

CHAPTER 1

**Inland Revenue Department
Lands Department
Home Affairs Bureau
Social Welfare Department
Companies Registry
Hong Kong Police Force
Education Bureau
Development Bureau**

**Government's support
and monitoring of charities**

**Audit Commission
Hong Kong
3 April 2017**

This audit review was carried out under a set of guidelines tabled in the Provisional Legislative Council by the Chairman of the Public Accounts Committee on 11 February 1998. The guidelines were agreed between the Public Accounts Committee and the Director of Audit and accepted by the Government of the Hong Kong Special Administrative Region.

Report No. 68 of the Director of Audit contains 8 Chapters which are available on our website at <http://www.aud.gov.hk>

Audit Commission
26th floor, Immigration Tower
7 Gloucester Road
Wan Chai
Hong Kong

Tel : (852) 2829 4210
Fax : (852) 2824 2087
E-mail : enquiry@aud.gov.hk

GOVERNMENT'S SUPPORT AND MONITORING OF CHARITIES

Contents

	Paragraph
EXECUTIVE SUMMARY	
PART 1: INTRODUCTION	1.1 – 1.9
Audit review	1.10 – 1.11
General response from the Government	1.12
Acknowledgement	1.13
PART 2: ADMINISTRATION OF TAX EXEMPTION OF CHARITIES AND TAX-DEDUCTIBLE DONATIONS	2.1
Administration of tax exemption of charities	2.2 – 2.22
Administration of tax-deductible donations	2.23 – 2.28
Audit recommendations	2.29
Response from the Government	2.30 – 2.31
PART 3: ADMINISTRATION OF LAND GRANTED TO CHARITIES FOR OPERATING WELFARE/SOCIAL SERVICES	3.1
Land administration policy	3.2 – 3.6

	Paragraph
Alleged hotel operations on sites granted to charities at nil or concessionary premium	3.7 – 3.24
Audit recommendations	3.25 – 3.28
Response from the Government	3.29 – 3.32
 PART 4: FILING AND DISCLOSURE REQUIREMENTS OF CHARITIES INCORPORATED/ESTABLISHED UNDER THREE ORDINANCES	 4.1
Filing and disclosure requirements under the Companies Ordinance	4.2 – 4.11
Audit recommendations	4.12
Response from the Government	4.13
Filing and disclosure requirements under the Societies Ordinance	4.14 – 4.18
Audit recommendations	4.19
Response from the Government	4.20
Filing and disclosure requirements of IMCs of schools under the Education Ordinance	4.21 – 4.30
Audit recommendations	4.31
Response from the Government	4.32
 PART 5: REGULATION OF CHINESE TEMPLES	 5.1 – 5.5
Management of delegated temples	5.6 – 5.11
Review of the Chinese Temples Ordinance	5.12 – 5.14
Audit recommendations	5.15
Response from the Government	5.16

	Paragraph
PART 6: WAY FORWARD	6.1
Law Reform Commission Report on Charities	6.2 – 6.5
Audit recommendations	6.6 – 6.7
Response from the Government	6.8 – 6.10

Appendices	Page
A : Inland Revenue Department: Organisation chart (extract) (31 December 2016)	105
B : Particulars of 14 land leases alleged to have hotel operations	106 – 109
C : Recommendations of the Law Reform Commission Report	110 – 113
D : Acronyms and abbreviations	114

GOVERNMENT'S SUPPORT AND MONITORING OF CHARITIES

Executive Summary

1. Charities make an important contribution to the community. The Government has provided various support to them, including: (a) tax exemption under the Inland Revenue Ordinance (IRO — Cap. 112) (for 8,923 recognised charitable organisations as at September 2016) and tax deduction for donations made to tax-exempt charities (totalling \$11.84 billion for the year of assessment 2014-15); (b) granting land at a nominal premium to non-profit-making charitable institutions mainly for operating schools, hospitals and social welfare facilities; and (c) provision of recurrent subventions to some of these institutions for providing services primarily in the education, social welfare and health sectors.

2. There is no overall statutory scheme for the registration and regulation of charities in Hong Kong. Depending on their legal forms and whether they have sought recognition of tax exemption status and government support, charities are subject to the monitoring and/or registration framework of different government bureaux/departments (B/Ds), as follows:

(a) ***Inland Revenue Department (IRD)***. The IRD is responsible, as a tax administrator, for raising revenue through taxes, duties and fees in accordance with the relevant legislation. In addition to making tax assessments, collecting taxes, and other statutory functions, it processes applications for the recognition of tax exemption status of charities under section 88 of the IRO. Charities are chargeable to profits tax if they carry on trade or business with profits in Hong Kong and fail to satisfy the provisions of section 88;

(b) ***Lands Department (Lands D)***. Land is made available by the Government by way of a private treaty grant (PTG) at nominal or concessionary premium or a short term tenancy at nominal or concessionary rent to non-profit-making organisations for operating schools, hospitals, and social welfare and community facilities. Many of the entities receiving such land grants are tax-exempt charities. In such

Executive Summary

cases, the charitable organisations are regulated by the Lands D and the supporting B/Ds to ensure their compliance with the conditions of land grant and the policy intention of granting the land;

- (c) **Companies Registry (CR).** The CR is responsible for administering and enforcing the Companies Ordinance (Cap. 622) for some 1.34 million limited companies on the Companies Register. As at September 2016, 6,619 charities which obtained tax exemption status under section 88 of the IRO were incorporated as companies under the Companies Ordinance;
- (d) **Hong Kong Police Force (HKPF).** The Societies Office of the HKPF is responsible for administering the Societies Ordinance (Cap. 151) and granted registration or exemption from registration to 37,861 local societies as at September 2016. 1,000 societies so registered or exempted from registration were charities and 811 of which had obtained tax exemption status under section 88 of the IRO;
- (e) **Education Bureau (EDB).** Under the Education Ordinance (Cap. 279), all aided schools are required to set up incorporated management committees (IMCs). Direct Subsidy Scheme schools may opt to establish IMCs under the Ordinance. As at September 2016, 772 of the 846 IMCs on the EDB's Register of IMCs obtained tax exemption status under section 88 of the IRO; and
- (f) **Home Affairs Bureau (HAB).** As at September 2016, there were 2,480 tax-exempt charities established for purposes of advancement of religion. It is the Government's policy to respect the autonomy of religious organisations. However, the Chinese Temples Ordinance (CTO — Cap. 153) was enacted in 1928 to suppress and prevent mismanagement of Chinese temples and abuses of donated funds. The Chinese Temples Committee (CTC) is established, with the Secretary for Home Affairs as the Chairman, to regulate Chinese temples. As at September 2016, 347 of around 600 Chinese temples were registered with the CTC under the CTO. Of these 347 registered Chinese temples, 45 were administered directly or indirectly by the CTC, with the remaining 302 managed by individuals or organisations. Of the 347 registered temples, 129 were managed by tax-exempt charities.

Executive Summary

The Audit Commission (Audit) has recently conducted a review on the Government's support and monitoring of charities with a view to identifying areas for improvement.

Administration of tax exemption of charities and tax-deductible donations

3. According to the legal advice obtained by the IRD, section 88 of the IRO does not confer on it the power to grant tax exemption status. What section 88 provides is that charitable institutions or trusts of a public character are exempt from tax and they can seek recognition of such exemption by the IRD. They will be put on a list of charitable institutions or trusts of a public character maintained by the IRD subject to their consent. The IRD is not responsible for the governance of a charity, nor does it have regulatory power over the operation of a charity. As administrative procedures, it will conduct periodic reviews to see whether the organisations' objects are still meeting the eligibility criteria of charitable purposes and their activities are compatible with their objects. According to the tax guide issued by the IRD, the governing instrument of a charity should generally include clauses stating its objects and limiting the application of its funds towards the attainment of its stated objects. The Charitable Donations Section (CDS), led by a Chief Assessor and comprises eight staff, is responsible for processing applications for recognition of tax exemption status and conducting periodic reviews by issuing questionnaires to obtain information from charities concerned (paras. 1.7(a), 2.3(b) and 2.4).

4. *Delays in taking follow-up actions in uncompleted review cases.* Audit analysis of the IRD's computer database revealed that as at September 2016, there were 635 uncompleted review cases, of which 71 (11%) had remained uncompleted over five years. Audit sample checked 17 of the 71 uncompleted review cases and found that in 15 (88%) cases, there were delays on the part of the IRD. For example, in one case, the charity concerned submitted a questionnaire in April 2009 which was left unattended to until September 2016 when the IRD resumed follow-up action. There is a need to closely monitor the uncompleted review cases because if the IRD subsequently finds it necessary to withdraw the recognition of the tax exemption status of a charity, there could be delays in raising assessments on its profits, given the six-year time limit in raising assessments and demanding tax under the IRO (paras. 2.10 to 2.12).

Executive Summary

5. Audit examined 160 review cases and 10 applications for reinstatement of tax exemption status and found limitations in the IRD's follow-up actions on matters of regulatory concern in 6 review/reinstatement cases (para. 2.13):

- (a) ***Directors' remuneration.*** In four cases, the IRD found that the charities concerned had paid remunerations to their directors, which were not allowed in their governing instruments. While remedial actions were taken by the charities concerned, ranging from cessation of payment (without any refund of \$13 million paid) to partial refund (5% of \$276,100 paid in one case and 50% of \$375,000 paid in another case) and full refund (of \$64,200 paid), their tax exemption status was not affected (para. 2.14); and
- (b) ***Expenses not in furtherance of charitable objects.*** In two cases, the IRD identified expenditures which were not in furtherance of the objects of the charities concerned. In both cases, the IRD continued their tax exemption status after remedial actions had been taken, i.e. a full refund (of \$704,500) in one case and an undertaking not to make similar payment (without refund of \$236,000 paid) in another case (para. 2.15).

6. ***Limitations of the IRO provisions on tax exemption status of charities.*** According to the IRD, while the breach of the directors' remuneration clauses may constitute a breach of fiduciary duty, such breach would not alter the charity's objects and hence its charitable status. Based on the legal advice obtained by the IRD in 2003, it was not legally proper to overturn a charity's tax exemption status solely because the charity had not complied with any obligations which were not provided in the IRO. The IRD also informed Audit that the IRD had no authority to demand the charity to refund (in full or in part) of the payment made. However, there is a gap between the public expectation of the IRD's role in administering the tax exemption status of charities and what the IRD can do under the existing provisions of the IRO. In its Report on Charities of 2013, the Law Reform Commission (LRC) considered that the IRD's function of reviewing the accounts of charities to ensure that their income was used solely for charitable purposes was highly important, underpinning the public's confidence in the charity sector. This view was shared by many respondents to the LRC's consultation paper on charities. The LRC has recommended that the IRD should conduct more frequent reviews of the accounts of tax-exempt charities. To address the expectation gap, there is a need to consider reviewing the provisions of the IRO with a view to enabling the

Executive Summary

IRD to effectively perform its role of administering the tax exemption status of charities (paras. 2.16 and 2.17).

7. ***Donations made by charities.*** In two review cases, the IRD's case officers had not requested the charities concerned to provide sufficient explanations on their donation expenditures to support that they were compatible with their objects, although such expenditures (\$1 million in one case and \$0.46 million in another) were the only activities of the charities concerned, using up all/most of their donation income for the years (para. 2.18).

8. ***Dormant charity.*** According to the CDS's Staff Handbook, the tax exemption status of a charity may be withdrawn if it has ceased operation or is dormant. Audit examined seven review cases and found that in three cases, the CDS had taken a long time (over two years) to deal with dormant cases. In one case, the charity had not commenced operation for 12 years since it was recognised as a tax-exempt charity (para. 2.19).

9. ***Need to take timely action upon dissolution of a tax-exempt charity.*** The IRD has made arrangements with the CR whereby companies to be struck off by the CR would be brought to the IRD's attention. Since January 2016, the CDS has used a computer program to conduct matching exercise twice a month to identify tax-exempt charities to be struck off by the CR. This is important for the IRD to: (a) protect revenue in case there are any outstanding tax liabilities of a company to be struck off; (b) make enquiry into whether the assets of such company after dissolution have been disposed of in accordance with the governing instrument requirement; and (c) update the list of tax-exempt charities posted on the IRD's website. Audit notes that the IRD has not made similar notification arrangements with relevant B/Ds for tax-exempt charities which are established under other ordinances (paras. 2.20 and 2.22).

10. ***Room for improvement in conducting desk audits on charitable donation claims.*** Since April 2001, in order to streamline the assessing procedures, the IRD has used a computerised Assess First Audit Later System for screening tax returns for automated assessment and selecting cases for post-assessment desk audit. Based on a sample check of 30 desk audit cases for profits tax and 50 desk audit cases for salaries tax/personal assessment in 2015-16, Audit found that in one profits tax case, the supporting schedule filed by the taxpayer did not show whether the donations

Executive Summary

were made to tax-exempt charities but the assessing officer had allowed tax deduction without seeking clarification from the taxpayer. In two salaries tax cases, the assessing officers had allowed tax deductions although the donation was not made to a recognised tax-exempt charity in one case and the taxpayer's name did not match with the donor's name in another case (paras. 2.26 and 2.28).

Administration of land granted to charities for operating welfare/social services

11. In 1959, the Executive Council (ExCo) noted the statement of government policy on land administration that for land granted by PTG at nil premium for welfare purposes, very stringent powers of control conditions would be included and no distribution of profits would be allowed. In 1981, ExCo endorsed the principle that lessees holding sites granted for social service purposes at nil/concessionary premium should be allowed to redevelop such sites to improve their facilities, provided that: (a) premium should be charged at full market value for the commercial element included in the development; (b) the income derived from the development would be applied to purposes acceptable to the Government; and (c) the project would benefit the public purse by decreasing the need for subventions (paras. 3.2 and 3.3).

12. *Alleged hotel operations on sites granted to charities at nil or concessionary premium.* From 2013 to 2015, there were media reports and public complaints to the Government alleging that 14 sites (under Leases A to N) granted at nil/concessionary premium were partly used to operate hotels. For the 14 sites, in each instance, the grantee (either the organisation or its parent organisation) was a tax-exempt charity. According to the Lands D, three of the sites were granted by virtually unrestricted leases (Leases A, B and E). For the other 11 leases, some specifically permitted the running of hostels and there was no definition under lease of the terms "hostel" and "hotel". Audit reviewed the provisions of the 11 leases (excluding the three unrestricted leases) and the Lands D's follow-up actions on 4 leases (Leases G, H, M and N) and found lessons to be learnt in the lease and planning control of these sites (paras. 3.7, 3.8 and 3.10).

13. *Only one lease stipulated the no-profit-distribution requirement.* According to the 1959 land administration policy (see para. 11 above), stringent powers of control would be included in the conditions and no distribution of profits

Executive Summary

would be allowed for a site granted at nil premium for welfare purposes. While 9 of 11 leases were granted for welfare/social services at nil or concessionary premium after 1959, Audit noted that only one lease (Lease M) stipulated the no-profit-distribution requirement. According to the Lands D: (a) the land administration policy had evolved since 1959 with due regard to 7 cases which were submitted to ExCo for approval; (b) the no-profit-distribution clause was not imposed in these seven cases which served as precedents for subsequent cases; and (c) accordingly, the no-profit-distribution requirement in PTGs for welfare purposes was no longer applicable. However, there were indications that the hostels in the 11 cases were being operated on a commercial basis. Audit noted that the grantees of 9 of the 11 leases had been operating their hostels with hotel licences issued by the Home Affairs Department (HAD). For the remaining two leases, the grantees had placed advertisements offering serviced residence to the public on a monthly rental basis. To ensure that all profits derived from facilities built on sites granted at nil/concessionary premium are applied to purposes acceptable to the Government, there is a need to incorporate the no-profit-distribution requirement in the leases. Moreover, while statements of accounts were important documents to show whether and how the profits derived had been distributed/applied, only 4 of the 11 leases required the submission of accounts. For these four leases, accounts were either not received or not always obtained (paras. 3.11 and 3.12).

14. *Need to regularly monitor compliance with the lease requirements under Lease M and the related conditions.* According to Lease M, Grantee M shall use the site for operating a hostel and other social welfare facilities. Since the facilities came into operation in 1991, the hostel was operated by Grantee M's appointed operator and the social welfare services were provided by Grantee M's parent organisation (Charity M). Although the lease condition specifies that there shall be no distribution of profit derived from the facilities, a letter issued by the then Director of Buildings and Lands in June 1989 allowed the profits derived from the facilities to be used towards the improvement and/or extension of all charitable services provided by Charity M. In this connection, the statements of accounts of Grantee M are important documents to show whether such requirements have been complied with. While Lease M provided that the grantee would submit a statement of accounts to the then Director of Buildings and Lands if so required, the Lands D only commenced to obtain such accounts in 2013 (22 years after the hostel came into operation). While some assurance was provided by Charity M's auditor in May 2014 and Grantee M in March 2016, there was insufficient information to show that income derived from the hostel/hotel had been applied towards the purposes specified by the Government for some 25 years during which the hostel was operated by Grantee M's appointed operator under a hotel licence. There is a

Executive Summary

need to regularly monitor compliance with the lease requirements under Lease M and the related conditions (paras. 3.13 and 3.14).

15. ***Monitoring income-generating facilities of a lease and subvention reduction arrangement.*** In 1989, ExCo approved granting of a site to Grantee N for the construction of: (a) a new headquarters including offices, hostel, dormitory and canteen at a nominal premium; and (b) other facilities including a multi-storey vehicle park at full land premium which was to be operated by Grantee N on a commercial basis in line with the 1981 land administration policy (see para. 11 above). The new headquarters and other facilities were completed in 1993 and came into operation in 1994 (paras. 3.15 and 3.16). Audit has found the following areas for improvement:

- (a) ***Management Committee and submission of accounts requirements.*** Lease N required Grantee N to: (i) establish a Management Committee with representatives of the Government to ensure the proper and efficient operation of the income-generating facilities of the headquarters and the vehicle park; and (ii) submit annually a statement of accounts on the operation of the headquarters and the vehicle park to the supporting B/D (the Social Welfare Department (SWD) up to 1999 and the HAB since 2000). While the Management Committee held five meetings from 1993 to 1998, no further meetings had been held thereafter. The SWD obtained the statements of accounts for three years (1995-96 to 1997-98) and there was no record showing that similar statements of accounts had been submitted thereafter (paras. 3.16 and 3.17);

- (b) ***Subvention reduction arrangement.*** The ExCo's approval of the land grant to Grantee N was made on the understanding that there would be reduction and eventual elimination of the annual subvention of Grantee N's activities. The SWD withheld part of the rent and rates subsidy in the sum of \$4.04 million for the five-year period from 1994-95 to 1998-99. In 2000, the HAB (as the supporting B/D) decided to review the subvention reduction issue but had not taken any action until 2010-11 when it froze Grantee N's subvention. After negotiation, the HAB and Grantee N agreed in February 2013 to reduce the subvention to the level in 1993-94 (when the new headquarters came into operation) in three years and to resume adjustment in subvention thereafter. However, the agreed subvention reduction arrangement has yet to give full effect to the ExCo's understanding of eventual elimination of the annual subvention

Executive Summary

to Grantee N. According to the HAB, it will continue its discussion with Grantee N to further reduce the subvention level having regard to Grantee N's financial situation and development needs, and will seek the ExCo's endorsement if it is eventually considered that the ExCo's understanding cannot be achieved (paras. 3.18 to 3.21); and

- (c) *Non-exclusive use of catering facilities.* According to the records of the Food and Environmental Hygiene Department (FEHD), from 1996 to 2015, Grantee N's canteen had been operated as a restaurant under a General Restaurant Licence. In connection with the application for a restaurant licence by Grantee N's new restaurant operator in 2015, the Lands D obtained legal advice and noted that the canteen should be used exclusively by Grantee N's members. The HAB commented that the restaurant was commercial in nature and could not be regarded as "ancillary accommodation and facilities" of Grantee N's headquarters under Lease N. The Planning Department also commented that planning permission for the restaurant was required under the relevant Outline Zoning Plan (OZP) before Grantee N could apply to the Lands D for a waiver to permit the use of the canteen space for restaurant purpose. In December 2016, Grantee N obtained the Town Planning Board's approval to use the canteen for a temporary restaurant for three years. Up to March 2017, the Lands D offered the waiver terms for Grantee N's acceptance. Based on the FEHD's licensing records of two other catering facilities of Grantee N's headquarters and relevant advertisement on a commercial website, there were indications that these facilities were also serving the public. There is a need to review whether the operations of these catering facilities are permitted under Lease N and the relevant OZP (para. 3.22).

16. *Consulting supporting B/Ds on compliance with lease conditions.* According to Lease N, the new headquarters shall include, among others, hostel, canteen and such other ancillary facilities as shall be approved by the SWD. In 1987, Grantee N confirmed to the SWD that all the areas in its headquarters were directly related to its purposes and the then Secretary for District Administration's support for the grant of the headquarters site at nominal premium was also based on the understanding that the facilities were to meet Grantee N's purposes. However, based on the HAD's hotel licence information (see para. 13), there were indications that the hostel had likely been converted to hotel use for the general public. Audit also found similar converted use of the hostels under Leases G and H. In Audit's

Executive Summary

view, for leases with clauses governing the use or operation of the hostels, the Lands D needs to seek confirmation from the relevant B/Ds on whether the current use or operation of the hostels is in line with their policy intent, and take necessary follow-up actions in case of any breach of the lease conditions (para. 3.23).

Filing and disclosure requirements of charities incorporated/established under three ordinances

17. *Filing requirements under the Companies Ordinance.* As at September 2016, there were 6,619 tax-exempt charities incorporated as limited companies, of which 6,523 were companies limited by guarantee. These charities need to comply with the same statutory requirements under the Companies Ordinance as other limited companies. For example, they are required to deliver annual returns to the CR within prescribed time periods. Members of the public can access company information posted on the CR's Cyber Search Centre (paras. 4.2, 4.3 and 4.5).

18. *Non-compliance with filing requirements under the Companies Ordinance.* The timely filing of annual returns by charities which are companies is important for donors to gain access to their financial information so as to make an informed choice when making donations. Audit's analysis of the CR's computer records of the 6,523 charities (which were companies limited by guarantee) revealed that up to November 2016, 1,237 annual returns for the years from 2011 to 2016 (i.e. 6 years) had not been filed. In particular, 21 companies had repeatedly breached the filing requirements, i.e. 12 companies for 5 years and 9 companies for 6 years. For the 2016 annual returns filed by 3,219 charities, 126 were late submissions. The delays were over 90 days in 35 cases (paras. 4.8 to 4.11).

19. *Filing requirements under the Societies Ordinance.* As at September 2016, there were 1,000 registered/exempted charitable societies, of which 811 were tax-exempt charities. These charitable societies are required to comply with the same statutory requirements under the Societies Ordinance as other registered/exempted societies. For example, they shall provide the HKPF with information such as their names, objects and particulars of office-bearers (paras. 4.14 and 4.15).

Executive Summary

20. *Need to keep the registered/exempted society information up-to-date.* The HKPF keeps a list of registered/exempted societies which is posted on its website. According to the HKPF, it endeavours to update the list of registered/exempted societies as soon as possible. The HKPF also carries out regular reviews to identify inactive societies and requests them to furnish proof of their existence and updated particulars. Audit's examination revealed that the HKPF had not: (a) conducted any reviews of inactive societies in 2015 and 2016; (b) requested 53 charitable societies which had not contacted the HKPF for ten years or more at the time of the 2014 review to furnish proof of their existence; and (c) updated the list of registered/exempted societies in respect of 19 societies with society status marked cancelled (paras. 4.16 and 4.17).

21. *Filing requirements of IMCs.* As at September 2016, there were 846 IMCs of which 772 were tax-exempted. These 772 tax-exempt IMCs are required to comply with the same statutory requirements as other IMCs under the Education Ordinance, e.g. preparation of audited accounts. According to the EDB's guidelines, tax-exempt IMCs should submit the annual audited financial statements to the EDB within prescribed periods (paras. 4.22 and 4.23).

22. *Late submission of audited financial statements by some IMC schools.* Audit's analysis of the EDB's computer records for the five school years from 2010/11 to 2014/15 revealed that the percentage of late submission of audited financial statements by IMC schools decreased from 40% for 2010/11 to 36% for 2014/15. However, of the 305 late submissions for 2014/15, 26 (9%) IMC schools had submitted their audited financial statements more than 120 days after the submission due date. Moreover, for school years 2010/11 to 2014/15, 68, 41 and 70 IMC schools had repeatedly submitted their audited financial statements late for 3, 4 and 5 years respectively (paras. 4.27 and 4.30).

Regulation of Chinese temples

23. The CTC was established to carry out duties under the CTO, including the registration of all Chinese temples. According to the HAB, the CTC has not taken any action against the unregistered temples because some provisions of the CTO might be outdated in the present day context. It was not the intention of the CTC to monitor the operation of Chinese temples other than the 25 temples under its

Executive Summary

direct administration and the 20 temples managed by delegated organisations (i.e. the delegated temples) (paras. 5.1 to 5.5).

24. ***Need to renew two expired delegation agreements.*** The delegation agreements for two temples expired in 2006 and 2007 respectively and have not been renewed because one delegated organisation did not accept some new agreement requirements (e.g. submission of audited accounts) and the other has not removed an unauthorised building structure at the temple. In the absence of any delegation agreements in force, donations and other revenues of these temples had been kept and used by the delegated organisations concerned without accountability to the CTC for some ten years (paras. 5.7 and 5.8).

25. ***Need to enhance transparency.*** Both the directly administered temples and the delegated temples receive voluntary donations from the public. However, at present, only the financial information of the 25 directly administered temples and 9 of the 20 delegated temples is accounted for in the financial statements of the Chinese Temples Fund, which are posted on the CTC's website for public inspection. The CTC has neither made available the audited accounts of the remaining 11 delegated temples for public inspection nor required the delegated organisations to do so (para. 5.9).

26. ***Non-compliance with delegation agreement requirements.*** Audit found cases of non-compliance with the audited accounts and administrative report submission requirements by four delegated organisations. Up to January 2017, an organisation had not submitted the audited accounts of its managed temple for the previous 3 years and its administrative reports for the previous 11 years. There were delays in submissions of three other organisations which together managed 15 temples. For example, for the organisation with 5 managed temples, the audited accounts due for submission in March 2014, 2015 and 2016 were not submitted until December 2016 (para. 5.10).

27. ***Review of audited accounts.*** According to the delegation agreement, the income of a delegated temple must be applied in the first instance to the due observance of the customary ceremonies and the maintenance of the temple. Any surplus shall be applied to pay staff salaries and expenses in compliance with the agreement and for the purposes of Chinese charity in Hong Kong. Audit noted in a submitted account a staff messing expenditure of about \$380,000 which was

Executive Summary

disproportionate to the salary expenditure of \$301,000 for the same year but the CTC had not sought clarification from the delegated organisation concerned (para. 5.11).

