

Not-for-Profit Law and Culture in Asia

CHARITY LAW REFORM IN HONG KONG: TAMING THE ASIAN DRAGON?

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The number of charitable organizations in Hong Kong has increased significantly despite unclear and lax regulation. A legislator has identified flaws in the present law and recommended changes. The proposed recommendations, however, do not consider the unique characteristics of Hong Kong. If implemented, they would not address the existing problems adequately. In order to tame the Asian Dragon, this article proposes an alternative model: self-regulation, which relies on the work of charity watchdogs.

I. Introduction

“The great personal freedom granted modern men has meant that one can be free and rich, or free and just getting by, or free and poor or destitute—and with no master to fall back on.”¹

The charitable landscape in Hong Kong, formally known as the Hong Kong Special Administrative Region, is unique. The Hong Kong people feel a responsibility toward their communities based on traditional Chinese thoughts and perceptions. In 2012, almost US\$1.3 billion (HK\$10 billion) was donated by the local people, with the largest donation amounting to US\$257 million (around HK\$1.9 billion). If the numbers are to be trusted, the charitable landscape is remarkably vibrant.

However, charitable organizations act in a legal vacuum, without clear regulation. In recognition of the problem, the Law Reform Commission of Hong Kong initiated a review of charity law in September 2007. It recently published its comprehensive review, including eighteen generally modest recommendations. While some have criticized the reform package for not going far enough, its shortcomings are actually more fundamental.

This article explores the ongoing charity law reform in Hong Kong. It examines the historical development of charitable organizations, reviews the charity law reform, and argues that the current proposals fail to address the interests involved. The article suggests a more flexible yet robust solution, one that is closer to market needs: reliance on independent charity watchdogs.

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¹ Whalen Lai, *Chinese Buddhist and Christian Charities: A Comparative History*, *Buddhist-Christian Studies*, 12 (1992), 29.

II. The Charitable Sector in Hong Kong

In 2014, 8,044 charitable organizations were registered with the Internal Revenue Department (IRD).² The figure was 7,592 in 2013, 7,194 in 2012, and 6,788 in 2011, marking a continuous growth of charitable organizations.³ The amount of donations has increased as well. It was almost US\$1.3 billion (HK\$10 billion) in the tax years of 2011-2012 and 2010-2011, and more than US\$1.03 billion (HK\$8 billion) in 2009-2010.⁴ Remarkably, donations did not decrease after the SARS outbreak in 2003 and the financial crisis in 2008.

These numbers were supported by a surge in super-donations worth more than one million U.S. dollars. The brothers Ronnie and Gerald Chan donated US\$175 million (HK\$1.3 billion) each to Harvard University.⁵ Gordon Wu gave US\$100 million (HK\$775 million) to Princeton University,⁶ and Robert Ho donated US\$25 million (HK\$193 million) to his alma mater, Colgate University.⁷ According to a study, 104 donations worth more than US\$1 million each were made by 47 donors in 2012—including one donation worth more than US\$257 million⁸—for a total of US\$877 million (around HK\$6.8 billion). Most “super-donors” gave around US\$1.3 million, an amount that is “not surprising given that it’s worth around HK\$10m – a natural threshold for high-net-worth giving in Hong Kong.”⁹ Some donors also made several US\$1 million donations in 2012. The Hong Kong Jockey Club Charities Trust, for example, made 36 such donations.¹⁰ Donations made by individuals were significantly larger than donations made by foundations such as the Hong Kong Jockey Club Charities Trust.

² Inland Revenue Department, Annual Report 2013-14, 46, http://www.ird.gov.hk/eng/ppr/are13_14.htm.

³ Inland Revenue Department, Annual Report 2012-13, 49, http://www.ird.gov.hk/eng/ppr/are12_13.htm; Annual Report 2011-12, 45, <http://www.ird.gov.hk/dar/2011-12/table/eng/misc.pdf>; Annual Report 2009-10, 49, http://www.ird.gov.hk/dar/2010_11/table/eng/others.pdf. Cf. http://www.hkcss.org.hk/e/cont_detail.asp?type_id=11&content_id=862.

⁴ Inland Revenue Department, Annual Report 2012-13, 49. Cf. iDonate, Analysis of Donation Trend in Past Five Years (2011), http://www.theidonate.com/media/report_file/iDonate-Analysis-201106_1.pdf; Hong Kong Council of Social Service, The Rise of the Middle-Class Donor, http://www.hkcss.org.hk/e/cont_detail.asp?type_id=11&content_id=862; Hong Kong Council of Social Service, Charitable Donations Allowed Under Profits Tax and Salaries Tax, http://www.hkcss.org.hk/e/cont_detail.asp?type_id=11&content_id=801.

⁵ South China Morning Post, *Hong Kong tycoons’ US\$350m Harvard gifts among world’s top charity donations of the year*, Dec. 10, 2014, <http://www.scmp.com/news/hong-kong/article/1659362/hong-kong-philanthropists-harvard-gifts-top-10-charitable-donations?page=all>.

⁶ Giving to Princeton, *Princeton Celebrates Sir Gordon Wu’s Extraordinary Support*, May 1, 2007, <http://giving.princeton.edu/news/2007/05/princeton-celebrates-sir-gordon-wus-extraordinary-support>.

⁷ Colgate, *Colgate’s most generous “investor,”* March 2004, <http://www4.colgate.edu/scene/mar2004/ho.html>.

⁸ The donation was made by Dr. Tin Ka Ping, founder of Tins Chemical Limited and Tin Ka Ping Foundation. South China Morning Post, *Charity begins at home for city’s HK\$7b top philanthropists*, Nov. 21, 2013, <http://www.scmp.com/news/hong-kong/article/1362360/charity-begins-home-citys-hk7b-top-philanthropists>. Cf. Coutts, *The Million Dollar Donors Reports 2013*, 17, <http://philanthropy.coutts.com/en/reports/2013/executive-summary.html>; Coutts, *The Million Dollar Donors Reports 2014*, <http://philanthropy.coutts.com/en/reports/2014/executive-summary.html>.

⁹ Coutts, *Million Dollar Donations 2013*, 18.

¹⁰ *Id.*, 17.

For three reasons, these numbers understate the actual situation. First, the figures for the number of charitable organizations only cover organizations registered with the IRD, whereas some charitable organizations are under no registration obligation. Second, because of cultural and legal factors, not all donations are disclosed. Chinese donors often keep a low profile and prefer to stay anonymous.¹¹ Finally, the official figures provided by the IRD account for donations for which tax deduction was made. However, the low-tax system of Hong Kong provides limited incentives for such super-donations, so some donors do not deduct them from taxes.

“Private philanthropy in Hong Kong has both the virtues and the flaws of the family-controlled companies whose earnings have created the wealth that translates into generosity, often on a grand scale.”¹²

A charitable landscape is shaped by the people who donate not only money but also time. These people make a charitable sector dynamic and active. There is a long line-up of events in Hong Kong throughout the year that raise funds for charitable causes.¹³ Local universities motivate students to engage in charitable activities and incorporate such activities into the curriculum.¹⁴ Organizations run community involvement programs to encourage citizens to help one another.¹⁵

Beyond the classical concept of charity focused on donations, a new form of charity focused on doing good has emerged. Indeed, new ways are sought to combine entrepreneurial skills with a charitable purpose, known as social venture or social enterprise.¹⁶ Under the paradigm of “make money and do good,” socially conscious entrepreneurs build businesses to drive change. Charitable organizations, for example, open cafes employing people with different abilities.¹⁷ The most famous example of a local social venture is probably Dialogue in the Dark Hong Kong, which operates as a global franchise business and attempts to empower and change perceptions toward people with visual impairments.¹⁸ By contrast to classical charities, such organizations generate money themselves and do not rely only on donations. Recognizing their potential, the government now attempts to support social ventures through different programs.¹⁹ Social ventures are more than a mere trend in Hong Kong. They represent a shift in the understanding of how social problems are best solved.

The principle that making money and creating social impact ought to go together is to be welcomed. However, charitable organizations with an entrepreneurial approach raise unique issues. The Li Kai Shing Foundation is an example of a charitable organization that executes

¹¹ *Id.*, 6.

¹² South China Morning Post, *Spirit of Giving*, Dec. 23, 2005, <http://www.scmp.com/node/530396>.

¹³ E.g., Hong Kong Standard Chartered Marathon, Operation Santa Claus.

¹⁴ E.g., OSC Inter-School MBA Charity Challenge, CUHK I Care Programme.

¹⁵ Swire, Sustainable Development, http://www.swire.com/mt/en/about_swire/subsustainable_development.

¹⁶ Damian Bethke, Jędrzej Górski, *Rethinking Social Ventures in Hong Kong*, RJGLB 13 (2014), 1.

¹⁷ E.g., Cafe 8, opened by the Nesbitt Centre. See <http://www.nesbittcentre.org.hk/index.php/the-coffee-shops/cafe-8>.

¹⁸ <http://www.dialogue-experience.com.hk/web/index.php?lang=en&mid=0>.

