

THE LAW REFORM COMMISSION OF HONG KONG
CHARITIES SUB-COMMITTEE
CONSULTATION PAPER ON CHARITIES
EXECUTIVE SUMMARY

(This executive summary is an outline of the consultation paper issued to elicit public response and comment on the Sub-committee's preliminary recommendations. Those wishing to comment should refer to the full text of the consultation paper which can be obtained from the Secretary, Law Reform Commission, 20th Floor, Harcourt House, 39 Gloucester Rd, Hong Kong, or downloaded from the Commission's website at: <http://www.hkreform.gov.hk/en/publications/charities.htm> Comments should be submitted to the Secretary by 16 September 2011. References in this executive summary to paragraph numbers are to paragraphs in the consultation paper.)

Preface

1. It is estimated that there are approximately 6,000 charities operating in Hong Kong. During the course of the fiscal year 2008-9 alone, around \$8 billion dollars was raised in Hong Kong through charitable donations. This is more than double the figure for the year 2000-1. Our vibrant charity sector therefore has much to be proud of.
2. Faced with a similar rapid growth in charitable-giving in recent years, a number of overseas jurisdictions have undertaken major reforms of their laws on charities. These developments have been aimed at both protecting the interests of charitable donors and supporting the activities of charities by providing a modern and streamlined charity law framework in which they can operate.
3. In Hong Kong, such a comprehensive legal framework for regulating charities does not yet exist. There is limited statutory definition of what constitutes a "charity" or a "charitable purpose". There is also a limited system of oversight and legislation relating to charities which qualify for tax exemption appears in various *ad hoc* provisions.

Terms of reference

4. In June 2007, the Chief Justice and the Secretary for Justice asked the Law Reform Commission to review this subject. The terms of reference are:

"To review the law and regulatory framework relating to charities in Hong Kong and to make such recommendations for reform as may be considered appropriate."

Chapter 1: Introduction to charities in Hong Kong

5. A significant benefit of creating a charitable organisation is that the organisation itself is not generally liable to tax and those who make donations to it may claim the amount donated as a deduction from their assessable income. Section 88 of the Inland Revenue Ordinance (Cap 112) provides that *"any charitable institution or trust of a public character"* is exempt from tax and shall be deemed always to have been exempt. Sections 16D and 26C of the Inland Revenue Ordinance allow a deduction for approved charitable donations to be made by a person during the year of assessment.

6. In order for an institution or a trust to be considered *"a charity"*, it must be established *"for purposes which are exclusively charitable according to law"*. Charitable purposes are currently defined by case law in Hong Kong and include:

- the relief of poverty;
- the advancement of education;
- the advancement of religion; and
- other purposes of a charitable nature beneficial to the community not falling under any of the preceding heads.

7. The breakdown into the four main categories of charitable purpose of the 5,123 charitable organisations recognised as at December 2007 by the Inland Revenue Department for tax exemption purposes was as follows:

| | |
|--------------------------|-------|
| Relief of poverty | 1,037 |
| Advancement of education | 1,790 |
| Advancement of religion | 1,773 |
| Others | 523 |

The need to review Hong Kong's charity law

8. We note that in Hong Kong public concern is growing over how charities are regulated, and there have been calls from many quarters for tighter controls and increased transparency to be implemented.

9. It is the Sub-committee's view that the regulation of charities should aim to:

- ensure compliance with charity law;
- enhance accountability to beneficiaries and donors;
- improve public trust and confidence; and
- encourage charities to maximise their social and economic potential.

Chapter 2: Overview of the current legal position in Hong Kong

Oversight of charitable organisations and fundraising activities

10. Depending on the type of charity, Government monitoring in Hong Kong ranges from

"stringent statutory overall control" to limited scrutiny of specified activities only.¹ If a charity wishes to raise funds through an activity held in a public place, such as a flag day, it must first obtain a public subscription permit from the Social Welfare Department under section 4(17)(i) of the Summary Offences Ordinance (Cap 228). This section makes it an offence for any person to organise or participate in "any collection of money or sale or exchange for donations of badges, tokens or similar articles in a public place", except in accordance with a permit issued by the Director of Social Welfare for a collection, sale or exchange for charitable purposes. The aim of this control is to limit public nuisance and to maintain order.

11. Charitable fundraising activities which involve on-street selling may be subject to the Hawker Regulation (Cap 132A1), and would require advance application to the Food and Environmental Hygiene Department for a temporary hawker licence for on-street selling activities.

12. Similarly, if a charity wishes to raise funds through a lottery, a licence is required from the Commissioner for Television and Entertainment Licensing under section 22(1)(a)(i) of the Gambling Ordinance (Cap 148).

Chapter 3: Perceived deficiencies in the regulatory framework for supervision of charities in Hong Kong

13. The perceived deficiencies are, firstly, the definition of "charity" in Hong Kong is not based upon a clear statutory definition, but upon the common law interpretation of English legislation dating back hundreds of years, namely to the preamble to the 1601 Statute of Elizabeth I. The terminology used in the preamble is archaic and not suited to modern conditions. Secondly, there is a lack of a coherent system for the registration of charities. Thirdly, there are inconsistent standards or requirements on governance, accounting and reporting by charities. Charitable organisations may be established under a number of different legal structures in Hong Kong, including statutory bodies, incorporated companies, charitable trusts and societies, and each of these types of organisation structure can involve differing legislative requirements at the time of the organisation's formation and throughout the duration of its operations. Fourthly, there is limited control of charitable fundraising (which is discussed in more detail in Chapter 9). Fifthly, the fact that the current oversight measures are vested in a variety of Government authorities, each imposing their own requirements and standards in differing circumstances, creates confusion and does not support the efficient operation of charities.

Chapter 4: Overview of the law of charities in other jurisdictions

Australia

14. Although there has been a significant effort to reform charity law in Australia, this has not yet resulted in major reform apart from the Extension of Charitable Purpose Act 2004 (Commonwealth), which mainly concerns the definition of charity. Theoretically, state Attorneys General are responsible for supervising charitable trusts, but in practice the Australian Taxation Office serves as the closest body to a national regulator.