Way forward

28. According to the 2013 LRC Report, there are deficiencies in the existing regulatory framework of charities, including inconsistent standards or requirements on governance, accounting and reporting by charities, and limited control of charitable fund-raising activities. The LRC made 18 recommendations to improve the transparency and accountability of charities, which included, among others, establishing a clear statutory definition of what constitutes a charitable purpose, requiring all charitable organisations which solicit public donation and/or have sought for tax exemption to be registered, adopting a specifically formulated financial reporting standard for charities in Hong Kong, and ensuring that tax-exempt charities make information about their operations available to the public (paras. 6.2 and 6.3).

29. The HAB has been coordinating inputs from relevant B/Ds with a view to formulating a response to all the recommendations of the LRC Report for the Government's consideration. There is a need to take into account the areas of improvement identified in this Audit Report which are complementary to the LRC's recommendations in considering the way forward. For example, the need to review the provisions of the IRO to enable the IRD to perform effectively its role in administering the tax exemption status of charities should be addressed when taking forward the LRC's recommendation on more frequent review of tax-exempt charities by the IRD (paras. 6.3 and 6.4).

Audit recommendations

30. **Audit recommendations are made in the respective sections of this Audit Report. Only the key ones are highlighted in this Executive Summary. Audit has *recommended* that:**

- (a) **the Commissioner of Inland Revenue should:**

Executive Summary

- (i) **take measures to enhance the monitoring of the progress of periodic review cases of tax exemption status of charitable organisations (para. 2.29(b));**
 - (ii) **in consultation with the Secretary for Financial Services and the Treasury, consider the need for reviewing the provisions of the IRO with a view to enabling the IRD to effectively perform its role of administering the tax exemption status of charities (para. 2.29(d)(i)); and**
 - (iii) **remind CDS staff to obtain from the charities concerned a breakdown of their donation expenditures to support that they are compatible with their objects (para. 2.29(d)(ii));**
- (b) **the Director of Lands should:**
- (i) **in collaboration with the supporting B/Ds, consider incorporating lease conditions restricting profit distribution and requiring submission of accounts in a PTG or lease modification (including land exchange) granted at nil/concessionary premium for welfare/social services in future; (para. 3.25(a));**
 - (ii) **require Grantee M to provide regularly sufficient information to demonstrate its compliance with the lease requirements and related conditions in the letter of approval of 1989 (see para. 3.13) and, where appropriate, seek the assistance of the SWD in scrutinising the statements of accounts obtained from Grantee M (para. 3.25(c)); and**
 - (iii) **for leases with clauses governing the use or operation of the hostels, seek confirmation from the relevant B/Ds on whether the current use or operation of the hostels is in line with their policy intent, and take necessary follow-up actions in case of any breach of the lease conditions (para. 3.25(d));**

Executive Summary

- (c) **the Secretary for Home Affairs should:**
 - (i) **seek the ExCo's endorsement for any material deviations from its understanding of the implementation of a PTG for operating welfare/social services on land granted at nil/concessionary premium (such as the subvention reduction arrangement in Lease N) (para. 3.27(b)); and**
 - (ii) **for Lease N, in consultation with the Director of Lands and the Director of Planning, review the operations of the western restaurant and lounge to determine whether they are permitted under the lease conditions and the relevant OZP, and take necessary follow-up actions accordingly (para. 3.27(c));**
- (d) **the Registrar of Companies should step up the CR's monitoring of the compliance with the statutory filing requirements by charities which are limited companies and take more timely follow-up actions against cases of repeated breaches of the filing requirements and the long delay cases (para. 4.12);**
- (e) **the Commissioner of Police should step up efforts to identify inactive societies and take timely follow-up actions to ensure that the list of registered/exempted societies posted on the HKPF's website is kept up-to-date (para. 4.19(b));**
- (f) **the Secretary for Education should continue to closely monitor the IMC schools' compliance with the filing requirements of audited financial statements and offer assistance to IMC schools for cases of long delays and/or repeated non-compliance where necessary (para. 4.31(a));**
- (g) **the Secretary for Home Affairs, as the Chairman of the CTC, should:**
 - (i) **for the two temples with expired delegation agreements, expedite action to resolve the long outstanding issues with the two delegated organisations concerned with a view to renewing the delegation agreements as soon as practicable (para. 5.15(a)); and**

Executive Summary

- (ii) **step up monitoring of the delegated organisations' compliance with the terms of the delegation agreements to ensure that audited accounts and administrative reports of the temples are submitted in a timely manner (para. 5.15(c)); and**

- (h) **the Secretary for Home Affairs should take into account the areas for improvement identified in this Audit Report in coordinating inputs from relevant B/Ds for formulating a response to the LRC's recommendations for the Government's consideration (para. 6.6).**

Response from the Government

31. The Government generally agrees with the audit recommendations.

PART 1: INTRODUCTION

1.1 This PART describes the background to the audit and outlines the audit objectives and scope.

Charities in Hong Kong

1.2 Charities make an important contribution to Hong Kong, such as bringing communities together and providing transformational changes as well as caring services and support to meet the needs of some of the most vulnerable members of the community. Over the years, the Government has provided the following support to charities:

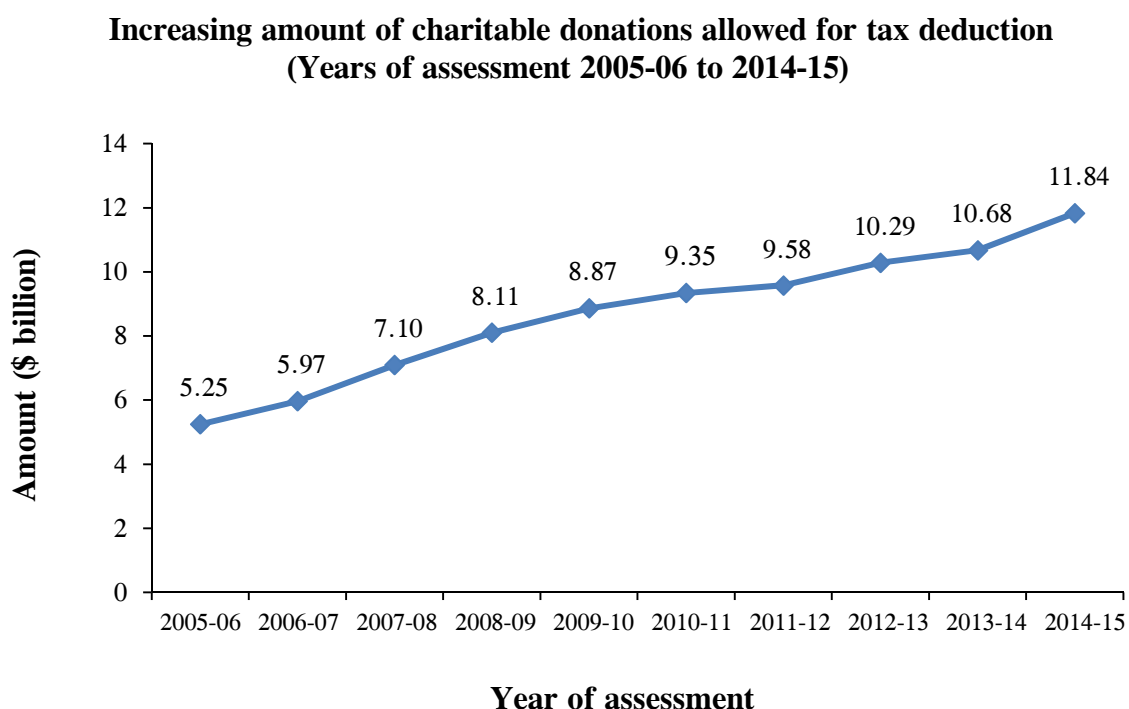
- (a) ***Tax relief.*** A charitable organisation recognised under the provisions of the Inland Revenue Ordinance (IRO — Cap. 112) is not generally liable to tax, and donations to such an organisation can be tax deductible (Note 1);
- (b) ***Land grant.*** Land is made available by the Government by way of a private treaty grant (PTG) at a nominal or concessionary land premium to non-profit-making educational, medical and charitable institutions for operating schools, hospitals, and social welfare and other community facilities; and
- (c) ***Subvention.*** The Government provides recurrent subventions to service providers primarily in the education, social welfare and health sectors, some of which are charitable organisations.

Note 1: *Tax deduction for charitable donations has been provided since 1970 under the IRO (first enacted in 1947). Sections 16D and 26C of the IRO allow a deduction for approved charitable donations made by a person during the year of assessment under profits tax and salaries tax/personal assessment respectively. Approved charitable donation is defined in the IRO as a donation of money to any charitable institution or trust of a public character exempt from tax under section 88 of the IRO or the Government for charitable purposes. The aggregate amount of donations deductible for the year should not be less than \$100 and should not exceed 35% of the total assessable profits/income (since the year of assessment 2008-09).*

Introduction

1.3 Figure 1 shows that the charitable donations allowed for tax deduction by the Inland Revenue Department (IRD) had increased from \$5.25 billion for the year of assessment 2005-06 to \$11.84 billion for 2014-15, or an increase of 126% in these ten years. The number of taxpayers with tax deduction allowed for approved charitable donations totalled 588,000 (comprising 558,000 for salaries tax, 21,000 for profits tax and 9,000 for personal assessments) in 2014-15. Tax revenue foregone is estimated to be over \$1.5 billion in the year of assessment of 2014-15 (Note 2). There are no readily available statistics on the revenue foregone by the Government by providing tax exemption to charities which carry on trade or business with profits chargeable to profits tax in Hong Kong (Note 3).

Figure 1



Source: IRD records

Note 2: *The estimation is based on a standard tax rate of 15%.*

Note 3: *According to the IRD, section 88 of the IRO (added in 1949) was introduced because it was considered not desirable to impose tax on institutions of a charitable, ecclesiastical or educational nature except in so far as such bodies may be engaged in trade or business. However, the profits derived by a charity can still be exempt from profits tax if, inter alia, the trade or business is exercised in carrying out the expressed objects of the institution and if the profits derived therefrom are not expended substantially outside Hong Kong.*

Existing monitoring framework for charities

1.4 At present, the statutory definition of what constitutes a charity or a charitable purpose in Hong Kong is limited. Under the provisions of the IRO, a charitable institution or trust of a public character is generally exempt from tax and donations made to such organisations are tax deductible. There is, however, no statutory definition in the IRO of what constitutes a charity. The IRD has to refer to the case law in determining whether an organisation is established for “charitable purposes” (Note 4). “Charitable purposes” are defined in the case law to mean:

- (a) relief of poverty;
- (b) advancement of education;
- (c) advancement of religion; and
- (d) other purposes of a charitable nature beneficial to the community not falling under any of the preceding categories.

Apart from case law definitions, “charitable purpose” as defined under section 2(1) of the Registered Trustees Incorporation Ordinance (Cap. 306) includes: (a) relief of poverty; (b) advancement of art, education, learning, literature, science or research; (c) provision for the cure, alleviation or prevention or the care of persons suffering from or subject to any disease, infirmity or disability affecting human beings (including the care of women before, during and after child birth); (d) advancement of religion; (e) any ecclesiastical purpose; (f) promotion of moral, social and physical well-being of the community; and (g) any other purpose beneficial to the community.

1.5 According to the IRD, the number of charitable organisations recognised for tax exemption purpose under section 88 of the IRO had doubled from 4,435 in March 2006 to 8,923 in September 2016 (see Figure 2). Charities have full autonomy in choosing their own legal forms, either as incorporated bodies (e.g. companies) or unincorporated bodies (e.g. societies and trusts) to suit their

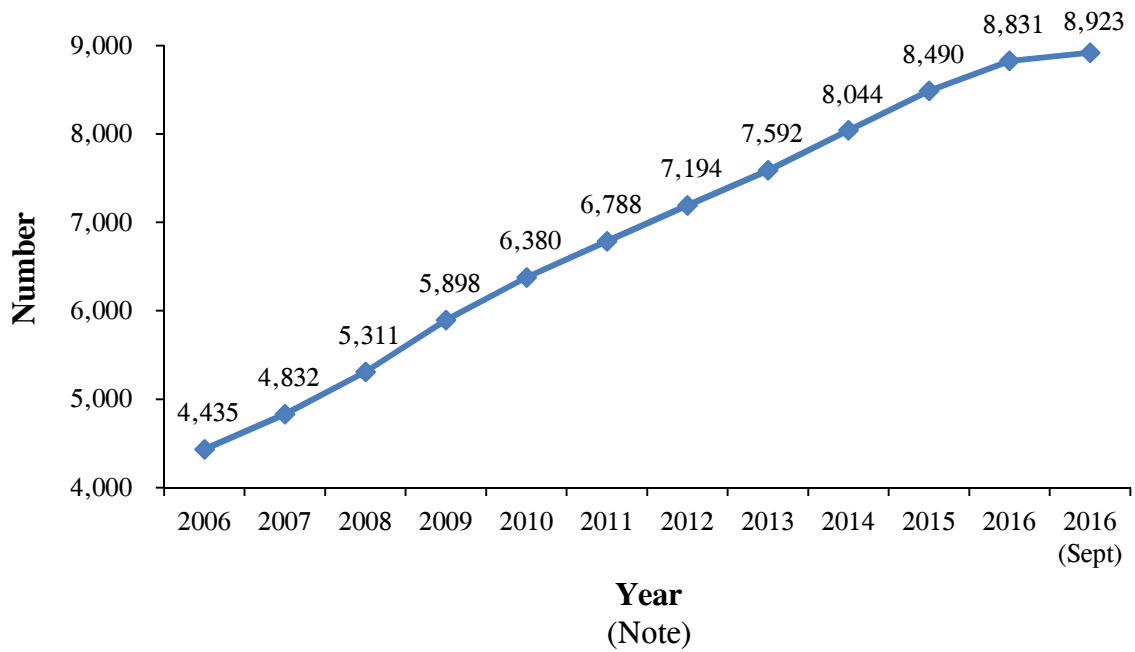
Note 4: *According to a case law ruling quoted by the IRD, whether an organisation is a charity is a matter for the court to decide, even though the organisation may have been recognised as a charitable institution for tax purposes.*

Introduction

operations in achieving their charitable causes. An analysis of the legal forms of the 8,923 tax-exempt charities is shown in Figure 3.

Figure 2

**Increasing number of tax-exempt charities
(March 2006 to September 2016)**

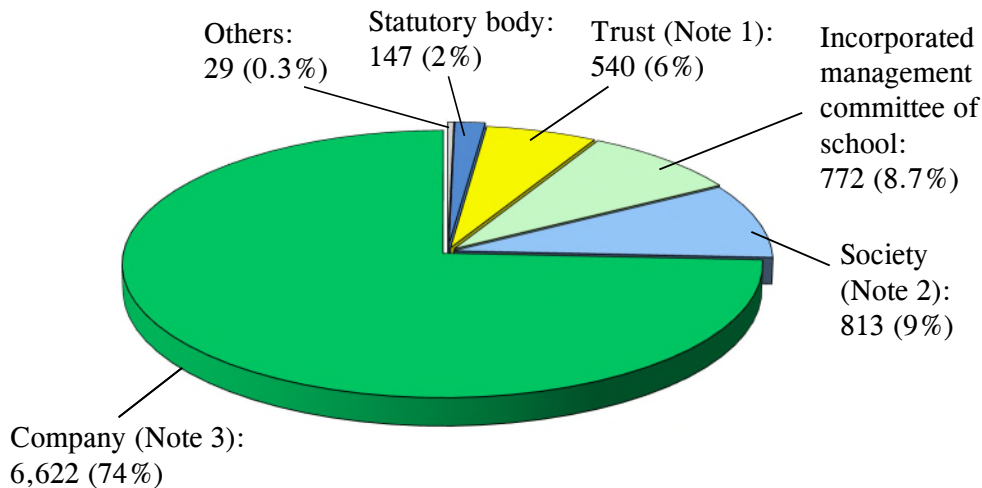


Source: Audit analysis of IRD records

Note: The figures show the numbers of tax-exempt charities as at end of March of each year from 2006 to 2016 and September 2016.

Figure 3

**Legal forms of 8,923 tax-exempt charities
(30 September 2016)**



Source: Audit analysis of IRD records

Note 1: Of the 540 tax-exempt charitable trusts, 58 were incorporated under the Registered Trustees Incorporation Ordinance (see para. 1.7(c)).

Note 2: Of the 813 tax-exempt societies, two had been deregistered as at 30 September 2016 but had not been reflected in the IRD's records (see para. 2.22).

Note 3: Of the 6,622 tax-exempt companies, three had been deregistered as at 30 September 2016 but had not been reflected in the IRD's records. One of the three deregistered companies remaining on the list of charitable institutions and trusts of a public character which are exempt from tax under section 88 of the IRO was due to the biweekly lead time in updating the list (see para. 2.20). The delays in updating the IRD's records for the other two cases are detailed in paragraph 2.21.

1.6 The rapid rise in philanthropy (see paras. 1.3 and 1.5) has highlighted the need to ensure that the charitable organisations exercise good governance, stewardship and ethical practices, and the monies collected are applied to their professed charitable purposes. From time to time, there have been public concerns over the adequacy of the Government's monitoring of charitable organisations and their activities. An effective monitoring framework has an important role to play in enhancing the standards of charities and ensuring that they uphold accountability and transparency for the donations they received.

Introduction

1.7 There is no overall statutory scheme for the registration and regulation of charities in Hong Kong. Depending on their legal forms and whether they have sought recognition of tax exemption status and government support, charities are subject to the monitoring and/or registration framework of different government bureaux/departments (B/Ds), as follows:

- (a) **IRD.** The IRD is responsible, as a tax administrator, for raising revenue through taxes, duties and fees in accordance with the relevant legislation. In addition to making tax assessments and collecting taxes, and other statutory functions, it processes applications for the recognition of tax exemption status of charities under section 88 of the IRO (Note 5). Charities are chargeable to profits tax if they carry on trade or business with profits in Hong Kong and fail to satisfy the provisions of section 88 (see para. 2.2). As administrative procedures, the IRD calls for accounts, annual reports or other documents from time to time from tax-exempt charities to review whether their objects are still meeting the eligibility criteria of “charitable purposes” (see para. 1.4) and their activities are compatible with their objects. Donations made to tax-exempt charities would be tax deductible under the IRO (see Note 1 to para. 1.2(a));

- (b) **Lands Department (Lands D).** The Lands D grants land by way of a PTG at nominal or concessionary premium or a short term tenancy at nominal or concessionary rent to some charitable organisations for operating schools, hospitals, and social welfare and community facilities. Many of the entities receiving such land grants are tax-exempt charities. In such cases, the charitable organisations are regulated by the Lands D and the supporting B/Ds to ensure their compliance with the conditions of land grant and the policy intention of granting the land;

Note 5: *According to the legal advice obtained by the IRD in 2003, section 88 of the IRO does not confer on it the power to grant tax exemption status. What section 88 provides is that charitable institutions or trusts of a public character are exempt from tax and they can seek recognition of such exemption by the IRD if they like. Such institutions are also exempt from certain duties and fees under the Stamp Duty Ordinance (Cap. 117) and registration under the Business Registration Ordinance (Cap. 310). Subject to the consent of the charitable institutions and trusts of a public character recognised for tax exemption under section 88, the IRD maintains a list of such institutions or trusts of a public character on its website. Donors can refer to the list to check whether a donee is a charitable institution not subject to tax and the donation is tax deductible. The IRD is not responsible for the governance of a charity, nor does it have regulatory power over the operation of a charity.*

- (c) ***Companies Registry (CR)***. The CR is responsible for administering and enforcing the Companies Ordinance (Cap. 622 — Note 6) for some 1.34 million limited companies on the Companies Register, e.g. filing of annual returns. Charities which choose to be incorporated as companies under the Ordinance need to comply with the same statutory requirements as other incorporated companies. The CR is also responsible for administering filings by trustees incorporated under the Registered Trustees Incorporation Ordinance (Note 7). The CR maintains records of registered companies and incorporated trustees which are open to public inspection. As of September 2016, there were 1,337,989 registered companies (including both local and registered non-Hong Kong companies) and 95 incorporated trustees, of which 6,619 (0.5%) registered companies and 58 (61%) incorporated trustees were on the IRD’s list of approved tax-exempt charitable institutions or trusts of a public character (s88 list) (Note 8);
- (d) ***Hong Kong Police Force (HKPF)***. The Societies Office of the HKPF is responsible for administering the Societies Ordinance (Cap. 151) and has granted registration or exemption from registration to around 38,000 local societies. Charities wishing to be set up under the Societies Ordinance are required to comply with the same statutory requirements as other registered societies, e.g. they shall within one month of their establishment or deemed establishment apply to the Societies Officer (i.e. the Commissioner of Police) for registration or exemption from registration under the Ordinance. The Societies Officer may exempt a

Note 6: *The new Companies Ordinance took effect on 3 March 2014 and replaced the old Companies Ordinance (Cap. 32). All companies referred to in this Report include those incorporated under the new or old Companies Ordinances.*

Note 7: *According to the CR, its responsibilities do not encompass monitoring the “charity” status or conduct of the tax-exempt charities and there is no provision under the Companies Ordinance or the Registered Trustees Incorporation Ordinance that enables the CR to give any direction or seek information from a body by virtue of it being a charity.*

Note 8: *According to the CR, there are no provisions under the Companies Ordinance or the Registered Trustees Incorporation Ordinance for a charity to be incorporated as a company/trustee. The CR has no means under the Ordinances to identify whether an incorporated company is a tax-exempt charity. The numbers of incorporated trustees and registered companies on the s88 list as of September 2016 were derived by Audit after cross-checking the IRD’s records against the records of registered companies and incorporated trustees of the CR.*

Introduction

society from registration if he is satisfied that the society is established solely for religious, charitable, social or recreational purposes or as a rural committee or a federation or other association of rural committees. However, such societies exempt from registration are also subject to the same statutory requirements as registered societies. The HKPF maintains a list of societies which is available for public inspection on its website. As of September 2016, there were 37,861 societies. Of 1,000 charitable societies so registered or exempted from registration, 811 were on the IRD's s88 list;

- (e) ***Education Bureau (EDB).*** According to the Education Ordinance (Cap. 279), every aided school (Note 9) is required to set up an incorporated management committee (IMC), in the form of a statutory body, to manage the school. Direct Subsidy Scheme schools (Note 10) may, according to their own needs, opt to establish IMCs under the Ordinance. The purpose of establishing IMCs is to manage schools through participatory governance by key stakeholders. While schools with IMCs are given a high degree of autonomy, the IMCs themselves are required to account for their use of public funds. As such, the IMCs are required to maintain proper books of account and submit their audited statement of accounts to the EDB. As of September 2016, there were 846 IMCs, of which 772 (91%) were on the IRD's s88 list. These charities are required to comply with the same statutory requirements under the Education Ordinance as other IMCs;
- (f) ***Home Affairs Bureau (HAB).*** As of September 2016, there were 2,480 tax-exempt charities established for purposes of advancement of religion. It is the Government's policy to respect the autonomy of religious organisations. However, the Chinese Temples Ordinance (CTO — Cap. 153) was enacted in 1928 to suppress and prevent mismanagement of Chinese temples and abuses of donated funds. Under

Note 9: *Aided school means any school that receives subsidies from the Government in accordance with the codes of aid for primary schools, secondary schools or special schools.*

Note 10: *Direct Subsidy Scheme schools are schools receiving subsidies directly from the Government. The amount of subsidy is calculated by reference to the average unit cost of an aided school place and the number of student enrolment of the Direct Subsidy Scheme school.*

the CTO, all Chinese temples should be registered with the Chinese Temples Committee (CTC — Note 11). As of September 2016, 347 of around 600 Chinese temples were registered (Note 12), of which 129 (37%) were managed by organisations on the IRD's s88 list. The list of registered Chinese temples is available for public inspection on the HAB's website; and

- (g) **Other B/Ds.** Some other B/Ds also exercise monitoring functions in relation to charities falling within their purview as follows:
- (i) **Subvention.** Charitable organisations receiving government subventions (such as some non-governmental organisations providing services in education, social welfare and health sectors) are regulated by the Government to the extent that the relevant B/Ds (e.g. the EDB, Social Welfare Department (SWD) and Department of Health) monitor the use of their government subvention. The recurrent subventions in 2015-16 totalled \$128.8 billion, some of which were provided to charitable organisations; and
 - (ii) **Charitable trusts.** There is no specified regulator of charities under the Trustee Ordinance (Cap. 29). However, section 57A of the Ordinance empowers the Secretary for Justice to act if there is a case of a breach of a charitable trust or the need for better administration of a charitable trust.

Note 11: *The CTC is a statutory body established under the CTO, which comprises the Secretary for Home Affairs as the Chairman, 7 appointed members and 16 co-opted members. One of its major responsibilities is to operate and manage 25 directly administered temples.*

Note 12: *Of these 347 registered Chinese temples, 25 (7%) were directly administered by the CTC, 20 (6%) managed by organisations under the delegated authority of the CTC and the remaining 302 (87%) managed by individuals or organisations such as religious organisations.*

Introduction

Previous audit review on monitoring of charities

1.8 In 1997, the Audit Commission (Audit) conducted a review of “Monitoring of charities: fund-raising and tax allowances” covering the Government’s procedures on monitoring of charitable fund-raising activities and those on administering tax exemptions. The results were reported in Chapter 4 of the Director of Audit’s Report No. 29 of October 1997. The Government accepted the audit recommendations for implementation.

Law Reform Commission Report on Charities

1.9 In view of the wide discussion by the community on the need for greater monitoring of charitable organisations, in June 2007, the Chief Justice and the Secretary for Justice asked the Law Reform Commission (LRC — Note 13) to review the subject. In December 2013, after completing a public consultation in 2011, the LRC published a Report on Charities (LRC Report) with a number of recommendations, including the definition and registration of charities, facilitation of good practice, financial reporting by charities and filing requirements (and requirement of display of registration number) for charitable fund-raising activities. In particular, the LRC Report recommended that all charitable organisations should be subject to the requirement of registration and a platform of coordination in dealing with applications for licences of charitable fund-raising activities among the relevant departments should be set up. Given that the recommendations touched on areas which fell within the policy responsibilities of several bureaux, the HAB has been tasked to coordinate inputs from relevant B/Ds for formulating a response to the LRC’s recommendations for the Government’s consideration.

Audit review

1.10 Against the above background, in October 2016, Audit commenced a review on the Government’s support and monitoring of the rapidly expanding charity sector (see paras. 1.3 and 1.5) and their charitable fund-raising activities.

Note 13: *The LRC, established in January 1980, considers for reform those aspects of the laws of Hong Kong which are referred to it by the Secretary for Justice or the Chief Justice. Members of the LRC are appointed by the Chief Executive of the Hong Kong Special Administrative Region and include academic and practising lawyers, and prominent members of the community.*

This audit did not cover the Government's management and control of the subventions provided to charitable organisations for their services (see para. 1.7(g)(i)). The audit findings are contained in two Audit Reports, namely the Government's support and monitoring of charities (the subject matter of this Audit Report) and the monitoring of charitable fund-raising activities (in Chapter 2 of the Director of Audit's Report No. 68).