¹⁹ Bethke, Górski, *Rethinking Social Ventures in Hong Kong*, 13.

strategic investment choices. It acquired a 0.8% stake in social networking website Facebook for US\$60 million and invested in the music streaming service Spotify.²⁰ Such investments are not as such to be criticized, but the absence of transparency and clear-cut definitions can be problematic. As the law now stands, a charitable organization could be easily abused as a shield against tax obligations.

III. Origins of Charitable Giving

A. Early Roots

The idea of giving is deeply rooted in Chinese culture.²¹ Early altruism was based on religious thoughts and practices of Chinese custom.²² With the influence of Western traditions during the British colonial period in Hong Kong, particularly British common law, the Chinese form of altruism was legally institutionalized in the concept of charity. However, charitable giving remains fundamentally inspired by the distinctive Chinese attitude.

The Asian notion of charity has strong foundations in Buddhism, Confucianism, Taoism, and folk culture.²³ Confucianism regarded philanthropy as one of the fundamental constituents of nobleness and superiority of character and as a virtue natural to all persons.²⁴ Buddhist monks followed a set of monastic precepts which required them to care for the sick.²⁵ Accordingly, Buddhist monasteries provided social services such as building schools, hospitals, and orphanages, and helping the victims of famines.²⁶ Buddhist schools and hospitals were known for being “wards for nursing the sick [of] the merit field of compassion.”²⁷ But even though the hospitals were open to the public, services were provided only within their gates.²⁸ Buddhist monasteries enjoyed tax exemption as well as strong financial support from the public.²⁹ Donors

²⁰ Reuters, *Li Ka-shing Foundation buys Facebook stake*, Dec. 3, 2007, <http://www.reuters.com/article/2007/12/04/us-facebook-likashing-idUSN0344520920071204>; Forbes, *Li Ka-shing Confirms Spotify Stake*, Aug. 20, 2009, <http://www.forbes.com/2009/08/20/spotify-li-hutchison-markets-equities-technology.html>.

²¹ Cf. Yu Yue Tsu, *The Spirit of Chinese Philanthropy* (1912).

²² *Id.*

²³ *Id.*, 16.

²⁴ *Id.* “The feeling of commiseration belongs to all men; so does that of shame and dislike; and that of reverence and respect; and that of approving and disapproving. The feeling of commiseration implies the principle of benevolence; that of dislike and shame; the principle of righteousness; that of reverence and respect, the principle of propriety; and that of approving and of disapproving, the principle of knowledge. Benevolence, righteousness, propriety and knowledge, are not infused into us from without. We are certainly furnished with them. Hence it is said ‘Seek and you will find them. Neglect and you will lose them.’ Men differ from one another in regard to them; some as much again as others, some five times as much, and some to an incalculable amount: it is because they cannot fully their natural powers.” Mencius, in Yu Yue Tsu, *Spirit of Chinese Philanthropy*, 17.

²⁵ Peter Harvey, *An Introduction to Buddhist Ethics* (2000), 147.

²⁶ Keulman Kenneth, *Critical Moments in Religious History* (1993), 64; Whalen, *Chinese Buddhist and Christian Charities*, 9.

²⁷ Whalen, *Chinese Buddhist and Christian Charities*, 10.

²⁸ *Id.*, 11.

²⁹ Yongshan He, *Buddhism in the Economic History of China: Land, Taxes and Monasteries*, Master Thesis, 2011, 31, <http://digitalcommons.mcmaster.ca/cgi/viewcontent.cgi?article=7442&context=opendissertations>.

did not see this as a mere act of giving; they believed in a principle of reciprocity.³⁰ Donations were seen as a chance for laymen to accrue merit by emulating monks' freedom from material concerns.³¹ Gifts were made for a specific purpose, and monks could not use them for something else.³² Donors' wills were respected.

Monasteries later experienced a decline and were taken over by civil authorities;³³ "the state charities competed with and undercut the Buddhist charities."³⁴ Nonetheless, the idea of charity persisted and influenced other institutions, such as mutual aid associations, members' associations, trade guilds, and clans, which were based on a similar idea of mutual benefit.³⁵ Members of an association would more readily help members of the same association than members of other associations.³⁶ Clan organizations sometimes had clan charities, handed down from their ancestors, which might distribute grain to their members.³⁷ Poor families were also supported with loans provided by mutual loan societies.³⁸ People organized civic associations, such as clansman associations, and supported one another.³⁹ The center of the culture, in their view, was not the individual but the family, community, or clan.⁴⁰

The principle of mutuality was the main motivation behind charitable giving and had the function of insurance. It guaranteed that the community would help anyone who had previously helped others.⁴¹ This idea of *do ut des* is similarly expressed in the principle of *guangxi*, which held that help must be provided to people with whom one had a personal relation.⁴² If such ties were absent, Chinese people would not feel an obligation to help.⁴³

Besides the idea of mutuality as a basis of charitable giving, China also had experience with do-good or benevolence associations, which provided help to anybody in need and not solely within the ambit of members. Benevolence associations were established on the belief that

³⁰ Whalen, *Chinese Buddhist and Christian Charities*, 8, 11. This was similar in Europe, where a beggar would say, "Bless ye, sire."

³¹ *Id.*

³² *Id.*, 8.

³³ *Id.*, 13.

³⁴ *Id.*, 12.

³⁵ Elizabeth Sinn, *Power and Charity, A Chinese Merchant Elite in Colonial Hong Kong* (2003), 13; cf. Henry James Lethbridge, *The Evolution of a Chinese Voluntary Association in Hong Kong: The Po Leung Kuk*, *Journal of Oriental Studies*, 10 (1972); Thomas Menkhoff, Hoon Chang-Yau, *Chinese Philanthropy in Asia Between Continuity and Change*, *Journal of Asian Business*, 24 (2010), 2; John Kerr, *Native Benevolent Institutions of Canton*, *China Review* (1873), 88.

³⁶ Yu Yue Tsu, *Spirit of Chinese Philanthropy*, 75.

³⁷ *Id.*, 78.

³⁸ *Id.*, 85.

³⁹ *Id.*, 75.

⁴⁰ Ho Andrew, *Asian-American Philanthropy: Expanding Knowledge, Increasing Possibilities*, Working Paper No. 4 Georgetown University, Center for Public & Nonprofit Leadership (2004), presented at the ARNOVA Annual Conference, Los Angeles, California, 2, <http://issuu.com/andyho/docs/asianamerican>.

⁴¹ Yu Yue Tsu, *Spirit of Chinese Philanthropy*, 75.

⁴² Ho, *Asian-American Philanthropy*, 5.

⁴³ *Id.*

doing “good is a joy.”⁴⁴ Being engaged in such an association was seen as a status symbol, and the local elite, merchants, and other notables were involved in them.⁴⁵ Religious beliefs were unimportant in these associations, and they were not based on a principle of mutuality.⁴⁶ They were run “by the better off for the less well off.”⁴⁷ Nonetheless, the help provided was still morally colored, and it was usually confined to widows, widowers, orphans, and others without families.⁴⁸

In a nutshell, the original form of Chinese philanthropy was based on the idea of mutuality or reciprocity. Making donations was a cultural requisite that grew out of a cultural obligation to help one’s community. A deep-rooted sense of obligation towards the community is an important motivation for charitable giving.

These aspects can still be identified in modern donors’ behavior. People in Hong Kong donate because they feel a sense of obligation to help the underprivileged and because making donations allows them to appreciate their wellbeing and fortune. Ignoring communal problems would isolate them and prevent them from receiving support if they were ever themselves in distress. And with many of the Hong Kong people still strongly connected with families and communities living in the mainland of the People’s Republic of China (Mainland), donors often prefer to contribute to projects that focus on the Mainland.⁴⁹

B. Development of Charitable Organizations in Hong Kong

Modern charity law in Hong Kong has been deeply influenced by the social and economic policy of the British government toward Hong Kong. This influence resulted in a symbiosis of foreign elements with Hong Kong characteristics.⁵⁰ A look into the historical development of charitable organizations is helpful to explore this relationship.

The colonial government adhered to a policy of maintaining a distance from the Chinese people of Hong Kong. While foreigners enjoyed all the amenities of the colonial rule, the Chinese people were excluded. Rather than aiding the Chinese, foreigners urged them to find means of self-help. Ever since, the Chinese have organized themselves in associations such as trade and craft guilds.⁵¹ But the British rule also witnessed a growth in secret societies that pursued criminal activities such as robbery, smuggling, or piracy.⁵² Although the powerful locals involved in such societies sometimes carried out criminal activities, they also had an important

⁴⁴ Whalen, *Chinese Buddhist and Christian Charities*, 21.

⁴⁵ *Id.*, 23.

⁴⁶ *Id.*, 22.

⁴⁷ *Id.*, 23.

⁴⁸ *Id.*, 22; see also Yu Yue Tsu, *Spirit of Chinese Philanthropy*, 43.

⁴⁹ See e.g. the projects funded by the Li Ka Shing Foundation, <http://www.lksf.org>.

⁵⁰ Wai-Fung Lam and James L. Perry, *The Role of the Nonprofit Sector in Hong Kong’s Development*, *International Journal of Voluntary and Nonprofit Organizations*, 11 (2000), 364, 356-362. For an analysis of the reasons leading to a rise of charitable organizations in general, see Lester M. Salamon, *The Rise of the Nonprofit Sector*, *Foreign Affairs*, 73 (1994) 109, 115.