¹ Office of the Ombudsman, *Investigation Report: Monitoring of Charitable Fund Raising Activities* (Feb 2003), at para 5.3.

Canada

15. The provinces in Canada have the power to supervise charities under the Canadian constitution. In practice, however, the *de facto* primary regulator of charities is the Canada Revenue Agency, the federal taxing authority. Organisations may apply to the Agency for registration as charities which are then subject to audit and enforcement activities by the Charities Directorate under the CRA.

England and Wales

16. The Charities Act 2006 defines what constitutes a charity and charitable purposes and establishes a regulatory framework for charities. The Act is to come into force in stages. Part 1 defines the meaning of "*charity*" and "*charitable purposes*". Chapter 1 of Part 2 regulates charities, creating a new Charity Commission as a corporate body, setting out its objectives, functions and duties, abolishing the existing Charity Commissioner and transferring its functions, rights and liabilities to the new Charity Commission. Chapter 3 of Part 2 provides for registration of charities. Chapter 8 of Part 2 introduces the new concept of the "*Charitable Incorporated Organisation*" which can be established with limited or unlimited liability, but only for charitable purposes. To facilitate good governance, provisions on removal, suspension, remuneration and disqualification of charity trustees, etc, are included.

Ireland

17. The enactment of the Charities Act 2009 in March 2009 followed studies of the charities sector and calls for reform from the Law Society of Ireland, the Department of Community, Rural and Gaeltacht Affairs and the Irish Law Reform Commission. Part 1 of the Act defines the meaning of "*charitable purpose*". Part 2 establishes a new Charitable Regulatory Authority: shifting the regulatory responsibilities (including the responsibility to determine whether an applicant is charitable in nature) from the tax agency to a more independent body, and transferring all functions relating to charitable organisations or charitable trusts vested in the Attorney General to the Authority (section 38). Part 3 regulates charitable organisations by way of:

- establishing a register of charitable organisations in which all charities must register;
- imposing a duty to keep proper accounts available for inspection and to prepare an annual statement of accounts;
- requiring charitable organisations to submit to the Authority annual activity reports which are to be made publicly available; and
- providing for disqualification of charity trustees, etc.

New Zealand

18. The Charities Act 2005 establishes the Charity Commission which is to assess an entity's application for charitable status. Part 1 of the Act establishes the Commission, and sets out its functions, powers and obligations. Sections 4 and 5 in Part 1 define "*charitable entity*" and "*charitable purpose*". Subpart 1 of Part 2 provides for registration and de-registration of societies, institutions, and trustees of trusts as charitable entities. Subpart 2 of Part 2 provides for the regulatory role of the Commission, including, requiring charitable entities and certain other persons to comply with certain obligations, for example, charitable

entities' duties to prepare annual returns and empowering the Commission to examine and inquire into any charitable entity or any relevant person and making it an offence for non-compliance with a notice issued by the Commission.

Scotland

19. Following a Scottish review of charity law, there is a new regulatory framework as enshrined in the Charities and Trustee Investment (Scotland) Act 2005. This involves the establishment of the Office of the Scottish Charity Regulator, a new independent lead regulatory body: shifting the regulatory responsibilities (including the responsibility to determine whether an applicant is charitable in nature) from the tax agency to a more independent body.

Singapore

20. The existing law on charities in Singapore is contained in the Charities Act (Cap 37), as significantly amended by the Charities (Amendment) Act 2007. The Singapore Charities Act provides for the registration of charities, the administration of charities and their affairs, the regulation of charities and institutions of a public character, the regulation of fundraising activities carried on in connection with charities and other institutions and the conduct of fundraising appeals.

South Africa

21. South Africa's legal system is a mixed system, combining elements of Roman-Dutch law and English common law. South Africa has therefore developed a law of charitable trusts which, while sharing elements with English common law jurisdictions, is quite distinctive.

22. The Directorate of Non-profit Organisations registers organisations under the Non Profit Organisations Act, 71 of 1997 which was enacted to encourage and support organisations by creating an enabling environment for organisations to flourish, and setting and maintaining adequate standards of governance, accountability and transparency. There are three legal forms of non-profit organisations and four tiers in the regulatory framework for not-for-profit organisations. Consequently, an organisation may have to comply with various requirements and regulations at different tiers.

Chapter 5: Conclusions and proposals on the definition of charity

The specific heads of "*charitable purpose*" at common law

23. The meaning of the term "*charity*" under Hong Kong law follows the common law, and is concerned with whether the particular purposes of the organisation or activity are "*charitable*" in the legal sense. Lord Macnaghten's dictum in the 1891 case of *Income Tax Special Purposes Commissioners v Pemsel* is the leading common law authority on the definition of charity. Lord Macnaghten's list of "*four principal divisions*" of charitable purposes was itself derived from the preamble to the Charitable Uses Act 1601 in England, also known as the Statute of Charitable Uses or the Statute of Elizabeth I.

24. *The relief of poverty.* The preamble to the English Charitable Uses Act 1601 lists the relief of aged, impotent and poor people, but these words are to be construed

disjunctively, so that the relief of poor persons is charitable *per se* and there is no need for them to be also "aged" or "impotent" at the same time, in order to satisfy the object of charity.

25. *The advancement of education.* Charity law gives a wide meaning to "education" and does not limit it to education by a teacher in a classroom, playground or sports field. In order to be charitable for the advancement of education, the organisation must be for an educational purpose which the law regards as charitable and fall within the spirit and intendment of the preamble to the Statute of Elizabeth I. Further, the education for which the donor intends to provide must be of educational value to the community and the benefits must be available to the public or to a sufficiently important section of the community.

26. *The advancement of religion.* A gift for religious purposes has to satisfy two conditions in order to come within the meaning of Lord Macnaghten's third head of charity. First, the gift must contribute to the advancement of religion as that word is interpreted by the courts. Secondly, the gift must promote the religious instruction or education of the public.