1.11 This Audit Report focuses on the following areas:

- (a) administration of tax exemption of charities and tax-deductible donations (PART 2);
- (b) administration of land granted to charities for operating welfare/social services (PART 3);
- (c) filing and disclosure requirements of charities incorporated/established under three ordinances (PART 4);
- (d) regulation of Chinese temples (PART 5); and
- (e) way forward (PART 6).

General response from the Government

1.12 The Government generally agrees with the audit recommendations.

Acknowledgement

1.13 Audit would like to acknowledge with gratitude the assistance and full cooperation of the staff of the IRD, Lands D, HAB, Planning Department (Plan D), SWD, Home Affairs Department (HAD), Food and Environmental Hygiene Department (FEHD), CR, HKPF, EDB and Development Bureau during the course of the audit review.

PART 2: ADMINISTRATION OF TAX EXEMPTION OF CHARITIES AND TAX-DEDUCTIBLE DONATIONS

2.1 This PART examines the IRD's administration of tax exemption of charities and claims for tax deduction of approved charitable donations.

Administration of tax exemption of charities

The legal basis

2.2 Section 88 of the IRO states that:

“Notwithstanding anything to the contrary in this Ordinance contained there shall be exempt and there shall be deemed always to have been exempt from tax any charitable institution or trust of a public character:

Provided that where a trade or business is carried on by any such institution or trust the profits derived from such trade or business shall be exempt and shall be deemed to have been exempt from tax only if such profits are applied solely for charitable purposes; and are not expended substantially outside Hong Kong and either -

- (a) the trade or business is exercised in the course of the actual carrying out of the expressed objects of such institution or trust; or*
- (b) the work in connection with the trade or business is mainly carried on by persons for whose benefit such institution or trust is established.”*

According to the IRD, section 88 of the IRO provides general tax exemption to charitable institutions or trusts of a public character. However, it does not empower the Commissioner of Inland Revenue to determine whether an organisation is a charity or not. To provide certainty to charitable institutions and trusts of a public

character on their tax exemption status, the IRD has the practice of issuing confirmation to them if they apply to do so.

The tax guide

2.3 To facilitate an organisation to apply for recognition of tax exemption under section 88 of the IRO, the IRD has issued an information pamphlet entitled “A tax guide for charitable institutions and trusts of a public character” (the tax guide is also available on the IRD’s website) setting out the following:

- (a) ***Eligibility for tax exemption.*** To be eligible for tax exemption, a charity must be:
 - (i) established exclusively for charitable purposes (see examples of purposes which may be accepted as charitable in para. 1.4);
 - (ii) established by a written governing instrument (e.g. the Memorandum and Articles of Association in the case of a corporation); and
 - (iii) subject to the jurisdiction of Hong Kong courts, i.e. established in Hong Kong or Hong Kong establishments of overseas charities deemed to be established in Hong Kong under section 4 of the Societies Ordinance or registered under Part XI of the Companies Ordinance;
- (b) ***Documents required for processing applications.*** The documents required for filing an application include a certified true copy of the governing instrument, a list of activities for the past and coming years, and a copy of the accounts for the last financial year (for applicants established for more than 18 months). If the organisation has not yet been established, only a draft governing instrument and a list of the activities planned for the next 12 months from the date of establishment/application are required. To ensure that all the objects of the applicants are charitable and there are adequate safeguards to prevent the channelling of funds for non-charitable purposes, the tax guide draws particular attention to the following crucial clauses that the governing instrument of a charity should generally include:

Administration of tax exemption of charities and tax-deductible donations

- (i) clause stating precisely and clearly its objects;
 - (ii) clause limiting the application of its funds towards the attainment of its stated objects;
 - (iii) clause prohibiting distribution of its incomes and properties amongst its members;
 - (iv) clause prohibiting members of its governing body (e.g. directors, trustees, etc.) from receiving remuneration;
 - (v) clause requiring the keeping of sufficient records of income and expenditure (including donation receipts), proper accounting books and compilation of annual financial statements; and
 - (vi) clause specifying how the assets should be dealt with upon its dissolution (the remaining assets should normally be donated to other charities); and
- (c) **Review requirement.** The IRD will, from time to time, call for accounts, annual reports or other documents to review tax exemption status of a charity to ensure that its objects are still charitable and its activities are compatible with its objects.

IRD's organisation and instructions

2.4 The Charitable Donations Section (CDS) of the Commissioner's Unit (see Appendix A for an extract of the organisation chart of the IRD) is responsible for the work in connection with the tax exemption under section 88 of the IRO. The CDS is led by a Chief Assessor and comprises eight staff (Note 14). The IRD has issued a Staff Handbook setting out the practices and procedures in processing new applications for tax exemption and carrying out reviews of tax-exempt charities. The salient points are summarised below:

Note 14: *The IRD has also employed summer interns to assist in reviewing cases, e.g. in 2016, four summer interns were employed each for two months.*

Administration of tax exemption of charities and tax-deductible donations

- (a) ***Processing new applications.*** In considering a new application for tax exemption, the case officer is required to check the documents and information provided by the applicant until he is satisfied that the following requirements are fulfilled:
- (i) the applicant is a charity established according to the eligibility requirements set out in the tax guide (see para. 2.3(a));
 - (ii) the applicant's governing instrument contains all the crucial clauses set out in the tax guide (see para. 2.3(b)) and additional clauses viz. avoidance of conflict of interests of members of the governing body; and
 - (iii) the applicant's activities for the past 12 months and/or activities planned for the coming 12 months are compatible with its stated charitable objects.

The case officer's recommendation for recognising tax exemption status must be approved by the Section's Chief Assessor;

- (b) ***Review of tax-exempt charities.*** Such reviews are conducted from time to time having regard to their circumstances (such as receipt of complaints). In general, such reviews are conducted at least once every four years (Note 15). The charities selected for review are required to complete a questionnaire within one month providing information (such as whether the governing instrument has been changed since the last review) and documents (such as financial statements and reports on activities for the last financial year). The case officer is to examine the information provided by the charity to ensure that its objects are still charitable and that its activities are compatible with its charitable objects. Follow-up actions to be taken during the review include the following:

Note 15: *Prior to 2014, some 250 charities were not subject to periodic reviews (e.g. charities administered by government departments, and long and well-established charities). In 2014, the IRD started to review these charities by phases. As at December 2016, there were 94 such charities pending review.*

Administration of tax exemption of charities and tax-deductible donations

- (i) ***Qualified accounts.*** Where an auditor has expressed an adverse opinion on a charity's accounts on issues which may affect the charity's tax exemption status, the case officer may raise enquiries on the pertinent issues and seek remedial actions; and
- (ii) ***Directors' remuneration.*** Where a charity has paid remuneration to members of the governing body (e.g. directors) which is not allowed in the governing instrument, the case officer has to draw the charity's attention to the breach and seek the charity's remedial actions.

The review action is not regarded as completed unless a decision to continue or withdraw the recognition of tax exemption status is made;

- (c) ***Withdrawal of tax exemption.*** Recognition of tax exemption status is normally withdrawn for the following reasons:
 - (i) the charity was dissolved or wound up;
 - (ii) the charity has ceased operation or is dormant;
 - (iii) the charity no longer qualifies for the status of a charitable institution or trust of a public character; and
 - (iv) the charity did not respond to the IRD's enquiries or considered untraceable despite various efforts; and
- (d) ***Reinstatement.*** A charity whose recognition of tax exemption status is removed because it was untraceable or failed to give reply to the IRD's enquiries may apply for reinstatement of the recognition. In processing a tax exemption reinstatement application, the case officer will adopt an approach similar to processing new applications.

2.5 Table 1 shows the number of charities with their tax exemption status recognised, withdrawn and reinstated by the CDS from April 2012 to September 2016.

Administration of tax exemption of charities and tax-deductible donations

Table 1

Number of charities with tax exemption status recognised, withdrawn and reinstated (April 2012 to September 2016)

Year	Number of charities with tax exemption status			Number of tax-exempt charities at year end
	recognised	withdrawn	reinstated	
2012-13	517	128	9	7,592
2013-14	594	156	14	8,044
2014-15	611	175	10	8,490
2015-16	540	213	14	8,831
2016-17 (Up to September 2016)	199	113	6	8,923

Source: IRD records

Processing of applications for recognition of tax exemption status

2.6 ***Need to set a performance pledge for attending to new applications.*** The tax exemption status of charitable organisations enhances their recognition in the community and provides tax deduction for donors who make donations to support their work. It is important that the tax exemption applications by bona-fide charitable organisations are processed in an efficient and effective manner. In this regard, the CDS of the IRD aims to attend to new applications (i.e. issuing an initial response to the applicant) within four months. Audit test checked 30 applications and found that in 27 cases (90%), the applications were attended to within four months. The remaining three cases (10%) were attended to with minor delays (averaging 12 days). To enhance transparency and public accountability, the IRD should consider setting a performance pledge for attending to new applications.

Administration of tax exemption of charities and tax-deductible donations

Periodic review of tax exemption status

2.7 According to the CDS's Staff Handbook, reviews of the tax exemption status of charities are conducted from time to time having regard to their circumstances (such as receipt of complaints). In general, such reviews are conducted at least once every four years (see para. 2.4(b)). With effect from 1 September 2016, it has been the aim of the CDS to attend to charities' submitted questionnaires and replies to the CDS's enquiries (such replies are hereinafter referred to as "correspondence") within four months. Table 2 shows the processing time of reviews which commenced or were scheduled for commencement from 2012 to 2016 and were completed by September 2016.

Table 2

Processing time of completed reviews

Review commencement year	Reviews completed by September 2016 (Number)	Processing time	
		Average (Day)	Range (Day)
2012	1,328	468	11 to 1,440
2013	1,308	385	13 to 985
2014	1,433	313	14 to 698
2015	1,053	200	11 to 366
2016	739	105	24 to 179

Source: Audit analysis of IRD records

Remarks: In April 2013, the number of staff in the CDS increased from 5 to 8.

Administration of tax exemption of charities and tax-deductible donations

2.8 *Monitoring the progress of review cases.* At the end of each month, the CDS prepares a work report for management information purposes (Note 16). The monthly report contains, among other things, the following information:

- (a) the number of charities with their tax exemption status recognised, withdrawn and reinstated by the CDS during the month;
- (b) the number of charities' submitted questionnaires and correspondence pending the CDS's attention. Based on the monthly reports from January 2012 to September 2016, the numbers of such review cases (with submitted questionnaires and correspondence pending the CDS's attention) are shown in Figure 4; and
- (c) the dates of receipt of the earliest questionnaire and correspondence among those pending the CDS's attention at the end of each month. Based on such dates, Audit calculated the number of days for which the earliest questionnaire and correspondence had been pending the CDS's attention as at the end of each month (Note 17). The results for the period from January 2012 to September 2016 are shown in Figure 5.

Based on the monthly reports from October 2015 to September 2016, the number of submitted questionnaires and correspondence pending the CDS's attention at month end during the year averaged 742 which was lower than 807, 1,028 and 1,139 for the years ended September 2013, 2014 and 2015 respectively. The longest waiting time of the earliest questionnaire at month end during the year from October 2015 to September 2016 was 324 days, which was lower than 487, 516 and 506 days for the years ended September 2013, 2014 and 2015 respectively. Similarly, the longest waiting time of the earliest correspondence during the year from October 2015 to

Note 16: *According to the IRD, the monthly report by the CDS serves to inform the IRD management of the volume of the outstanding work pending the CDS's attention but not the number of uncompleted review cases. The number and details of the uncompleted review cases can be extracted from the IRD's database as and when necessary.*

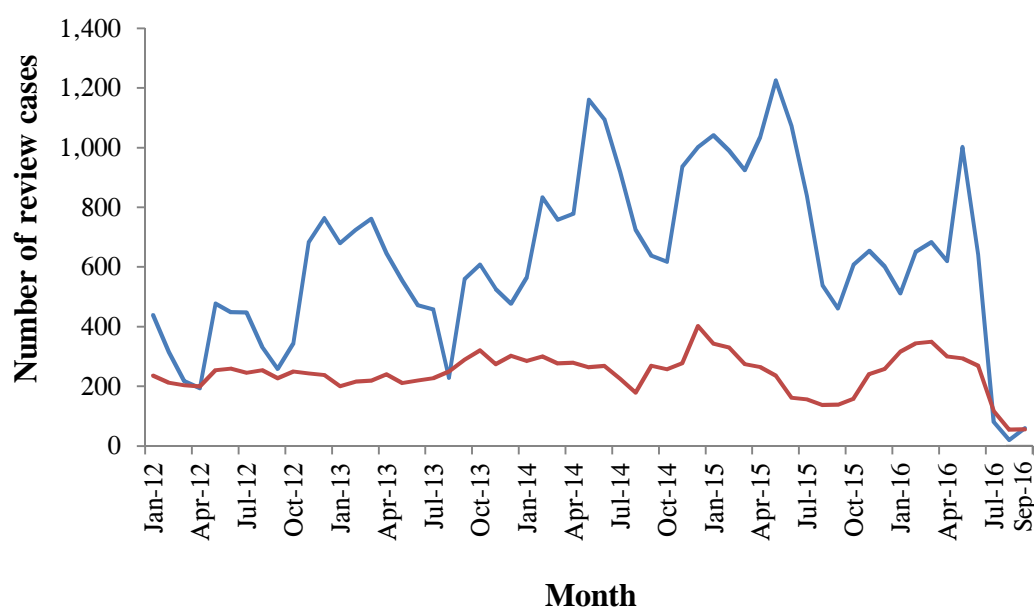
Note 17: *For example, as at 30 September 2016, the CDS had not attended to 60 submitted questionnaires. The waiting time for the earliest questionnaire which was received on 19 August 2016 was therefore 42 days up to 30 September 2016.*

Administration of tax exemption of charities and tax-deductible donations

September 2016 was 283 days, which was lower than 661, 598 and 476 days for the years ended September 2013, 2014 and 2015 respectively.

Figure 4

Number of review cases pending the CDS's attention (January 2012 to September 2016)



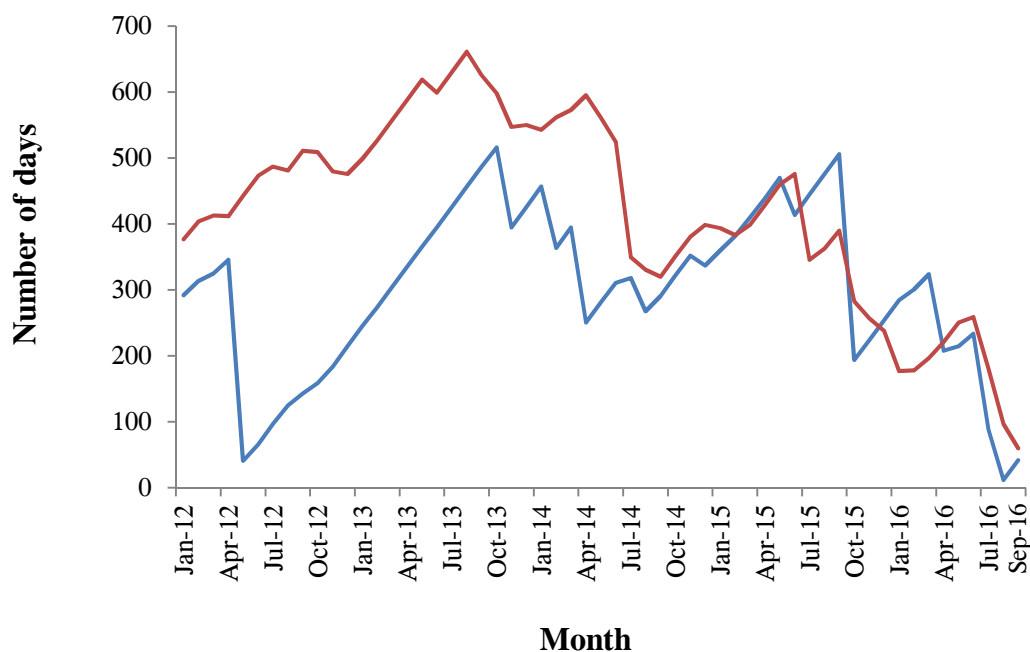
Legend: — Correspondence pending the CDS's attention
— Submitted questionnaires pending the CDS's attention

Source: IRD records

Remarks: The fluctuations from month to month in the number of submitted questionnaires/correspondence pending the CDS's attention were attributable to the CDS's practice of issuing questionnaires by three to four batches each year and the employment of summer interns to assist in reviewing cases (see Note 14 to para. 2.4).

Figure 5

**Number of days for which the earliest submitted questionnaire/correspondence
had been pending the CDS's attention
(January 2012 to September 2016)**



Legend: — Earliest correspondence
— Earliest submitted questionnaire

Source: *Audit analysis of IRD records*

Remarks: *The fluctuations from month to month in the number of days for which the earliest submitted questionnaire/correspondence had been pending the CDS's attention were related to the fluctuations in the number of uncompleted review cases (see Remarks in Figure 4).*

Administration of tax exemption of charities and tax-deductible donations

2.9 *Inadequacies of the monthly work reports.* While both the number of review cases pending the CDS's attention and the number of days for which the earliest submitted questionnaire/correspondence had been pending the CDS's attention had decreased over the years (see para. 2.8), Audit's enquiries of the reporting mechanism revealed the following issues:

- (a) for each review case with correspondence pending the CDS's attention, there was no information showing the date on which the review first commenced. For review cases with several rounds of exchange of correspondence with the charities concerned, the dates of the most recent correspondence pending attention did not reflect how long the cases had been in process. Moreover, the reported figures did not cover those review cases where the charities concerned had not responded to the CDS's queries (see para. 2.12(b) for an example); and
- (b) the reported information was collated from returns provided by individual case officers. Audit examination of the uncompleted review cases revealed incidents of long delays by the CDS in attending to the charities' correspondence/submitted information suggesting that there could have been omissions of uncompleted cases under this manual reporting system (see para. 2.12(a) for an example).

As such, the monthly reports could not provide a complete picture of all the uncompleted cases and their age profile.

2.10 *Audit analysis.* The IRD has maintained a computer database of all the tax-exempt charities and kept a record of the review year for each charity. The review year provides an indication of the review status of a case (Note 18). Audit analysis of the review year records of 8,923 tax-exempt charities kept in the computer database revealed that the IRD's reviews of the tax exemption status of 635 charities commenced or scheduled for commencement from 2006 to 2015 had remained uncompleted as at 30 September 2016. However, the IRD's

Note 18: *For example, a charity with a review year record (say 2013) which is earlier than the current time (say March 2017) means that the review commenced/scheduled for commencement in 2013 has not been completed. When the review is completed (say in June 2017), the review year record will be updated to 2021 in accordance with the 4-year review interval.*

Administration of tax exemption of charities and tax-deductible donations

September 2016 report only showed 116 uncompleted review cases pending the CDS's attention due to the inadequacies mentioned in paragraph 2.9(a) and (b).

2.11 **635 uncompleted review cases.** An ageing analysis of the 635 uncompleted review cases showed that 71 (11%) had remained uncompleted over five years as at 30 September 2016 (see Table 3). There is a need for the IRD to closely monitor these uncompleted review cases because:

- (a) if the IRD subsequently finds it necessary to withdraw the recognition of the tax exemption status of a charity, there could be delays in raising assessments on its profits. Under the IRO, the IRD is empowered to raise assessments and demand tax within six years after the expiration of the relevant year of assessment; and
- (b) as the effective date of withdrawal would be dated back to the event leading to the withdrawal, members of the public could have made donations and claimed tax deductions on their tax returns based on the information about the tax exemption status of the charities concerned as posted on the IRD's website, which turns out to be inaccurate.

In this connection, Audit examined 30 cases of withdrawal and found that the IRD withdrew the recognition of the tax exemption status of the charities concerned a long time after commencing the periodic reviews, i.e. five to seven years in four cases.

Table 3

**Ageing analysis of the 635 uncompleted review cases
(30 September 2016)**

Number of years a review case remained uncompleted	Number of review cases
< 2	461 (73%)
2 to 5	103 (16%)
> 5	71 (11%)
Total	635 (100%)

Source: Audit analysis of IRD records

2.12 ***Delays in taking follow-up actions.*** According to the IRD, there is no operative provision under the IRO that requires a charity to respond to the IRD's requests for information and documents for the periodic reviews of its tax exemption status within a specific time. The long time taken in processing the cases could have been caused by delays of the charities concerned in responding to the IRD's enquiries. Audit selected 17 review cases for examination (i.e. about one-fourth of the 71 review cases which had remained uncompleted over five years). Audit found that in 15 (88%) cases, there were instances of delays by the IRD and the following are three examples:

- (a) ***Case A.*** In March 2009, the IRD commenced a review of the tax exemption status of a charity (Charity A) by issuing a questionnaire to obtain relevant information and documents. The questionnaire was submitted in April 2009. However, it was left unattended to until September 2016 (some 7.5 years later) when the IRD resumed its follow-up action. This case was not included in the monthly work report on the review cases pending the CDS's attention (see para. 2.9(b));
- (b) ***Case B.*** In March 2011, the IRD commenced a review of the tax exemption status of a charity (Charity B) by issuing a questionnaire to obtain relevant information and documents. The questionnaire was submitted in April 2011. In January 2012, the IRD raised an enquiry

about the financial accounts. While the enquiry was not answered by the charity concerned, the IRD had not taken any follow-up action until August 2016 (some 4.5 years later). This case was not included in the monthly report because it did not cover review cases where the charities concerned had not responded to the IRD's enquiries, i.e. an inadequacy mentioned in paragraph 2.9(a); and

- (c) **Case C.** In March 2011, the IRD commenced a review of the tax exemption status of a charity (Charity C) and the questionnaire was submitted in May 2011. During the course of review, the IRD found that Charity C had paid rent 67% higher than the rateable value in 2007-08 and 2008-09 for use of premises owned by a related company (which had common directors with Charity C) when its governing instrument only allowed the payment of proper and reasonable rent to members of the governing body. Up to December 2016 (after the lapse of five years), the IRD had not finalised the case. Audit noted that on three occasions during the five years, the IRD only requested further explanations and documents after long periods of inaction ranging from 9 to 16 months.

Follow-up actions on matters of regulatory concern

2.13 In both the periodic reviews and processing of new applications (including reinstatement applications) for tax exemption, the IRD would examine the submitted documents and make enquiries to ascertain whether the activities or expenditures of the charities concerned are compatible with their objects. Audit examined 160 review cases and 10 reinstatement application cases and found limitations/inadequacies in the IRD's follow-up actions on matters of regulatory concern in 10 review/reinstatement cases. The detailed findings are reported in paragraphs 2.14 to 2.19.

2.14 ***Directors' remuneration.*** According to the CDS's Staff Handbook, where a charity is found in a periodic review to have paid remunerations to directors which is not allowed in its governing instrument, the case officer has to draw the charity's attention to the breach and seek the charity's remedial actions (see para. 2.4(b)(ii)). Audit found four cases of breach of the directors' remuneration clauses (Cases D to G). While remedial actions were taken by the charities concerned, ranging from cessation of payment (Case D) to partial refund

Administration of tax exemption of charities and tax-deductible donations

(Cases F and G) and full refund (Case E), their tax exemption status was not affected:

- (a) **Case D.** In March 2016, the IRD received a complaint that some members of a tax-exempt charity (Charity D) had received remunerations for the years ended 2012 to 2015. In May 2016, the IRD obtained the financial statements of Charity D for these years and identified that remunerations had been paid to nine directors totalling about \$13 million for the three years ended 2012 to 2014, which was not allowed under the Charity D's governing instrument. In August 2016, the IRD requested Charity D to confirm whether the practice had ceased and what remedial action would be taken. In October 2016, Charity D confirmed that it had ceased paying remuneration and provided information showing that the practice ceased in 2015. Audit noted from the IRD's records of an Employer's Return for salaries tax and financial statements filed by Charity D which showed that remunerations totalling \$5 million had also been paid by Charity D to ten directors for the year ended 2011;
- (b) **Case E.** In a 1999 review, the IRD found that a tax-exempt charity (Charity E) had breached the directors' remuneration clause and paid three directors a total sum of \$20,700 for the year ended 1999. Charity E arranged full refund of the remunerations by the three directors and undertook to comply with the governing instrument requirements in future. The IRD accepted the remedial action and continued Charity E's tax exemption status. However, in another review in 2007, the IRD found that Charity E had breached the directors' remuneration clause again and paid a director a total sum of \$43,500 for the years ended 2006 and 2007. Notwithstanding the repeated breaches, the IRD accepted Charity E's remedial action (i.e. full refund and undertaking of future compliance) and continued Charity E's tax exemption status. A warning that it would withdraw the tax exemption status for any recurrence of the similar problem was issued to Charity E after the detection of the breach in the 2007 review; and
- (c) **Cases F and G.** In processing a reinstatement application of Charity F in 2015 (the tax exemption status of Charity F was withdrawn in December 2003), the IRD found that Charity F had breached the directors' remuneration clause and paid a member of its governing body a total sum of \$276,100 for the years ended 2003 to 2013. After Charity F refunded \$13,100 (5% of the remuneration paid), the IRD reinstated the

Administration of tax exemption of charities and tax-deductible donations

recognition of its tax exemption status. Similarly, in processing a reinstatement application of Charity G in 2012 (the tax exemption status of Charity G was withdrawn in May 2006), the IRD found that Charity G had breached the directors' remuneration clause and paid a director a total sum of \$375,000 for the years ended 2008 to 2012. In the event, the IRD reinstated the recognition of its tax exemption status after Charity G proposed that \$187,500 (50% of the remuneration paid) would be refunded by the director.

2.15 ***Expenses not in furtherance of charitable objects.*** According to the CDS's Staff Handbook, the governing instrument of a tax-exempt charity should generally contain a clause limiting the application of its funds towards the attainment of its stated objects. Audit noted two cases (Cases H and I) in which the IRD had identified the expenditures which were not in furtherance of the objects of the charities concerned. In both cases, the IRD continued their tax exemption status after remedial actions had been taken, with one case satisfied by a full refund and the other case no refund, as follows:

- (a) ***Case H.*** In December 2010, the IRD received a complaint about a charity (Charity H) alleging that some of its income should be subject to tax. After obtaining clarifications from Charity H, the IRD found that the complaint was unsubstantiated. However, in the course of examining its financial statements for the years ended 2010 to 2013, the IRD found that some of its travelling expenditure items totalling \$704,500 could not have been used for furthering its charitable objects. In response to the IRD's observations, Charity H confirmed that it had claimed back \$500,000 of the money paid and the rest would be recovered in due course. No follow-up actions were taken and the IRD continued Charity H's tax exemption status; and
- (b) ***Case I.*** In a 2008 review, the IRD found that a charity (Charity I)'s activities included repairing of an ancestral tomb of a director. The IRD raised questions on how the activities were compatible with its objects of relief of poverty and requested Charity I to provide a breakdown of its donation expenses. As Charity I failed to respond to the IRD's enquiries despite repeated reminders, the IRD withdrew its tax exemption status in December 2011. In July 2014, Charity I applied for reinstatement of its tax exemption status. The IRD found from Charity I's submitted breakdown of donation expenses for the year ended 2008 that

Administration of tax exemption of charities and tax-deductible donations

two expenditure items totalling \$236,000 were for the re-construction of an ancestral temple and repair of an ancestral tomb (related to the Charity's founder). While the IRD considered the former expenditure was not charitable in nature and the latter expenditure was for discharging the personal liability of the founder, it accepted Charity I's undertaking not to make similar payments as a remedy and reinstated its tax exemption status.