⁵¹ Sinn, *Power and Charity*, 13.

⁵² *Id.*

stabilizing function. They engaged with their communities by providing support.⁵³ For example, the secret societies known as *kai fong* associations, meaning neighborhood associations, provided social services neglected by the colonial government.⁵⁴

“Colonial ignorance, indifference, and incompetence created a demand for services that these merchants were in a special position to offer. Through charitable and voluntary organizations, they resolved civil and commercial disputes, provided medical facilities, and created a voice for the Chinese community. By offering such services, local Chinese merchants were able to take advantage of Hong Kong’s position at the edge of the Chinese and British empires to enhance their own power and prestige.”⁵⁵

The colonial government adhered to a social policy of separation, and social aid was kept to a bare minimum. With power centralized and vested in the colonial government, a bridge was struck between popular consent building and strong colonial rule.⁵⁶ The provision of social services was not on the agenda of the government.⁵⁷ Welfare services played a minor role in colonial Hong Kong from 1880s to 1950s.⁵⁸ Welfare services were generally rendered only when they served the interests of the government, such as the education of personnel needed for the administration.⁵⁹ The financial policy overall was conservative; it sought to avoid budget deficits.⁶⁰ In brief, charitable activities were not on the minds of government officials.

The earliest exception to this policy of non-intervention was the establishment of the Tung Wah Hospital in 1872, the first institution in Hong Kong that provided free medical treatment to local Chinese people in need.⁶¹ The government initiated the hospital because it was concerned about the sick and destitute. Wealthy locals financed the hospital,⁶² and influential residents, successful businessmen, and leaders of *kai fong* organizations managed it.⁶³

The next institution set up for the benefit of the underprivileged was the Po Leung Kuk, established in 1878. To stop kidnappers from bringing children and women into Hong Kong,

⁵³ Id., 16.

⁵⁴ Cf. for more details Aline K. Wong, *Chinese Voluntary Associations in Southeast Asian Cities and the Kai fongs in Hong Kong*, *Journal of Royal Asiatic Society Hong Kong Branch*, 11 (1971), 62.

⁵⁵ John M. Carroll, *Edge of Empires: Chinese Elites and British Colonials in Hong Kong*, Harvard University Press, 2005, 60.

⁵⁶ Lam, Perry, *The Role of the Nonprofit Sector in Hong Kong’s Development*, 363. Cf. id., 356: “The government could be described as an executive-led and centralized political-administrative system which did not intervene into matters which would have posed a departure of its traditional role best described as ‘positive non-interventionism.’”

⁵⁷ Id., 366

⁵⁸ Elyza W.Y. Lee, *Nonprofit Development in Hong Kong: The Case of a Statist-Corporatist Regime*, *Voluntas: International Journal of Voluntary and Nonprofit Organizations*, 16 (2005), 55.

⁵⁹ Id., 55.

⁶⁰ Id. Cf. Elyza W.Y. Lee, *The Politics of Welfare Developmentalism in Hong Kong*, *Social Policy and Development Programme Paper*, 21 (2005), 3.

⁶¹ Carroll, *Edge of Empires*, 61.

⁶² Id., 37.

⁶³ For more information see Carl T. Smith, *Chinese Christians, Elites, Middlemen and the Church in Hong Kong*, Hong Kong University Press, 2005, 124.

influential Europeans and wealthy Chinese founded the institution as a refuge for people who would otherwise be socially marginalized.⁶⁴

The Tung Wah Hospital and the Po Leung Kuk were new types of institutions in Hong Kong. Although hospitals had been operated by Buddhist monasteries for hundreds of years, they were not public and did not provide any services outside the gates of the monasteries. These two institutions provided shelter and services to members of the general public regardless of their religion or communal group. This marked the introduction of a new concept of social responsibility.

There seems to be a connection between the arrival of Christian missionaries and the establishment of the next charitable organizations in Hong Kong. These organizations resembled Western institutions established for the poor and operated by churches.⁶⁵ The Young Men's Christian Association (YMCA) was set up in 1918 to provide community services to the public, to organize camps, and to provide children with education.⁶⁶ It was the first gymnasium with an indoor swimming pool, restaurant, and dormitory, which was new to the Chinese people in Hong Kong. Unlike earlier organizations such as the benevolence associations, the YMCA did not exclusively operate on a Christian mission; it also helped people of other beliefs. Local people appreciated the support and considered the institution a success. The YMCA served as an example for other international organizations,⁶⁷ and the Red Cross and the Salvation Army launched similar efforts in Hong Kong.⁶⁸ The colonial government trusted these organizations and relied on them to support the underprivileged and to educate the children of colonial officials.⁶⁹ Further, the government found it convenient to contract out more and more educational services to the church.⁷⁰ The Christian anticommunist Christian religion was regarded as an ideological protection against the influence of the Chinese Communist Party.⁷¹

The next level of evolution was reached when the government established the Hong Kong Council of Social Service (HKCSS) in 1947. Recognizing that more needed to be done about the underprivileged, the government adopted a policy described as "big bang."⁷² The HKCSS was founded as a result of increased need after World War II. Its purpose was planning

⁶⁴ Lethbridge, *The Evolution of a Chinese Voluntary Association in Hong Kong*, 33. Cf. id., 39: "The undersigned merchants, engaged here in trade for many years past, have lately noticed that the crimes of kidnapping are increasing from day to day. Many of both the kidnappers and of their kidnapped victims are natives of our native district (Tung-kun). Seeing this to be the state of affairs, it is unbearable to think that these villains take this hospitable Colony for a convenient refuge. A meeting has therefore been held and it is proposed to raise subscriptions with the view to publish everywhere offers of reward."

⁶⁵ E.g. the Hospital of St. Wulstan established around 1085, the hospital of St. Oswald established around 1268, and the hospital of St. Cross established around 1132.

⁶⁶ Whalen, *Chinese Buddhist and Christian Charities*, 29.

⁶⁷ Terence Yiu Kai Yuen, *Hong Kong, Asia Pacific Philanthropy Consortium Conference*, September 5-7, 2003, 91; Lee, *Nonprofit Development in Hong Kong*, 58.

⁶⁸ Lee, *Nonprofit Development in Hong Kong*, 58.

⁶⁹ Id.

⁷⁰ Id.

⁷¹ Lee, *The Politics of Welfare Developmentalism in Hong Kong*, 2.

⁷² Tang Leung Kwong, *Colonial State and Social Policy: Social Welfare Development in Hong Kong, 1842-1997*, University Press of America, 1998, 61.

and coordinating the welfare services and relief that various organizations provided.⁷³ The HKCSS is still a fundamental structure in the charitable landscape in Hong Kong because it is the bridge between the government and the non-profit sector. It began as a facilitator but gradually took on a more comprehensive role.⁷⁴ The HKCSS focuses on quality management and efficiency enhancement of its partners. It provides training for, among others, fundraising and management, and it publishes guidelines for people involved in charitable organizations. The HKCSS is funded through WiseGiving,⁷⁵ its own development fund, and government subventions and grants, such as the Lump Sum Grant system of the Social Welfare Department, the Lotteries Fund, and the Community Chest.⁷⁶

During the turbulences in Hong Kong culminating in social unrest during 1966 and 1967, the government further intensified its social policy.⁷⁷ It invested in education, public housing, and social service. The people of Hong Kong entered into a social pact which combined economic individualism with social interventionism, described as a system of economic freedom in combination with an adequate social safety net.⁷⁸ With the political transition in 1997, the government commenced to spend more on social welfare in order to enhance its legitimacy.⁷⁹ This new approach was aptly labeled the “Confucian welfare state,” and it is regularly referred to as such.⁸⁰

Although Hong Kong is generally not regarded as a welfare state but rather as neoliberal,⁸¹ its social policy shows a peculiar feature. Charitable organizations fulfill a broad range of essential functions not carried out by the government. The government is not only the regulator but also the financier of charitable services.⁸² More and more tasks are left to the private sector. This may explain the boom in the number of charitable organizations. In 2013-2014, over 90 percent of social services were offered to the public through 419 not-profit organizations (NPOs), of which 33 percent (138) were subsidized by the government Social Welfare Department (SWD) and 67 percent (281) were not.⁸³ At the same time, however, subvention to NPOs was capped, which required the organizations to do more fundraising

⁷³ Chung Woon Fan Flora, *The Role of The Hong Kong Council of Social Service in Social Welfare Development in Hong Kong*, Dissertation, 30 June 2008.

⁷⁴ *Id.*, 10.

⁷⁵ WiseGiving also provides consultancy services to the third sector. The profits generated through this work are channeled to the HKCSS.

⁷⁶ HKCSS, Annual Report 2012-13, 40, http://www.hkcss.org.hk/uploadFileMgnt/0_20131113142639.pdf.

⁷⁷ Lee, *Nonprofit Development in Hong Kong*, 61.

⁷⁸ Lee, *The Politics of Welfare Developmentalism in Hong Kong*, 5.

⁷⁹ *Id.*, 6.