27. *The promotion of health.* The protection of human life is a well established charitable purpose within the preamble to the Statute of Elizabeth I. A trust for the promotion of health is charitable. This includes the prevention, cure or treatment of diseases for the promotion of health.

28. *The relief of victims of a disaster.* This purpose falls within the head of the "relief of distress" in the preamble to the Statute of Elizabeth I.

29. *The relief of disabled persons.* The preamble to the Statute of Elizabeth I refers to "the relief of impotent people". A dictionary definition of "impotent" is "powerless, helpless, ineffective; physically weak, decrepit". In modern language, this refers to persons under a physical or mental disability.

30. *The protection of animals.* A trust for the protection or welfare of animals, irrespective of whether or not they are useful to man, is *prima facie* charitable within the fourth head of the *Pemsel* case.

31. *The preservation of the environment.* The preservation of the environment, including its flora and fauna, is a recognised charitable purpose.

Purposes held not to be charitable

32. Conversely, a trust for political purposes is not charitable. This rule, which is sometimes called "*the rule against politics*," is easy to state but not to apply, and the cases disclose inconsistencies.

Problems with the current law and the need for reform

33. Clearly, there are difficulties in attempting to determine the scope of what should constitute a charity in twenty-first century Hong Kong by reference to a statute from Tudor England, and from case law founded in the Victorian era.

Recommendation 1

We recommend that there should be a clear statutory definition of what constitutes a charitable purpose.

34. The Sub-committee has studied various overseas models on the definition of charitable purposes. In doing so, we note our preference for the approaches adopted in England and Wales, and in Scotland.

Recommendation 2

We recommend that the statutory definition of what constitutes a charitable purpose that is exclusively charitable should include the following heads:

- (1) The prevention or relief of poverty;²**
- (2) The advancement of education;**
- (3) The advancement of religion;³**
- (4) The advancement of health;**
- (5) The saving of lives;**
- (6) The advancement of citizenship or community development;**
- (7) The advancement of arts, culture, heritage or science;**
- (8) The promotion of religious or racial harmony;**
- (9) The promotion of equality and diversity;**
- (10) The advancement of environmental protection or improvement;**
- (11) The relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantage;**
- (12) The advancement of animal welfare;**
- (13) Any other purpose that is of benefit to the community.**

We further recommend that, whichever head of charitable purpose the particular purpose falls under, it must be also for the public benefit.⁴

In relation to "*The advancement of human rights, conflict resolution or reconciliation*", we welcome the public's views as to whether these purposes should be included in the list of charitable purposes.

² Subject to further refinements suggested in paragraph 5.69.

³ Subject to further refinements suggested in paragraph 5.76.

⁴ We note that this would have the effect of removing the present common law presumption that purposes for the relief of poverty, the advancement of education and the advancement of religion are *prima facie* charitable and for the public benefit.

Chapter 6: Conclusions and proposals on the legal structures of charities

35. According to Inland Revenue Department statistics, in December 2007, the distribution of charities across the various legal forms was as follows:

| Form | No. of Organisations |
|-------------|----------------------|
| Corporation | 3,680 |
| Society | 626 |
| Trust | 406 |
| Others | 411 |
| Total | 5,123 |

Recommendation 3

We invite views from the public on whether, and to what extent, the various existing legal forms for charities should be reformed.

In particular, we invite comments on:

- (1) whether the current system of allowing a variety of legal forms of charitable organisations to exist should continue, and if so, what modifications, if any, should be made to it; and**
- (2) whether, in the alternative, a unitary approach of imposing one uniform model of charitable organisation structure should be adopted, and if so, what form that model should take.**

Chapter 7: Conclusions and proposals on registration of Charities

36. Currently there is no formal, established registration system for charitable organisations in Hong Kong and no government authority with overall responsibility in this area. Separate lists exist for different purposes but these are not formal lists of all charitable organisations. Some charitable organisations may not appear in any of these lists. This means that in some cases, members of the public may not be able to ascertain whether an organisation in Hong Kong representing itself as a charity is in fact a charity.

37. A number of jurisdictions have registration systems for charities, including England and Wales, Ireland, Scotland and New Zealand. The register of charities within these systems is generally maintained by the charity regulatory body of that jurisdiction. For example, in England and Wales, a register of charities is kept by the English Charity Commission and the register contains the name of every charity registered and other particulars and information relating to each such charity. The English Charity Commission is empowered to remove from the register any institution which is no longer considered as a charity, and any charity which has ceased to exist or does not operate. The register (including the entries cancelled when institutions are removed from the register) is open to public inspection at all reasonable times.

38. We consider that there is a need for a registration system in Hong Kong, particularly to cover charitable organisations which make charitable appeals to the public and those allowed to claim tax exemption.

Recommendation 4

We recommend that all charitable organisations which:

- (1) make any charitable appeal to the public; and/or**
- (2) seek tax exemption**

should be subject to the requirement of registration.

We recommend that the list of registered charitable organisations should be established and maintained by the future charity commission and that this list should be available for public inspection.

We recommend that the application process for registration should not be subject to public notification.

We recommend that the matter relating to allowing or disallowing the use of particular names of charitable bodies should be left to the future charity commission to determine, on a case by case basis.

Chapter 8: Proposed framework for governance, accounting and reporting by charities

39. In Hong Kong there is no single piece of legislation governing charitable organisations. Existing government monitoring of charities is fragmented and is mainly confined to charitable fundraising activities, such as the controls exercised by the Social Welfare Department, the Food and Environmental Hygiene Department and the Television and Entertainment Licensing Authority.

40. In the course of our deliberations, we have examined the systems for regulating and monitoring charities in a number of jurisdictions. Broadly speaking, the approach is for charities monitoring authorities to set up a suitable framework for reporting and accounting by charities. The authorities are empowered to conduct inquiries of problematic charities and to act for their protection.