2.16 *Limitations of the IRO provisions on tax exemption status of charities.*

In response to the audit observations in paragraphs 2.14 and 2.15, the IRD informed Audit in March 2017 of the following limitations in its powers to take enforcement actions on the six cases of breach of the governing instrument/objects of charities:

- (a) ***Directors' remuneration.*** According to a case law ruling, while payment of remunerations to directors of a charity not provided for in the governing instrument might constitute a breach of fiduciary duty, such breach would not alter the charity's objects and hence its charitable status. The IRD had no legal basis or authority to withdraw the tax exemption status of a charity merely because of the non-compliance. Based on the legal advice obtained in 2003, the IRD noted that an offence committed by an official of the institution might not necessarily be attributable to the institution. The IRD also had no authority to demand the charities to refund (in full or in part) the directors' remunerations paid. The IRD had ceased to issue warning letters in respect of any breach of the directors' remuneration clause after the one issued in Case E (see para. 2.14(b)). Instead, a closing letter reminding the charities to comply with the relevant provisions in their governing instruments would be issued; and

- (b) ***Expenses not in furtherance of charitable objects.*** The IRD was not responsible for the governance of a charity, nor did it have regulatory power over the operation of a charity. Based on the legal advice obtained in 2003, the IRD noted that it was not legally proper to overturn a charity's tax exemption status solely because the charity had not complied with any obligations, whether statutory or not, which were not provided in the IRO. Even though the case officer was of the view that certain items of expenditure were not paid for the furtherance of the charitable objects of a charity, this did not affect its charitable status. The IRD had no authority to demand the charity to refund (in full or in part) the expenditure concerned. Based on the legal advice obtained in 2003, the

Administration of tax exemption of charities and tax-deductible donations

IRD noted that an isolated incident might not necessarily be conclusive as to the true nature of the business of an institution. The best the IRD could do was to remind the charity of the compliance with the income clause in its governing instrument and advise it to take remedial actions.

2.17 *Need to consider reviewing the provisions of the IRO on tax exemption status of charities.* In its Report on Charities of 2013, the LRC noted that the IRD would from time to time call for accounts, annual reports or other documents for the purpose of conducting a review of the tax exemption status of a particular organisation so as to ensure that the organisation remained charitable and its activities were compatible with its objects. The LRC considered that the IRD's function of reviewing the accounts of charities to ensure that their income was used solely for charitable purposes in compliance with the law was highly important, underpinning to a large extent, the public's confidence in the charity sector. Many responses obtained by the LRC during its consultation stage acknowledged the need for the IRD to carry out the function of reviewing annual accounts. There was also a suggestion that the IRD should carry out reviews on the charitable status of charities more frequently for the better monitoring of the accounts of charities and their operations related to charitable activities. The LRC has recommended that the IRD should conduct more frequent reviews of the accounts of tax-exempt charities as and when necessary, to ascertain whether the activities of these charities are compatible with their charitable objects. However, according to the IRD, there is a lack of enforcement powers under the existing provisions of the IRO for the IRD to take effective follow-up actions on charities found with expenses/activities contravening their governing instruments or incompatible with their charitable objects (see para. 2.16). Apparently, there is a gap between the public expectation of the IRD's role in administering the tax exemption status of charities and what the IRD can do under the existing provisions of the IRO. To address the expectation gap, there is a need to consider reviewing the provisions of the IRO with a view to enabling the IRD to effectively perform its role of administering the tax exemption status of charities.

2.18 *Donations made by charities.* According to the tax guide, a tax-exempt charity shall have a clause in its governing instrument requiring the keeping of sufficient records of income and expenditure, including donation receipts (where donations were made to another charity — see para. 2.3(b)(v)). Audit noted that in two review cases, the case officers had not requested the charities concerned to provide sufficient explanations on their donation expenditures to support that they were compatible with their objects:

Administration of tax exemption of charities and tax-deductible donations

- (a) in one case (Case J), while the charity's financial statements for the year ended 2015 showed donation income of \$0.9 million and donation/scholarship expenditure of \$1 million, the case officer noted down on file that no expenditure breakdown was requested as similar information had been provided in the previous review of 2011. Given the lapse of four years and the possibility that the nature and extent of the donation expenditure items might have changed between the two reviews, a breakdown of the donation expenditures for 2015 should have been obtained; and

- (b) in another case (Case K), while the charity's financial statements for the year ended 2014 showed donation income of \$0.39 million and donation expenditure of \$0.46 million, no expenditure breakdown was requested. The case officer noted down on file her observation from the charity's submitted questionnaire that its activities in 2015 included supporting other charities in the relief of victims of an earthquake in Nepal and advancement of religion which were compatible with its objects as a reason for not requesting a breakdown of the donation expense. However, there was no explanation on why the donations in 2015 were considered relevant to those made in 2014. A breakdown of the donation expenditures for 2014 should have been obtained.

In March 2017, in response to Audit's enquiry, the IRD said that the case officers had exercised their professional judgement and adopted a risk-based approach in conducting reviews. In both cases, no expenditure breakdown was considered necessary by the IRD. However, Audit noted that there were instances that the case officers had requested the charities concerned to provide a breakdown of their donation expenditures even though similar information had been provided in previous reviews. For example, in one case, the CDS obtained a breakdown of donations of \$0.6 million made by a charity in its 2014 review although similar breakdown for donations of \$0.73 million had been provided in the 2009 review. Moreover, given that the donation expenditures in Cases J and K were the only activities of the charities using up all/most of their donations received for the years, there is a need to remind the case officers to also give due consideration to the materiality of the donation expenditures in relation to the charity's income in determining the extent of verification work.

Administration of tax exemption of charities and tax-deductible donations

2.19 *Dormant charity.* According to the CDS's Staff Handbook, the recognition of tax exemption status of a charity may be withdrawn if it has ceased operation or is dormant (see para. 2.4(c)(ii)). Audit examined seven review cases and found that in three cases, the CDS had taken a long time (over two years) to deal with dormant cases. The following are two examples:

- (a) in one case (Case L), the charity concerned was recognised as a tax-exempt charity in 1997. In three subsequent reviews of its tax exemption status (i.e. in 2002, 2004 and 2009), the submitted financial statements showed that the charity had not commenced operation (for some 12 years up to 2009). In the 2002 review, the charity stated in its submitted questionnaire that it had a plan to operate as a church later that year. In response to the case officer's enquiries in the 2004 review exercise, the charity stated that it would start operation in January 2005 and provided information in relation to the activities intended to carry out. In the 2009 review, the charity stated that it would start operation from November 2009. The IRD continued its tax exemption status each time after obtaining a future activity plan (to operate as a church). For the 2014 review, the charity provided information (including donation receipts dated 13 September 2015 and 31 July 2016, and an activity pamphlet of Sunday services) to show that it had charitable activities in 2015 and 2016. In the event, the IRD continued the charity's tax exemption status in September 2016. However, Audit noted from the financial statements of the charity for the year ended 31 March 2016 (which were available from the CR as the charity was a registered company) that there was no income for the year and a note to the financial statements also stated that the charity had not commenced any activities and remained dormant. The IRD needs to seek explanations from the charity in this regard; and

- (b) in another case (Case M), the charity concerned was recognised as a tax-exempt charity in 2006. In response to the IRD's 2011 review of its tax exemption status, the charity reported in April 2011 that it was dormant. In May 2012 (one year later), the IRD enquired the charity if it had a future activity plan. In July 2012, the charity requested an extension to furnish a reply about its future activities for one year. However, for three years the charity had not responded to the IRD's reminders (of December 2012, February 2014 and May 2015) on its outstanding reply. In June 2015, the charity (a registered company) applied to the IRD for a notice of no objection to its application to the CR

Administration of tax exemption of charities and tax-deductible donations

for deregistration in accordance with the Companies Ordinance requirement. The case officer issued enquiries to the charity after noticing that it had applied for deregistration. In July 2015, the charity informed the IRD that it had never commenced business since its incorporation. The IRD then withdrew the recognition of its tax exemption status.

In March 2017, the IRD informed Audit that it had to strike a balance in maintaining the recognition of the tax exemption status of a charity and the damage that would be done to the charity if the recognition was withdrawn without a legally defensible reason. However, in four of the seven cases examined by Audit, the case officers had taken action to withdraw the recognition of tax exemption status of dormant charities in a more timely manner. For example, in one case, the charity replied in February 2015 that it had not held any activities. After issuing an enquiry letter for a future activity plan in April 2015 and three reminders in August and December 2015, and May 2016 which were met with no response, the CDS withdrew the recognition of tax exemption status of the charity in September 2016 (i.e. after 19 months). In Audit's view, the IRD needs to remind CDS staff to take action on dormant cases in accordance with the Staff Handbook requirements if the charities concerned have failed to respond to the CDS's enquiries or failed to realise their activity plans within a reasonable time.

Need to take timely action upon dissolution of a tax-exempt charity

2.20 According to the tax guide, the governing instrument of a tax-exempt charity should contain a clause specifying how its assets should be dealt with upon its dissolution (the remaining assets should normally be donated to other charities) (see para. 2.3(b)(vi)). The IRD has made arrangements with the CR whereby companies to be struck off by the CR would be brought to the IRD's attention. Since January 2016, the CDS has used a computer program to conduct matching exercise twice a month to identify tax-exempt charities to be struck off by the CR. This is important to protect revenue in case there are any outstanding tax liabilities of a company to be struck off. Where the company is a tax-exempt charity, the arrangements also enable the IRD to take timely actions on:

- (a) updating its s88 list by removing the name of the struck-off charitable company; and

Administration of tax exemption of charities and tax-deductible donations

- (b) making enquiry into whether the assets of such company after dissolution have been disposed of in accordance with the governing instrument requirement.

2.21 Audit examined the notification arrangements by cross-checking the tax-exempt charities on the IRD's s88 list as at 30 September 2016 against the Companies Register maintained by the CR. Audit found that two tax-exempt charitable companies which had been struck off by the CR were still on the s88 list:

- (a) in the first case, the charity had been struck off by the CR in October 2015 but was removed from the s88 list by the CDS on 7 December 2016 (when the case officer was informed by the IRD's Headquarters Unit about the striking off of the charity); and
- (b) in the second case, the matching exercise in June 2016 revealed that the charity was pending striking off. The case officer issued a letter on 16 June 2016 asking the charity to provide the final accounts. In response to the charity's enquiry of 7 September 2016, the case officer issued a letter on 29 September 2016 to explain the "striking off" arrangement and request the provision of the required information. Subsequently, the matching exercise (see para. 2.20) revealed that the charity was struck off on 30 September 2016 but the matching report for this file was mislaid. As a result, the recognition of tax exemption status of the struck-off company was only withdrawn on 27 January 2017.

In March 2017, the IRD informed Audit that: (i) before rolling out the computer program for the matching exercise in January 2016 (see para. 2.20), the CDS had to first manually check the status of the then existing corporate charities from the CR's cyber search centre; (ii) for the first case in (a) above, the manual checking of 6,532 corporate charities was accomplished within a month's time and the CDS had only failed to identify one struck-off case; and (iii) the mislaid matching report for the second case mentioned in (b) was also an isolated incident. However, given that members of the public have been advised by the IRD's departmental interpretation and practice notes to refer to the s88 list for checking whether their charitable donations will qualify for tax deduction, there is a need to ensure timely removal of the struck-off charitable companies from the s88 list.

Administration of tax exemption of charities and tax-deductible donations

2.22 Audit also notes that the IRD has not made similar notification arrangements with relevant B/Ds for tax-exempt charities which are established under other ordinances (e.g. the Societies Ordinance administered by the HKPF — see para. 1.7(d)). In this connection, Audit cross-checked the tax-exempt charities on the IRD’s s88 list as at 30 September 2016 against the register of societies maintained by the HKPF. Audit found that two tax-exempt charitable societies which had been deregistered by the HKPF (one in 1997 and the other in September 2016) were still on the s88 list. In March 2017, in response to Audit’s observation, the IRD said that:

- (a) for the first case, notwithstanding that the charity was not registered with the Societies Office of the HKPF, in the four consecutive reviews of its tax exemption status (i.e. 2000, 2004, 2010 and 2015), the submitted financial statements and lists of activities showed that the charity operated a church and carried out charitable activities compatible with its charitable objects. Based on the manual checking exercise mentioned in paragraph 2.21 which also covered charities established by other legal structures (such as societies), the CDS identified that the charity had been deregistered during the exercise and then sought clarification with it. The charity advised the IRD in late August 2016 that it was trying to resolve the issue with the Societies Office and would provide relevant documents to the IRD. The IRD was of the view that the charity’s failure of registration with the Societies Ordinance would not affect the charity’s charitable status based on a case law ruling. As at March 2017, the CDS’s clarification with the charity was still in progress; and
- (b) for the second case, the tax exemption status was removed on 19 December 2016 upon the Societies Office’s confirmation that the charity was dissolved.

Administration of tax-deductible donations

2.23 Under sections 16D and 26C of the IRO, a taxpayer making an approved charitable donation is allowed tax deduction under profits tax and salaries tax/personal assessment respectively. Besides the tax guide, the IRD has issued departmental interpretation and practice notes advising the public of the criteria governing the allowance of tax deduction for charitable donations under section 26C of the IRO, including the following:

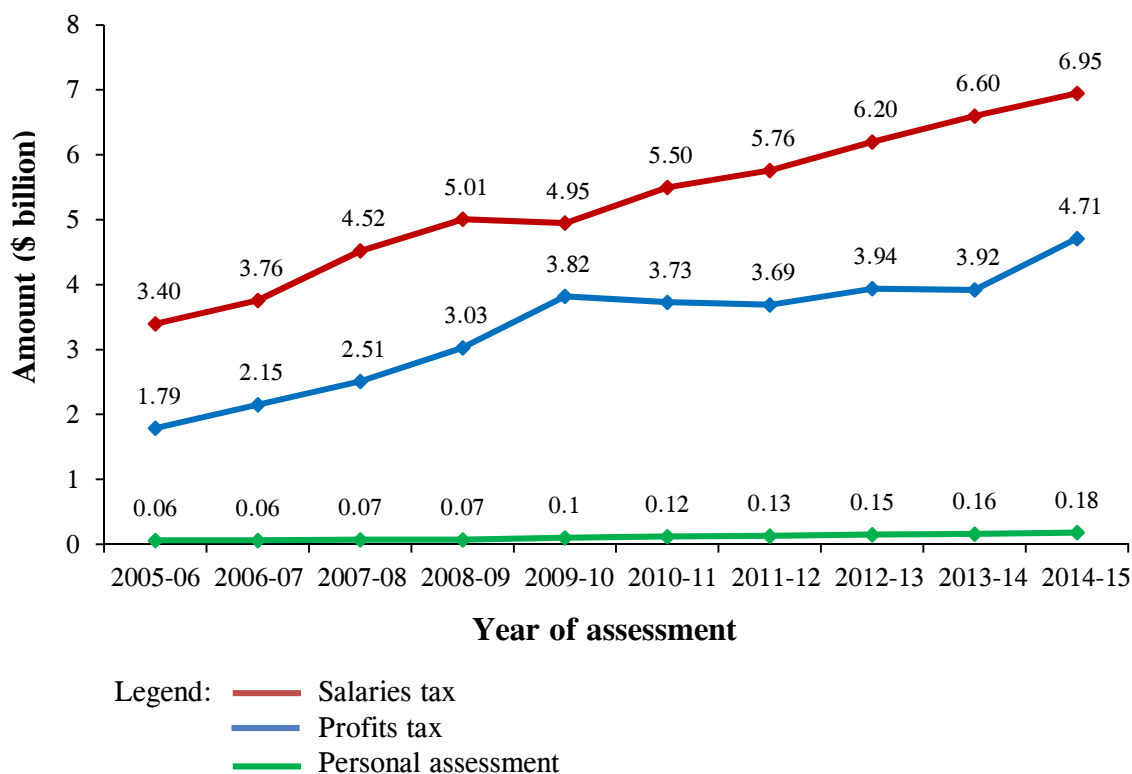
Administration of tax exemption of charities and tax-deductible donations

- (a) the payment must be a donation. The donor must not receive any benefit or advantage of a material nature by way of return. Examples of payments not recognised for tax deduction include purchase of raffle tickets, and cost of tickets for charity balls, concerts and film shows;
- (b) the donation must be a donation of money to a tax-exempt charitable institution or trust of a public character under section 88 of the IRO;
- (c) a deduction in respect of the same donation cannot be allowed to more than one taxpayer;
- (d) the aggregate of a taxpayer's donations (including the donations of his or her spouse, not being a spouse living apart from the person for salaries tax and personal assessment) must not be less than \$100; and
- (e) the allowable deduction in any year cannot exceed a specified percentage of the person's assessable income (i.e. 35% since year of assessment 2008-09).

2.24 The amounts of charitable donations approved for tax deduction under profits tax, salaries tax and personal assessment for the years of assessment from 2005-06 to 2014-15 are shown in Figure 6.

Figure 6

Charitable donations approved for tax deduction under profits tax, salaries tax and personal assessment (Years of assessment 2005-06 to 2014-15)



Source: IRD records

2.25 Unit 1 of the IRD is responsible for administering tax deduction claims for charitable donations of corporations and partnerships as part of its tax assessment work on their profits tax. Unit 2 is responsible for administering tax deduction claims for charitable donations of individuals as part of its tax assessment work on their salaries tax, profits tax and personal assessment. As at June 2016, there were 360 staff working in Unit 1 and 766 in Unit 2. In 2015-16, 461,000 assessments were made under profits tax, 2,797,000 under salaries tax and 362,000 under personal assessments.

2.26 *Desk audits.* Since April 2001, in order to streamline the assessing procedures, the IRD has used a computerised Assess First Audit Later System for screening tax returns for automated assessment and selecting cases for

Administration of tax exemption of charities and tax-deductible donations

post-assessment desk audit. Both Units 1 and 2 have used a risk-based approach in selecting returns for conducting desk audits:

- (a) for profits tax cases selected, assessing officers will examine the profits tax returns and supporting documents (e.g. tax computation and financial statements) already submitted by the taxpayers. According to the IRD, all aspects of a selected profits tax case (i.e. all account items including charitable donation claims) will be examined although special attention will be paid to the risk areas for which each case is selected. The objective is to ascertain whether assessable profits/loss issued by the automated assessment is correct. In the process, assessing officers would exercise professional judgement and may seek clarifications from the taxpayers concerned where necessary and worthwhile. There is no requirement that enquiries must be issued in each desk audit case. Original receipts and supporting evidence will only be asked in exceptional cases; and

- (b) for salaries tax and personal assessment cases selected based on charitable donation claims, the IRD will require taxpayers concerned to submit the donation receipts (usually the original receipts) or other acceptable supporting evidence (such as bank pay-in slips showing details of the donations made) for verification. In examining the documents submitted, assessing officers would exercise professional judgement on whether the donations made have fulfilled the deduction requirements.

2.27 The IRD will make adjustments where charitable donations are found to be overclaimed or underclaimed as a result of the desk audits. Table 4 shows the number of tax files with adjustments made and the corresponding adjustments made relating to charitable donations for the years of assessment 2010-11 to 2014-15.

Administration of tax exemption of charities and tax-deductible donations

Table 4

Desk audit adjustments made in relation to disallowed charitable donation claims for the years of assessment 2010-11 to 2014-15 (September 2016)

Year of assessment	Unit 1		Unit 2	
	Number of tax files for corporations/partnerships	Adjustment (\$)	Number of tax files for individuals	Adjustment (\$)
2010-11	6	1,800,323	428	14,724,978
2011-12	10	978,978	305	14,516,564
2012-13	11	317,372	238	13,585,036
2013-14	5	216,882	140	7,711,211
2014-15	7	697,186	102	11,373,940
Total	39	4,010,741	1,213	61,911,729

Source: IRD records

Room for improvement in desk audits on charitable donation claims

2.28 Based on a sample check of 30 desk audit cases for profits tax conducted by Unit 1 in 2015-16 and 50 desk audit cases for salaries tax/personal assessment conducted by Unit 2 in 2015-16, Audit noted the following:

- (a) **Profits tax.** In one case, the supporting schedule filed by the taxpayer did not show whether the donations for \$50,000 were made to recognised charities on the s88 list. However, the assessing officers had allowed tax deduction for the said amount without seeking clarification from the taxpayer. While the claimed amount of \$50,000 representing only 0.72% of the assessable profits might not warrant a detailed verification, there is a need to maintain a minimum level of verification, such as requesting a breakdown of the donation expenditures to show that they are made to recognised charities on the s88 list. In this connection, Audit noted that for salaries tax, the IRD would require the taxpayers concerned to submit donation receipts for claims of \$100 or more; and

- (b) *Salaries tax.* In one case, the charity shown on the donation receipt for US\$100 was not a recognised charity on the s88 list. In another case, the donor's name on the donation receipt for \$100 did not match with the name of taxpayer or his spouse claiming tax deductions. However, the assessing officers had allowed tax deductions for the said amounts in both cases. In Audit's view, the IRD needs to remind assessing officers to be more vigilant in checking the validity of donation receipts in the desk audits.

Audit recommendations

2.29 *Audit has recommended that the Commissioner of Inland Revenue should:*

- (a) **consider setting a performance pledge for attending to new applications for recognition of tax exemption status;**
- (b) **take measures to enhance the monitoring of the progress of periodic review cases of tax exemption status of charitable organisations such as ensuring that all uncompleted review cases are included in the monthly work report submitted for management review;**
- (c) **closely monitor the uncompleted review cases and remind CDS staff to take timely follow-up actions on outstanding issues;**
- (d) **take measures to improve the follow-up actions on matters of regulatory concerns identified during reviews of the tax exemption status of charitable organisations, including:**
 - (i) **in consultation with the Secretary for Financial Services and the Treasury, considering the need for reviewing the provisions of the IRO with a view to enabling the IRD to effectively perform its role of administering the tax exemption status of charities;**
 - (ii) **reminding CDS staff to obtain from the charities concerned a breakdown of their donation expenditures to support that they are compatible with their objects and, in exercising their**

Administration of tax exemption of charities and tax-deductible donations

- judgement to determine the extent of verification work, give due consideration to the materiality of the donation expenditures; and
- (iii) reminding CDS staff to take action on dormant cases in accordance with the Staff Handbook requirements if the charities concerned have failed to respond to the CDS's enquiries or failed to realise their activity plans within a reasonable time, and seek further explanations from the charity mentioned in paragraph 2.19(a);
 - (e) remind CDS staff to take timely action on updating the s88 list by removing charities which had been deregistered by the CR/HKPF;
 - (f) expedite action to liaise with relevant B/Ds (such as the HKPF) to set up notification arrangements of charitable organisations which have been deregistered under their respective ordinances; and
 - (g) remind assessing staff in conducting desk audits:
 - (i) to seek clarification from the taxpayer concerned if the supporting schedule for a profits tax case cannot show whether the claimed charitable donations are made to recognised charities on the s88 list; and
 - (ii) to be more vigilant in checking the validity of donation receipts for allowing tax deduction under salaries tax.

Response from the Government

2.30 The Commissioner of Inland Revenue generally agrees with the audit recommendations. He has said that:

- (a) regarding paragraph 2.9(b), the IRD management has noticed the large volume of outstanding work pending the CDS's attention and has taken steps (including increasing the CDS's manpower in 2013 and recruiting interns since 2014) to clear the outstanding work;

Administration of tax exemption of charities and tax-deductible donations

- (b) regarding paragraph 2.11(a), the IRD officers remain vigilant in reviewing the tax exemption status of charities under section 88 of the IRO. Assessments will be raised whenever necessary to assess the profits derived from trade or business carried on by charities where the profits so derived are not exempt by virtue of the proviso to section 88 of the IRO;
- (c) regarding paragraph 2.12, the review of the three cases, namely Cases A, B and C, has been completed;
- (d) regarding paragraph 2.13, the IRD performs no regulatory role as it is not responsible for the governance of a charity, nor does it have regulatory power over the operation of a charity. It also does not have any enforcement power when a charity's act contravenes its governing instrument. Periodic reviews, being administrative procedures, are conducted to ascertain whether charities recognised as tax-exempt should continue to be eligible for tax exemption;
- (e) regarding the audit recommendation in paragraph 2.29(a), the IRD publicised on its website on 1 April 2017 that the CDS would endeavor to give a reply to applications for recognition of tax exemption status (provided that all the required information and documents were received by the CDS) within four months of the date of receipt of the application, and will consider the feasibility of setting a performance pledge for attending to new applications;
- (f) regarding the audit recommendation in paragraph 2.29(b), since February 2017, the CDS has enhanced its monthly work report for management review by incorporating the number of all uncompleted review cases with their age profile and their position at the end of each month, so as to facilitate the monitoring of the progress of handling these cases;
- (g) regarding the audit recommendation in paragraph 2.29(c), the CDS will take further measures to closely monitor the uncompleted review cases, which include strengthening the control system of outstanding replies to enquiries raised by the IRD. CDS staff have been reminded to take timely follow-up actions on outstanding issues;

Administration of tax exemption of charities and tax-deductible donations

- (h) regarding the audit recommendation in paragraph 2.29(d)(i), while appreciating Audit's efforts in putting forward constructive recommendations to improve the monitoring of charities, the IRD wishes to emphasise that its key responsibilities, as a tax administrator, are to make tax assessments and collect taxes. At the same time, the IRD needs to update the tax law from time to time to ensure that Hong Kong has a robust tax regime and is in compliance with the fast evolving world standards on tax cooperation (e.g. on exchange of information) as well as enhancing Hong Kong's competitiveness. The IRD is not in a position to oversee the governance of a charity (e.g. whether remunerations are paid to directors of a charity, or whether the expenses are paid for the furtherance of the charitable objects of a charity);
- (i) regarding the audit recommendation in paragraph 2.29(d)(ii), CDS staff would continue to exercise their professional judgement in administering the tax exemption status of charities. CDS staff have been reminded to give due consideration to the materiality of the donation expenditures when deciding the extent of verification work;
- (j) regarding the audit recommendation in paragraph 2.29(d)(iii), CDS staff have been reminded to continue taking timely follow-up actions on dormant cases in accordance with the requirements in the Staff Handbook if the charities concerned have failed to respond to the CDS's enquiries or the charities have apparently failed to carry out their objects as laid down in the governing instruments. For the case mentioned in paragraph 2.19(a), the CDS will seek clarification with the charity concerned as to its operational status;
- (k) regarding the audit recommendation in paragraph 2.29(e):
 - (i) with the launch of the computer matching exercise since January 2016, the IRD shall be able to prevent similar incident in updating the s88 list seen in the case mentioned in paragraph 2.21(a); and
 - (ii) the CDS has enhanced the control on the matching reports by requiring case officers to initial on the reports after withdrawing the recognition of tax exemption status of the relevant charities and an Assessor would review the matching reports by the end of each

Administration of tax exemption of charities and tax-deductible donations

month to ensure that the recognition of tax exemption status of all the charities which have been struck off by the CR has been timely withdrawn;

- (l) regarding the audit recommendation in paragraph 2.29(f), the CDS matched the s88 list with the records of Societies Office in January 2016 and liaised with the HKPF in March 2017 to set up a notification arrangement in respect of societies which have been deregistered under the Societies Ordinance to ensure the timely withdrawal of the recognition of their tax exemption status; and

- (m) regarding the audit recommendation in paragraph 2.29(g), the IRD attaches great importance to the assessment work and desk audit. To minimise revenue leakage due to incorrect claims, the IRD will from time to time remind its staff to stay vigilant in conducting desk audit, including checking the validity of donation receipts and seeking clarifications from taxpayers concerned whenever necessary.