⁸⁰ Gordon White and Roger Goodman, *Welfare Orientalism and the Search for an East Asian Welfare Model*, in: *The East Asian Welfare Model: Welfare Orientalism and the State*, edited by Roger Goodman, Gordon White, and Huck-ju Kwon, Routledge, 1998, 13.

⁸¹ Lee, *The Politics of Welfare Developmentalism in Hong Kong*, 10.

⁸² *Id.*, 1.

⁸³ HKCSS, Annual Report 2013-14, 41, http://www.hkcss.org.hk/uploadFileMgnt/0_2014115102852.pdf. Furthermore, it is crucial to note that not all NPOs operate as charitable organizations, which may distort the market because different set of rules apply to charitable organizations and for-profit entities. This problem has been explored by Bethke, Górski, *Rethinking Social Ventures in Hong Kong*, 13.

activities.⁸⁴ Under this status quo, NPOs compete with the business sector for new services.⁸⁵ The bidding process is nontransparent, and it may raise suspicion about whether some bidders are favored.⁸⁶ Some NPOs rely heavily on subsidized projects for income,⁸⁷ which poses a risk to their independence from the government.⁸⁸ It is questionable whether this system addresses social problems in the most effective way.

The rise of charitable organizations happened without a broad legal framework. Section 3 of the Ordinance No. 3 of 1870 incorporating the Tung Wah Hospital, for example, provided, “The Corporation is erected for the purpose of establishing and maintaining a public free hospital for the treatment of the indigent sick among the Chinese population, to be supported by voluntary contributions and governed by a Board of Directors, etc.” The terminology of charitable or tax-exempt organization was not available at that time. Instead, the ordinance used the loose term of “eleemosynary corporation.” The Po Leung Kuk Incorporation Ordinance Cap. 306 of 1893 also did not make reference to any kind of charity or tax-exempt organization. This may seem surprising because the notion of “charitable uses” as defined in the statute of Elizabeth of 1601 was already established before the adoption of these ordinances. Interestingly, however, such specific provisions allowing for deductions of donations were also not needed, because Hong Kong had no income tax until 1940.⁸⁹

The first law applicable to charitable organizations as a category was enacted only in 1950 with the introduction of the Inland Revenue Ordinance (section 88).⁹⁰ The notion of charitable organization was introduced in Hong Kong through tax law because “it was not thought desirable to impose tax on institutions of a charitable, ecclesiastical or educational nature.”⁹¹ The IRO of 1950 kick-started the modern form of charitable organization. As of May 1, 2014, there were 8,044 registered charitable organizations in Hong Kong.

This proliferation of charitable organizations received an essential impetus from the Asian Financial Crisis in 1998, which tumbled the economy into a recession, with widespread unemployment, a decline in wages, and deflation of assets.⁹² As the government cut back on welfare expenses, it introduced a series of tools further supporting the local charitable sector. First, the government introduced the Service Performance Monitoring System (SPMS), a

⁸⁴ Id.

⁸⁵ Id.

⁸⁶ Id., 74.

⁸⁷ Id.

⁸⁸ This was also one of the concerns mentioned by interviewees of an extensive study conducted in Hong Kong: Charles Chan, Chapter 1, Education and Research, Study on the Third Sector Landscape in Hong Kong, 24, http://www.cpu.gov.hk/doc/en/research_reports/3rd_content.pdf.

⁸⁹ For more information see, Halsbury’s Laws of Hong Kong, 2nd ed., Cap 112, Inland Revenue Ordinance, Butterworths, 2001. Cf. Michael Littlewood, *The Hong Kong Tax System: Its History, Its Future and the Lessons It Holds for the Rest of the World*, Hong Kong Law Journal, 40 (2010). The enactment history is No. 13 of 1940 War Revenue Ordinance; No. 21 of 1940 War Revenue Amendment Ordinance; No. 29 of 1940 War Revenue (No. 2) Amendment Ordinance; No. 13 of 1941 War Revenue Ordinance; No. 20 of 1947 Inland Revenue Ordinance.

⁹⁰ Halsbury’s Laws of Hong Kong, Cap 112, 1.

⁹¹ Hong Kong Hansard, 12th January 1949, 14.

⁹² Lee, *The Politics of Welfare Developmentalism in Hong Kong*, 7.

mechanism that aims at assessing the efficiency of the provision of social services. Second, the government adopted the Lump Sum Grant System as a new funding mechanism for NPOs. And third, the government introduced a competitive bidding process to procure service contracts.⁹³ These measures boosted the nonprofit sector but made it also more dependent on state involvement – “thus, increasingly, the nonprofit sector has become an extension of bureaucracy.”⁹⁴

C. The Charity Law Reform

The charity law reform was initiated in 2007, when the Chief Justice and the Secretary for Justice asked the Law Reform Commission “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.”⁹⁵ A subcommittee established in September 2007 put forward a consultation paper in 2010 and solicited public make comments on the local charity law.⁹⁶ A total of 264 comments were submitted. The Law Reform Commission published its report on the consultation process in December 2013. This report provided a comprehensive review of local charity law and recommendations for improvement. These recommendations are generally modest, because the most contentious proposal—to establish a centralized regulatory and supervisory authority in the form of a charity commission—was eventually abandoned. The report offers a practical analysis with few new insights. A number of aspects were ignored. Accordingly, the recommendations are likely to have little impact if they are implemented.

The reform has been driven by concerns about the existing law, particularly its lack of a statutory definition of charity, a system of oversight, a uniform and concise statute applying to charitable organizations, and a legal requirement for the disclosure of annual reports. Luckily, Hong Kong has yet not been affected by scandals, but the weak regulatory basis gives rise to concern.

Other issues also helped drive the push for a review of charity law. International trends played a role—specifically, the war on terror and the fear that terrorist organizations may use charitable organizations to launder money.⁹⁷ Further, the local reform process coincides with general reviews of the charity law in other common law jurisdictions.⁹⁸ This certainly influenced the outcome of the reform, because the law of the other jurisdictions was closely examined through the published reports. Some of the examined jurisdictions, such as Ireland, have

⁹³ Lee, *Nonprofit Development in Hong Kong*, 64.

⁹⁴ Yuen, *Hong Kong*, 91.

⁹⁵ The Law Reform Commission of Hong Kong, Charities Sub-Committee, Consultation Paper, Charities, June 2011, 2, <http://www.hkreform.gov.hk/en/publications/charities.htm>.

⁹⁶ *Id.*

⁹⁷ Kerry O’Halloran, Government – Charity Boundaries, in *Modernising Charity Law: Recent Developments and Future Directions*, edited by Myles McGregor-Lowndes and Kerry O’Halloran, Edward Elgar Publishing, 2010, 168. This happened in Ireland: cf. e.g. Oonagh B. Breen, Ireland Pemsel Plus, in *Modernising Charity Law: Recent Developments and Future Directions*, edited by Myles McGregor-Lowndes and Kerry O’Halloran, Edward Elgar Publishing, 2010, 74.

⁹⁸ For an overview cf. e.g. Kerry O’Halloran, Bob Wyatt, Laird Hunter, et al., Charity Law Reforms: Overview of Progress Since 200, in *Modernising Charity Law*, 13.

themselves reformed their legislation amid fears that the laws had loopholes for terrorist organizations to exploit.⁹⁹

But the principal motivation for the reform is a perceived lack of transparency of charitable organizations and resultant mistrust.¹⁰⁰ A review showed that 90 percent of the public regards the issue of transparency the dominant factor when making a decision to donate.¹⁰¹ Criticism has also come from the media.¹⁰²

The recommendations made by the Law Reform Commission attempt to enhance transparency by statutory provisions and voluntary codes of conduct. The following section of this article examines perceived holes in the charity law and the charity law reform's attempts to address them.

D. Perceived Holes in the Law

*"I am unable to find any principle which will guide one easily, and safely, through the tangle of the cases as to what is and what is not a charitable gift."*¹⁰³

1. Lack of Statute

There is no comprehensive ordinance or statute that applies to charitable organizations in Hong Kong. Depending on the legal structure under which the charitable organization is formed, different laws apply, a fact that may be the cause of some of the difficulties in understanding the local law.¹⁰⁴

"Charity" is not a distinct legal entity, and different legal entities may qualify as charitable organizations. A charitable organization has a status granted by the IRD based on the IRO, which exempts any charitable organization from profits tax.¹⁰⁵ A charitable organization can be formed as a trust, as a society, as a statutory body established under specific ordinance, or as a company limited by shares or limited by guarantee.¹⁰⁶ As a result, the Companies Ordinance, the Societies Ordinance, or the Registered Trustees Incorporation Ordinance may apply.¹⁰⁷ The IRO also contains a provision on the dissolution of charitable organizations. This means that charitable organizations seeking tax exemption under section 88 IRO have to specify how the remaining assets of the organization should be dealt with. Additional specific requirements are

⁹⁹ Breen, Ireland Pemsel Plus, 75.

¹⁰⁰ South China Morning Post, *Spirit of Giving*.

¹⁰¹ South China Morning Post, Shirley Kwok, *Bogus Charities Duping Public*, 8 April 1995, 46.

¹⁰² *Id.*, 50.