Recommendation 5

We recommend that registered charitable organisations should be required to file an annual activity report to the future charity commission. Such a report should be provided in a standard form and matters covered should include –

- (1) change of charitable objects;**
- (2) main activities carried out to fulfil the charitable objects;**

- (3) **change of directors;**
- (4) **change of registered office address.**

41. We consider that the future charity commission should be responsible for the management and governance of charities by promoting greater compliance with legal obligations by charity trustees or directors when managing their charitable organisations.

42. Furthermore, charity trustees or directors are under a fiduciary duty to exercise their powers for the purposes for which they were conferred, and *bona fide* for the benefit of the charity and not to put themselves in a position in which their duties to the charity and their personal interests conflict. Charitable trustees or directors should be subject to a duty to declare any conflicts of interest.

Recommendation 6

We recommend that charity trustees or directors of a registered charity should be under a duty to declare any conflicts of interest and personal interests.

43. From our study of overseas jurisdictions, we note that nearly all of the monitoring authorities require charitable organisations to submit an annual financial return after the end of their financial year.

Recommendation 7

We recommend that:

- (1) **Registered charitable organisations with an annual income exceeding \$500,000 should be required to file an auditors' report and financial statements with the future charity commission.**
- (2) **Without prejudice to the statutory requirements under the Companies Ordinance (Cap 32), registered charitable organisations with an annual income not exceeding \$500,000 should be required to file financial statements certified by the Board of these charitable organisations with the future charity commission.**
- (3) **The auditor's report and financial statements submitted by charitable organisations to the future charity commission should be accessible to the public.**

We also invite views from the public on –

- (1) **whether, for every charity registered with the future charity commission, an activities report and financial statements should be filed with the future charity commission on an annual basis; and if so**
- (2) **the contents to be included in the annual report of activities.**

44. Many overseas jurisdictions, such as England and Wales, Ireland, Scotland and Singapore, impose a legal obligation on the charity or the charity trustees to keep proper books of account.

Recommendation 8

We recommend that charity trustees or directors of a registered charity should be under a statutory duty to keep proper accounting records of the charity which are sufficient to show and explain all transactions of a charity. Such records should be retained for at least seven years.

45. We consider that the ability of the future charity commission to investigate and check abuses is crucial to building and maintaining public confidence. In most overseas jurisdictions, the regulatory authority is vested with statutory power to investigate any reports of breaches of trust and maladministration by charities or their officers.

Recommendation 9

We recommend that the future charity commission should be vested with the power to investigate any alleged mismanagement and misconduct of charitable organisations with regard to its charitable objects.

In the exercise of this power to investigate alleged mismanagement and misconduct of a charitable organisation, the future charity commission should have power, in respect of a particular charity under investigation, to investigate the charity's funding, property and activities and to obtain relevant information, including documents, records, books and accounts from the charity. During the course of such investigations, there should be appropriate safeguards to ensure confidentiality.

Recommendation 10

We recommend that any person who intentionally or recklessly provides false or misleading information to the future charity commission or its appointed investigators, or fails to provide the information required for the purpose of investigation, or alters, conceals or destroys any document required for production for the purpose of an investigation, will be guilty of an offence.

46. Monitoring charities through proper enforcement procedures and remedial action will ensure charities meet their legal obligations and operate in accordance with their proper purposes. The future charity commission should be empowered to take appropriate and proportionate measures to investigate and enforce compliance with specified requirements. Based on the experience of overseas jurisdictions, we note that there are different enforcement powers and remedies and that these may be applied to charitable organisations to different degrees, depending on the severity and persistence of the default in complying with their legal obligations.

Recommendation 11

We recommend that the future charity commission should be vested with powers relating to enforcement and remedies in the case of non-compliance by charities with their legal obligations.

These powers should include, but not be limited to:

- (1) de-registration of a charity from the register of charities;**
- (2) referring criminal offences to appropriate law enforcement agencies;**
- (3) referring possible civil actions to the Secretary for Justice; and**
- (4) powers for the purpose of protection of property of charities.**

Recommendation 12

We recommend that the future charity commission should be vested with the power to protect property of charities in cases of misconduct or mismanagement in the administration of charities, and that this power should include, but not be limited to, the powers to:

- (1) appoint additional trustees or directors of the charity;**
- (2) suspend or remove trustees, directors or officers of the charity;**
- (3) vest property of charities in an official custodian; and**
- (4) require persons holding property on behalf of the charity not to part with the property without the approval of the future charity commission.**

Chapter 9: Conclusions and proposals on the regulation of fundraising activities

47. The fundraising activities of all charitable organisations in Hong Kong, whether statutory or non-statutory, which are conducted in public places (such as collections of donations or charity sales), or involve the sale of lottery tickets, have to be approved by the Government in advance, and a permit or a licence has to be obtained from the appropriate Government authority before these activities can be carried out. The government departments and bureaus concerned include the Social Welfare Department, the Home Affairs Bureau, the Food and Environmental Hygiene Department and the Television and Entertainment Licensing Authority.

48. To supplement these limited statutory measures which regulate fundraising, the initiative has been taken by the Social Welfare Department, the Hong Kong Institute of Certified Public Accountants and, more recently, by the Independent Commission Against Corruption, to produce non-mandatory practice guidelines for those involved with charitable fundraising activities.

49. We have conducted a detailed review of the system for regulating fundraising activities in a number of overseas jurisdictions. The nature and degree of oversight varies from jurisdiction to jurisdiction and we have found the systems in England and Ireland particularly instructive.

50. In the course of our deliberations, we have endeavoured to formulate proposals to directly address the perceived weaknesses in the current system of regulating charitable fundraising in Hong Kong. Our guiding principle has been that such activities should be conducted in future in a more transparent and accountable manner. Nonetheless, we are also conscious that any future regulatory measures should be no more than is necessary to improve the system, as we would not wish to see introduced unnecessary inconvenience, either to the dedicated charitable organisations and voluntary agencies which carry out this important charity work, or to the philanthropic public which provides their donations so generously. In balancing these two objectives, we believe that, overall, a relatively light-handed approach in this area is appropriate.