2.31 The Commissioner of Police has said that he raises no objection to the proposed notification arrangement between the CDS and the Societies Office mentioned in paragraph 2.29(f).

PART 3: ADMINISTRATION OF LAND GRANTED TO CHARITIES FOR OPERATING WELFARE/SOCIAL SERVICES

3.1 In general, the Government sells government sites for commercial industrial or residential development, by public auction or tender to the highest bidder. However, government sites are sometimes granted by private treaty to charitable and non-profit-making organisations at nominal or concessionary premium for special purposes, such as for operating welfare/social services, private hospital developments, religious or educational purposes. All such direct land grants are subject to stringent policy scrutiny and are thoroughly considered to be justified in the public interest, with specific approval granted by the Executive Council (ExCo) or by delegated authority exercised in accordance with the approved criteria set by ExCo, on a case-by-case basis. This PART examines the administration of land granted directly to charities for operating welfare/social services.

Land administration policy

3.2 *Granting of sites by PTG.* In 1959, ExCo noted the statement of government policy on land administration that, among other things, for disposal of land by PTG, the following principles were laid down in that ExCo submission:

- (a) nil premium would be charged for non-profit-making schools, hospitals, clinics, nurseries, recreation clubs, and other welfare purposes. Very stringent powers of control would be included in the conditions under which land was granted for welfare purposes, and in each case the institution must be run to the satisfaction of the appropriate head of department. No distribution of profits would be allowed; they must be applied to improving the welfare services provided by the grantee;
- (b) concessionary premium would be charged at one-third of market value for workers housing schemes and at two-thirds of market value for churches; and
- (c) full market value would be charged for public utilities such as electric sub-stations.

Administration of land granted to charities for operating welfare/social services

3.3 *Redevelopment of sites granted at nil or concessionary premium for social service purposes.* In the early 1980's, there were requests from some lessees holding under-developed sites that they should be allowed to redevelop the sites so as to provide new and improved social service facilities and then to use up the remaining plot ratio for profit-making "commercial" development. The aim of maximising the commercial element would be to pay for the redevelopment and provide future income for the maintenance and running of the social service facilities and for future expansion. In 1981, ExCo endorsed the principle that lessees holding sites granted for social service purposes at nil/concessionary premium should, as an alternative to surrendering the sites to the Government for redevelopment, be allowed to redevelop those sites or exchange sites to include a "commercial" element, provided that the following principles and criteria were met:

- (a) premium should be charged at full market value for the "commercial" element in the development;
- (b) the lessee should be made accountable for income derived from its share in the development and this income would be applied to purposes acceptable to the Government; and
- (c) the project would benefit the public purse by decreasing the need or potential need for direct subventions.

Each individual proposal would be submitted to ExCo for consideration, with an indication in each case as to how the proposal complied with the ExCo's requirements, and that the Director of Social Welfare (DSW) would explain, when the first proposal was put forward, how the DSW intended to implement monitoring arrangements for it.

3.4 According to the Government's information paper for the Legislative Council (LegCo) Panel on Development of January 2011, the land administration policy in respect of PTG was as follows:

"we also grant land by PTG for specified use in justified circumstances, to comply with approved Government policies and to meet Hong Kong's economic, social and community needs. All such direct land grants have to be subject to stringent policy scrutiny and are thoroughly considered to be

Administration of land granted to charities for operating welfare/social services

justified in the public interest, with specific approval granted by ExCo or by delegated authority exercised in accordance with the approval criteria set by ExCo, on a case by case basis.

PTGs are normally for a specific purpose with the land use specified in the grant. Premium payable varies from nominal, concessionary to full market value depending on the nature of the use. Currently, the amount of nominal premium is \$1,000 which is applicable to all cases charging a nominal premium.”

3.5 ***Previous audit reviews.*** In 2012 and 2013, Audit completed two reviews to examine the monitoring of land grants for operating private hospitals and private sports clubs respectively. The review results were included in the following reports:

- (a) Chapter 4 of the Director of Audit’s Report No. 59 of October 2012 entitled “Land grants for private hospital development”; and
- (b) Chapter 1 of the Director of Audit’s Report No. 61 of October 2013 entitled “Direct land grants to private sports clubs at nil or nominal premium”.

The reviews found areas for improvement in administering the land grant and utilisation of the PTG sites. The Public Accounts Committee of LegCo held public hearings in 2012 and 2013 to examine the findings included in the two reports.

3.6 ***Protocol on delineation of responsibilities on PTGs.*** In July 2014, as part of the Administration’s responses to the recommendations of the Public Accounts Committee of LegCo and the Director of Audit on matters concerning PTGs (see para. 3.5(a)), the Lands D, after consulting the relevant B/Ds, issued a protocol delineating the sharing of responsibilities between the Lands D as the Government’s land agent and the B/Ds which supported various types of PTGs (hereinafter referred to as the 2014 Protocol). Among other things, the 2014 Protocol has stated that:

- (a) ***Application stage for a site.*** The policy bureau overseeing the proposed operations/services to be provided by the applicant at the proposed PTG

Administration of land granted to charities for operating welfare/social services

site and its executive departments (supporting B/Ds) should advise on the lease conditions specific to the operations/services to be provided, e.g. types and scope of essential services/facilities to be provided, permissible ancillary facilities, etc.;

- (b) ***Monitoring and enforcement of lease conditions throughout lease term.*** The supporting B/Ds should be responsible for monitoring or exercising control over operations/services to the satisfaction of the Government. Examples included the PTG clauses concerning:
- (i) user;
 - (ii) type of building;
 - (iii) continuous operation to a scale to the satisfaction of Government after commencement of operation;
 - (iv) submission of accounts and scrutiny; and
 - (v) non-distribution of profits; and
- (c) ***Supporting B/Ds.*** The corresponding supporting B/D for PTG relating to social welfare facilities (including those commercial facilities run on a non-profit-making basis) are the Labour and Welfare Bureau and the SWD respectively.

The Lands D also informed B/Ds that any departure from the Protocol should be discussed and agreed with the Lands D on a case-by-case basis.

Alleged hotel operations on sites granted to charities at nil or concessionary premium

3.7 From 2013 to 2015, there were media reports and public complaints to the Government alleging hotel operations on 14 sites (under Leases A to N — see particulars at Appendix B) granted to non-governmental organisations at nil or concessionary premium. However, only 8 of the 14 land leases specified hostel or

Administration of land granted to charities for operating welfare/social services

dormitory use. All the grantees (except for Grantee M — Note 19) were tax-exempt charities on the s88 list (see para. 1.7(a)).

3.8 *Government's responses.* The replies of the Development Bureau and the Lands D to media enquiries and complaints on the 14 sites (including one complaint relating to Lease M addressed to LegCo) from 2013 to 2016 are summarised as follows:

- (a) there was no definition under lease of the terms “hostel” and “hotel” but generally both allowed lodging;
- (b) the contractual obligations of lessees/grantees of private lots were set out in the individual government leases which were executed at different points in time, having regard to different circumstances as well as considerations prevailing then;
- (c) 3 of the 14 sites were held on virtually unrestricted leases (see Leases A, B and E at Appendix B which were not PTGs and not restricted to operating welfare/social services), for which the Lands D was not in a position to exercise any control under the land leases concerned. For the remaining 11 sites:
 - (i) some were held on leases which referred to a broader use, for example, the leases permitted the lots to be used for any purposes carried out under the purview of the grantee organisations which might be governed by their respective Memoranda of Incorporation or incorporating ordinances (see Leases C, D and K at Appendix B); and
 - (ii) for cases where the leases specifically permitted the running of hostels by the non-profit-making organisations (see Leases F, G, H, I, J, L, M and N at Appendix B), in the absence of specific provisions governing aspects such as the clientele, services standards and charges of the hostels in question, the Lands D could not unilaterally assume that the hostels should be run in a

Note 19: *Grantee M was a company limited by guarantee which was owned by a tax-exempt charitable organisation (hereinafter referred to as Charity M).*

**Administration of land granted to charities
for operating welfare/social services**

manner different from commercial hotels in the market and thereby asserted that failure to do so would be a breach of the lease;

- (d) the non-profit-making operation referred to in Lease M did not mean that the grantee concerned was prohibited from making any profit from operating the facilities (including hostels). The prime and foremost requirement was that any profit derived from the facilities should not be distributed;
- (e) the Lands D had taken legal advice, solicited inputs from relevant departments as well as approached the hostel/hotel owners for clarifications as necessary. So far (i.e. up to the date of the Lands D's reply of September 2014), it had not established any case involving a breach of the user clause and the "non-profit-making" clause under those land leases carrying such clauses; and
- (f) should the Government contemplate the granting of new site or modification of existing leases at nominal or concessionary premium to non-profit-making organisations for the running of hostels or hotels in future, it would propose the inclusion of suitable clauses in the land grant document to avoid ambiguity (e.g. whether the hostel or hotel was expected to serve a particular group of clientele and/or offer services at certain charges) and impress upon the supporting policy bureau the need for designing an appropriate monitoring mechanism to ensure delivery of the stated policy objectives.

3.9 ***Lands D's follow-up actions.*** Since 2014, the Lands D in consultation with relevant departments had continued to monitor the alleged hotel operations on the 14 sites and conducted investigations on individual cases of doubt. The Lands D had summarised the progress of its actions up to January 2016 as follows:

- (a) ***10 cases with actions completed on the part of Lands D.*** For the three leases (Leases A, B and E) with virtually unrestricted user clause (see para. 3.8(c)) and two leases (Leases C and D) referred to a broader use (see para. 3.8(c)(i)), the Lands D was not in a position to exercise any control. For two leases with non-profit-making operation of the facilities requirement (Leases F and L), the Lands D had reminded the grantees concerned to comply with such requirement. For two leases with

Administration of land granted to charities for operating welfare/social services

other specific requirements (such as submission of accounts requirement in Leases H and N), the Lands D had reminded the relevant supporting B/D (i.e. the SWD — see para. 3.6) to follow up on such requirements. For Lease J with both non-profit-making operation and submission of accounts requirements, the Lands D had reminded the grantee and relevant supporting B/D to take similar follow-up actions; and

- (b) **4 cases with ongoing actions.** The remaining four leases with ongoing actions included: (i) following up suspected breach of the user clause of Lease G; (ii) monitoring the submitted accounts of Lease M; (iii) responding to the SWD's request for records of its approval of the hostel operation of Lease I; and (iv) reminding the grantee of Lease K to comply with the user clause requirement.

3.10 **Audit examination.** Audit examined the provisions of the 11 leases related to charities for operating welfare/social services (i.e. excluding the three unrestricted leases — see para. 3.8(c)) to see whether there were lessons that could be applied generally. Audit also selected 4 of the 11 leases for reviewing the Lands D's follow-up actions on specific issues (including two leases, i.e. Leases H and N for which the Lands D had considered action completed on its part and two leases, i.e. Leases G and M for which actions were still ongoing). Audit found the following issues and lessons to be learnt:

- (a) implementing and monitoring the no-profit-distribution requirement (paras. 3.11 to 3.14);
- (b) monitoring income-generating facilities of a lease and subvention reduction arrangement (paras. 3.15 to 3.22);
- (c) consulting supporting B/Ds on compliance with lease conditions (para. 3.23); and
- (d) assessment of the taxability of profits derived from commercial operations on 13 sites (para. 3.24).

***Implementing and monitoring
the no-profit-distribution requirement***

3.11 ***Only one lease stipulated the no-profit-distribution requirement.*** According to the land administration policy of 1959, stringent powers of control would be included in the conditions and no distribution of profits would be allowed for a site granted at nil premium for welfare purposes (see para. 3.2(a)). However, as can be seen in Appendix B and Table 5, of the nine leases granted for welfare/social services at nil or concessionary premium after 1959, only one lease (Lease M) contained a clause restricting the distribution of profit derived from the facilities including the hostel. While the user clauses in four (Leases F, J, L and M) of the nine leases specified the non-profit-making operation of facilities (including hostels), the Lands D had taken the view that such clauses did not mean that the grantees were prohibited from making any profit from operating the facilities, and the prime and foremost requirement was that any profit derived from the facilities should not be distributed (see para. 3.8(d)). In response to Audit's enquiry in March 2017, the Lands D said that:

- (a) since 1959, PTG for welfare uses had been submitted to ExCo for consideration and approval on a case-by-case basis for 7 of the 11 cases examined by Audit. The no-profit-distribution clause was not imposed in these seven ExCo approved cases which served as precedents for subsequent cases; and
- (b) the land administration policy had evolved since 1959 with due regard to those individual cases submitted to ExCo for approval and also their terms and conditions approved by ExCo. The requirement on imposition of the no-profit-distribution clause in PTGs for welfare purposes was no longer applicable.

Administration of land granted to charities for operating welfare/social services

For all the 11 leases examined by Audit (comprising Lease M and 10 other leases without a no-profit-distribution clause), there were indications that the former hostels/dormitories had been converted to hotel/serviced residence use and operated on a commercial basis (see Table 5). Audit noted that the grantees of 9 of the 11 leases had been operating their hostels with hotel licences issued by the HAD (the licensing authority of the Hotel and Guesthouse Accommodation Ordinance (Cap. 349 — Note 20). Audit also found that the grantees of the remaining two leases (i.e. Leases G and L) had placed advertisements on their premises/websites and hotel websites offering serviced residence to the public on a monthly rental basis. To ensure that all profits derived from facilities built on the sites granted at nil/concessionary premium are applied to purposes acceptable to the Government, there is a need to incorporate the no-profit-distribution requirement in the leases. For the existing ten leases without a no-profit-distribution clause but with income-generating hotel/serviced residence operations, the Lands D in collaboration with the supporting B/Ds concerned should, upon their renewal or on receipt of applications for their modification, review whether there is a need to include such clause.

Note 20: *According to the Ordinance, a “hotel” and “guesthouse” mean any premises whose occupier, proprietor or tenant holds out that, to the extent of his available accommodation, sleeping accommodation is provided for any person presenting himself who appears able and willing to pay a reasonable sum for the services and facilities provided and is in a fit state to be received for a period of less than 28 continuous days.*

**Administration of land granted to charities
for operating welfare/social services**

Table 5

**Lease conditions of 11 sites with hostels/dormitories operating
as hotels/serviced residence**

Lease	Lease condition			Hostel operating under hotel licence
	User clause (see Appendix B for details)	No-profit-distribution requirement	Submission of audited accounts requirement	
C	For grantee's object	No	No	Yes
D	For promoting grantee's religious character and spirit	No	No	Yes
K	For grantee's object	No	No	Yes
F	Non-profit-making institution providing accommodation for hostel and other facilities	No	No	Yes
G (Case 2 in para. 3.23)	Dormitory use permitted under the lease	No	No	No (operating as serviced residence)
H (Case 3 in para. 3.23)	Hostel use permitted under the leases	No	Yes	Yes
I		No	No	Yes
J		No	Yes	Yes
L	Non-profit-making hostel and other facilities	No	No (Note)	No (operating as serviced residence)
M (Case 1 in para. 3.14)		Yes	Yes	Yes
N (paras. 3.15 to 3.22)	Hostel use permitted under the lease	No	Yes	Yes

Source: Audit analysis of Lands D and HAD records

Note: The grantee is required to submit audited accounts for the nursery and educational facilities under the lease.

Remarks: Leases C and D were granted before 1959 while the remaining nine leases were granted after 1959.

Administration of land granted to charities for operating welfare/social services

3.12 *Statements of accounts not always obtained.* Among the 11 leases examined by Audit, there were conditions in four leases (Leases H, J, M and N — see Table 5 in para. 3.11) requiring the submission of accounts for the operation of hostels. These accounts are important documents to show whether and how the profits derived have been distributed/applied. As mentioned in paragraph 3.11, for all the 11 leases, there were indications that the former hostels had been converted to hotel/serviced residence use. However, according to Lands D and SWD records, no hostel accounts had been received for Leases H and J. As for Leases M and N, the accounts had not always been obtained (see paras. 3.14 and 3.17). In Audit's view, there is a need to obtain accounts from the four grantees for monitoring the use of profits derived from operating the facilities on the land lots. For the 7 leases without no-profit-distribution and submission of accounts clauses, there is no assurance that all the profits so derived have been applied to purposes acceptable to the Government. The Lands D in collaboration with the supporting B/Ds concerned should, upon renewal of the 7 leases or on receipt of applications for their modification, review whether there is a need to include these clauses.

3.13 *Need to regularly monitor compliance with the lease requirements under Lease M and the related conditions.* Among the 11 leases granted at nil or concessionary premium and with hotel/hostel operation, Lease M is the only one which has incorporated both no-profit-distribution and submission of accounts clauses. The site under Lease M was originally held by Charity M, the parent organisation of Grantee M (see Note 19 to para. 3.7). In November 1986, the District Lands Conference (DLC — Note 21) agreed to grant the site to Grantee M by way of contemporaneous surrender of the site by Charity M. Lease M was granted in December 1988 at a nominal premium of \$1,000 with the following salient conditions:

Note 21: *The DLC is chaired by an Assistant Director of Lands. Its members include the responsible District Lands Officer, the case officers of the Lands D, and representatives from other relevant government departments (such as the Plan D and the Transport Department). The terms of reference of the DLC include the consideration, in the light of overall land policy and land instructions, of the terms and conditions for the disposal of land.*

**Administration of land granted to charities
for operating welfare/social services**

- (a) Grantee M shall at its own expense redevelop upon the lot a building or buildings comprising: (i) a non-profit-making hostel and ancillary offices as may be approved by the then Director of Buildings and Lands (Note 22); and (ii) accommodation for institution and community purposes which shall comprise (1) a children and youth centre; (2) a nursery; and (3) ancillary offices as may be approved by the then Director of Buildings and Lands;
- (b) Grantee M shall, if so required, submit to the then Director of Buildings and Lands annually a complete statement of accounts of the facilities mentioned in (a) above; and
- (c) there shall be no distribution of profit derived from the facilities. All profits, if any, derived from the facilities shall be applied towards the improvement or extension of the grantee's services provided in the facilities or such other services as may be approved by the then Director of Buildings and Lands.

Pursuant to a letter of June 1989 issued by the then Director of Buildings and Lands, approval was given to allow profits derived from the facilities to be used towards the improvement and/or extension of all charitable services provided by Charity M. In 1991, Grantee M obtained an occupation permit for its redeveloped building which comprised a hostel and other institution and community facilities as mentioned in Lease M.

3.14 Audit examined the Lands D's records to ascertain how the requirements on the use of profits in Lease M had been monitored (see para. 3.13) and found the following inadequacies as summarised in Case 1.

Note 22: *In 1982, the Lands D was established. In April 1986, the Lands D merged with the Buildings Ordinance Office of the former Public Works Department to become the then Buildings and Lands Department. Since August 1993, the Lands D has operated as an independent department.*

Case 1

**Need to regularly monitor compliance with the lease
requirements under Lease M and the related conditions**

1. ***Submission of accounts.*** In 1991, Grantee M obtained an occupation permit for its redeveloped building (see para. 3.13). Notwithstanding the submission of accounts provision in Lease M (see para. 3.13(b)), the Lands D had not requested Grantee M to do so until August 2013 (22 years later) in response to a complaint received in April 2011. In December 2013, Grantee M submitted the statements of accounts for the years ended March 2011 and March 2012 for the social welfare services provided by Charity M (see Note 19 to para. 3.7) in the lot (Note 1). However, these accounts did not include the financial affairs of the hostel/hotel which was operated by Grantee M's appointed operator. In November 2015, the Lands D requested Grantee M to submit complete statement of accounts of all facilities on the lot, including the hostel/hotel. Grantee M submitted the audited hostel/hotel operation accounts of its appointed operator to the Lands D for the years ended December 2013 and December 2014 in February 2016, and for the year ended December 2015 in May 2016 (Note 2).

2. ***Vetting of submitted accounts.*** In May 2014, in connection with a complaint referred by the LegCo Secretariat on alleged non-compliance with the lease conditions of Lease M, the SWD informed the Lands D that it had conducted preliminary vetting of the accounts on the welfare/welfare-related facilities provided on the lot as submitted by Charity M (see Note 1) for the years ended 31 March 2011 and 2012, and no serious irregularity or non-compliance regarding the deployment of profits derived from the self-financed welfare/welfare-related facilities had been observed. The SWD's comments were included in the Development Bureau's reply to the LegCo Secretariat in 2014 (see para. 3.8).

3. In May 2016, the Lands D forwarded the statements of accounts for both the hostel/hotel and welfare facilities submitted by Grantee M for the years ended 2013, 2014 and 2015 (see para. 1 above) to the SWD for comments on whether Grantee M had used profits derived from the facilities for the purposes as stated in the lease conditions and the letter of approval of June 1989. In its reply to the Lands D of January 2017, the SWD reiterated that its input would be confined to the welfare-related facilities/services (in vetting the accounts for the years ended March 2011 and 2012 — see para. 2 above). In the SWD's view, the hostel should not be treated as a welfare facility, and accordingly, the SWD would not comment on the compliance with the lease condition and the 1989 letter of approval in respect of the use of income derived from the hostel.

**Administration of land granted to charities
for operating welfare/social services**

Case 1 (Cont'd)

4. *Use of income from hostel/hotel operation.* As Grantee M is a registered company, Audit examined its statements of accounts filed with the CR. Audit noted that \$16 million of hostel/hotel operation income was earned and the same amount was paid to Charity M in Grantee M's audited accounts for the year ended March 2013. The amounts of similar related party transactions were not shown in the accounts for the years 2014 and 2015. Instead, the notes to the accounts for the years 2014 and 2015 stated that the income derived from its hostel/hotel operation had been assigned to and belonged to Charity M and was not treated or accounted for as revenue of Grantee M (Note 3). Based on the audited accounts of the hostel/hotel operator in respect of the subject hostel/hotel provided by Grantee M to the Lands D, Audit noted that payments totalling some \$70 million had been made for the three years from 2013 to 2015 (Note 4) in accordance with the agreed operating arrangement. In two letters to the Lands D of May 2014 (Note 5) and March 2016, Grantee M confirmed that all surplus (if any) from the facilities provided on the lot had been used towards the improvement and/or extension of all charitable services provided by Charity M.

Audit comments

5. According to Lease M and the letter of approval of 1989, there shall be no distribution of profit derived from the facilities including the hostel as all profits shall be applied to purposes specified by the Government (see para. 3.13). The statements of accounts submitted by Grantee M are important documents to show the income derived from the hotel/hostel operation and whether the lease condition has been complied with. While Lease M provided that the grantee would submit a statement of accounts to the then Director of Buildings and Lands (see Note 22 to para. 3.13(a)) if so required (see para. 3.13(b)), the Lands D only commenced to obtain such accounts in 2013 (22 years after the hostel came into operation).

6. Apart from the assurance provided by Charity M's auditor in May 2014 and Grantee M in March 2016, there was insufficient detailed information to show that income derived from the hostel/hotel had been applied towards the social/charitable purposes as stated in the lease condition and the letter of approval of June 1989 for some 25 years since the hostel operated under a hotel licence in 1991. There is a need to require Grantee M to regularly submit sufficient information (including related party transactions with Charity M and the third party operator of the hostel/hotel) to demonstrate its compliance with the requirement that the profits derived from the facilities provided under Lease M had been used towards the improvement and/or extension of all charitable services provided by Charity M (as mentioned in para. 3.13).

**Administration of land granted to charities
for operating welfare/social services**

Case 1 (Cont'd)

7. In March 2017, the Lands D informed Audit that the lease did not mandate the submission of annual accounts but only specified that the grantee should submit the annual accounts if so required. The Lands D's understanding all along was that the submission of accounts was on a need basis upon instruction from the supporting B/Ds or upon receipt of complaints. Moreover, the Lands D did not have the expertise or knowledge to scrutinise the accounts submitted or determine whether the profit had been used in a manner and for purposes acceptable to the Government. However, Audit noted that no supporting B/D was specified in the lease except that the then Director of Buildings and Lands was designated as the authority for obtaining the statements of accounts from Grantee M and approving Grantee M's other services to which the profits derived shall be applied (see para. 3.13). In Audit's view, there is a need for the Lands D to take a more proactive role in enforcing the relevant requirements in respect of the hostel/hotel operation, and where appropriate, seek the assistance of the SWD in scrutinising the accounts obtained from Grantee M.

Source: Audit analysis of Lands D records

Note 1: In March 2017, the SWD informed Audit that Charity M separately submitted audited accounts for the self-financed welfare/welfare-related facilities operating on the site (excluding the hostel/hotel) to the SWD.

Note 2: Grantee M also separately submitted Charity M's audited accounts as related to the welfare-related facilities on the site for the years ended March 2013 and March 2014 in September 2015 and for the year ended March 2015 in March 2016 to the Lands D.

Note 3: The notes to the accounts for the years 2014 and 2015 also stated that in 2012, Grantee M had entered into an agreement with Charity M whereby Grantee M assigned all income from the hostel to Charity M.

Note 4: The year end of audited accounts of the hostel/hotel operator was December.

Note 5: Grantee M provided in its letter of May 2014 a certification by Charity M's independent auditor that the hostel income for the periods up to and including 31 December 2013 (see Note 3 above) had been applied by Charity M towards the improvement and/or extension of its charitable services.