¹⁰³ *In re Tetley* [1922 T 468]; [1923] 1 Ch 258, at 266 (CA).

¹⁰⁴ It has prompted the Ombudsman to the comment that the law is "partial and patchy, fragmented and ineffective." Office of the Ombudsman, Investigation Report, para. 6.1 c.

¹⁰⁵ Section 88 IRO, Cap 112.

¹⁰⁶ Also see Law Reform Commission of Hong Kong, Report, Charities, December 2013, 83, <http://www.hkreform.gov.hk/en/publications/rcharities.htm>. For a typology of charitable organizations in Hong Kong see Lam, Perry, The Role of the Nonprofit Sector in Hong Kong's Development, 358 [graphic with number of charities classified according to the legal form used].

¹⁰⁷ Another statute further states that unauthorized collection of donations may be punished with HKD 2,000 or 3 months imprisonment (Section 4 (17) (i) Summary Offenses Ordinance, Cap 228).

imposed by the SWD, Home Affairs Bureau, Education Bureau, and Department of Health on charitable organizations falling under their authority.¹⁰⁸

A main criticism concerns the definition of charitable organization, which follows the rule set down in *Income Tax Special Purposes Commissioners v. Pemsel*.¹⁰⁹ This decision is based on the statute of Elizabeth of 1601, entitled *An Acte to redresse of Landes Goodes and Stockes of Money hereto given to Charitable Uses*. Introduced in response to the devastation of war and the dissolution of monasteries, the act attempted to channel private help to sectors of public need.¹¹⁰ *Income Tax Special Purposes Commissioners v. Pemsel* specifies those purposes recognized as charitable.¹¹¹ The decision states that in order to be considered a charity, an organization must be established for a so-called charitable purpose such as relief of poverty, advancement of education, advancement of religion, or any other purpose beneficial to the community. The purpose must be for the public benefit.¹¹²

Since then, additional charitable purposes were recognized under the general category of other purposes that benefit the community. The Hong Kong courts, for example, have decided that “the development of culture” is covered under the charitable purpose of advancement of education.¹¹³ On the other hand, it has ruled that the encouragement of sports is not a charitable purpose.¹¹⁴ Meanwhile, the charity law in Hong Kong comprises eleven different charitable purposes,¹¹⁵ to which the reform proposes to add another three.¹¹⁶

These charitable purposes are deemed controversial because they do not reflect the values of a modern society.¹¹⁷ The definition of charity is further complicated by provisions applicable to charitable organizations scattered over the IRO (Cap. 112) and the Registered Trustees Incorporation Ordinance (Cap. 306, “TIO”). While the IRO remains silent on defining charitable purposes, the TIO includes a definition of charitable purposes that does not match the ones acknowledged by the IRD.¹¹⁸ This adds further confusion to the law. The Law Reform Commission has recommended statutory definitions of charitable purposes. However, the decision shows the challenges any reform is facing.

¹⁰⁸ Law Reform Commission of Hong Kong, Charities Sub-Committee, Consultation Paper, 103.

¹⁰⁹ [1891] A.C. 531.

¹¹⁰ O’Halloran, Wyatt, Hunter, et al., *Charity Law Reform*, 165.

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ Cf. e.g. *Ng Chi-fong v. Hui Ho Pui-fun* [1987] HKLR 462.

¹¹⁴ Departmental Interpretation and Practice Notes, No. 37 (Revised) Concessionary Deductions: Section 26C: Approved Charitable Donations (Sept. 2006), at para. 9, http://www.ird.gov.hk/eng/pdf/e_dipn37.pdf.

¹¹⁵ Law Reform Commission of Hong Kong, Charities Sub-Committee, Consultation Paper, 50: Relief of poor people, Relief of victims of a particular disaster, Relief of sickness, Relief of physically and mentally disabled, Establishment or maintenance of non-profit-making schools, Provision of scholarships, Diffusion of knowledge of particular academic subjects, Establishment or maintenance of a church, establishment of religious institutions of a public character, Prevention of cruelty to animals, Protection and safeguarding of the environment or countryside.

¹¹⁶ *Id.* Moreover, it is confusing that section 2(1) TIO, Cap. 306 puts forward a different definition of the charitable purpose.

¹¹⁷ Departmental Interpretation and Practice Notes, No. 37 (Revised), Para. 9.

¹¹⁸ See section 2(1) TIO, Cap. 306.

“[A]n attempt to define charity by any of these means would be fraught with difficulty, and might put at risk the flexibility of the present law which is both its strength and its most valuable feature. In particular, consider that there would be great dangers in attempting to specify in statute those objects which are to be regarded as charitable.”¹¹⁹

2. Lack of Registration, Monitoring, and Supervision System

Charitable organizations in Hong Kong also lack any comprehensive registration, monitoring, or supervision system. The rules are piecemeal, and different authorities are in charge. The IRD keeps a public directory of approved charitable organizations on its website.¹²⁰ The Companies Registry maintains another registry, which covers all charitable organizations formed under the Company Ordinance and which includes valuable information about the organizations; however, the directory does not distinguish between for-profit companies and organizations with approved charitable missions. If a charitable organization is not listed in the directory of the IRD, citizens cannot obtain information about it. Another brief directory of charitable organizations covers trust funds for which the Home Affairs Bureau is the trustee.¹²¹ The lack of a comprehensive directory including all approved charitable organizations is a major concern because it hinders the public from ascertaining the legal status of an organization.¹²² A directory would improve the system and would address the problem of monitoring charitable activities.

Furthermore, there is a limited system of monitoring in place. When charitable organizations apply to conduct fundraising activities in public places, colloquially described as *flag days*, permission must be granted by the Social Welfare Department.¹²³ Alternatively, if funds are raised through a lottery, the charitable organization must first have been granted a license from the Commissioner for Television and Entertainment Licensing.¹²⁴ However, charitable organizations can escape this control if they do not undertake fundraising in public (flag days) and do not engage in activities with an element of chance (lotteries). Fundraising activities are monitored by the government only if they require authorization by the SWD or the Television and Entertainment Licensing Authority.¹²⁵ When it does occur, the monitoring is confined to the funds raised through the specific fundraising activity in the application.¹²⁶

In addition to the lack of a proper registration system and the lack of a monitoring system, different government authorities are involved in the administration of charitable organizations. This is another barrier for the adequate registration and monitoring of charitable organizations.

¹¹⁹ UK Home Office, *Charities: A Framework for the Future* (1989) Cm 694 White Paper, at para. 2.11.

¹²⁰ http://www.ird.gov.hk/eng/tax/ach_index.htm. The list of approved charitable organizations runs over 939 pages. See http://www.ird.gov.hk/eng/pdf/e_s88list_emb.pdf.

¹²¹

http://www.hab.gov.hk/en/policy_responsibilities/District_Community_and_Public_Relations/trustfnd.htm.

¹²² Law Reform Commission of Hong Kong, *Charities Sub-Committee, Consultation Paper*, 91.

¹²³ See section 4(17)(i) of the Summary Offences Ordinance, Cap. 228.

¹²⁴ Gambling Ordinance, Cap. 148.

¹²⁵ Office of the Ombudsman, *Investigation Report*, 5.5.

¹²⁶ *Id.*, 5.6.

3. No Disclosure Requirements

Charitable organizations face essentially no disclosure requirements. No statutory provisions oblige charitable organizations to submit annual reports or financial overviews to a supervision body.¹²⁷ The IRD may occasionally review an organization's charitable status by examining financial statements, annual reports, and accounts, but this is not mandatory.¹²⁸ A charitable organization formed as a company must submit audited accounts to the IRD every four years, but charitable organizations formed as trusts or societies are required to present only self-certified accounts. Charitable organizations formed under the Companies Ordinance must file their reports with the Companies Registry annually,¹²⁹ but this only covers basic information such as address, board of directors, and any outstanding mortgages. Unincorporated organizations are under no such duty at all.

By contrast, a charitable organization established as statutory body may be subject to stringent control.¹³⁰ The Tung Wah Ordinance and the Po Leung Kok Ordinance oblige their boards to keep proper records of all transactions of the organization. The books have to be open for inspection by any director and by any person appointed by the Chief Executive Officer of Hong Kong. They also have to be audited by a certified public accountant.

E. The Reform

These criticisms are addressed by the Law Reform Commission in its eighteen recommendations. The core of the reform is to strengthen public trust in the charitable sector, for which recommendations on better governance and accountability standards were put forward. The recommendations range from voluntary codes of conducts to mandatory statutory provisions, and they concern both private and public law rules. The reform attempts to strengthen transparency not only by increasing disclosure standards but also by clarifying the law to make it more accessible to the public in general. Enforcement measures are also proposed, which reflects the understanding that strengthening transparency standards must go in tandem with enforcement rules. The high number of responses received during the consultation process proves that the reform is a topic of public concern and not confined to the political arena.

“Some in our community expect Government to monitor each and every fundraising-activity to prevent malpractices: this is not realistic. Another body of community opinion suggests total non-intervention by Government: donors pick the beneficiaries of their choice and rely on the reputation of the charities concerned. This involves a risk of unscrupulous or fraudulent fund-raisers passing off as established and responsible charities.”¹³¹

1. Eighteen Recommendations

The first two recommendations concern the definitions of charity and charitable purpose. The commission suggested introducing a clear statutory definition of what constitutes a

¹²⁷ Section 51 (1), Cap. 112.