Recommendation 13

We recommend that:

- (1) there should be a sole regulatory body (a "one-stop shop") to process and grant all permits and licences necessary for charitable fundraising, and to monitor the use of funds raised by such activities;**
- (2) this "one-stop shop" service should be provided by the future charity commission which should be vested with the powers and duties currently exercised by the Social Welfare Department, the Food and Environmental Hygiene Department and the Television and Entertainment Licensing Authority in relation to authorising charity fundraising activities in public places and those involving lotteries; and**
- (3) the future charity commission should be responsible for enabling public access to information relating to fundraising activities and for providing an enquiry response service to the public.**

Recommendation 14

We recommend that, for all forms of charitable fundraising activities, the registration number of any charitable organisation involved in the activities should be prominently displayed on any related documents, or displayed on any means through which appeals for charitable donations are made (such as solicitation leaflets).

Recommendation 15

In relation to professional fundraisers, we recommend that:

- (1) the future charity commission should develop and issue non-statutory codes of good practice to regulate the activities of professional fundraisers;
- (2) the future charity commission should consider the feasibility of requiring professional fundraisers to register with it;
- (3) the future charity commission should encourage as a matter of good practice among professional fundraisers or commercial participators (including, but not limited to) -
 - (a) the making of solicitation statements (such as those used under the system in England and Wales) by professional fundraisers;
 - (b) disclosure of their remuneration to the future charity commission and the public;
 - (c) disclosure to the future charity commission of any prior written agreement between them and charities; and
- (4) the future charity commission should review the position and issue guidelines concerning the hiring of elderly persons to solicit donations on the street.

Chapter 10: Charities and tax

51. According to the Inland Revenue Department's statistics, the number of charities that have been granted tax exemption in recent years is as follows:

(Charities Granted Tax Exemption)

| <i>As at year ending</i> | <i>Number</i> |
|--------------------------|---------------|
| 31.3.2005 | 4,162 |
| 31.3.2006 | 4,435 |
| 31.3.2007 | 4,832 |
| 31.3.2008 | 5,311 |
| 31.3.2009 | 5,898 |
| 31.3.2010 | 6,380 |

52. Tax exemption may be granted to an organisation if it is a charitable institution or trust of a public character within the scope of section 88 of the Inland Revenue Ordinance (Cap 112).⁵ In practice, the Inland Revenue Department looks to the common law to determine whether an organisation can be accepted as being established for charitable

⁵ The online version of this list is available at: http://www.ird.gov.hk/eng/tax/ach_index.htm.

purposes,⁶ in particular to Lord Macnaghten's four principal divisions of charitable purpose set out in *Income Tax Special Purposes Commissioners v Pemsel*. Further, the organisation must have been established for exclusively charitable purposes.

53. Under section 26C of the Inland Revenue Ordinance (Cap112), a taxpayer may deduct any "approved charitable donations" made by him (in the aggregate sum of not less than HK\$100) from his assessable profits or chargeable income during a year of assessment. Section 16D of the Ordinance also allows deductions for approved charitable donations to be made by a taxpayer who is subject to profits tax. Deductions under both sections are subject to a current ceiling of 35% of the assessable income or profits. The table below sets out figures provided by the Inland Revenue Department for the total amount of approved charitable donations allowed as tax deductions in Hong Kong in recent years.

*(Amount of Approved Charitable Donations
Allowed for Deduction)*

| <i>Year of Assessment</i> | <i>Profits Tax (\$ billion)</i> | <i>Salaries Tax (\$ billion)</i> | <i>Total (\$ billion)</i> |
|-------------------------------|-------------------------------------|--------------------------------------|-------------------------------|
| 2003/04 | 1.28 | 2.89 | 4.17 |
| 2004/05 | 1.72 | 3.39 | 5.11 |
| 2005/06 | 1.79 | 3.40 | 5.19 |
| 2006/07 | 2.15 | 3.76 | 5.91 |
| 2007/08 | 2.51 | 4.52 | 7.03 |
| 2008/09 | 3.03 | 5.01 | 8.04 |

54. One of the issues we have considered is the extent to which the role of the future charity commission should interface with that of the Inland Revenue Department for the purposes of assessing the tax exemption status of charities. Reviewing the position overseas, we have focused on the charity commissions or similar bodies in England, Scotland, Ireland and New Zealand, and have studied the "division of labour" between their respective charity commissions and taxation authorities in handling tax exemptions for charities. As our findings indicate, generally there is a clear demarcation in the roles between these two types of authorities, with the responsibility for assessing a charity's eligibility for tax exemption resting firmly with the relevant tax authority.

Recommendation 16

We recommend:

- (1) that existing powers of tax exemption and functions of periodic review of charities for taxation purposes should remain with the Inland Revenue Department;**

⁶ Inland Revenue Department information pamphlet, *A Tax Guide for Charitable Institutions and Trusts of a Public Character* (revised ed, Sept 2010), available at: http://www.ird.gov.hk/eng/tax/ach_tgc.htm.

- (2) tax exemption may be granted to a charity by the Inland Revenue Department only when the charity has been registered with the future charity commission;**
- (3) subject to (2) above, no change to the existing law on the taxation of charities in Hong Kong;**
- (4) that the future charity commission should collaborate with the Inland Revenue Department as far as possible, particularly by the provision of relevant charities' accounts information, to facilitate the Department's functions in assessing charities for tax where appropriate; and**
- (5) that the Administration should ensure that sufficient resources are allocated to the Inland Revenue Department to carry out the function of reviewing annual accounts submitted by charities to the future charity commission.**

Chapter 11: Conclusions and proposals on the *cy-près* doctrine

55. While a number of other jurisdictions have moved towards a statutory framework for the variation of charities, Hong Kong still adopts the common law basis for the *cy-près* doctrine.

