

IRD enhances processing of applications for tax exemption status of charities

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In brief

Charities play a vital role in contributing to the community. Over the years, the Government has provided support to charities through various policy measures such as granting tax exemption status to recognised charitable institutions and trusts as well as allowing tax deduction to donors for donations made to them.

As part of an initiative to develop Hong Kong into a philanthropic centre¹, the Inland Revenue Department (IRD) announced on 9 June 2023 the enhanced procedures on application for recognition of tax exemption status of charities². Applicants are now required to complete a new application form and provide the supporting documents specified therein³. Meanwhile, the IRD has updated the *Tax Guide for Charitable Institutions and Trusts of a Public Character* (Tax Guide) to reflect the enhanced application procedures and provide further guidance to applicants on drafting their governing instruments⁴.

This news flash provides an overview of the above changes and our observations thereon.

In detail

Enhanced application procedures for tax exemption status of charities

In the past, a charity wishing to apply for tax exemption status under section 88 of the Inland Revenue Ordinance was required to submit a letter to the IRD stating its request together with supporting documents specified in the previous version of the Tax Guide. To facilitate the submission and streamline the processing of these applications, the IRD has enhanced the application procedures whereby an applicant is now required to complete a new standard application form and provide the supporting documents specified therein. Similar to the previous procedures, it generally takes four months for the IRD to process the application provided that all relevant information is provided to the IRD.

Our observations: *The information and documents required in the new application form are broadly the same as those required under the previous application procedures, except for Part 4 of the application form, which requires the applicant to provide the relevant details and documents if it intends to take over or replace an existing entity after obtaining tax exemption recognition. The information to be provided would presumably help the IRD assess whether the applicant is of good financial standing. The IRD has stated clearly in the updated Tax Guide that an incomplete application form (including a form with insufficient supporting documents) will be returned to the applicant for follow-up before the application is processed.*

In addition, a proforma has been designed to facilitate applicants to provide particulars of the charitable activities carried out / to be carried out during the specified period of time which can demonstrate how they work towards the furtherance of their charitable objects.

Updated Tax Guide

The IRD has updated the Tax Guide to reflect the enhanced application procedures and provide further guidance to applicants on drafting their governing instruments with illustrative examples.

Guidance on writing charitable purposes in the governing instrument

The guidance is set out in a new Appendix 2 to the updated Tax Guide. The key points are summarised below:

- Charitable purposes and object clauses

Charitable purposes refer to the objectives of a charity that is exclusively charitable and for public benefit. A charity should state its charitable purposes clearly in the object clauses of its governing instrument. The wording of the object clauses should be clear and contain the following three elements:

- (1) The charitable purpose category (which is generally classified into four heads laid down by Lord Macnaghten in the case of *Commissioners for Special Purposes of Income Tax v Pemsel* [1891] AC 531, namely (i) relief of poverty; (ii) advancement of education; (iii) advancement of religion; and (iv) other purposes of a charitable nature beneficial to the community not falling under any of the preceding heads);
- (2) The means of providing the charitable benefit (i.e. how the charity will achieve its charitable purpose category); and
- (3) The eligible beneficiary group (i.e. the members of the public who can potentially benefit from the charitable purpose or the relevant activities).

The updated Tax Guide also provides examples of charitable objects under each of the four heads of charitable purposes.

- Power clauses

A charity's powers refer to what the charity can do to achieve its objects, such as raising funds, employing and paying staff and making investments. Power clauses should be listed separately from a charity's objects and often follow the object clauses in a charity's governing instrument.

The takeaway

We appreciate that the Government has stepped up its efforts to bolster Hong Kong's philanthropic sector. The enhanced application procedures and updated guidance for tax-exempt charities can provide greater clarity to potential applicants and allow the IRD to process the relevant applications more efficiently.

While the IRD's updated guidance may address some of the charities' concerns when drafting the governing instrument, defining a precise object that would fall under the relevant charitable purpose category may not be that straightforward. This is because in its assessment of whether an institution/trust can be accepted as being established exclusively for 'charitable purposes', the IRD has to rely on case law precedent which is less than clear. In particular, the fourth head in the *Pemsel* case, namely 'other purposes of a charitable nature beneficial to the community not falling under any of the preceding heads', offers limited guidance as to what is, and what is not, a 'charitable purpose'.

Charities should also bear in mind that the IRD periodically calls for accounts, annual reports or other documents from tax-exempt charities to review whether their objects still meet the eligibility criteria of 'charitable purposes' and their activities are compatible with their objects. As demonstrated in the recent court decision in *The Servicemen's Guides Association v. The Commissioner of Inland Revenue*, the IRD has apparently adopted a more stringent approach in reviewing the tax exemption status of charities in recent years to address increased public expectation for enhanced accountability of tax-exempted charities to donors and beneficiaries⁵.

In light of the above, existing tax-exempt charities are advised to maintain robust documentation to ensure that they can withstand any potential challenges from the IRD. Professional advice should be sought where appropriate.

Endnotes

1. The initiative was announced in the Government's *Policy Statement on Developing Family Office Businesses in Hong Kong* issued in March 2023, which can be accessed via this link:
https://gia.info.gov.hk/general/202303/24/P2023032300717_415645_1_1679627481405.pdf
2. The enhanced procedures are set out in the IRD's updated webpage on charitable donations and tax-exempt charities, which can be accessed via this link:
<https://www.ird.gov.hk/eng/tax/ach.htm>
3. The new application form can be accessed via this link:
https://www.ird.gov.hk/eng/pdf/Application_Form_for_new_applications.pdf
4. The updated Tax Guide can be accessed via this link:
https://www.ird.gov.hk/eng/pdf/tax_guide_for_charities.pdf
5. For a detailed discussion of the case, please refer to our previous news flash which can be accessed via this link:
<https://www.pwchk.com/en/hk-tax-news/2023q1/hongkongtax-news-feb2023-1.pdf>

Let's talk

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