¹²⁸ Inland Revenue Department information pamphlet, *A Tax Guide for Charitable Institutions and Trusts of a Public Character* (revised ed. Sept. 2010), at para. 17, http://www.ird.gov.hk/eng/tax/ach_tgc.htm.

¹²⁹ Section 107 Cap. 32.

¹³⁰ See e.g. Tung Wah Group of Hospitals Ordinance, Cap. 1051; Po Leung Kuk, Cap. 1040.

¹³¹ Office of the Ombudsman, *Investigation Report*, 12.

charitable purpose.¹³² This comes together with a change in understanding of charity, which nowadays covers general philanthropic undertakings and not only aid to the poor.

“While the essential characteristics of charitable purposes do not change, what will satisfy those purposes changes with society.... What is charitable is to be determined in accordance with contemporary community values. A contemporary activity may be charitable now, though it would not have been charitable a century ago, or less.... Rules established a century ago relating to what is charitable need to be revisited in this light.”¹³³

However, defining specified charitable purposes only makes practical sense when a regulator has powers to condemn acts of organizations that go beyond their permitted scope. The commission recommends that the IRD should undertake frequent reviews of the accounts of charitable organizations to ensure that the money is spent in compliance with their charitable objects.¹³⁴ The IRD is indeed the proper body to make such inquiries, but any further responsibility is practical only if it is accompanied by additional manpower. Further, this rule would make practical sense only if the IRD had authority to enforce actions upon non-compliance. These aspects would need to be considered by the Law Commission.

As to the legal forms available for charitable organizations, the commission found the current situation to be satisfactory and did not recommend any changes.¹³⁵ This conclusion is to be welcomed, because a specific legal entity for charitable organizations would have only further complicated the law. However, given the fragmentation of legal rules among several statutes, it would be helpful if clear information on the regulatory system was provided.

The commission made fundamental recommendations to improve the governance and accountability of charitable organizations. All charitable organizations which publicly solicit for donations and which seek tax exemption should be subject to the requirement of registration, and their list should be publicly available.¹³⁶ The commission preferred this approach rather than establishing a centralized charity body.¹³⁷ Furthermore, a specific financial reporting standard should be adopted,¹³⁸ and charitable organizations exceeding a certain annual income should be under a duty to file audited financial statements.¹³⁹ All other charitable organizations should make information such as financial statements and activities reports available on their websites.¹⁴⁰ If the organizations do not comply with these requirements, the government should be responsible for enforcement actions.¹⁴¹

¹³² Law Reform Commission of Hong Kong, Report, Recommendation 1 and 2, 23, 81.

¹³³ *Aid/Watch Incorporated v Commissioner of Taxes* [2008] AATA 652, pars. 16-17 (Justice Downes).

¹³⁴ Law Reform Commission of Hong Kong, Report, Recommendation 16, 189.

¹³⁵ *Id.*, Recommendation 3, 91.

¹³⁶ *Id.*, Recommendation 4, 107.

¹³⁷ *Id.*, Recommendation 18, 226. Similarly to a centralized charity commission, Edith Terry suggested a Hong Kong center for philanthropy, which would function like “a clearing house for information and best practices.” <http://www.scmp.com/node/530396>.

¹³⁸ Law Reform Commission of Hong Kong, Report, Recommendation 5, 129.

¹³⁹ *Id.*, Recommendation 6, 130.

¹⁴⁰ *Id.*, Recommendation 7, 131.

¹⁴¹ *Id.*, Recommendation 8, 140.

Such a registration requirement covering all tax-exempt charitable organizations would help people know which organizations qualify. The transparency rules are imperative. In essence, additional bureaucracy does not provide for a better framework for regulation, and the proposed requirements of registration coupled with increased disclosure duties would be the right move forward.

“We consider a responsible charity to have a duty to be open, transparent and publicly accountable, even where they are not legally required to do so. They should maintain a high standard of integrity.”¹⁴²

The commission also made recommendations as to the regulation of fundraising activities. It recommended adoption of a standardized application form for certain fundraising activities.¹⁴³ It also recommended the establishment of a centralized hotline for complaints.¹⁴⁴ When raising funds, a charitable organization must clearly identify itself by displaying the registration number¹⁴⁵ and thereby follow codes of good practices.¹⁴⁶ The public should also be educated on the fundraising activities to raise awareness of charitable organizations and their operations.¹⁴⁷ In addition, more resources should be allocated for government departments to intensify supervision,¹⁴⁸ and a platform should be set up between the independent departments so they can deal more efficiently with inquiries and applications.¹⁴⁹

Furthermore, the commission suggested broadening the *cy-près* doctrine to ensure that property can be distributed not only where a charitable organization is being dissolved but also where property given for a specific charitable purpose cannot be returned to the donor and attainment of the purpose have failed.¹⁵⁰ This recommendation is overdue. By adopting such a broader doctrine Hong Kong would align its rules to other common law jurisdictions.

2. Aspects Left Out of the Reform

Although the report by the Law Reform Commission is comprehensive, a number of considerations have unfortunately been left out.

To begin with, it is regrettable that the charity reform ignored the important topic of so-called social ventures, which try to do good while also making money.¹⁵¹ Although social

¹⁴² Office of the Ombudsman, Investigation Report, 5.11.

¹⁴³ Law Reform Commission of Hong Kong, Report, Recommendation 9, 161.

¹⁴⁴ *Id.*, Recommendation 10, 164.

¹⁴⁵ *Id.*, Recommendation 11, 168.

¹⁴⁶ *Id.*, Recommendation 12, 173.

¹⁴⁷ *Id.*, Recommendation 13, 175.

¹⁴⁸ *Id.*, Recommendation 15, 178.

¹⁴⁹ *Id.*, Recommendation 14, 178.

¹⁵⁰ *Id.*, Recommendation 17, 204.

¹⁵¹ Despite their significant importance, the government has largely ignored the legal perspective of social ventures and excluded them from the charity reform. The problem is that social ventures are caught in the trap of the bipolarity of the Hong Kong company law, which either allows a company to be for-profit or not-for-profit but nothing in between. If this problem was addressed, clear distinctions could be drawn between organizations which entirely rely on donations and such which make money while they also do good. But given the clear emphasis on social entrepreneurship in Hong Kong, the traditional law of charitable organizations at least seems outdated.

ventures have evolved into a fundamental and integral part of the business landscape, they continue to live a precarious existence in Hong Kong.¹⁵²

Methodological justification is another omission. Besides the law of Hong Kong, the reform commission studied the law of other Ireland, England and Wales, Scotland, Singapore, Australia, Canada, and New Zealand. This comparative examination, however, does not consider those features of the Hong Kong charitable sector that are based on the culture and traditions of the Hong Kong people.¹⁵³ Other than Singapore, only Western jurisdictions with a distinctively different charitable sector were examined. What may be needed is a regulatory concept of charity based not on a Western understanding of charity but on a specifically Asian understanding, one that takes the peculiarities of Chinese traditions into consideration. Inadequate regulation could turn into overregulation, which might deter citizens from making donations. The reform must not merely incorporate other countries' regulatory parameters; instead, it ought to identify and develop an appropriate regulatory system for Hong Kong.

“Asia is fundamentally different.... The theories regarding philanthropy have all emerged from the west. While they have their good aspects, I believe that Asia will develop its own unique brand of philanthropy.”¹⁵⁴

Furthermore, the new regulatory system must fit the macroeconomic structures of Hong Kong. Hong Kong's economy has peculiar characteristics. Some have described Hong Kong as the freest economy in the world.¹⁵⁵ Others, however, have stressed that the economy is dominated and steered by a handful of local tycoons.¹⁵⁶ This picture is mirrored in the charitable sector, which is largely dominated by the few charitable organizations of Hong Kong tycoons. “Dominated” means that many of the small charitable organizations depend on the large charities, which act as financiers to smaller projects. These large charities introduce a kind of regulation in the market, because they use their liquidity to implement projects according to their own choice and standards and thereby operate as regulators over smaller charitable organizations. But the major charitable enterprises themselves act outside the realm of regulation. This essential aspect ought to be considered in the reform. Regrettably, it has been ignored. Before the reform moves on, the implications of this macroeconomic situation must be taken into account in order to design the appropriate regulatory model.

Another important aspect left out of the reform is the tax system. Charity law is closely intertwined with aspects of taxation because charitable organizations are commonly tax-exempt, and donations to such organizations are usually tax-deductible. Deductions for donations to approved charitable organizations can be made up to 35 percent of the total chargeable salaries or profits tax but must in any case not be lower than HK\$100 one-off.¹⁵⁷ Tax planning is an essential issue for wealthy people, who usually prefer to give to organizations of their own

¹⁵² Id.

¹⁵³ Cf. supra chap II.

¹⁵⁴ South China Morning Post, *Spirit of Giving*.

¹⁵⁵ Cf. e.g. Heritage Foundation, Index of Economic Freedom 2015, <http://www.heritage.org/index/country/hongkong>.

