

## **Research on Chinese Preferential Tax Policy about Private Pension Institutions and the Improving Suggestions**

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### **Abstract**

*Since stepped into aging society early in 1999, the endowment institutions have been playing an increasingly important role in China. Unlike western developed countries, our country was in the case of an underdeveloped economy when faced with the problem of aging population. Relying solely on state financial support to set up pension institutions, on the one hand, may increase the financial burden, on the other hand, is not conducive to capital market operation. The key to achieve the industrialization of pension service is to support the development of private pension institutions. The government has issued a series of preferential policies for welfare institutions, but policies to private pension institutions' benefit are few and far between. National policy guidance is necessary to encourage private capital to enter into the pension service industry. Based on the analysis of pension institutions' preferential tax policies, this paper puts forward some reasonable recommendations to promote the normalized development of the private pension agencies.*

**Key Words:** Aging population; Private pension institution; Tax policy; Tax preference

### **1. Introduction**

According to the sixth national population census in 2010, among the population of the 31 provinces, autonomous regions, municipalities and servicemen in mainland, the number of people aged 60 or above was 177648705, accounting for 13.26% of the population; among which 118831709 people were 65 or older, making up 8.87% of the total population. Compared with the fifth national census in 2000, population aged 60 or above rose 2.93%, while population above 65 years old rose 1.91%<sup>[1]</sup>. Along with the large elderly population base and high average growth rate was the miniaturization of family structure, the accelerated migration and the elderly empty-nest tendency, which had strong impact on the traditional family pension mode, thus highlighting the growing importance of endowment institutions in China.

In accordance with the <Circular of the General Office of the State Council Concerning Transmitting Suggestions Submitted by the Aging Committee Office and the State Development and Reform Commission and Other Departments on Speeding up the Development of Pension Services> in 2006: gradually establish and perfect a home-care based, community service as the backing, supplemented by institutional pension service system; But in 2011, it was explicitly pointed out in the <Circular of the General Office of the State Council Concerning Social Endowment Service System Construction Plan (2011-2015)>: the social endowment service system construction should be home-based, community-dependend and agency-supported. That Changing "supplement" to "support" fully affirmed the positive role pension institutions play in dealing with the population aging process. By nature, pension institutions in China can be divided into three categories: welfare pension agencies, non-profit pension agencies and profit pension agencies.

Welfare pension institutions are registered as institutions in the personnel department, mainly referred to public pension agencies; non-profit pension agencies are registered as non-enterprise units in civil department, mainly referred to civilian-run government-supported pension agencies; profit pension agencies are registered as enterprise legal persons in industrial and commercial administration departments and tax departments, mainly referred to private and public-to-private pension agencies.

In more situations in our country, pension agencies are controlled by the government, meanwhile the relevant preferential fiscal and tax policies are also inclined to support for the development of welfare and non-profit pension institutions, which may increase the state's financial burden on the one hand, on the other hand is not conducive to arouse the enthusiasm of social individuals operating private pension institutions, incurring that the number of existing pension institutions are far below the actual needs. Now, China is faced with the reality that the market mechanism is imperfect, non-profit organizations' development is immature. To meet the serious demand gap between pension agencies' supply and demand, the emphasis is to develop private pension institutions, which may make up for the lack of national resources with social resources, forming a diversified pension service system together with families, market, enterprises, non-profit organizations and the nation<sup>[2]</sup>.

## **2. Current preferential tax policies about pension institutions**

As an important means of macro-control, taxation is the most fundamental direct way to adjust the distribution relationship between the nation, enterprises and individual citizens, playing an irreplaceable role in guiding social capital into the pension service market. There have already been a series of endowment institutions preferential tax policies in our country. Article 8 of the <Provisional Regulations of the People's Republic of China on Business Tax points out: Nursing services provided by nurseries, kindergartens, homes for the aged, welfare institutions for the handicapped, matchmaking and funeral services shall be exempt from Business Tax; Article 8 of the <Provisional Regulations of the People's Republic of China on Farmland Occupation Tax > states briefly: Farmland occupied by schools, kindergartens, homes for the aged and hospitals shall be exempt from farmland occupation tax; <Interim Provisions of the Customs of the People's Republic of China Concerning Import Tax Exemption for Charitable Organization> shows clearly: Foreign persons or legal persons or other organizations who donate directly to State Council-approved, humanitarian-aided social charity groups or provincial, autonomous district, municipality government for poverty-relief or philanthropy use can get exemption on import duties and import value-added tax; <Circular Concerning Specific Problems Regulation on Land Value Increment Tax> specifies: Property owners and land use right owners who donate properties or land usage rights for education, civil affairs and other social welfare cause through non-profit community groups or government agencies in China will get tax exemption; <Circular of the Finance Ministry and State Taxation Administration Concerning Tax Policy Problem about Pension Service Institutions> formulates: Welfare, non-profit pension institutions who take real estates, land, vehicles and ships for self use shall be exempt from housing property tax, urban land use tax, vehicles and ships use tax; <Interim Regulations of the People's Republic of China on Stamp Tax> indicates: documents executed for the donation of property to the government, social welfare establishments or schools by the property owner shall be exempt from stamp tax; Article 9 of the <Law of the People's Republic of China on Enterprise Income Tax> refers to: In calculating the amount of income taxable, an enterprise may deduct its expenses incurred due to donation for public welfare, provided that the portion involved is not more than 12 percent of the total amount of its annual profits; Article 26 of the <Law of the People's Republic of China on Enterprise Income Tax> stipulates: income of a qualified non-profit organization shall be income exempted from tax;

