and academic significance of comparative tax studies can hardly be achieved by a limited comparison falling on the technical elements of a tax concept. This "big-picture" perspective is also in line with the rationale applicable to both the rule of law construction and assimilation to the WTO system. This article, therefore, tentatively incorporates tax culture into its considerations to compare primary elements of nonprofit tax schemes of U.S. and China. It argues that a comprehensive tax transplant effort of valuable ideas and practices, although bold and uncomfortable for the recipient country at the beginning, is what China needs to build a robust nonprofit sector.