56. Generally, charitable trusts are set up for the advancement of *particular* charitable purposes. The trustees of a charitable trust are under a duty to make use of the property vested in the charitable trust to advance the charitable purposes of the trust. Occasionally, a situation might arise where the stated purpose becomes "*impossible or impractical to be effectuated*," that is, the trust can no longer carry out the purposes for which it was first created. Without the court's intervention, a gift in these circumstances may fail and the trust property may have to be returned to the donor or the donor's estate under the *resulting trust* principle. If certain required conditions are met, however, the court can use the *cy-près* doctrine to order that the property of the charity should be used for a purpose which is as near as possible to the expressed or original intention of the donor. If this is achieved, the gift will not fail.

57. The donor's intention is crucial in deciding whether the *cy-près* doctrine can be applied. If any "*general charitable intention*" is found under the trust, the doctrine of *cy-près* will allow the trust property to be applied for other purposes which are as near as possible to the expressed intentions of the donor, so that the trust property can remain dedicated to charity.

58. While the *cy-près* doctrine as applied in Hong Kong is derived from and follows the common law, a number of overseas jurisdictions have broadened the scope of the doctrine and codified it in legislation. We have closely examined a number of statutory *cy-près* regimes in different overseas jurisdictions such as England and Wales, Scotland, Ireland, Australia, New Zealand and South Africa. While legislative changes in these jurisdictions have, in different ways, broadened the application of the *cy-près* doctrine, we consider the English model to be a particularly useful model for Hong Kong.

Recommendation 17

We recommend the introduction in Hong Kong of legislation along the lines of the English statutory model of the *cy-près* doctrine (comprised in provisions of the English Charities Act 1993, as amended in 2006), so as to provide a statutory basis for the doctrine in Hong Kong and to broaden the scope of its application.

In line with the English model, we recommend that the *cy-près* doctrine should be broadened in Hong Kong so that it may apply in the following situations even where it is not impossible or impractical to carry out the charitable purpose of the charitable trust:

- (1) where property given for a specific charitable purpose has failed, and the donors are either unknown or have disclaimed their rights to have the property returned;
- (2) where property is given for a specific charitable purpose in response to a solicitation;
- (3) where a charitable body has dissolved.

We also recommend that the future charity commission should be empowered by statute to administer the application of the *cy-près* doctrine in particular cases.

Chapter 12: Conclusions and proposals on the establishment of a charity commission for Hong Kong

59. We consider that there is a need for, as far as possible, a "one-stop shop" which can serve as a centralised body and take over the functions of the various government authorities responsible for monitoring charitable organisations and their fundraising activities.

60. A number of jurisdictions have a centralised regulatory body for charities performing important functions, such as maintaining a register of charities, monitoring charities' compliance with their legal obligations, instituting inquiries and protecting funds and property of charities in cases of misconduct or mismanagement.

Recommendation 18

We recommend that a charity commission should be set up as a sole regulatory body for charities.

The objectives of the charity commission would be:

- (1) to increase public trust and confidence in charities;
- (2) to enhance transparency and accountability to donors and beneficiaries;

- (3) to promote good governance and good management practice on matters related to charities; and**
- (4) to promote greater compliance among charities with their legal obligations.**

61. Taking into account the overseas experience with respect to charity regulatory bodies, we consider that the future charity commission should have the general characteristics set out below.

- (1) Proportionate power

62. Since the future charity commission will have a duty to ensure that charitable organisations comply with their legal obligations, a variety of powers will be vested in the commission. These powers of the future charity commission should be exercised in a fair, reasonable and proportionate manner.

- (2) Accountability

63. We consider that, in line with other statutory commissions in Hong Kong, such as the Equal Opportunities Commission and Securities and Future Commission, there should be a proper appeal mechanism for any person or organisation aggrieved by the decision of the charity commission. We propose that such an appeal could be made to the Court of First Instance.

- (3) Transparency

64. In setting up an effective system of regulation and monitoring of charities, the future charity commission should publish clear and transparent guidelines to enable charitable organisations to have a clear understanding of the procedures and requirements relating to charity matters, such as registration and fundraising.

65. In order to achieve its objectives, we consider that the future charity commission should be equipped with the appropriate functions and powers.

Recommendation 19

We recommend that the future charity commission should have the following functions and powers:

- (1) To determine whether organisations are or are not charities;**
- (2) To maintain and administer the register of charities, including a power to refuse registration in appropriate cases;**
- (3) To monitor compliance by charities with their legal obligations;**
- (4) To vet applications for requisite approval in relation to fundraising activities;**
- (5) To promote good governance and good practice among charities;**

- (6) To investigate, either by itself or by appointed investigators, into misconduct or maladministration by charitable organisations or their officers;**
- (7) To enforce decisions and to grant remedies; and**
- (8) To apply the *cy-près* doctrine.**

66. To balance the vesting of these powers in the future charity commission and to ensure fairness, we consider that an appeal mechanism should be in place to enable charitable organisations or aggrieved persons to appeal against certain decisions of the future charity commission.

Recommendation 20

We recommend that a charitable organisation or person aggrieved by the decision of the future charity commission, either:

- (1) in its refusal to register an organisation as a charitable organisation;**
- (2) in the exercise of its powers relating to enforcement and remedies due to non-compliance of charities with their legal obligations; or**
- (3) in the application of the *cy-près* doctrine;**

shall have the right to appeal to the Court of First Instance.

67. In line with the example in England and Wales, the Sub-committee considers that the Secretary for Justice should continue to contribute to the framework of supervision and control over charities which will be implemented by the future charity commission. Furthermore, the Secretary for Justice will continue to be a necessary party to all claims relating to charities in order to represent the beneficial interest or objects of the charity.

Invitation to comment

This consultation paper has been issued by the Law Reform Commission's Charities Sub-committee to elicit views and comment from the public on the recommendations for change that it contains.