¹⁵⁶ CNN, Sophia Yan, *Hong Kong has a tycoon problem*, <http://money.cnn.com/2014/11/02/news/economy/hong-kong-tycoons>.

¹⁵⁷ Sections 16D and 26C IRO, Cap. 112.

choice rather than to the government. Nonetheless, the situation is more intractable in Hong Kong because tax considerations only play a limited role when donors decide to make a donation. In Hong Kong, the standard rate for personal income is 15 percent and for corporations 16.5 percent, while there is no capital gains tax or investment income tax. This leaves more disposable income to the people while creating only small tax incentives for donations. Although such considerations may be decisive for some people, they are largely irrelevant for others. Super-donations play by different rules. They are not motivated by tax considerations, because the money is usually derived from investment gains or stock dividends; if not, any such donation would most certainly be well beyond the cap of 35 percent. This reinforces the conclusion that the charitable behavior of the Hong Kong people is engraved in culture and traditions.¹⁵⁸ Monetary considerations such as tax incentives are of minor importance.

Hong Kong is also aware that charitable organizations may be misused for terrorist financing, but it regards the risk as low. The topic is ignored in the report.¹⁵⁹ As a member of the Financial Action Task Force (FATF), Hong Kong is bound by the Special Recommendation VIII, which obliges member states to prevent charitable organizations from financing terrorism. Based on this international code of best practice, Hong Kong has compiled guidelines for charitable organizations.¹⁶⁰ These guidelines suggest that strong corporate governance, responsible service management, financial transparency, and accountability are required for an anti-terrorist financing framework to be effective.¹⁶¹ They also suggest a *Know Your Donor* principle and introduce a suspicious transaction system.¹⁶² In addition, the guidelines set forth recommendations for supervising and monitoring charitable organizations.¹⁶³ Furthermore, Hong Kong has adopted the Organized and Serious Crimes Ordinance, which aligns the local legislation to the Forty Recommendations and Nine Special Recommendations of the FATF relevant in context of money laundering.¹⁶⁴ These rules create liability for anyone involved in money laundering who fails to report knowledge or suspicion to authorities. The institute of chartered secretaries has also published guidelines against money laundering and terrorist financing, and it encourages its secretaries to track each organization's charitable purpose, its sources of income and donations, and the people behind it.¹⁶⁵ Given these international commitments, it is surprising that the topic was not mentioned in the report.

¹⁵⁸ Cf. supra chapter 0

¹⁵⁹ Narcotics Division Security Bureau: An Advisory Guideline on Preventing the Misuse of Charities for Terrorist Financing: July 2007, para. 1.2, <http://www.nd.gov.hk/pdf/guideline-e.pdf>.

¹⁶⁰ Id.

¹⁶¹ Id., chapter 3.

¹⁶² Id., chapter 4.

¹⁶³ FATF, Interpretative Note to Special Recommendation VIII: Non-profit Organizations, 6 b, <http://www.un.org/en/sc/ctc/docs/bestpractices/fatf/9specialrec/9special-rec8.pdf>.

¹⁶⁴ Cf. Organized and Serious Crimes Ordinance, Cap 455. One should also mention the United Nations (Anti-Terrorism Measures) Ordinance, Cap. 575 (UNATMO).

¹⁶⁵ Hong Kong Institute of Chartered Secretaries, Anti-Money Laundering and Counter-Terrorist Financing – Guidelines, para. 5.5, 19, http://www.hkics.org.hk/media/publication/attachment/2141_AML%20Guidelines.pdf.

F. Charity Watchdogs – An Alternative Form of Regulation

The charitable sector obviously needs some kind of regulation to provide transparency and ensure adherence to generally applicable established rules and principles. But is the proposed regulatory framework a constructive way forward? Although current law is inadequate, an ineffective regulatory system will not be an improvement. Regulatory reform should never be an end in itself; there ought to be an overarching justification for any legislative intervention. In the absence of such a justification, alternative models must be considered.

A possible solution to increase transparency and enhance trust in the charitable sector in Hong Kong would be the establishment of an independent charity evaluator. Such a charity evaluator or watchdog is a sensible form of regulation that would resolve some of the inadequacies of the current system. After examining accountability and transparency standards, corporate governance rules, and financial statements, the watchdog would grant a charity a seal of quality that informs the public. Charity evaluators bridge the gap between charitable organizations and donors by interpreting information on the charitable organization and making it accessible to the donors and the public.¹⁶⁶ By doing this, they promote transparency, improve accountability, strengthen governance of such organizations, and enhance efficiency of their work.¹⁶⁷

*“Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.”*¹⁶⁸

However, charity watchdogs are not without critics.¹⁶⁹ Charity ratings have significant effects on the behavior of donors, which may suggest that donors sometimes put excessive reliance on ratings.¹⁷⁰ Thus, a rating score may also be regarded as a form of coercion, pressuring charitable organizations to comply with requirements for a favorable rating out of fear of losing out to other organizations.¹⁷¹ One may also be concerned that powerful rating agencies could be in the position to steer and manipulate donors. An example of such concern is a lawsuit between the American Institute of Philanthropy (AIP) and a charitable organization (Father Flanagan’s Boys Home). The AIP graded that charity as one of the “least needy charities” because of its large accumulated assets. The dispute triggered the director of the charity to say that “the

¹⁶⁶ Cf. Teresa P. Gordon, Cathryn L. Knock, Daniel G. Neely, *The Role of rating agencies in the market for charitable contributions: An empirical test*, *Journal of Accounting and Public Policy*, 28 (2009), 469.

¹⁶⁷ Margaret F. Sloan, *The Effects of Nonprofit Accountability Ratings on Donor Behavior*, *Nonprofit and Voluntary Sector Quarterly*, 38 (2009), 220; but critically, Jennifer A. Lammers, *Know Your Ratios? Everyone Else Does*, *The Nonprofit Quarterly*, 10 (2003), 1; Tobin Aldrich, *Benchmarking the fundraising performance of UK charities*, *International Journal of Nonprofit and Voluntary Sector Marketing*, 14 (2009), 353.

¹⁶⁸ Justice Louis D. Brandeis.

¹⁶⁹ Cf. e.g. Prives D, *Charity Standards Proposed by Watchdog Group Are Deeply Flawed*, <https://philanthropy.com/article/Charity-Standards-Proposed-by/51592>; also see Bruce R. Hopkins, *The Law of Fundraising*, 3rd ed., John Wiley & Sons, 2002, chapter 8. But positively, Aldrich, *Benchmarking the fundraising performance of UK charities*.

¹⁷⁰ Vidhi Chhaochharia and Suman Ghosh, *Do Charity Ratings Matter?*, <http://home.fau.edu/sghosh/web/images/CharityFeb19.pdf>; but critically Jordan E Silvergleid, *Effects of watchdog organizations on the social capital market*, *Philanthropic Fundraising*, 2003, 7.

¹⁷¹ Cf. Hopkins, *The Law of Fundraising*, 447.

watchdog has become an attack dog. Somebody has to muzzle it. It is causing great harm to worthy charities.”¹⁷²

These concerns are, however, unjustified in Hong Kong. People in Hong Kong show a different donor-behavior. As noted earlier, tax incentives play little role. Donors give because they like to give.¹⁷³ Accordingly, donors want to ensure that an organization complies with the standards set upon them. In other words, it is necessary for donors that they can identify themselves with the recipient of their donations.

Moreover, the charitable organizations of the Hong Kong tycoons would remain unaffected by these ratings, because they do not rely on donations from the public; instead, they are funded by the super-donations of the tycoons themselves. Although a bad rating might impair their reputations, there would be no financial consequences. Small charitable organizations, by contrast, would be motivated to earn ratings that would allow them to present themselves in a positive light to the public. In their case, such an excess of watchdog-power could occur, but given the various types of donors involved (government, private donors, and the trusts of the tycoons), an over-reliance is unlikely. Also, the media can monitor the power of watchdogs—as it has done in Hong Kong.¹⁷⁴ However, in order to forestall suspicion, it would be helpful if watchdogs were required to publish annual reports about their work and a rating guide clearly setting out their parameters and ratings. Such a requirement would enable watchdogs to make the charitable sector more professional and to improve accountability, transparency, and governance of charitable organizations.

Despite the strong charitable sector in Hong Kong, the idea of a charity evaluator is rather new. A single charity evaluator has emerged in Hong Kong, called iDonate. Another initiative, WiseGiving, does not qualify as a watchdog; instead it is a mere intermediary that makes information accessible to the public.

1. iDonate

The charity watchdog iDonate awards each organization a rating score based on the information disclosed.¹⁷⁵ It covers around 2,000 charitable organizations, of which the majority are organizations incorporated under the Companies Ordinance and are tax-exempt under section 88 of the IR. iDonate thereby relies on annual reports downloaded from the websites of charitable organizations and audited financial reports purchased from the Integrated Companies Registry Information System.¹⁷⁶ In the first part of the analysis, iDonate uses this information to calculate the operational efficiency of each charitable organization based on factors such as fundraising efficiency, fundraising expense, project expense, salaries, and administrative expense. The rating scores are based on parameters, each of which uses a ten-point scoring system. The higher the score, the better the operational efficiency of the organization (as defined by iDonate). In the second part of the analysis, iDonate uses the working capital ratio and the

¹⁷² The dispute was settled in court. For more see Hopkins, *The Law of Fundraising*, 442.