Article 24 of the <Determination of the State Council Concerning the Modification on Regulations for the Individual Income Tax Law of the People's Republic of China> regulates: Individuals who donate for education or other social welfare undertakings or to poor areas or areas suffered from serious natural disaster through the social organizations or state organs in the mainland can get donation reduction no more than 30% of their taxable income.

The implementations of these tax preferential policies promote the development of China's aging industry. However, there are still some places to be the perfect.

### **3. The shortage of tax policy on endowment institutions**

#### **3.1 Business registration is deficient in enablement**

Private pension institutions include non-profit and profit pension institutions. Non-profit pension agencies are registered as non-enterprise units in civil department while profit ones are registered as enterprise legal persons in industrial and commercial administration departments and tax departments.

But there is no licensed business item related to pension services, coupled with the state's tax incentives for private non-enterprise units, private pension institutions are more inclined to be registered as non-enterprise units. But non-profit pension agencies in our country are required be audited, charged, supervised by their registered management authorities as well as competent business units, too strict access mechanism makes some pension agencies fail to obtain civil registration have to seek for industrial and commercial registration even or non-registration. This registration status quo is quite controversial. First, being registered as people-run non-enterprise units makes private pension institutions' sustainable management suffer policy bottlenecks.

According to article 2 of <The Nongovernmental Nonprofit Organization Accounting System> submitted in 2005: (1) The group is non-profit for purpose; (2) Resource providers are not for economic returns; (3) Resources providers are not entitled to the ownership of the organization. Endowment institutions' registration as people-run non-enterprise units means investors losing the ownership of property rights, which may increase the investment risk on the one hand, on the other hand lead to the lack of supporting mortgage loan for sustainable development. Second, non-profit endowment institutions are registered in civil departments, while the tax administration law only requires industrial and commercial departments should inform registration and licensure they have handled to tax departments regularly, while other departments including civil department needn't to , thus making it difficult for tax authority to implement effective tax control for non-profit organizations<sup>[3]</sup>.

#### **3.2 Tax incentives are partial to welfare and non-profit pension agencies**

Although the government has always stressed on supporting the development of private pension institutions through policy method, but our country doesn't have a complete set of taxation system related with pension service, and the existing sporadic tax laws have unequal treatment on public pension institutions and private pension institutions obviously. Among the 10 categories connected to pension institutions, except business tax and farmland occupation tax, all other taxes state clearly in their implementing regulations that only welfare and non-profit organizations can enjoy preferential rights. Tax laws do not define expressly whether the specific preferential tax provisions are for non-profit endowment agencies or for agencies providing non-profit endowment services. That being registered as people-run non-enterprise unit equals to achieving taxation exemption, which makes this kind of registration a tax haven for private pension institutions. Their profit-making activities can receive financial subsidies and tax breaks, while public non-profit pension services provided by profit organizations get no relevant taxation concessions, which is not conducive to social forces' participation in the construction of pension institutions actively and effectively<sup>[4]</sup>. Pension service's low-profit industry nature, coupled with private pension institutions' late start in our country and the operative burden exacerbated by the unequal politic treat, lead to the struggling industrialization of endowment service in China and meanwhile has seriously affected private pension institutions' rapid development in competitive market environment.

