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Insider Analysis From Sidley Austin LLP: China's Restrictions On Corporate Donations And Sponsorships

By [Zhengyu Tang](#), Sidley Ausin LLP, Shanghai

Under People's Republic of China law, donations are generally defined as funds or goods voluntarily and gratuitously provided by individuals, legal entities or other organizations to a social organization for public good (such as a foundation or a charity organization) or a not-for-profit public institution (such as a public school, hospital or a scientific research institute) for the purpose of carrying out activities that benefit the public.

Sponsorship, however, is not clearly defined under PRC law. Sponsorships are often provided by a company, partially for corporate image or general business promotion purposes and are not tax deductible. True donations, as distinguishable from sponsorships, must be made without reference or linkage to the donor's business interest/purpose and are tax deductible if made to certain statutory recipients within certain statutory limits.

Unfair Competition Law And Donation

PRC Law strictly prohibits unfair competition or commercial bribery conducted under the guise of donations, and as such sets forth the following requirements and restrictions on donation activities (including donations to medical institutions):

- When making a donation, companies should not seek any favors from or impose any conditions on recipients which would result in unfair competition. Such favors or conditions include, among other things, requiring market-entry advantages or procurement of specific products and/or services.
- Companies or their employees in charge of donations should not seek or receive kickbacks, commissions, information fees, service fees or other monetary benefits from donation recipients for any reason.

General Restrictions On Donations

In general, under PRC law, the following requirements and restrictions must be complied with when a company makes a donation:

- Donations can be made only to a legally established (often government affiliated or sponsored) (i) social organization or (ii) not-for-profit public institution that engages in activities benefiting the public, such as a foundation, a charity organization, a public school, hospital, or a scientific research institution, etc.[1]
- Donations must be made only to support activities for public good. Such activities include, but are not limited to, the assistance of impoverished citizens, support and assistance of the physically disabled, support of educational, scientific and public health undertakings, and building of social infrastructure or of infrastructure that benefit environmental protection.
- Donations must be made voluntarily and gratuitously. Companies should refuse to provide donations that have been requested or solicited by any authorities, institutions or organizations.
- Funds or goods to be donated must be legally owned by the donor company and can be disposed of by the company with no restrictions. Properties such as main fixed assets, equity interests and creditor rights, damaged properties and properties without clean titles, and properties which are mortgaged, pledged, or under custody or lien, cannot be donated. Donated properties should also be in compliance with the legal requirements and standards on quality control and environmental protection.

- When a donation is made for the construction of a project for public good, a written agreement should be entered into between the donor and the recipient specifying the capital, construction, management and intended use of the project.
- Foreign corporate donations subject to border-entry requirements (such as import license) must be handled accordingly.

When donations are made to medical institutions, a company must also comply with the following requirements and restrictions under the Ministry of Health (MOH) Regulations:

- The donations should be made to medical institutions that are not-for-profit institutions. Donations should not be made to a functionary department or an individual employee of a medical institution unless prior approval is obtained from the institution's management after a collective review. Healthcare agencies with regulatory or law enforcement powers cannot accept donations relating to such powers.
- The donations should be made to support mainly (but are not limited to) the following public good activities: aid or treatment of impoverished patients, healthcare education of the public, training of healthcare and technical professionals, exchange of medical knowledge, scientific research, and building medical infrastructure.
- Whenever a donation is made, a written agreement^[2] should be entered into between the donor and the medical institution specifying the type, quantity, quality, value and designated purpose for the use of the donation as well as the rights and obligations of the two parties.
- Companies should fulfill the donation agreement and transfer the donated funds to the medical institution's valid account or deliver the donated property to the competent department of the medical institution, and should not manipulate accounting procedures to evade financial/taxation supervision.