¹⁷³ *Id.*

¹⁷⁴ Cf. <http://www.theidonate.com/en/media>.

¹⁷⁵ iDonate is similar to the charity watchdogs known from the US such as Charity Navigator or BBB Wise Giving Alliance.

¹⁷⁶ Cf. <http://www.theidonate.com/en/methodology>.

surplus-to-donation ratio to estimate the charitable organization's effective need for funds. This parameter is helpful for donors who wish to fund an organization that will invest the donations immediately. iDonate also comments on the transparency of a charitable organization, which indicates the credibility of the rating. These parameters allow the public to get a clearer understanding of the organization.

The iDonate approach to fundraising efficiency is straightforward. An organization that spends HK\$50 to raise HK\$100 is highly inefficient and receives a lower score than an organization that spends HK\$50 to raise HK\$500.

The assessment of fundraising expenses indicates how much the organization spends on its charitable purpose. However, fundraising activities may also serve another interest, by helping spread the mission of a charitable organization. Treating these efforts solely as fundraising expenses is hard to justify. This criticism could perhaps be addressed with proper accounting tools, which is indeed one of the recommendations of the Law Reform Commission. But the recommendation would need to differentiate between fundraising costs which merely seek to raise funds and those that also promote the charitable mission.

iDonate also puts project expense in relation to total expenses. Again, the higher the ratio, the greater the organization's efficiency. The problem here is another accounting issue: specifically, what can be regarded as project expense? If a charity spends money on an awareness campaign that also calls for donation, does it count as project expense or fundraising expense?

Similar issues can arise concerning iDonate's measure of staff salaries in relation to the total expenditures of the organization. An isolated look at this number can be misleading, because highly effective charitable organizations need to pay competitive salaries to attract the most talented staff. A particular salary may be assigned to project costs if the employee works exclusively on a project, but not if his or her work concerns strategic or general operational decisions. It is in any case wrong to expect people in the NGO sector to work for free.¹⁷⁷ "Such an attitude implies that community work is unworthy of full payment when compared with the commercial sector because the Third Sector is seen essentially as the charity sector where people should work with at least some volunteering spirit. This assumption may misconceive the role of the Third Sector in a modern society, and lead to continuing under-valuation of the sector's importance and runs counter to the need to attract good people to work full-time in the Third Sector."¹⁷⁸ These aspects would need to be addressed by the Law Commission through carefully developed accounting standards.

Unfortunately, iDonate does not rank the governance of charitable organizations. Doing so using the neutral calculus of numbers would be no more difficult than developing financial standards. For example, the numerical rating might depend on whether the organization follows any governance standards, whether the board discloses conflicts of interests, whether the board convenes on a regular basis, and so forth.

If a charitable organization receives a low score, iDonate may make suggestions on how the rating could be improved. It may, for example, suggest that the organization needs

¹⁷⁷ Education and Research, Study on the Third Sector Landscape in Hong Kong, 26.

¹⁷⁸ *Id.*

managerial support and that it should attempt to improve the ratio of expenses and donations by increasing its income. This methodology confronts the charitable organization with its low rating and gives it a chance to improve its score. It thereby serves an educational function that is essential for the accountability of the sector. However, so-called winner rankings, such as lists of the charities with the greatest administrative expenses, improperly isolate certain facts.¹⁷⁹ Such rankings may be good for publicity, but they do not adequately inform donors.

2. WiseGiving

Whereas iDonate analyzes information on charities, WiseGiving merely makes the raw data available on its website, www.wisegiving.org.hk.¹⁸⁰ The service is free of charge, and charitable organizations may join the platform by submitting a set of documents that WiseGiving then will verify.¹⁸¹ WiseGiving publishes basic information about each organization, including financial statements, governance, mission, and charitable services. The financials are broken down in a simple and comprehensive way that allows the public to understand details of income and expenditures. The website also lists the current board of trustees by name and notes their compensation, if any. To remain on the website, an organization must submit updated documents each year. WiseGiving does not interpret the information or rate the organizations. It simply facilitates access to the information.

WiseGiving monitors about 247¹⁸² local charitable organizations. Unlike the private organization iDonate, WiseGiving is a governmental initiative, founded by the Hong Kong Council of Social Service (HKCSS).

3. Analysis

It is important to distinguish between WiseGiving and iDonate. Both aim at improving transparency, accountability, and governance, but their means differ. WiseGiving does not interpret the information provided by charitable organizations. It functions as a mere intermediary between the charitable organizations and the public. By contrast, iDonate is a rating agency.

But regardless of their different approaches, both WiseGiving and iDonate enhance accountability and transparency of charitable organizations. They disclose charitable organizations' flaws to the public. Facing the potential consequences of their wrongful (and sometimes maybe criminal) conduct,¹⁸³ charitable organizations will do more to avoid mistakes.¹⁸⁴ With its ratings, iDonate is the more effective of the two. The raw data that WiseGiving provides require donors to perform their own thorough analysis.

¹⁷⁹ Cf. <http://www.theidonate.com/en/aboutus>.

¹⁸⁰ South China Morning Post, Nora Tang, *Watchdog Steps Up Pressure on Non-Transparent Hong Kong Charities*, 21, May 2013, <http://www.scmp.com/lifestyle/family-education/article/1242049/watchdog-steps-pressure-non-transparent-hong-kong>.

¹⁸¹ Cf. <http://www.wisegiving.org.hk/en/wisegivinglogo.aspx>.

¹⁸² According to the results that appeared in their search engine.

¹⁸³ Dana Brakman Reiser, *There Ought to Be a Law. The Disclosure Focus of Recent Legislative Proposals for Nonprofit Reform*, *Chicago-Kent Law Review*, 80 (2005), 580.

¹⁸⁴ *Id.*

WiseGiving and iDonate both improve transparency of charitable organizations. iDonate also reveals whether an organization voluntarily publishes annual reports and financial statements. They base their assessment on information provided by the organization itself or otherwise freely accessible. Left to their own devices, charitable organizations might withhold negative information from the public. WiseGiving and iDonate operate as direct incentives to make relevant information accessible to the public, so that all organizations can be evaluated on the same set of information. As a further consequence of higher accountability standards and improved transparency, WiseGiving and iDonate facilitate the punishment of misbehavior by governmental authorities.¹⁸⁵

WiseGiving may also strengthen governance of charitable organizations, by providing information on members of the board of an organization, their general profile, their compensation, their duties, and the number of meetings they have held in the past financial year. This information allows the public to get a better understanding of the organization. Governance standards are unfortunately not considered by iDonate.

While iDonate is an important effort to increase transparency, accountability, and governance of charitable organizations in Hong Kong, one must not take its ratings as absolute and final truth.¹⁸⁶ Ratings are only one part of the picture. Other “soft” factors must be considered too. A donor may make decisions based on a relationship of trust nurtured by personal contact with the organization, for example, rather than based on the relation between spending and administrative and project costs. Similarly, some donors may value the ability to give a project a personal touch by being part of the planning and implementation more highly than neutral ratings.

The good done by a charity cannot be measured precisely. Parameters provide at most an approximation. If we focus predominantly on overhead, we can create what the Stanford Social Innovation Review has coined “The Nonprofit Starvation Cycle.”¹⁸⁷ We starve charities of the freedom they need to best serve the people they are trying to serve. A high efficiency ratio does not guarantee that the project is well and wisely managed.

By enhancing transparency and accountability and by educating the public, such organizations as iDonate and WiseGiving serve as an alternative or at least a supplement to legal rules. The Law Reform Commission must acknowledge their important role. In order to facilitate their work, the government must adopt a publicly accessible system in which all tax-exempt organizations are registered. Such a central registration system does not require new laws. It would enhance the quality of the charitable sector and provide the market with the tools to regulate itself.

IV. Summary

Charitable organizations in Hong Kong have developed under a very loose regulatory regime. The Law Reform Commission has recently put forward a report with 18 recommendations for improving charity law. While the Law Reform Commission undertook a

¹⁸⁵ Id., 597.

¹⁸⁶ iDonate refers to this aspect on its website and encourages donors to do more specific due diligence before making a donation: see <http://www.theidonate.com/en/methodology>.

¹⁸⁷ Ann Goggins Gregory and Don Howard, *The Nonprofit Starvation Cycle*, Stanford Social Innovation Review, Fall 2009, 49.

comprehensive comparative review, it failed to consider essential aspects specific to Hong Kong: the people's unique understanding of charitable giving, based on Chinese tradition and customs; the minor importance of monetary incentives such as tax deductions, compared to people's sense of obligation towards their communities; and the dominant influence of the tycoons, who impose their own rules on the sector.

In place of the Law Reform Commission's recommendations, a preferable system would rely on self-regulation informed by charity watchdogs. In order for this system to be effective, the Law Reform Commission must only introduce a publicly accessible registration system for all charitable organizations in Hong Kong. The suggested model would require minimal alteration of the law.