***Monitoring income-generating facilities of a lease
and subvention reduction arrangement***

3.15 ***Redevelopment of a site under Lease N granted at concessionary premium.*** In February 1989, ExCo approved Grantee N's application for granting a site zoned as "Government, Institution or Community (G/IC)" under the Outline Zoning Plan (OZP — Note 23) site by private treaty for the construction of a new headquarters based on the following understanding and justifications:

- (a) the then existing headquarters building of Grantee N was inadequate for its need and the site thereof was also required to be returned to the Government for residential development;
- (b) to maximise the use of the G/IC site to be granted, Grantee N would be responsible for the construction of its new headquarters and other facilities to be provided thereon, including a multi-storey vehicle park, a coach terminus and a telephone exchange (Note 24). The new headquarters shall include an assembly hall, gymnasium, offices, grantee's shop, hostel, dormitory, canteen, staff quarters and such other non-industrial accommodation as shall be approved by the then Director of Buildings and Lands;
- (c) the grant of the proposed new headquarters, covering the income-generating facilities such as a hostel and a canteen, at a nominal premium was supported by the then Secretary for District Administration (now the Secretary for Home Affairs) and the DSW. Grantee N shall finance the full land premium of the vehicle park to be operated by it on a commercial basis and the construction cost of both the headquarters and the vehicle park. It was estimated that the income-generating facilities

Note 23: *OZP shows the land use zones, development parameters and major road systems of an individual planning area. Areas covered by OZPs are in general zoned for uses such as residential, commercial, industrial, green belt, open space, G/IC uses or other specified purposes.*

Note 24: *Grantee N would be reimbursed the construction cost of the coach terminus and the telephone exchange by the then Secretary for Transport and the relevant utility company respectively. The full market premium of the telephone exchange would also be paid by the relevant utility company.*

Administration of land granted to charities for operating welfare/social services

used to their full capacity could fully repay the capital cost plus interest between 10 and 12 years after completion of the project; and

- (d) after repayment of the development costs, continued subvention of Grantee N's activities by the SWD would have regard to the level of income from the project. As Grantee N's income was expected to exceed the amount of government subvention, it would gradually cease to be reliant on the subvention and would be able to devote more resources to its activities. These arrangements were in line with the 1981 land administration policy on redevelopment of sites granted at nil or concessionary premium for social service purposes (see para. 3.3). The advantage of the arrangements to the Government would be reduction and eventual elimination of the annual subvention of Grantee N's activities.

3.16 In 1990, the Government entered into a lease (Lease N) with Grantee N and laid down the following conditions:

- (a) Grantee N shall not erect on the lot any building other than that comprising a headquarters, a vehicle park, a bus terminus and a telephone exchange;
- (b) Grantee N shall submit to the DSW annually beginning one year from the opening of the headquarters and vehicle park a complete statement of accounts on the operation of the headquarters and the vehicle park audited by an auditor approved by the then Governor; and
- (c) Grantee N shall establish a Management Committee comprising its own representatives, the DSW and the then Secretary for District Administration or their representatives to ensure the proper and efficient operation of the income-generating facilities of the headquarters and the vehicle park.

In June 1993, Grantee N was issued with an occupation permit for its new headquarters and other facilities thereof which came into operation in 1994.

**Administration of land granted to charities
for operating welfare/social services**

3.17 *Management Committee and submission of accounts requirements.* In accordance with the lease conditions, Grantee N formed a Management Committee in September 1993 with representatives of the SWD and the then City and New Territories Administration (the HAB since 1996) sitting in the Committee (see para. 3.16(c)). The Committee held five meetings from 1993 to 1998. Since then, the Committee had not held further meetings. From 1996 to 1998, the SWD obtained the statements of accounts of Grantee N's income-generating facilities for the years 1995-96, 1996-97 and 1997-98. However, there was no record showing that similar statements of accounts of Grantee N had been submitted annually thereafter. In April 2000, the HAB took over from the SWD the management and subvention of uniformed groups (including Grantee N) and assumed the supporting B/D's role for Lease N. In November 2014, the Lands D reminded the HAB about the lease conditions on the Management Committee and submission of accounts (see para. 3.9(a)). According to the HAB, its representative had attended Grantee N's Executive Committee meetings, which also discussed Grantee N's financial matters, as an observer. However, Audit noted that the Committee was not a designated forum for discussing the proper and efficient operation of the income-generating facilities. In Audit's view, the HAB (as the supporting B/D for Lease N) needs to enforce the lease conditions on Management Committee and submission of accounts.

3.18 *Subvention reduction by SWD.* Having regard to the 1989 ExCo's decision on reducing the annual subvention of Grantee N's activities (see para. 3.15(d)), the SWD (as the supporting B/D for Lease N at that time) started negotiation with Grantee N in 1997 and withheld part of the rent and rates subsidy totalling \$1.1 million for 1994-95, 1995-96 and 1996-97 from its reimbursement of government rent and rates to Grantee N. In 1999, the SWD informed the HAB that based on its analysis of Grantee N's financial situation from 1995-96 to 1997-98, operating surpluses were identified. On that basis, the SWD expected that there was room for reduction in its subvention to Grantee N. Meanwhile, the SWD withheld part of the reimbursement of rent and rates amounting to \$1.47 million each year for 1997-98, 1998-99 and 1999-2000 after discussion with Grantee N.

3.19 In January 2000, upon Grantee N's request for the release of the amount withheld in previous years in light of the unfavourable economic atmosphere, the HAB (as the new supporting B/D for Lease N — see para. 3.17) agreed with the SWD to release the withheld sum of \$1.47 million for the year 1999-2000 to Grantee N. The HAB then decided to review the subvention reduction issue. In the

Administration of land granted to charities for operating welfare/social services

event, the HAB had not taken any action until 2010-11 (10 years later) when it froze Grantee N's subvention while other uniformed groups were granted an increase of subvention.

3.20 *Subvention reduction arrangement has yet to give full effect to the ExCo's understanding.* In 2012, the HAB conducted a review of the financial information obtained from Grantee N for its new headquarters and other facilities for the past 18 years since they came into operation in 1994. The HAB noted that the subvention level for Grantee N's activities had increased from \$10.61 million in 1993-94 (apart from the reductions in 2004-05 and 2005-06 by \$0.54 million and \$0.67 million respectively) to \$17.28 million in 2008-09 and thereafter remained at the same level up to 2010-11, totalling \$280 million. Over the 18 years of operation, the net profit from the income-generating facilities of Grantee N had reached a level of \$829 million (Note 25), enabling it to launch and develop new programmes and redevelop the dilapidated facilities for its members. On the other hand, in March 2011, Grantee N presented its views to the HAB that the proportion of government subvention to its expenditure had dropped from 64% in 1989-90 to 29% in 2009-10, giving effect to the ExCo's understanding that it had become less reliant on government subvention. After negotiation, the HAB and Grantee N agreed in February 2013 to reduce the subvention from \$17.28 million in 2012-13 to \$10.61 million in 2015-16 (the subvention level in 1993-94 when the headquarters facilities came into operation — Note 26) by \$2.23 million each year and thereafter to resume adjustment in subvention on par with other uniformed groups. In the event, the HAB's subvention for Grantee N's activities was reduced to \$15.06 million in 2013-14 but increased to \$25.66 million in 2014-15 (due to the increase in subvention for all uniformed groups — Note 27) and subsequently reduced to \$23.44 million in 2015-16.

Note 25: *According to the minutes of the fifth meeting of the Management Committee held in December 1998, the loan for financing the redevelopment of the headquarters was fully repaid in March 1998 (see para. 3.15(c)).*

Note 26: *According to the HAB, taking into account the inflation for 1993-94 to 2015-16, the real value of \$10.61 million in 2015-16 would approximately be \$5.9 million only, significantly less than the 1993-94 level.*

Note 27: *In line with the 2014 Chief Executive's Policy Address of doubling the subvention for all uniformed groups in 2014-15, the subvention for Grantee N was \$25.66 million [(\$15.06 million – \$2.23 million) × 2].*

**Administration of land granted to charities
for operating welfare/social services**

3.21 The ExCo's approval of the PTG to Grantee N was made on the understanding that there would be reduction and eventual elimination of the annual subvention of Grantee N's activities (see para. 3.15(d)). However, the agreed subvention reduction scheme reached between the HAB and Grantee N in February 2013 has yet to give full effect to the ExCo's understanding and there was no record showing that follow-up action had been taken in this regard. In response to Audit's enquiry in March 2017, the HAB said that:

- (a) the subvention reduction arrangement in 2013 was not a final step in implementing the 1989 ExCo's understanding. It remained the HAB's intention to continue its discussion with Grantee N to further reduce the subvention level having regard to its financial situation and development needs; and
- (b) the HAB would seek the ExCo's endorsement if it was eventually considered that the ExCo's understanding could not be achieved.

3.22 ***Non-exclusive use of catering facilities.*** According to Lease N, the new headquarters shall include assembly hall, gymnasium, offices, grantee's shop, hostel, dormitory, canteen, staff quarters and such other ancillary accommodation and facilities as shall be approved by the DSW. Audit has found the following issues on the non-exclusive use of catering facilities:

- (a) ***Canteen operating as a restaurant.*** According to the FEHD's records, from February 1996 to April 2015, Grantee N's canteen had been operated as a restaurant under a General Restaurant Licence. In December 2014, Grantee N appointed a new restaurant operator with effect from March 2015. In April 2015, the operator applied to the FEHD for a new General Restaurant Licence and commenced operating the restaurant at the same time. In processing the application, the FEHD consulted the Lands D and the HAB. In September 2015, the Lands D obtained legal advice and noted that pursuant to Lease N, the canteen should form part of the headquarters and was for the exclusive use of members of Grantee N (i.e. it should not be open to the public). In July and December 2015, the HAB informed the FEHD and Lands D respectively that the restaurant was commercial in nature and could not be regarded as "ancillary accommodation and facilities" of Grantee N's headquarters under Lease N. In December 2015, Grantee N applied to the Lands D for a temporary waiver to permit the use of the canteen space

Administration of land granted to charities for operating welfare/social services

for restaurant purpose as it was difficult to prevent residents nearby to use the restaurant given its convenient location. In January 2016, the HAB informed the Lands D that it supported Grantee N's waiver application subject to the imposition of full administrative fee and waiver fee. At a DLC meeting held in June 2016, the Plan D advised that if the restaurant was directly related and ancillary to the permitted uses of Grantee N's headquarters, no planning application was required. However, as the HAB had indicated that the restaurant could not be regarded as ancillary accommodation and facilities, planning permission by the Town Planning Board (TPB) was required under the relevant OZP before the granting of waiver. In December 2016, Grantee N obtained the TPB's approval to use the canteen for a temporary restaurant for three years. Up to March 2017, the Lands D offered the waiver terms for Grantee N's acceptance; and

- (b) ***Other catering facilities.*** According to the FEHD's licensing records posted on its website, Audit noted that Grantee N had been operating two catering facilities (other than the restaurant mentioned in (a)) on different floors of its headquarters, i.e. a western restaurant under a General Restaurant Licence and a lounge under a Light Refreshment Restaurant Licence. The operation of the western restaurant and lounge under FEHD's licences suggested that these facilities were also open to the general public (not just Grantee N's members — Note 28). Moreover, Audit noted from an advertisement leaflet of a local travel agency of January 2017 that the western restaurant had offered buffet service as part of a package tour and buffet coupons were also available for sale on a commercial website, further suggesting that it had also served the general public. According to the Lands D records, while the lounge (for members only) was included in the approved building plan for the headquarters, the location of the western restaurant was designated as a foyer, thus raising question on whether the western restaurant and the lounge (both open to the public) were permitted uses. In Audit's view, the HAB, in consultation with the Lands D and the Plan D, needs to review whether the operations of the western restaurant and lounge are permitted under Lease N and the relevant OZP.

Note 28: *According to the Food Business Regulation (Cap. 132X), clubs offering food and drinks for members are not required to apply for a General Restaurant Licence or a Light Refreshment Restaurant Licence.*

Consulting supporting B/Ds on compliance with lease conditions

3.23 According to Lease N, the new headquarters shall include, among others, hostel, canteen and such other ancillary accommodation and facilities as shall be approved by the DSW (the HAB since April 2000 — see para. 3.17). In support of its application for the grant of the headquarters site at a nominal premium, Grantee N confirmed to the DSW in December 1987 that all the areas in its headquarters were directly related to its purposes. Moreover, in his memo of November 1987 to the then Secretary for Health and Welfare, the then Secretary for District Administration indicated that he had no objection to the grant of the headquarters site at nominal premium on the understanding that the facilities were to meet Grantee N's purposes. However, based on the HAD's hotel licence information (see para. 3.11), there were indications that the hostel had likely been converted to hotel use for the general public. Moreover, according to Grantee N's website, members' booking was entitled to preferential room booking rates, suggesting that the hostel/hotel could also serve non-members with different room rates. Similarly for two other leases also selected for case study (see para. 3.10), Audit found that the dormitory under Lease G (Case 2) had likely been operated as a hotel for the general public for 20 years before converting to the current use as a serviced residence for students, local people and non-local guests. Under Lease H (Case 3), the hostel had likely been used as a hotel. In Audit's view, for leases with clauses governing the use or operation of the hostels/dormitories, the Lands D needs to seek confirmation from the relevant B/Ds on whether the current use or operation of the hostels/dormitories is in line with their policy intent and to their satisfaction, and take necessary follow-up actions in case of any breach of the lease conditions.

Case 2

Lease compliance issue under Lease G

1. A piece of land covering the lot under Lease G was sold by public auction at a premium in 1928 with conditions restricting the development to a church, detached or semi-detached European type houses, all limited to a height of 35 feet. In 1965 after obtaining a portion of the land (Lot G) through a Deed of Gift, Grantee G applied for modification of the lease terms to allow the construction on Lot G a 12-storey building containing a non-profit-making nursery, vocational training centre, dormitories for young male workers and such staff quarters as the DSW may permit.

2. In an ExCo submission of 1965 setting out the above background, the then Public Works Department and the SWD recommended modification of the lease condition at a nil premium as the proposed use was for welfare purposes. In September 1965, ExCo approved the modification of the original lease (which became Lease G) to allow the construction of the proposed new building at nil premium. The modification was to be effected by contemporaneous exchange (i.e. by surrendering and re-granting Lot G) on the same basic conditions but with modified terms including:

- (i) a building not exceeding 12 storeys which shall only be used for the purposes of a nursery, training centre, dormitories, and such staff quarters and other welfare purposes as the DSW may approve; and
- (ii) the whole to be conducted on a non-profit-making basis and to the satisfaction of the DSW.

In 1966, Lease G was granted with lease conditions as stated in paragraph 2 above.

3. In March and June 2014, the Lands D noted that the dormitory had been operating as a licensed hotel (in the name of a lodge) but the SWD had not given approval for such operation. In June 2014, the Lands D issued a warning letter to Grantee G requiring it to cease the hotel operation.

4. From June 2014 to April 2016, Grantee G sought the SWD and EDB's support for operating the dormitory to provide training opportunities to students studying hotel and catering management courses but without success. Meanwhile, the Lands D issued five more warning letters to Grantee G.

**Administration of land granted to charities
for operating welfare/social services**

Case 2 (Cont'd)

5. In June 2016, Grantee G informed the Lands D that the lodge operation had ceased in May 2016 and the premises would be converted to a non-profit-making dormitory pursuant to the lease condition. In an inspection conducted in August 2016, Lands D staff found that the name of the lodge had been changed to a dormitory. However, Audit noted from an advertising leaflet obtained during a visit to the dormitory in December 2016 that Grantee G had been promoting the dormitory as serviced residence suitable for students, local people and non-local guests who needed a long-term accommodation arrangement.

Audit comments

6. According to the HAD's records, the dormitory under Lease G had been operating as a licensed hotel since the enactment of Hotel and Guesthouse Accommodation Ordinance in 1991, suggesting that it had been open to the public for over 20 years. Notwithstanding the cessation of the hotel operation in May 2016, its current use as a dormitory for the general public and non-local guests (see para. 5) might not fully meet the welfare purposes based on which the then Public Works Department and the SWD recommended the modification of the lease condition for Lease G at nil premium (see para. 2).

7. In March 2017, the Lands D informed Audit that Lease G required inter alia that the dormitory should be conducted to the satisfaction of the SWD. If the SWD considered and confirmed to the Lands D that the dormitory was not conducted in line with the policy intent and to the satisfaction of the SWD, there was an apparent breach, and appropriate lease enforcement action would be taken by the Lands D in accordance with the SWD's policy directive at such time.

Source: Audit analysis of Lands D records

Case 3

Lease compliance issue under Lease H

1. In October 1966, Grantee H applied for a direct grant of land to erect a welfare centre with hostel accommodation for young low-income factory workers. In the ExCo submission of 1969 setting out the above background, the then Director of Public Works recommended the granting of a site with a premium charged at one-third of the market value for the portion of land used for the hostel accommodation. The DSW also supported the application on the grounds that the hostel formed part of an overall welfare project. In July 1969, ExCo approved granting a site to Grantee H based on the following terms:

- (i) a welfare centre (including a hostel and staff quarters) to be operated at all times to the satisfaction of the DSW; and
- (ii) premium of \$115,641 (being one-third of the full market value for the portion of site used for hostel accommodation and the remainder at nil premium) should be charged.

2. In March 1971, Lease H was granted with lease conditions stating that Grantee H shall erect and maintain upon the subject lot a building providing accommodation for a welfare centre, including a hostel and staff quarters as may be approved by the DSW.

3. According to the HAD's records, the hostel has been operating under a hotel licence since the enactment of the Hotel and Guesthouse Accommodation Ordinance in 1991, suggesting that it has been open to the public for over 20 years. Audit also noted that online booking of the hostel rooms was available on commercial hotel-booking websites by the public and non-local visitors.

Audit comments

4. It appears that the current use of the hostel for the public (see para. 3) might not fully meet the welfare purposes based on which the then Public Works Department recommended the approval of the land grant at a concessionary premium (see para. 1).

5. In March 2017, the Lands D informed Audit that if the SWD considered and confirmed that the hostel was not operating in line with the policy intent and to the satisfaction of the SWD, the Lands D might consider taking lease enforcement action as appropriate in accordance with the SWD's policy directive at such time.

Source: Audit analysis of Lands D records

***Assessment of the taxability of profits
derived from commercial operations on 13 sites***

3.24 For 14 sites with suspected hostel/hotel operations, the grantees of 13 sites are recognised tax-exempt charitable organisations (Note 29). The profits derived from their income-generating operations are exempt from tax only if they meet the following requirements as laid down in a proviso to section 88 of the IRO (see para. 2.2):

- (a) such profits are applied solely for charitable purposes; and
- (b) the profits are not expended substantially outside Hong Kong and either:
 - (i) the trade or business is exercised in the course of the actual carrying out of the expressed objects of such institution or trust; or
 - (ii) the work in connection with the trade or business is mainly carried on by persons for whose benefit such institution or trust is established.

In this connection, Audit noted that the restaurant operation in Lease N was considered to be commercial in nature by the HAB (see para. 3.22(a)). Similarly, there was no indication that the SWD had given approval to the hotel operation under Lease G (see Case 2 in para. 3.23). In Audit's view, the IRD needs to review the taxability of the income derived from the commercial operations of the 13 sites for revenue protection.

Audit recommendations

3.25 **Audit has recommended that the Director of Lands should:**

- (a) **in collaboration with the supporting B/Ds, consider incorporating lease conditions restricting profit distribution and requiring submission of accounts in a PTG or lease modification (including land**

Note 29: *Grantee M of the remaining site is not a tax-exempt charitable organisation (see Note 19 to para. 3.7).*

**Administration of land granted to charities
for operating welfare/social services**

exchange) granted at nil/concessionary premium for welfare/social services in future;

- (b) upon renewal of leases or on receipt of applications for lease modification, in collaboration with the supporting B/Ds, review whether there is a need to include:
 - (i) a no-profit-distribution clause for the 10 leases granted at nil/concessionary premium for welfare/social services but without such clause (see para. 3.11); and
 - (ii) a submission of accounts clause for the 7 leases granted at nil/concessionary premium for welfare/social services but without such clause (see para. 3.12);
- (c) require Grantee M to provide regularly sufficient information to demonstrate its compliance with the lease requirements and related conditions in the letter of approval of 1989 (see para. 3.13) and, where appropriate, seek the assistance of the SWD in scrutinising the statements of accounts obtained from Grantee M; and
- (d) for leases with clauses governing the use or operation of the hostels/dormitories, seek confirmation from the relevant B/Ds on whether the current use or operation of the hostels/dormitories is in line with their policy intent and to their satisfaction, and take necessary follow-up actions in case of any breach of the lease conditions.

3.26 Audit has *recommended* that the Director of Social Welfare should remind grantees concerned to submit accounts in accordance with the lease conditions (such as for Leases H and J) and in case of non-compliance, take enforcement action in conjunction with the Director of Lands.

3.27 Audit has *recommended* that the Secretary for Home Affairs should:

- (a) in conjunction with the Director of Lands, step up monitoring and enforcement of the lease conditions on Management Committee and submission of accounts for Lease N;

**Administration of land granted to charities
for operating welfare/social services**

- (b) seek the ExCo's endorsement for any material deviations from its understanding of the implementation of a PTG for operating welfare/social services on land granted at nil/concessionary premium (such as the subvention reduction arrangement in Lease N); and
- (c) for Lease N, in consultation with the Director of Lands and the Director of Planning, review the operations of the western restaurant and lounge to determine whether they are permitted under the lease conditions and the relevant OZP, and take necessary follow-up actions accordingly.

3.28 Audit has *recommended* that the Commissioner of Inland Revenue should review the taxability of the income derived from the commercial operations of the 13 sites for revenue protection.

Response from the Government

3.29 The Director of Lands generally agrees with the audit recommendations in paragraph 3.25. She has said that:

- (a) in processing proposed PTG cases for welfare/social service uses in future, the Lands D will consult the supporting B/Ds and impose the no-profit-distribution clause and submission of accounts clause if it is the policy intent;
- (b) as regards the audit recommendation in paragraph 3.25(b), according to the Lands D's practice, the Lands D will consult the supporting B/Ds upon renewal of the concerned leases (which do not expire on the same day) and when any application for modification of the concerned lease is received; and
- (c) the Lands D will follow up the recommendation in paragraph 3.25(c) as far as possible, by exercising the rights of the landlord conferred under Lease M.

3.30 The Director of Social Welfare agrees with the audit recommendation in paragraph 3.26.

Administration of land granted to charities for operating welfare/social services

3.31 The Secretary for Home Affairs agrees with the audit recommendations in paragraph 3.27. He has said that:

- (a) as regards the audit recommendation in paragraph 3.27(a), the HAB has taken action to step up its monitoring role under Lease N, and has requested Grantee N to reactivate the Management Committee for the income-generating facilities of its headquarters and the vehicle park, and submit the statements of accounts. The preparation work for the meeting is underway. The HAB will closely monitor the follow-up actions taken by Grantee N;
- (b) as regards the audit recommendation in paragraph 3.27(b), it is important to note that the ExCo's decision did not specify a timeline for achieving the objective of eventual elimination of Grantee N's subvention. Over the past 23 years, the annual subvention of Grantee N has been reduced or withheld several times (see paras. 3.18 to 3.20). He agrees that if the ExCo's understanding of eventual elimination of subvention could not be achieved ultimately, the ExCo's endorsement for the variation should be sought; and
- (c) as regards the audit recommendation in paragraph 3.27(c), since late 2015, the HAB has been reminding Grantee N to obtain necessary planning and lease permission as appropriate. The HAB will consult the Plan D and the Lands D on the issue and take necessary action accordingly.

3.32 The Commissioner of Inland Revenue generally agrees with the audit recommendation in paragraph 3.28. He has said that:

- (a) when conducting reviews for tax-exempt charities, the IRD would review whether the profits derived from any trade or business carried on by tax-exempt charities could be exempt from profits tax under the proviso to section 88 of the IRO; and
- (b) under the official secrecy provision in the IRO, the IRD cannot disclose any information of individual cases (including those of tax-exempt charities) or details of the review.

PART 4: FILING AND DISCLOSURE REQUIREMENTS OF CHARITIES INCORPORATED/ESTABLISHED UNDER THREE ORDINANCES

4.1 Charities of different legal forms may be granted tax exemption status provided that they satisfy the requirements of section 88 of the IRO. Some 92% of the tax-exempt charities on the s88 list are incorporated or established under three ordinances, i.e. as a limited company under the Companies Ordinance, as a society under the Societies Ordinance, or as an IMC of a school under the Education Ordinance. This PART examines the administration of these three ordinances, focusing on the filing and disclosure requirements through which members of the public may access information of these charities which have appealed to them for donations or received their donations.

Filing and disclosure requirements under the Companies Ordinance

4.2 The CR is responsible for administering and enforcing the Companies Ordinance. Its work includes registering local and non-Hong Kong companies and their statutory returns, de-registering defunct solvent companies and providing the public with services and facilities for inspecting and obtaining company information kept by the CR. As of September 2016, there were some 1.34 million limited companies on the Companies Register, of which 6,619 were tax-exempt charities on the IRD's s88 list. Among the 6,619 tax-exempt charitable companies, 6,523 (98.5%) were companies limited by guarantee (see para. 4.3(b)(i)). The remaining 96 (1.5%) were mainly private and non-Hong Kong companies. Tax-exempt charities which choose to be incorporated as companies under the Companies Ordinance need to comply with the same statutory requirements under the Companies Ordinance as other limited companies. They are also subject to review by the IRD regarding their tax exemption status once every four years (see para. 2.4(b)).

Statutory filing requirements

4.3 Under the present Companies Ordinance which came into effect in March 2014 (see Note 6 in para. 1.7(c)), when applying for registration, a company

Filing and disclosure requirements of charities incorporated/established under three ordinances

shall deliver to the CR its articles of association which include details of its name, liabilities of its members, the amount its members undertake to contribute if the company is wound up (for companies limited by guarantee — Note 30), share capital and initial shareholding (for companies limited by shares). After registration, a company shall deliver statutory returns to the CR within prescribed time periods including, but not limited to the following:

- (a) a notice of change of address of the registered office, company's director, company secretary, and/or in their particulars, within 15 days after the change;
- (b) an annual return together with an annual registration fee (Note 31):
 - (i) for a company limited by guarantee, in respect of every financial year, within 42 days after the company's return date (i.e. 9 months after the end of the company's accounting reference period (Note 32));
 - (ii) for a public company (Note 33), in respect of every financial year, within 42 days after the company's return date (i.e. 6 months after the end of the company's accounting reference period (see Note 32)); and

Note 30: *A company limited by guarantee does not have share capital. The liability of its members is limited by the company's articles to the amount that the members undertake.*

Note 31: *The annual registration fee varies for different types of companies (e.g. \$105 for a company limited by guarantee). Late submissions of annual returns are subject to higher annual registration fees under an escalating scale (i.e. at a multiple of \$870 for every three-month delay in submission until it reaches the ceiling of \$3,480 for a company limited by guarantee).*

Note 32: *Before the present Companies Ordinance came into effect in March 2014, a company limited by guarantee or a public company had to file the annual return within 42 days after its annual general meeting for the year.*

Note 33: *A company is a public company if it is not a private company nor a company limited by guarantee.*

Filing and disclosure requirements of charities incorporated/established under three ordinances

- (iii) for a private company (Note 34), in respect of every year, within 42 days after the anniversary of the date of incorporation of the company in that year; and

- (c) the annual return for a company limited by guarantee or a public company shall be accompanied by certified true copies of the company's financial statements, directors' report and auditor's report. This requirement is not applicable to a private company.