#### **3.3 The scope of Indirect taxes incentives is narrow**

Indirect taxes account for about 60% of the total tax revenue while direct taxes make up only about 25% in Chinese current tax structure<sup>[5]</sup>. But the main preferential tax related with pension institutions and the elderly is direct tax, while indirect taxes like value-added tax, consumption tax, contract tax, stamp tax have no tax concessions for endowment institutions. However, the survey shows that private pension agencies' main investment expenses are in fixed assets and diet charges. (1) As it was defined in Value-added tax law implementation regulation, input value-added tax of purchased goods for non-VAT taxable items should not be deducted from output tax, so pension institutions' investment on fixed assets and life necessities get no input value-added tax deduction. (2) It is stipulated in Article 4 of <Detailed Rule for the Implementation of the Provisional Regulation of the People's Republic of China on Value-added Tax>: Units or individual operators' activities, like giving out self-produced, processed or purchased goods to others as free gifts, shall be deemed as sales of goods, which have to be subject to value-added tax. Such regulation dampens units or individual operators' enthusiasm to donate for pension agencies.

(3) There are no preferential policies for enterprises' donations more than 12% of the total annual profits. (4) There is lack of training fees deduction, making this part of expenses account for pension institutions increasingly high proportion of the cost.

#### ***4. Improving suggestions on preferential tax policy for the development of Chinese private pension institutions***

##### **4.1 Improve the approval and registration system**

The State Council of the Central Committee of the Chinese Communist Party pointed out early in <Decisions on strengthening the aging work> that: Elderly service industry should step in a way of socialization and industrialization. All sectors of the society should be encouraged and guided to participate in elderly services actively, gradually forming a management system which is government micro-control, social forces-run and pension institutions-operate independently in accordance with market requirements. However, the business sector in our country has no registerable categories for pension service, restricting its industrial development. Take the western developed countries for reference, such as Germany, it introduced a new law in 2003, which stipulated that pension agencies of various types should get industrial and commercial registration, unified receiving corporate governance. In China, Shanghai Industrial and Commercial Bureau approved the foundation of Chinese first Sino-foreign joint profit pension institutions --- Shanghai Nan Qing Hua Zhan Elderly Service Limited Liability Company in July 2011, whose approval for being registered is a beneficial attempt to promote the industrial development of pension service<sup>[6]</sup>.

On March 18, 2013, Ningbo Government issued the circular concerning private profit pension agencies' approval and registration problems. It clearly pointed out anyone who had intention for providing pension services could get enterprise legal person registration in the industry and commerce administrative department within regulated period, business sector should authorize their licensing project for "providing maintenance, rehabilitation, hosting and other services for the elderly" in accordance with the approved application and approval certificate<sup>[7]</sup>. The two trails are all breakthrough in breaking private pension institutions' non-enterprise units-based registration pattern. To realize the industrialization development of pension institution in our country, we must take enterprise registration as the breakthrough point, realizing private pension institutions' enterprise legal person registration, promoting the pension agencies' industrial development, starting from the real demand of the elderly, making private pension institutions standardization and scale-development under the supervision and guidance of company law.

##### **4.2 Establish a Tax Policy system for the benefit of all types of pension institutions**

Pension issue should never just be a problem for one person or one family, it is essentially a social problem. Whether from the functions of government or private pension agencies' role in maintaining social stability, promoting the development of private pension institutions is the bounden duty of the government. Based on the theory of public policy's point of view, the main reason for a particular organization's tax exemption is that the organization can provide public goods and services for the community, while the government has the same purpose for tax collection<sup>[8]</sup>. We should never ignore pension institutions' public nature in our country, whether of profit or non-profit pension institutions. Private pension institutions lack of financial support and social donations, so they have to obtain capital for survival and development through the pursuit of profit, but that does not change its public welfare attribute and they should take equal treatment of tax incentives for granted.

A feature of Chinese private pension institutions is the coexistence of profit and non-profit. In America, Pension organizations can be divided into three categories: profit service agencies, non-profit service agencies and governmental public agencies. Among them, profit private service institutions account for 66%, non-profit organizations occupy 27%, the remaining 7% are government-run service agencies. U.S. officials specially stressed that the key judgment of an organization's nature is not whether it profit or not, but where its profit belongs to. If the profit belongs to the institution itself, it still can be regarded as non-profit organization<sup>[9]</sup>. Chinese private pension institutions' operating profit is for the sake of expanding their size and sustainable development, so they should be supported by relevant taxation policies. According to the definition of non-profit organization in enterprise income tax law, non-profit organizations' profit-seeking behaviors are not banned, it only emphasizes that they should not be for profit purpose only. In short, private pension institutions should also enjoy tax incentives, and the government could introduce relating policy to standardize their market management rather than limit their profit-seeking behavior.

### **4.3 Expand the range of tax incentives for private pension institutions**

Heavy tax burden is a significant pressure private pension institutions face in the course of operation and management. On the one hand private pension institutions have an important role in maintaining social stability, on the other hand it is under tremendous pressure to survive. Promoting the survival and development of private pension institutions by tax deduction is the responsibility of the government.