It has not been made clear under the MOH Regulations whether corporate sponsorships for the attendance of doctors to scientific/educational conferences should be handled as "donations" and thus subject to the above requirements and restrictions. Based on the implementation rules issued by the Shanghai Bureau of Health and some leading PRC state-owned hospitals, as well as a media interview with an MOH official, however, such sponsorships should be handled as donations subject to donation laws and regulations.

Tax Deductions And Special Requirements On Financial Management

Tax Deductions for Corporate Donations

To encourage corporate donations for public good, PRC law entitles companies to income tax deductions for making donations.

However, currently the tax deduction benefit only applies to public good donations made to qualified social organizations and foundations as well as government agencies and their departments at and above the county level (the "**Statutory Recipients**"). All or part of such donations which are less than 12% of the donor's total annual profits (as indicated by the income statement) may be deducted from the donor's taxable income for the income tax.

Donations directly made to medical institutions are not eligible for tax deduction under the current PRC law.^[3] A company may choose to provide donations to medical institutions indirectly through Statutory Recipients if it wants to enjoy the tax deduction benefit. Under such arrangement, a company may make donations to the Statutory Recipients specifying that such donations can only be used to support a specific medical institution.

Special Requirements on Financial Management

PRC law sets the following special requirements on financial management of corporate donations (including donations to medical institutions). Compliance with these requirements would facilitate a company's application for income tax deduction as stated above.

- Donations should be subject to the company's financial budget and should be disclosed in the company's financial statements.

- The company's corresponding department and personnel should create a donation plan to be approved by the finance department, specifying: reasons for the donation, recipient parties, method of donation, personnel in charge, amount of the donation and delivery procedures. However, according to our anonymous consultations with an official in the State Ministry of Finance, this may not need to be strictly enforced if the company has a reasonable internal approval system overseeing the company's donation procedures.
- Companies should ask the recipients to issue legal and valid receipts, invoices or other certificates for the donations, affixed with the financial chops of the recipients.

Corporate donations in China are mainly governed by the following PRC laws and regulations:

- Law of the People's Republic of China on Donations for Public Good (Promulgated by the Standing Committee of the National Congress on June 28, 1999, effective on September 1, 1999)
- Anti-Unfair Competition Law of the People's Republic of China (Promulgated by the Standing Committee of the National Congress on September 2, 1993, effective on December 1, 1993)
- Tentative Regulation for Medical Institutions Receiving Social Donations and Sponsorships (issued by the Ministry of Health on and effective from April 6, 2007, the "**MOH Regulations**")
- Circular of the Ministry of Finance on Strengthening the Financial Administration of Donations Made by Enterprises (issued on March 14, 2003, effective on May 1, 2003)

[Zhengyu Tang](#) is the Shanghai managing partner of Sidley Austin LLP who leads the firm's foreign direct investment (FDI), M&A and competition practice in China. Mr. Tang has been assisting numerous U.S. and European companies, including drug and device companies, in their FCPA and/or Chinese anti-bribery law compliance in the course of making their investments and conducting their operations in China, including conducting internal reviews, investigations and trainings and counseling on remedial actions, best practices and local AIC enforcement proceedings. He has been recognized, for many years, in AsiaLaw Leading Lawyers, Asia Pacific Legal 500 and Chambers & Partners Asia and Global, as one of the leading or top lawyers for corporate, M&A and competition work in China/Asia.

[Editor's note: PharmAsia News will host a webinar Aug. 27, featuring Zhengyu Tang, for pharmaceutical and medical device firms entitled "Anti-Bribery Compliance in China - Avoiding the Pitfalls." For more information, please click [here](#).]

ENDNOTES

1. However, in the case of natural disasters or upon the request of a foreign donor outside the PRC, donations can be made to government agencies and their departments at and above the county level for its further handling (used for public good only).
2. When a medical institution accepts a donation during its handling of emerging public health events, a written agreement may not be required.
3. An official from the Ministry of Finance of the PRC indicates that the authorities are working on new rules which will clarify whether or under what conditions are donations to medical institutions eligible for tax deduction benefits.

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