While all expressions of views on the paper would be welcome, the Sub-committee would particularly appreciate receiving your responses to the following questions, *including, in each case if possible, the reasons for your answers*:

(Definition of charity – Chapter 5)

- Q1.** Do you think that there should be a clear statutory definition of what constitutes a charitable purpose? (See Recommendation 1⁷.)
- Q2.** If you have answered "yes" to Question 1, please also answer the following questions:
- (a) Do you think that the statutory definition of what constitutes a charitable purpose that is exclusively charitable should include all of the heads of charitable purpose set out in Recommendation 2⁸?
 - (b) If not, which head or heads do you think should be deleted from the list? Which should be amended, and how? Are there any other heads which you think should be added to the list of heads of charitable purpose?
 - (c) Do you think that charities falling under any of the heads of charitable purpose must be also for the public benefit? (See Recommendation 2.)
 - (d) Do you think that "*The advancement of human rights, conflict resolution or reconciliation*" should be included in the statutory list of heads of charitable purpose? (See Recommendation 2.)

(Legal structures of charities – Chapter 6)

- Q3.** Do you think that the various existing legal forms for charities should be reformed? (See Recommendation 3⁹.)
- Q4.** If you have answered "yes" to Question 3, please also answer the following questions:

⁷ At para 5.42.

⁸ At para 5.128.

⁹ At para 6.41.

- (a) Do you think that the current system of allowing a variety of legal forms of charitable organisations to exist should continue, and if so, what modifications, if any, should be made to it? (See Recommendation 3.)
- (b) Alternatively, do you think that a unitary approach of imposing one uniform model of charitable organisation structure should be adopted, and if so, what form should that model take? (See Recommendation 3.)

(Registration of charities – Chapter 7)

Q5. Do you agree that all charitable organisations which:

- (a) make any charitable appeal to the public; and/or
- (b) seek tax exemption

should be required to register? (See Recommendation 4¹⁰.)

Q6. If you agree that charitable organisations should be registered, but do not agree with the pre-conditions for registration set out in Question 5(a) and (b), please answer the following questions:

- (a) which pre-condition(s) do you think should not be required, and why? Are there other pre-conditions which you think should be included, and why? (See Recommendation 4.)
- (b) Do you agree that the list of registered charitable organisations should be established and maintained by the future charity commission? (See Recommendation 4.)
- (c) Do you agree that this list should be available for public inspection? (See Recommendation 4.)
- (d) Do you agree that the application process for registration should not be subject to public notification? (See Recommendation 4.)
- (e) Do you agree that whether the use of particular names of charitable bodies is allowed or disallowed should be left to the future charity commission to determine, on a case by case basis? (See Recommendation 4.)

(Framework for governance, accounting and reporting by charities – Chapter 8)

Q7. Do you think that registered charitable organisations should be required to file an annual activity report to the future charity commission, and if so, should the report be provided in a standard form and should it cover the list of matters set out in Recommendation 5¹¹? Are there any matters which you think should be deleted from the list? Are there any matters which should be added?

¹⁰ At para 7.37.

¹¹ At para 8.20.

Q8. Do you think that charity trustees or directors of a registered charity should be under a duty to declare any conflicts of interest and personal interests? (See Recommendation 6¹².)

Q9. Recommendation 7¹³ proposes that:

"(1) Registered charitable organisations with an annual income exceeding \$500,000 should be required to file an auditors' report and financial statements with the future charity commission.

(2) Without prejudice to the statutory requirements under the Companies Ordinance (Cap 32), registered charitable organisations with an annual income not exceeding \$500,000 should be required to file financial statements certified by the Board of these charitable organisations with the future charity commission.

(3) The auditor's report and financial statements submitted by charitable organisations to the future charity commission should be accessible to the public."

Do you agree with the requirements set out in Recommendation 7? If not, which requirements do you think should be deleted? Are there other requirements which you think should be added?

Q10. Do you think that for every charity registered with the future charity commission, an activities report and financial statements should be filed with the future charity commission on an annual basis, and if so, what should be the contents included in the annual report of activities? (See Recommendation 7.)

Q11. Do you think that charity trustees or directors of a registered charity should be under a statutory duty to keep proper accounting records of the charity which are sufficient to show and explain all transactions of the charity, and if so, should such records be retained for at least seven years? (See Recommendation 8¹⁴.)

Q12. Do you agree that the future charity commission should be vested with the power to investigate any alleged mismanagement and misconduct of charitable organisations with regard to its charitable objects? (See Recommendation 9¹⁵.)

Q13. If you have answered "yes" to Question 12, do you agree that in the exercise of this power to investigate alleged mismanagement and misconduct of a charitable organisation, the future charity commission should have power, in respect of a particular charity under investigation, to investigate the charity's funding, property and activities and to obtain relevant information, including documents, records,

¹² At para 8.24.

¹³ At para 8.29.

¹⁴ At para 8.33.

¹⁵ At para 8.42.

books and accounts from the charity? (See Recommendation 9.)

Q14. Do you agree that during the course of investigations of the type set out in Question 13, there should be appropriate safeguards to ensure confidentiality? (See Recommendation 9.)

Q15. Do you agree that any person who intentionally or recklessly provides false or misleading information to the future charity commission or its appointed investigators, or fails to provide the information required for the purpose of investigation, or alters, conceals or destroys any document required for production for the purpose of an investigation, should be guilty of a criminal offence? (See Recommendation 10¹⁶.)

Q16. Do you agree that the future charity commission should be vested with powers relating to enforcement and remedies in cases of non-compliance by charities with their legal obligations? (See Recommendation 11¹⁷.)

Q17. If you have answered "yes" to Question 16, do you agree that these powers should include, but not be limited to:

- "(1) de-registration of a charity from the register of charities;*
- (2) referring criminal offences to appropriate law enforcement agencies;*
- (3) referring possible civil actions to the Secretary for Justice; and*
- (4) powers for the purpose of protection of property of charities"*

as listed in Recommendation 11? If not, which powers should not be included? Which additional powers relating to enforcement and remedies, if any, should be given to the future charity commission?