According to the CR, there are no provisions under the Companies Ordinance to identify or determine whether a company is a tax-exempt charity and the CR's enforcement policies are premised on all of the companies on the Companies Register.

Measures to ensure compliance with filing requirements

4.4 Over the years, the CR has implemented administrative measures to explain and promote compliance with the statutory filing requirements. These include: (a) setting up a thematic section on "Compliance" on the CR's website which provides information on the obligation of a company and its officers; (b) publication of information pamphlets, e.g. "Annual Return of a Local Public Company or a Company Limited by Guarantee" and "Filing Requirements of a Local Limited Company after Incorporation"; and (c) issuance of circular letters, etc. If a company fails to comply with the statutory requirements, the company and every responsible person of the company, including director, company secretary and manager of the company, commit an offence and are liable on conviction to fines (Note 35). To ensure compliance with the requirements and to optimise the use of judicial resources, since June 2014, the CR has compounded specified offences (e.g. failure to file annual return) under Schedule 7 of the present Companies

Note 34: *A company is a private company if its articles limit the number of its members to 50, restrict a member's right to transfer shares, prohibit any invitation to the public to subscribe for any shares or debentures of the company and it is not a company limited by guarantee.*

Note 35: *The maximum fine for failing to comply with the filing requirement of annual return is \$50,000 upon conviction and a daily fine of \$1,000 for a continuing offence.*

Filing and disclosure requirements of charities incorporated/established under three ordinances

Ordinance committed by companies, instead of direct prosecution (Note 36). If there is still non-compliance with the notice requirements specified in the compound offer, the CR may proceed to institute prosecution action. After introduction of this measure, the number of summonses issued by the CR had decreased by 58% from 6,624 in 2012 to 2,780 in 2016.

Public access to company information

4.5 Members of the public can use the search function in the CR's Cyber Search Centre (or through the Company Search Mobile Service by mobile devices) to conduct company searches on the current data of registered companies and image records of documents registered and kept by the CR. The CR provides free search services including search for company name and document index. Members of the public may also extend their search on payment of a fee. The payable search services include image record search (covering annual returns, financial statements and articles of association of companies), directors' index search and company particulars search (Note 37).

Compliance checks of filing requirements

4.6 The CR conducts compliance checks, including annual checks and weekly checks, to identify companies limited by guarantee which do not comply with the filing requirements of annual returns. The CR issues a notice-to-file to each of these default companies requiring them to file the outstanding documents within 28 days from the date of the notice. If a company still fails to comply with the notice requirements, the CR may prosecute the company or strike it off from the

Note 36: *In compounding an offence, the CR gives notice to a person who has been in breach of the specified offences, offering the person an opportunity to rectify the default by remedying the breach within a specified period and paying a specified amount (\$600) to the CR as a compounding fee. If the person accepts the offer and complies with the notice requirements, no prosecution action will be initiated. From June 2014 to December 2016, a total of 15,848 compound offers had been issued to private companies. According to the CR, compound offers would be extended to companies limited by guarantee in early 2018.*

Note 37: *According to the CR, the search function cannot identify a company which is also a charity as this is not a piece of information required to be recorded on the Companies Register under the Companies Ordinance.*

Filing and disclosure requirements of charities incorporated/established under three ordinances

Companies Register (Note 38). Companies to be struck off from the Companies Register would be brought to the attention of the IRD (see para. 2.20). In 2016, the CR issued 839 notices-to-file and took prosecution actions against some 200 default companies limited by guarantee as a result of the compliance checks.

Non-compliance with filing requirements for 2011 to 2016 annual returns by some charities which were companies limited by guarantee

4.7 Audit conducted a review to ascertain the compliance with the filing requirements by the 6,523 charities which were companies limited by guarantee (see para. 4.2). Audit findings are shown in paragraphs 4.8 to 4.10.

4.8 ***Failure to file annual returns.*** Audit's analysis of the CR's computer records of 2011 to 2016 annual returns filed by the 6,523 charities up to November 2016 revealed the following:

- (a) ***2011 to 2014 annual returns.*** Of the 6,523 charities, 263 (4%) had not filed 374 annual returns for the period 2011 to 2014; and
- (b) ***2015 and 2016 annual returns*** (Note 39). According to the CR's computer database, 342 and 830 charities had not filed their 2015 and 2016 annual returns respectively. After taking into account some companies not requiring to file annual returns in these years

Note 38: *In 2016, 42,162 companies were struck off from the Companies Register. The CR has not maintained separate statistics for the different types of struck-off companies.*

Note 39: *For 2015 annual returns, companies with their financial years straddling the effective date of the present Companies Ordinance on 3 March 2014 had to follow the filing requirements under the old Companies Ordinance (see Note 32 to para. 4.3(b)(i)). For companies with financial years commencing on or after 3 March 2014, they had to follow the filing requirements under the present Companies Ordinance.*

Filing and disclosure requirements of charities incorporated/established under three ordinances

(Note 40), it was estimated that 274 (4%) and 589 (9%) charities which were companies limited by guarantee had failed to submit the required annual returns for 2015 and 2016 respectively (Note 41).

Taking together, as at November 2016, some 1,237 (374 + 274 + 589) annual returns for the years from 2011 to 2016 had not been filed by the charities which were companies limited by guarantee.

4.9 ***Repeated breaches of filing requirements.*** Audit's analysis of the 263 non-compliant charities which were companies limited by guarantee (see para. 4.8(a)) found that 21 companies had repeatedly failed to do so up to 2016 (i.e. 12 companies for 5 years and 9 companies for 6 years). Audit's further analysis of the 9 companies with repeated breaches for 6 years revealed that:

- (a) 2 companies were not identified by the CR in its check (see para. 4.6) for the non-compliance. Upon Audit's enquiries, the CR said in March 2017 that the incidents were isolated cases as there had been confusion in identifying the two companies with annual returns submitted but returned for clarification subsequently. The CR was taking follow-up actions on these cases. As a result of the revised requirements for filing annual returns by companies limited by guarantee (see para. 4.3(b)(i)) under the Companies Ordinance, the CR was enhancing its bring-up system to conduct compliance checks, under which similar incidents would not occur again. The new system would be implemented in early 2018. Meanwhile, the CR had already reviewed its internal process for the proper identification of non-compliance cases;

Note 40: *Due to the implementation of the present Companies Ordinance, some companies were not required to file their 2015 and/or 2016 annual returns. For example: (a) for companies incorporated in November 2014 and the first set of financial statements covering 18 months after the date of incorporation (i.e. November 2014 to April 2016), they were not required to file their annual returns for 2015 and 2016; and (b) for companies with financial year ended on 30 June 2014 which had filed their annual returns on or before December 2014, they would not be required to file their 2015 annual returns.*

Note 41: *As seen in Note 40 above, the need to file annual returns in 2015 and 2016 depends on the specific circumstances of individual companies. Based on a sample check of 35 and 83 companies for their 2015 and 2016 annual returns respectively, Audit found that 20% and 29% of the sampled companies not having filed annual returns for 2015 and 2016 respectively were not required to do so or their returns were not yet due.*

Filing and disclosure requirements of charities incorporated/established under three ordinances

- (b) 4 companies had been prosecuted by the CR and were convicted between July 2013 and September 2015 respectively. For 2 companies which were convicted in 2015, the CR informed Audit in March 2017 that they were pending brought-up for review under the CR's established procedures after conviction. For the other 2 companies which were convicted in 2013 and 2015 respectively, the CR started the strike-off process for the companies in December 2016; and

- (c) for the remaining 3 companies, the CR published in the Gazette to strike off one company in December 2016 and withheld further actions against the other 2 companies either because there were legal proceedings or actions being taken by the IRD (see para. 2.20).

4.10 *Late submission of annual returns.* Audit's analysis of the 2016 annual returns submitted by 3,219 charities which were companies limited by guarantee revealed that, as of November 2016, 126 (3.9%) companies had filed their documents late. An ageing analysis of the late submission of annual returns is shown in Table 6.

Filing and disclosure requirements of charities incorporated/established under three ordinances

Table 6

**Ageing analysis of late submission of 2016 annual returns
by charities which were companies limited by guarantee
(November 2016)**

Number of days elapsed after submission due date	Companies	
	(Number)	(%)
Less than 31	39	31 %
31 – 60	44	35 %
61 – 90	8	6 %
Over 90 (Note)	35	28 %
Total	126	100 %

Source: Audit analysis of CR records

Note: The longest delay in submission was 229 days after the due date.

4.11 The timely filing of annual returns by charities which are companies limited by guarantee is important for donors to gain access to their financial information so as to make an informed choice when making donations. In light of the findings mentioned in paragraphs 4.8 to 4.10, the CR needs to step up monitoring the compliance with the statutory filing requirements by charities which are limited companies and take more timely follow-up actions against cases of repeated breaches of the requirements and long delay cases.

Audit recommendations

4.12 **Audit has recommended that the Registrar of Companies should:**

- (a) **step up the CR's monitoring of the compliance with the statutory filing requirements by charities which are limited companies; and**
- (b) **take more timely follow-up actions against cases of repeated breaches of the filing requirements and the long delay cases.**

Response from the Government

4.13 The Registrar of Companies agrees with the audit recommendations in general. She has said that there are over 1.34 million companies on the Companies Register and the CR's current enforcement policy is premised on all of the companies on the Companies Register, bearing in mind that charities do not constitute a separate category of companies under the Companies Ordinance. Even if the CR may make reference to the s88 list kept in the website of the IRD (which is the most relevant information available in the public domain, though it may not be a complete list of tax-exempt charities) when considering enforcement actions against the defaulting companies which are charities, it is important to strike a reasonable balance between enforcement actions taken against charities and other companies on the Companies Register.

Filing and disclosure requirements under the Societies Ordinance

4.14 The Societies Office of the HKPF is responsible for administering the Societies Ordinance which provides that a local society shall apply to the Societies Officer for registration or exemption from registration (see para. 1.7(d)) within one month of its establishment. As of September 2016, there were 37,861 societies in the HKPF's list of societies, of which 1,000 (2.6%) were charitable societies, i.e. 811 had been granted tax exemption status under section 88 of the IRO and 189 were established for charitable purposes (as indicated in their applications for registration/exemption) but without tax exemption status. These charities are required to comply with the same statutory requirements under the Societies Ordinance as other registered/exempted societies. The 811 tax-exempt societies are also subject to review by the IRD regarding their tax exemption status once every four years (see para. 2.4(b)).

Filing and disclosure requirements of charities incorporated/established under three ordinances

Statutory filing requirements

4.15 Under the Societies Ordinance, when applying for registration or exemption, a society shall provide the Societies Officer with the details of its name, objects, particulars of its office-bearers and the address of its principal place of business and of every place and premises owned or occupied by it (Note 42). The Ordinance also requires a registered/exempted society to inform the Societies Officer in writing of any change in its name, objects, office-bearers or principal place of business or closure of a branch which is registered or exempted from registration within one month from such change. While there is no provision requiring the submission of financial statements by a registered/exempted society, the Ordinance provides that the Societies Officer may, at any time, by notice in writing served on any society, require the society to furnish him in writing with information (including the income, the source of income and expenditure of the society or its branch) for the performance of his functions under the Ordinance (Note 43). The HKPF has not maintained statistics on non-compliance with the filing requirements by registered/exempted societies and its enforcement action in this regard.

Public access to registered/exempted society information

4.16 Under the Societies Ordinance, the Societies Officer shall keep a list of all registered/exempted societies setting out their names and the address of their principal places of business and the list shall be open to inspection by any person free of charge. The HKPF has posted the list onto its website for easy reference by the public. For other information of a society provided to the Societies Officer upon

Note 42: *If a society fails to comply with the application for registration/exemption requirements, every office-bearer commits an offence and is liable on summary conviction to a fine at level 3 (\$10,000) for a first conviction. For a second or subsequent conviction for the offence in relation to the same society, every office-bearer is liable to a fine at level 4 (\$25,000) and to imprisonment for three months and in addition to a fine of \$300 for each day during which the offence continues, commencing on the date of the first conviction.*

Note 43: *If a society fails to comply with the notification requirement, every office-bearer of the society shall be guilty of an offence and shall be liable on summary conviction to a fine of \$10,000. If a society fails to furnish the required information, every office-bearer and every person managing or assisting in the management of the society shall be liable on summary conviction to a fine of \$20,000.*

Filing and disclosure requirements of charities incorporated/established under three ordinances

application for registration and exemption (such as its objects and particulars of its office-bearers — see para. 4.15), the Societies Officer may, on a request in writing by any person and on payment of a prescribed fee, provide such information. If the Societies Officer has reason to believe that any society on the list has ceased to exist, he may publish in the Gazette a notification calling upon the society to furnish him with proof of its existence within three months from the date of such notification. If the society fails to comply with the requirement, the Societies Officer may remove the society from the list.

Need to keep the registered/exempted society information up-to-date

4.17 According to the HKPF's website, the HKPF endeavours to update the list of registered/exempted societies as soon as possible, i.e. after a new application for registration is approved or a notification of dissolution of society is received, and publishes the updated list on the HKPF's website on a monthly basis. The HKPF also carries out regular reviews based on the computer records of "last contact date" to identify societies which have not contacted the HKPF in the preceding ten years. The HKPF will send letters to such "inactive" societies and request them to furnish proof of their existence and updated particulars. Audit's examination of the HKPF's review records revealed the following:

- (a) based on the reviews from 2012 to 2014, the HKPF had identified 1,308 inactive charitable as well as non-charitable societies which were subsequently published in the Gazettes in 2012, 2013 and 2015 for taking strike-off actions;
- (b) the HKPF had not conducted any reviews in 2015 and 2016 (Note 44). Upon Audit's enquiry in January 2017, the HKPF said that the Societies Office was occupied by other pressing operational commitments in the two years;
- (c) based on the computer records of the 1,000 charitable societies (see para. 4.14), Audit noted that the HKPF had not requested 53 (5.3%) registered/exempted societies which had not contacted the HKPF for

Note 44: *As a result, the number of societies which had not contacted the HKPF for ten years or more had increased from 53 in 2014 (see para. 4.17(c)) to 85 (of which 45 were on the s88 list) as at September 2016.*

Filing and disclosure requirements of charities incorporated/established under three ordinances

ten years or more at the time of the 2014 review to furnish proof of their existence for taking follow-up actions. Of these 53 societies, 23 were on the s88 list; and

- (d) while the HKPF's computer records showed that the society status of 19 societies had been marked cancelled, they were still included in the list of registered/exempted societies posted on the HKPF's website as of December 2016 (Note 45).

4.18 Audit notes that the HKPF has not issued staff instructions to formalise the present practice of conducting regular reviews to identify inactive societies, including those which are charities, for compliance by staff of the Societies Office. In light of the findings in paragraph 4.17, Audit considers that the HKPF needs to step up efforts to identify inactive societies and take timely follow-up actions to ensure that the list of registered/exempted societies posted on the HKPF's website is kept up-to-date.

Audit recommendations

4.19 **Audit has recommended that the Commissioner of Police should:**

- (a) **issue staff instructions to formalise the present practice of conducting regular reviews to identify inactive societies for compliance by staff of the Societies Office; and**
- (b) **step up efforts to identify inactive societies including those which are charities and take timely follow-up actions to ensure that the list of registered/exempted societies posted on the HKPF's website is kept up-to-date.**

Note 45: *According to the HKPF, the error was due to problems in data migration during system upgrade and manual mistake during data input. The error was immediately rectified in January 2017 and the 19 societies were deleted from the list of registered/exempted societies accordingly.*

Response from the Government

4.20 The Commissioner of Police agrees with the audit recommendations.

Filing and disclosure requirements of IMCs of schools under the Education Ordinance

4.21 Under the Education Ordinance, all aided schools (see Note 9 to para. 1.7(e)) are required to set up an IMC, in the form of a statutory body, to manage the school. Direct Subsidy Scheme schools (see Note 10 to para. 1.7(e)) may, according to their own needs, opt to establish an IMC under the Ordinance. The IMC shall consist of key stakeholders (including representatives of the school sponsoring body, parents, teachers and alumni) to facilitate participatory decision-making, enhance the transparency and accountability of school governance and contribute to more effective school operation. As of September 2016, 826 (98%) of 840 aided schools in Hong Kong had set up IMCs. In addition, 23 (28%) of 82 Direct Subsidy Scheme schools opted to set up IMCs. The EDB is responsible for overseeing IMCs under the Education Ordinance.

4.22 Under the Education Ordinance, an IMC is responsible for handling funds and assets received from the Government as a trustee. It should also act as a trustee for subscriptions collected from students and for donations from the general public. According to the EDB's guidelines (Note 46), an IMC is required to establish proper and adequate financial management mechanism to ensure that the entrusted resources are properly spent and accounted for, and relevant policies and guidelines as promulgated by the EDB are complied with. According to the EDB, IMCs have also been advised to seek approval from the IRD to obtain tax exemption status under section 88 of the IRO. As of September 2016, there were 772 IMCs on the IRD's s88 list, representing 91% of the 846 IMCs (Note 47) on the EDB's Register of IMCs. These charities are required to comply with the same statutory requirements under the Education Ordinance as other IMCs. The 772 IMCs are

Note 46: *The EDB's guidelines highlight the principles and major points that warrant attention of the IMCs for establishing a sound and effective financial management mechanism.*

Note 47: *An IMC can oversee more than one school (e.g. an IMC may oversee a primary school cum secondary school). As of September 2016, there were 846 IMCs overseeing 849 schools.*

Filing and disclosure requirements of charities incorporated/established under three ordinances

also subject to review by the IRD regarding their tax exemption status once every four years (see para. 2.4(b)).

Filing requirements

4.23 Under the Education Ordinance, an IMC shall maintain proper books of account and prepare statements of the accounts of the IMC to be audited by a Certified Public Accountant (Practising). The EDB's guidelines also specify that an IMC should:

- (a) submit the annual audited accounts, auditor's report and management letter (hereinafter referred to as audited financial statements) to the EDB within six months for aided schools/seven months for Direct Subsidy Scheme schools after the end date of a school year or the end date of a financial year; and
- (b) give a financial summary in the school report for release to the stakeholders annually.

The EDB will review the audited financial statements submitted by IMCs and take follow-up action where necessary. In addition, the EDB's guidelines also specify that a financial statement for each fund-raising activity for school purposes should be properly compiled and displayed for a reasonable period of time on the school's notice board, after which it shall be retained for audit purposes.

Public access to IMC information

4.24 According to the EDB's guidelines, IMCs are advised to give a financial summary in their annual school reports (which are released to the stakeholders) uploaded onto their school websites. While there is no requirement for schools with IMCs (IMC schools) to publicise the audited financial statements, the EDB's guidelines state that IMC schools may consider uploading the annual audited accounts onto the school website to enhance transparency.

Measures to ensure compliance with filing requirements

4.25 According to the EDB, most of the IMC schools submitted their audited financial statements within three months from the submission deadline. In case of default, the EDB will issue reminders to the IMC schools concerned within two months after the submission deadline and the responsible EDB regional officer will take follow-up actions. If the outstanding audited financial statements have been overdue for more than ten months, the EDB will approach the sponsoring body of the school to request immediate submission. According to the EDB's guidelines, if an IMC school fails to submit its audited financial statements, the EDB may temporarily withhold payment of grants to the school.

Outstanding audited financial statements by some IMC schools

4.26 To ascertain the extent of IMC schools' compliance with the filing requirements of audited financial statements (see para. 4.23(a)), Audit analysed the EDB's computer records of the schools' filing of their audited financial statements for the 2010/11 to 2014/15 school years and found two IMC schools had not filed the audited financial statements for the 2014/15 school year up to January 2017 because of problems of filing and record keeping or change of accounting staff. According to the EDB, the two schools submitted their outstanding audited financial statements in mid-March 2017.

Late submission of audited financial statements by some IMC schools

4.27 Audit's further analysis of the EDB's computer records for the school years from 2010/11 to 2014/15 revealed that the percentage of late submission of audited financial statements by IMC schools decreased from 40% for 2010/11 to 36% for 2014/15 (see Table 7). An ageing analysis of the late submission of audited financial statements for 2014/15 shows that 26 (9%) of the 305 IMC schools had submitted their audited financial statements more than 120 days after the submission due date (see Table 8).

**Filing and disclosure requirements of charities
incorporated/established under three ordinances**

Table 7

**Number of IMC schools with late submission of audited financial statements
(2010/11 to 2014/15)**

School year (Note)	Number of IMC schools (a)	Number of IMC schools with late submission (b)	Percentage (c) = (b)/(a) x 100%
2010/11	481	190	40%
2011/12	531	167	31%
2012/13	659	213	32%
2013/14	764	221	29%
2014/15	845	305	36%

Source: Audit analysis of EDB records

Note: A school year runs from September to August of the following year.

Table 8

**Ageing analysis of the extent of late submission of
audited financial statements for 2014/15 by IMC schools
(January 2017)**

Time elapsed since submission due date (Day)	Number of IMC schools with late submission	
	(Number)	(%)
Less than 31	163	53%
31 – 60	54	18%
61 – 90	44	14%
91 – 120	18	6%
Over 120 (Note)	26	9%
Total	305	100%

Source: Audit analysis of EDB records

Note: The longest delay in submission was 332 days after the due date.

Filing and disclosure requirements of charities incorporated/established under three ordinances

4.28 Audit considers that the EDB should continue to closely monitor the IMC schools' compliance with the filing requirements of audited financial statements. For cases of long delay in submission, the EDB needs to contact the school sponsoring bodies to ascertain the reasons for the delay and offer assistance where necessary.

4.29 As a test check of the IMC schools' adopting the good practice specified in the EDB's guidelines of uploading their financial summaries/annual audited accounts onto their school websites (see para. 4.24), Audit sample checked the websites of 30 IMC schools and found that 27 (90%) had uploaded their financial summaries onto their websites but none of them had uploaded their annual audited accounts. To enhance transparency and financial accountability of IMC schools, the EDB needs to encourage more IMC schools to adopt the good practice of uploading their financial summaries/annual audited accounts onto their websites.

Repeated delays in submission of audited financial statements

4.30 Audit's analysis also revealed that some IMC schools had repeatedly submitted their audited financial statements late for the 2010/11 to 2014/15 school years, i.e. 68, 41 and 70 IMC schools for 3, 4 and 5 years respectively. For 8 of the 70 IMC schools which had submitted their audited financial statements late for five consecutive school years, the delays in their submission averaged over 190 days each (ranging from 132 to 372 days). Since long delays in submitting the audited financial statements could undermine the effectiveness of monitoring by the EDB, Audit considers that the EDB should closely monitor IMC schools which had repeated non-compliance with the filing requirements of the EDB's guidelines and offer assistance to them, where necessary.

Audit recommendations

4.31 **Audit has *recommended* that the Secretary for Education should:**

- (a) **continue to closely monitor the IMC schools' compliance with the filing requirements of audited financial statements and offer assistance to IMC schools for cases of long delays and/or repeated non-compliance with the filing requirements where necessary; and**

Filing and disclosure requirements of charities incorporated/established under three ordinances

- (b) **encourage more IMC schools to adopt the good practice of uploading their financial summaries/annual audited accounts onto their websites.**

Response from the Government

4.32 The Secretary for Education accepts the audit recommendations. He has said that:

- (a) the EDB will continue to monitor the IMC schools' compliance with the filing requirements of audited financial statements and offer assistance to those schools in need to avoid long delays and/or repeated non-compliance with the filing requirements; and
- (b) to enhance transparency, the EDB will encourage more schools to adopt the good practice of uploading their financial summaries/annual audited accounts onto their websites. The EDB will also update relevant guidelines and promulgate these messages in related seminars and briefings for IMC schools.

PART 5: REGULATION OF CHINESE TEMPLES

5.1 Advancement of religion is one of the charitable purposes defined in the case law (see para. 1.4(c)). According to the IRD's records, of the 8,923 tax-exempt charities as of September 2016, 2,480 (28%) tax-exempt charities are established for purposes of advancement of religion. It is the Government's policy to respect the autonomy of religious organisations. However, the CTO was specifically enacted in 1928 to suppress and prevent mismanagement of Chinese temples (Note 48) and abuses of donated funds. This PART examines issues relating to the regulation of Chinese temples under the CTO.

5.2 *The legal basis.* Under the CTO, a statutory body, namely the CTC was established to carry out the duties provided for in the CTO. Key provisions of the CTO include the following:

- (a) all Chinese temples must be registered;
- (b) the CTC has absolute control over the revenues, funds, investments and properties of all Chinese temples;
- (c) the CTC may require any person possessing or controlling the property of any Chinese temple to transfer or assign any such property to the Secretary for Home Affairs Incorporated (SHAI) which is established under the Secretary for Home Affairs Incorporation Ordinance (Cap. 1044); and
- (d) any person authorised by the Secretary for Home Affairs may enter and search any Chinese temples which may have breached the CTO.

5.3 *Registered Chinese temples.* Up to September 2016, 347 Chinese temples had registered with the CTC under the CTO, of which 129 (37%) were

Note 48: *The CTO defines Chinese temples as including, but not limited to, all temples, Buddhist monasteries, Taoist monasteries and nunneries.*

Regulation of Chinese temples

managed by tax-exempt charities. The 347 registered Chinese temples can be broadly classified into the following three categories:

- (a) *Temples directly administered by the CTC.* There are 25 (Note 49) temples currently under the direct administration of the CTC and most of these properties are vested in the SHAI and revenues are transferred to the Chinese Temples Fund (Note 50). The CTC, through open tendering, outsources the daily operation of the temples under its direct administration. A successful bidder (i.e. the temple keeper) is required to enter into a temple management agreement with the CTC (which normally lasts for a term of two years followed by renewal for another two years subject to satisfactory services and other conditions) and comply with the terms and conditions therein (Note 51). The CTC has also established a mechanism to receive and handle public complaints against the temples. From January to October 2016, 19 complaints against the directly administered temples had been received, mainly related to the temple environment and facilities (e.g. poor air quality and water seepage);
- (b) *Temples managed by organisations under delegated authority from the CTC (hereinafter referred to as delegated temples).* In exercise of its

Note 49: *Of the 25 Chinese temples directly administered by the CTC, only 24 are open to the public because the remaining temple has been closed since April 2004 due to its remote location.*

Note 50: *The Chinese Temples Fund is set up under the Chinese Temples Fund Regulations (Cap. 153A). The CTC transfers part of the accumulated surplus of the Chinese Temples Fund (i.e. after paying for customary ceremonies and maintenance of temple buildings) to the General Chinese Charities Fund, which is also set up under the CTO. The General Chinese Charities Fund can be applied to pay the staff and other expenses incurred by the CTC and for the purposes of any Chinese charity in Hong Kong. Both the Chinese Temples Fund and the General Chinese Charities Fund are exempt from tax under section 88 of the IRO.*

Note 51: *The conditions of the temple management agreements stipulate that: (a) worshippers' donations in the donation box set up in the temple belong to the CTC; (b) the temple keeper is required to pay a contract fee to the CTC; (c) the temple keeper is allowed to sell products (e.g. joss sticks) and provide customary services approved by the CTC in the temple, and retain the income; and (d) the temple keeper is required to submit income and expenditure accounts of the temple to the CTC on a quarterly basis.*

power under the CTO (Note 52), the CTC has delegated the administration of 20 Chinese temples (all standing on lands held by the SHAI) to eight organisations mainly because of their history and close linkage or connections with the temples. The delegates are allowed to keep and use the donations and any other revenues of delegated temples in the manner stipulated in the relevant delegation agreements; and

- (c) ***Other registered temples.*** The remaining 302 registered temples are managed by individuals or organisations such as religious organisations. The donations and any other revenues of these temples are managed by the respective temples themselves. The CTC maintains a register of the registered temples on its website. Basic information of the registered temples such as name of the temple, district in which the temple is situated and gods worshipped is available on the register.