Chinese government has been committed to the structural tax cuts and tax reform going hand in hand since structural tax reduction was proposed in the Central Economic Working Conference in 2008. According to the financial data released by the Ministry of Finance, our country's total tax revenue reached to ¥8.972031 trillion in 2011, growing by 22.6% year on year <sup>[10]</sup>; In 2012 it reached to ¥10.060088 trillion, growing by 12.1% year on year <sup>[11]</sup>; From January to June in 2013, it reached to ¥5.926061 trillion, growing by 7.9% year on year <sup>[12]</sup>. Comparing with the data released by the National Bureau of Statistics, we found the total GDP reached to ¥47.3104 trillion in 2011, growing by 9.3% year on year <sup>[13]</sup>; In 2012 it reached to ¥51.9322 trillion, growing by 7.8% year on year <sup>[14]</sup>; In the first half year of 2013 it reached to ¥24.8009 trillion, growing by 7.6% year on year <sup>[15]</sup>. Although tax revenue's growth rate has significantly decreased already, it is still faster than the growth rate of GDP, macro tax burden is still too heavy in China, there are still tax reduction spaces for private pension institutions.

#### **4.3.1 Change from Business Tax to Value-Added Tax on pension service**

It was pointed out in the <Circular Concerning the Pilot Proposals for the Change from Business Tax to Value-Added Tax in Transportation Industry and Part of the Modern Service Industry>, Changing from Business Tax to Value-Added Tax would be tried in Transportation Industry and Parts of the Modern Service Industry in Shanghai from January 1, 2012. Such change contributes to eliminating double taxation and promoting the development of tertiary industry. VAT mainly aims at the value-added part in transferring process, while Pension agencies' investments on fixed assets and diet items have no value addition, Changing from Business Tax to Value-Added Tax for pension services is more reasonable. The suggestion is that Changing from Business Tax to Value-Added Tax for pension services and returning the excess VAT paid part from the actual purchase process.

#### **4.3.2 Donation to pension institutions for free should no longer be regarded as sales**

To encourage units and individuals to donate to pension agencies, their donation to pension agencies should be exempted from value-added tax; at the same time, in order to prevent this preferential policies bringing them chances of tax evasion, the Business Sector should establish a sound system of charitable donations' publicity system, strengthening the public supervision by information openness. Pension agencies should set up particular "donated supplies subsidiary" demonstrating the revenue and expenditure of donation and announce to their competent department and social public regularly about relevant financial information on donated goods.

#### **4.3.3 Authorize deferred deduction for over donations**

According to Article 11 of the <Interim Regulations of the People's Republic of China on Enterprises Income Tax> : Losses incurred in a tax year by a Taxpayer may be offset against the income of the following tax year. Should the income of the following tax year be insufficient to absorb the said losses, the balance may be carried forward to be offset against the income of subsequent tax years. However, losses may only be carried forward over a period not exceeding five tax years. With reference to this regulation, donations above quota could be offset against the income of the following tax year and no more than the subsequent five tax years.

#### **4.4.4 Implement policy guidance for professionals' introduction and training for private pension institutions**

The industrialization of pension services is in its primary stage, management services are not standardized, professional level is low, the majority employees are "4050"(means 40 to 50 years old), which is seriously affecting the quality of private pension institutions service and its industrial development. Therefore, policy guidance is needed to encourage more professionals to concern about the elderly and go into the pension services industry.

Some Western developed countries earlier entered the aging society and their pension service system is getting mutual. The advanced experience of foreign countries and foreign professionals are required for China to take the path of industrialization of pension services industry.

Article 28 of <Enterprise Income Tax Law> provides that: Foreign experts employed in Chinese enterprises, social organizations, and government agencies to obtain wage and salary income, the addition or subtraction of their taxable income should be determined according to the average income level and living standards as well as exchange rate changes, on the basis of the taxable income deduction of ¥3,500, the cost will be taken out ¥1,300 from September 1, 2011. Taking this for reference, government can extend the candidates beneficiaries to foreign experts in our private pension institutions, reducing the tax burden on foreign individual working as pension services personnel in China, which will help attract more foreign professionals to serve our pension services, increase pension institutions' attractiveness of talent.

Meanwhile, in order to encourage regular training for private pension services staff, pension institutions should be allowed to extract training fees and these reasonable pre-extracted fees could be offset against their taxable income; Professional organizations providing pension service training should be exempted from business tax and enterprise income tax, thus helping to achieve the goal of promotion of pension service professionals' training and developing through the national policy guidance.

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