Q18. Do you think that the future charity commission should be vested with the power to protect charities' property in cases of misconduct or mismanagement in their administration? (See Recommendation 12¹⁸.)

Q19. If you have answered "yes" to Question 18, do you agree that this power should include, but not be limited to, the powers to:

- "(1) appoint additional trustees or directors of the charity;*
- (2) suspend or remove trustees, directors or officers of the charity;*
- (3) vest property of charities in an official custodian; and*

¹⁶ At para 8.44.

¹⁷ At para 8.50.

¹⁸ At para 8.51.

- (4) *require persons holding property on behalf of the charity not to part with the property without the approval of the future charity commission*"

as listed in Recommendation 12? If not, which powers should not be included? Which additional powers to protect property of charities, if any, should be given to the future charity commission?

(Regulation of fundraising activities – Chapter 9)

- Q20.** Do you think that there should be a sole regulatory body (a "*one-stop shop*") to process and grant all permits and licences necessary for charitable fundraising, and to monitor the use of funds raised by such activities? (See Recommendation 13(1)¹⁹.)
- Q21.** If you have answered "yes" to Question 20, please also answer the following questions:
- (a) Do you think that this "*one-stop shop*" service should be provided by the future charity commission, and that the commission should be vested with the powers and duties currently exercised by the Social Welfare Department, the Food and Environmental Hygiene Department and the Television and Entertainment Licencing Authority in relation to authorising charity fundraising activities in public places and those involving lotteries? (See Recommendation 13(2).)
- (b) Do you think that the future charity commission should be responsible for enabling public access to information on fundraising activities and for providing an enquiry response service to the public? (See Recommendation 13(3).)
- Q22.** How, and to what extent, do you think solicitation of donations via the internet should be regulated in order to minimise the risk of abuse, while at the same time not unduly inhibiting the work of *bona fide* charities? (See paragraph 9.48.)
- Q23.** Do you agree that for all forms of charitable fundraising activities, the registration number of any charitable organisation involved in those activities should be prominently displayed on any related documents, or displayed on any means through which appeals for charitable donations are made (such as solicitation leaflets)? (See Recommendation 14²⁰.)
- Q24.** Do you agree that the future charity commission should carry out the initiatives listed in Recommendation 15²¹ to promote good practice by professional fundraisers and, if not, which initiatives should not be included? Are there other initiatives which you think should be added to the list?

¹⁹ At para 9.44.

²⁰ At para 9.48.

²¹ At para 9.51.

- Q25.** Do you think that there should be an express power given to the future charity commission to sanction organisations for non-compliance with the terms laid down in codes of conduct issued by the commission? (See paragraph 9.57.)

(Charities and tax – Chapter 10)

- Q26.** Do you agree that existing powers of tax exemption and functions of periodic review of charities for taxation purposes should remain with the Inland Revenue Department? (See Recommendation 16(1)²².)
- Q27.** Do you agree that tax exemption should be granted to a charity by the Inland Revenue Department only when the charity has been registered with the future charity commission and, subject to this, there should be no change to the existing law on the taxation of charities in Hong Kong? (See Recommendation 16(2) and (3).)
- Q28.** Do you think that the future charity commission should collaborate with the Inland Revenue Department as far as possible, particularly by the provision of relevant charities' accounts information, to facilitate the Inland Revenue Department's functions in assessing charities for tax where appropriate? (See Recommendation 16(4).)
- Q29.** Do you agree that the Administration should ensure that sufficient resources are allocated to the Inland Revenue Department to carry out the function of reviewing annual accounts submitted by charities to the future charity commission? (See Recommendation 16(5).)

(The cy-près doctrine – Chapter 11)

- Q30.** Do you think that legislation should be introduced in Hong Kong along the lines of the English statutory model of the *cy-près* doctrine (comprised in provisions of the English Charities Act 1993, as amended in 2006), so as to provide a statutory basis for the *cy-près* doctrine in Hong Kong and to broaden the scope of its application? (See Recommendation 17²³.)
- Q31.** If you have answered "yes" to Question 30, do you agree that in line with the English model, the *cy-près* doctrine should be broadened in Hong Kong so that it may apply in the situations listed in Recommendation 17, even where it is not impossible or impractical to carry out the charitable purpose of the charitable trust? (See Recommendation 17.)
- Q32.** Do you agree that the future charity commission should be empowered by statute to administer the application of the *cy-près* doctrine in particular cases? (See Recommendation 17.)

²² At para 10.42.

²³ At para 11.27.

(Establishment of a charity commission for Hong Kong – Chapter 12)

- Q33.** Do you think that a charity commission should be set up as a sole regulatory body for charities in Hong Kong? (See Recommendation 18²⁴.)
- Q34.** If you have answered "yes" to Question 33, do you agree to the objectives of the future charity commission set out in Recommendation 18? If not, what objectives do you think should not be included in the list? Are there other objectives which you think should be added to the list?
- Q35.** Do you agree that the future charity commission should have the functions and powers set out at Recommendation 19²⁵? If not, which functions and powers should not be included in the list? Which additional functions and powers, if any, should be given to the future charity commission?
- Q36.** Do you agree that a charitable organisation or person aggrieved by a decision of the future charity commission, either:
- "(1) in its refusal to register an organisation as a charitable organisation;*
- (2) in the exercise of its powers relating to enforcement and remedies due to non-compliance of charities with their legal obligations; or*
- (3) in the application of the cy-près doctrine"*
- should have the right to appeal to the Court of First Instance? (See Recommendation 20²⁶.)
- Q37.** Do you think that appeals relating to applications for fundraising permits and licences should be handled by the Administrative Appeals Board or by a new administrative appeal system set up for the purpose? (See paragraph 12.45.)

Charities Sub-committee
The Law Reform Commission of Hong Kong
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²⁴ At para 12.11.

²⁵ At para 12.43.

²⁶ At para 12.44.