5.4 ***Unregistered Chinese temples.*** According to a paper submitted by the HAB and the CTC to the LegCo Panel on Home Affairs in March 2015, there were around 600 Chinese temples and among them, about 350 had registered with the CTC. For the 250 unregistered temples, the CTC has not taken any action against these unregistered temples because:

- (a) the Government considers that some provisions of the CTO (including those mentioned in para. 5.2) may be outdated in the present day context. Comparing with the societal developments in the 1920s, members of the public are now more aware of the risks associated with “pseudo-religious establishments” and there is now various legislation (Note 53) providing protection and remedies against frauds, malpractices and misuses of funds;
- (b) if the CTC exercises its powers under the CTO to enforce some provisions (e.g. requesting a Chinese temple to transfer its property to the

Note 52: *Under section 11 of the CTO, the CTC may delegate to any person the administration of any temple and of the revenues of such temple and to revoke any such delegation.*

Note 53: *For example, the Theft Ordinance (Cap. 210) covers fraudulent or deceitful solicitation of money.*

Regulation of Chinese temples

SHAI), it may raise public concern over the protection of property rights and religious freedom; and

- (c) the HAB and the CTC initiated a review of the CTO in 2012 with a view to updating the regulatory regime for Chinese temples, and conducted a public consultation in mid-2015 (see paras. 5.12 to 5.14).

5.5 In its reply to questions raised by a Member of LegCo in January 2012, the HAB said that it was not the intention of the CTC to monitor the operation of Chinese temples other than those directly administered by the CTC or managed by delegated organisations (i.e. the delegated temples).

Management of delegated temples

5.6 Currently, the CTC has delegated the administration of 20 Chinese temples to eight organisations (Note 54) through delegation agreements which usually last for a term of three years. These agreements set out the terms and conditions that the delegated organisations have to comply with. It is important that these agreements contain proper control and accountability provisions to ensure that the temples managed under the delegated authority of the CTC are run properly and the temple funds are spent appropriately. Audit examination of the delegation agreements of the 20 temples has revealed that:

- (a) ***Agreements with reporting requirements.*** The delegation agreements for 17 temples contain the following requirements on reporting the financial affairs and operations of the temples:
 - (i) a statement of accounts of the temple for each financial year shall be prepared, duly audited by an authorised auditor (i.e. audited accounts) and forwarded to the CTC not later than three months after the end of the relevant financial year; and

Note 54: *Of the eight delegated organisations, two manage more than one temple each (i.e. one manages five temples and the other manages nine temples). Each of the remaining six organisations manages one temple.*

- (ii) an annual administrative report of the temple duly certified by the delegated organisation shall be submitted within one month or three months after the end of each financial year. The report shall cover matters relating to the management of the temple during the relevant financial year, including the major problems encountered in daily management of the temple, the activities organised by the delegated organisation at the temple and the number and details of complaints received in relation to the temple and the management thereof;

- (b) ***Agreement without reporting requirements.*** The delegation agreement for one temple has been in force since 1956 and does not contain an expiry clause and requirements on the submission of audited accounts and administrative reports. However, it is noted that the delegated organisation has published its annual reports (including financial information of the delegated temple) on its website and the Secretary for Home Affairs has appointed three independent directors of the organisation to monitor and advise on its business and operations; and

- (c) ***Expired agreements.*** The delegation agreements for the remaining two temples expired in 2006 and 2007 respectively and have not been renewed (see para. 5.7).

Inadequacies in monitoring of delegated temples

5.7 ***Need to renew two expired delegation agreements.*** Audit found that the delegation agreements for two temples expired in 2006 and 2007 respectively and have not been renewed (see para. 5.6(c)). Details of the two cases are as follows:

- (a) for the temple managed by Organisation A without a delegation agreement in force since 2006, the CTC had tried to introduce some new requirements in the new agreement (e.g. requiring the delegated organisation to repair and maintain the temple at its own expenses and to submit audited accounts and administrative reports) but met with opposition by Organisation A. In the meantime, donations and other revenues were kept and used by Organisation A without accountability to the CTC. Additionally, Organisation A disputed the ownership of the land on which the temple stands and refused to enter into a delegation

Regulation of Chinese temples

agreement with the CTC. There was no record to show that the CTC had followed up with Organisation A since 2007; and

- (b) for the temple managed by Organisation B without a delegation agreement in force since 2007 (Note 55), the CTC found that Organisation B had breached the conditions of the agreement by erecting an unauthorised building structure at the temple premises before the expiry of the agreement in 2007. The CTC requested Organisation B to remove the unauthorised building structure before renewing the agreement but met with opposition. The issue dragged on for some ten years and remained unresolved. In the meantime, donations and other revenues were kept and used by Organisation B without accountability to the CTC. According to the CTC, it has been liaising with Organisation B to resolve the issue.

5.8 It is unsatisfactory that the two temples have been managed by the delegated organisations (Organisations A and B) without any delegation agreements in force for some ten years. The CTC needs to expedite action to resolve the long-outstanding issues with the delegated organisations concerned with a view to renewing the delegation agreements as soon as practicable.

5.9 *Need to enhance transparency.* Both the directly administered temples and the delegated temples receive voluntary donations from the public. It is important that their financial information is made available for public inspection. However, at present, only the financial information of the 25 directly administered temples and 9 of the 20 delegated temples is accounted for in the financial statements of the Chinese Temples Fund, which are posted on the CTC's website for public inspection. The CTC has neither made available the audited accounts of the remaining 11 delegated temples for public inspection (e.g. publishing on the CTC's website) nor required the delegated organisations to do so. In Audit's view, the CTC needs to work out with the delegated organisations of the 11 temples agreements and means to disclose the financial information and operations of the temples.

Note 55: *Audit noted that the expired agreement (effective from 2005 to 2007) contained the requirements on submission of audited accounts and administrative reports but Organisation B had not submitted the required accounts and reports throughout the term of the agreement.*

5.10 *Non-compliance with delegation agreement requirements.* For the 17 delegated temples (Note 56) with the audited accounts and administrative report submission requirements (see para. 5.6(a)), Audit conducted a compliance check based on the CTC's records up to January 2017. Audit found cases of non-compliance by four delegated organisations as follows:

- (a) the first organisation (Organisation C) had not submitted the audited accounts of the temple under its management for the previous 3 years and its administrative reports for the previous 11 years;
- (b) the second organisation (Organisation D) had submitted all the audited accounts of the five temples under its management but there were delays in submission. In particular, the audited accounts for the years ended December 2013, 2014 and 2015 (due for submission in March 2014, 2015 and 2016 respectively) were not submitted until December 2016. Moreover, Organisation D had not submitted the administrative reports of the five temples under its management for the previous five years;
- (c) the third organisation (Organisation E) had submitted all the audited accounts and administrative reports of nine temples under its management but there were delays in submission of the administrative reports. In particular, the administrative report for the year ended March 2016 (due for submission in April 2016) was only submitted in January 2017; and
- (d) the fourth organisation (Organisation F) had submitted all the accounts and administrative reports of the temple under its management but there were delays in submission. In particular, the accounts and administrative report of the temple for the year ended December 2015 (due for submission in March and January 2016 respectively) were only submitted in December 2016. Moreover, the submitted accounts had not been audited by an authorised auditor, contrary to the delegation agreement's requirements.

Note 56: *As at January 2017, the audited accounts and administrative report of one temple were not yet due for submission as the temple was converted into a delegated temple in February 2016.*

Regulation of Chinese temples

In light of the non-compliance cases noted above, the CTC needs to step up monitoring of the delegated organisations' compliance with the audited accounts and administrative report submission requirements.

5.11 **Review of audited accounts.** According to the delegation agreement, the income of a delegated temple must be applied in the first instance to the due observance of the customary ceremonies of the temple, and the maintenance of the temple, the lots and the assets, fittings and properties therein. Any surplus shall be applied to pay the salaries of those staff responsible for managing the temple and the expenses of the delegated organisation in compliance with the agreement and for the purposes of Chinese charity in Hong Kong. In scrutinising the submitted accounts for the five temples under Organisation D's management for the year ended December 2015, Audit noted that there was a staff messing expenditure of about \$380,000 which:

- (a) was disproportionate to the operational expenses of the temples (the staff salary expenditure for the same year only amounted to \$301,000); and
- (b) was higher than the \$137,000 incurred in the previous year.

However, the CTC had not sought clarifications from Organisation D. The CTC needs to tighten up the provisions in delegation agreements so as to ensure that temple funds are properly spent.

Review of the Chinese Temples Ordinance

5.12 In light of the outdated provisions of the CTO (see para. 5.4(a)), the HAB and the CTC conducted a review of the provisions during 2012 to 2015 with a view to making legislative amendments to better reflect current practices and serve current needs. The review recommended, among other things (Note 57):

Note 57: *The other recommendations included establishing the CTC as a body corporate, stipulating in the law its powers and functions, and optimising its operational procedures, as well as merging the Chinese Temples Fund and the General Chinese Charities Fund into a single fund with a broader scope to provide grants to meet the needs of the relevant services of the community.*

- (a) removing the outdated restrictions imposed on all Chinese temples, including the provisions requiring all Chinese temples to be registered, the revenues and properties of all Chinese temples to be under the absolute control of the CTC, and any person who possesses or controls the property of any Chinese temple to transfer such property to the SHAI; and

- (b) establishing a more reasonable regulatory regime for Chinese temples by replacing the mandatory registration requirement with a voluntary registration scheme and providing the Secretary for Home Affairs with power to participate in any legal proceedings against mismanagement of Chinese temples or abuses of temples' funds so as to safeguard public interest.

5.13 The HAB and the CTC briefed the LegCo Panel on Home Affairs on the outcome of the review of the CTO in March 2015 and conducted a public consultation from March to May 2015. However, diverse views were received during the public consultation exercise. For example, there was no consensus on the implementation of the proposed voluntary registration scheme. In late 2015, there was a widely reported case of abuse of temple funds by an unregistered Chinese temple (Temple A) and the CTC received a request for taking possession of Temple A in January 2016. In view of these developments, the CTC formed a sub-committee in August 2016 to follow up the alleged malpractices of Temple A and the review of the CTO.

5.14 Given the recent development (especially the lack of general consensus on the registration scheme), it is not expected that the review of the CTO could be finalised in the short term. In Audit's view, the HAB and the CTC need to implement interim measures to promote the transparency and accountability of the operation of Chinese temples with a view to safeguarding the temple funds from abuse. For example, the CTC may encourage organisations managing the registered temples to adopt the best practices promulgated by the Government (e.g. the Reference Guide on Best Practices for Charitable Fund-raising Activities promulgated by the SWD). As an incentive, higher priority could be given to temples which have adopted the best practices when they apply for funding from the Chinese Temples Fund (see Note 50 to para. 5.3(a)).

Audit recommendations

5.15 **Audit has *recommended* that the Secretary for Home Affairs, as the Chairman of the CTC, should:**

- (a) **for the two temples with expired delegation agreements (see para. 5.7), expedite action to resolve the long-outstanding issues with the two delegated organisations concerned with a view to renewing the delegation agreements as soon as practicable;**
- (b) **work out with the delegated organisations of the 11 temples (see para. 5.9) agreements and means to disclose the financial information and operations of the temples;**
- (c) **step up monitoring of the delegated organisations' compliance with the terms of the delegation agreements to ensure that audited accounts and administrative reports of the temples are submitted in a timely manner;**
- (d) **tighten up the provisions in delegation agreements to ensure that temple funds are properly spent; and**
- (e) **consider providing incentives to organisations managing registered temples to adopt the best practices promulgated by the Government to enhance the transparency and accountability of the temples' operation.**

Response from the Government

5.16 The Secretary for Home Affairs generally accepts the audit recommendations. He has said that the HAB will take into consideration the areas for improvement of the CTC as identified by Audit.

PART 6: WAY FORWARD

6.1 This PART examines the way forward on the monitoring of charities with reference to the recommendations of the LRC Report on Charities.

Law Reform Commission Report on Charities

6.2 According to the 2013 LRC Report, the existing regulatory framework of charities has the following deficiencies:

- (a) ***Out-dated definition of charity.*** The definition of “charitable purpose” 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. The leading case authority of 1891 on the definition of charity which enunciated the four principal divisions of charitable purpose (namely the relief of poverty, the advancement of education, the advancement of religion and any other purposes beneficial to the community not falling under any of these three heads) is still applied today. Many of the more recently developed charitable purposes necessarily fall within the vague “*any other purpose*” classification. This has resulted in evolving case law on charitable purposes which is confusing and unclear;
- (b) ***Lack of a coherent system for the registration of charities.*** While the IRD’s s88 list does not constitute a formal “register” of charitable organisations, there may be a danger that the public (and hence potential charity donors) may perceive that the recognition of tax exemption status and inclusion on the s88 list confers on those charities “*a cloak of respectability and the semblance of official sanction not intended by the Inland Revenue Ordinance*”;
- (c) ***Inconsistent standards or requirements on governance, accounting and reporting by charities.*** Charities of different legal forms established under different ordinances can be subject to different statutory controls. For example, charitable organisations established under the Companies Ordinance are required to prepare audited accounts in order to fulfil requirements under that Ordinance. However, this is not the case for

Way forward

charitable organisations established as societies registered under the Societies Ordinance. As for charities which are neither statutory nor subvented, they may operate autonomously under their own governing bodies and according to their own rules and regulations; and

- (d) *Limited control of charitable fund-raising activities.* Government oversight of the fund-raising activities of charities is confined specifically to those activities requiring the permission of the SWD, the HAD and the FEHD, such as flag days, lotteries and on-street selling. For other forms of fund-raising activity such as charity auctions, balls, concerts, dinners, or requests for donations by mail or through advertisements, no government oversight applies.

Recommendations of the LRC Report

6.3 After conducting a detailed study, including analysing the charities' regimes in a number of overseas jurisdictions and seeking views and comments from the public in 2011, the LRC issued a Report on Charities in December 2013. The LRC Report concluded that:

- (a) it should be a long-term goal that a charity commission or a centralised regulatory authority for charities should be established for Hong Kong. Given the lack of general consensus among the public on this issue (Note 58), the LRC believed that the community needed more time to discuss the concept of a charity commission; and
- (b) in the interim period, expedient administrative measures should be implemented to improve the transparency and accountability of charities and thus provide better safeguards to the public. In this connection, the LRC made a total of 18 recommendations, which included, among others, establishing a clear statutory definition of what constitutes a charitable purpose, requiring all charitable organisations which solicit public

Note 58: *According to the LRC Report, the number of respondents not in support of the recommendation to set up a charity commission greatly out-numbered those in support of the recommendation. However, the majority of the respondents agreed that it was important for charities to be more transparent and accountable to the community and there was also consensus on the need to safeguard the rights of donors.*

donation and/or have sought for tax exemption to be registered, adopting a specifically formulated financial reporting standard for charities in Hong Kong, and ensuring that tax-exempt charities make information about their operations available to the public (see Appendix C for details).

The HAB has been coordinating inputs from relevant B/Ds with a view to formulating a response to all the recommendations of the LRC Report for the Government's consideration.

6.4 In considering the way forward in formulating a response to the LRC's recommendations, there is a need to take into account the areas of improvement identified in earlier PARTs of this Audit Report which are complementary to the LRC's recommendations, as follows:

- (a) ***LRC recommendation: more frequent reviews by the IRD.*** In PART 2, Audit has found that there is a need to review the provisions of the IRO to enable the IRD to perform effectively its role in administering the tax exemption status of charities; and
- (b) ***LRC recommendation: enforcement action for non-compliance with filing and disclosure requirements.*** In PART 4, Audit has found that there is room for improvement in the CR, the HKPF and the EDB's administration of the filing and disclosure requirements under their responsible legislation, which could help members of the public to access information of charities. Similarly, in PART 5, Audit has found that the HAB and the CTC can improve the management of delegated temples to enhance the transparency and accountability of the use of temple funds.

6.5 While the LRC has not made specific recommendations on the administration of land granted to charities, it commented that the current monitoring arrangements for charities with split responsibilities across different authorities appeared to be fragmented and cumbersome. In PART 3 of this Audit Report, Audit has found that notwithstanding the issue of the 2014 Protocol on the delineation of responsibilities on monitoring PTGs among the Lands D and relevant supporting B/Ds, there could be difficulties in implementing the Protocol where there is no designated supporting B/D in a lease. Lease M in paragraph 3.14 is a case in point.

Audit recommendations

6.6 **Audit has *recommended* that the Secretary for Home Affairs should take into account the areas for improvement identified in this Audit Report (see para. 6.4) in coordinating inputs from relevant B/Ds for formulating a response to the LRC's recommendations for the Government's consideration.**

6.7 **Audit has also *recommended* that the Secretary for Development and the Director of Lands should, in collaboration with the supporting B/Ds, review the implementation of the 2014 Protocol to see whether there is room for improvement.**

Response from the Government

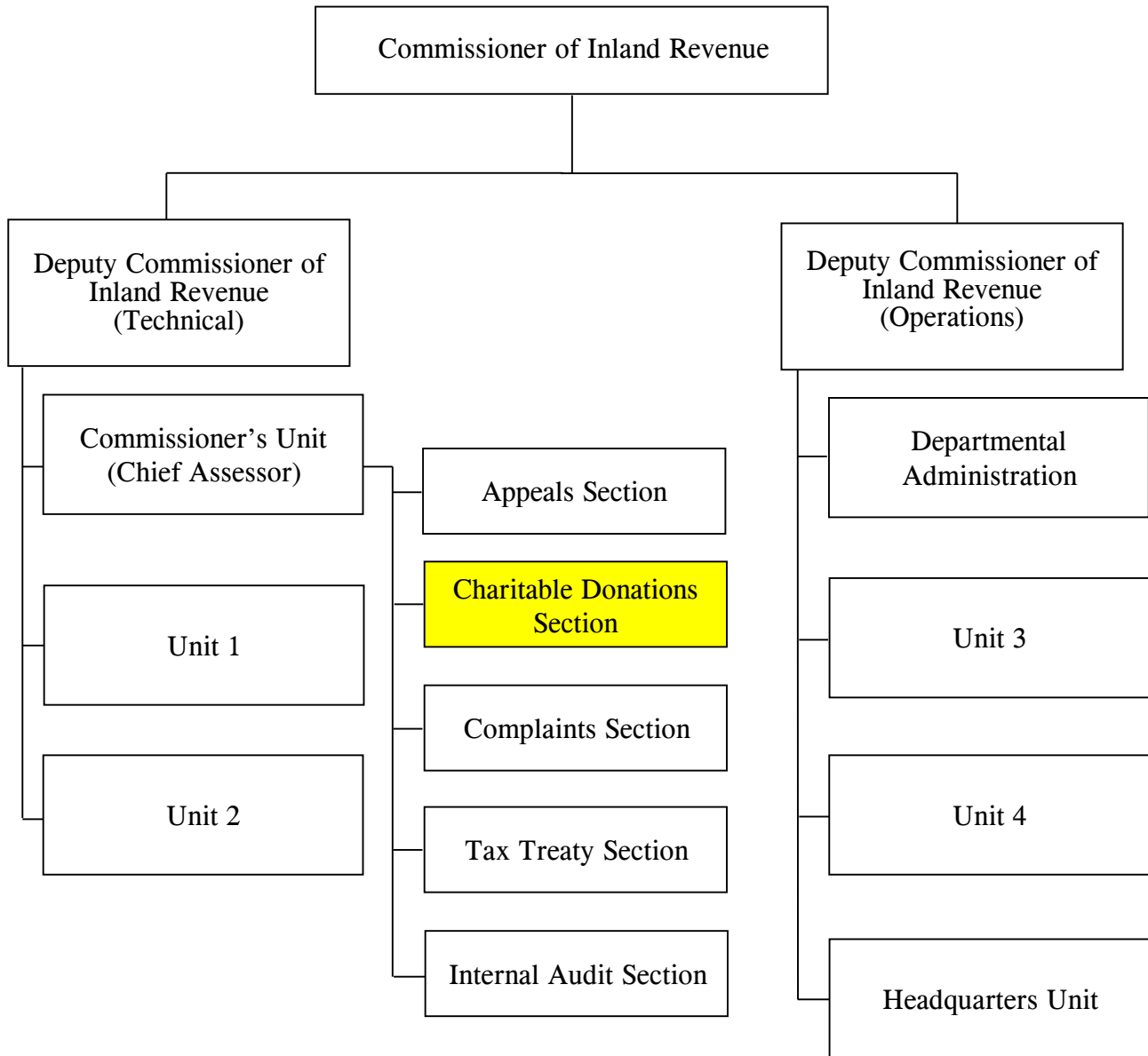
6.8 The Secretary for Home Affairs generally accepts the audit recommendation in paragraph 6.6. He has said that the HAB will continue to work with relevant B/Ds in coordinating their inputs for formulating a response to the recommendations of the LRC Report for the Government's consideration.

6.9 The Secretary for Development accepts the audit recommendation in paragraph 6.7. He has said that:

- (a) the 2014 Protocol was drawn up by the Lands D in response to the recommendations of the Public Accounts Committee of LegCo and the Director of Audit in 2012 on matters concerning PTGs, with a view to delineating the sharing of responsibilities between the Lands D (as the Government land agent) and the B/Ds which support various types of PTGs; and
- (b) with the benefit of additional actual experience in the past three years, the Development Bureau will work with the Lands D to follow up with relevant B/Ds to review and consider whether, and if so, how the Protocol may be refined.

6.10 The Director of Lands accepts the audit recommendation in paragraph 6.7. She has said that the Lands D would follow up with concerned B/Ds to see if there is any room for improvement and, as the Government land agent, will issue and monitor the land grant at the directive of concerned B/Ds.

**Inland Revenue Department:
Organisation chart (extract)
(31 December 2016)**



Source: IRD records

Particulars of 14 land leases alleged to have hotel operations

(I) 5 leases granted before 1959

Lease	Year of land grant	Land use condition
A	1845	Virtually unrestricted
B	1859	Virtually unrestricted
C	1927	Not be used for any other purpose than for the grantee's object or such other purpose as approved by the then Governor.
D	1932	For purpose of promoting the formation of the grantee's religious character and cultivating the grantee's religious spirit of service amongst young men.
E	1969	Virtually unrestricted (Note)

(II) 9 leases granted in or after 1959

Lease	Year of land grant	Land use condition
F	1974	For the purposes of a non-profit-making institution providing accommodation for a gymnasium, library, domestic science rooms, hostel accommodation for business girls and ancillary administrative offices or for such other purposes as may be approved by the DSW. The grantee shall operate the said institution on a scale satisfactory to the DSW and conduct the said institution in accordance with all relevant Ordinances and Regulations that are or may at any time be in force in Hong Kong and in all respects to the satisfaction of the DSW.

Appendix B
(Cont'd)
(paras. 3.7, 3.8(c)
and 3.11 refer)

Lease	Year of land grant	Land use condition
G (Grantee G)	1966	Be used only for the purposes of a nursery, training centre, dormitories, such staff quarters as the DSW may approve in writing and such other welfare purposes as the DSW may approve in writing, the whole to be conducted on a non-profit-making basis and to the satisfaction of the DSW.
H (Grantee H)	1971	Erect and maintain a building providing accommodation for a welfare centre including a hostel, together with staff quarters as may be approved by the DSW. The grantee shall conduct the centre in accordance with all relevant Ordinances and Regulations that are or may at any time be in force in Hong Kong and in all respects to the satisfaction of the DSW.
I	1980	Not be used for any purpose other than for the purposes of a hostel and other allied services as may be approved by the DSW together with such domestic quarters as the DSW may consider reasonable for housing staff and workmen employed on the premises. The grantee shall conduct the said hostel in accordance with all Ordinances and Regulations relating to such hostel which are or may at any time be in force in Hong Kong and in all respects to the satisfaction of the DSW.
J	1981	Not be used for any purpose other than non-profit-making headquarters, staff quarters, training college, youth hostel, multi-purpose hall and rooms and a chapel which shall be of such size as may be first approved in writing by the then Director of Public Works, a non-profit-making child care centre, a non-profit-making multi-service centre for the elderly, a non-profit-making kindergarten of 4 classrooms, and such other non-profit-making purposes as may be approved by the DSW. The grantee shall conduct and operate the services in accordance with all relevant Ordinances and Regulations that are or may at any time be

Appendix B
(Cont'd)
(paras. 3.7, 3.8(c)
and 3.11 refer)

Lease	Year of land grant	Land use condition
		in force in Hong Kong and in all respects to the satisfaction of the Government.
K	1987	Not be used for any purpose other than for the purposes, of the grantee's object and a children's and youth centre. The grantee shall operate the premises in accordance with all relevant Ordinances and Regulations which are or may at any time in force in Hong Kong.
L	1987	Not be used for any purpose other than for the purposes of a non-profit-making nursery approved by the DSW, a non-profit-making hostel, such non-profit-making educational facilities as may be approved by the Director of Education, such domestic quarters as the Director of Lands may consider reasonable for the use and occupation of supervisors and caretakers employed on the lot, a non-profit-making day care centre for the elderly as may be approved by the DSW and such facilities ancillary to the uses permitted as may be approved by the Director of Lands. The grantee shall conduct and operate the nursery and the day care centre for the elderly, the hostel and the educational facilities in all respects to the satisfaction of the DSW, the Director of Lands and the then Director of Education respectively, and in accordance with all Ordinances and Regulations which are or may at any time be in force in Hong Kong.

Appendix B
(Cont'd)
(paras. 3.7, 3.8(c)
and 3.11 refer)

Lease	Year of land grant	Land use condition
M (Grantee M)	1988	Not be used for any purpose other than for a non-profit-making hostel (of not more than 400 rooms together with domestic quarters for housing staff and workmen employed in the hostel and ancillary offices as may be approved in writing by the then Director of Buildings and Lands), church, social and welfare purposes. The grantee shall conduct the facilities in accordance with all Ordinances and Regulations relating to these services which are or may at any time be in force in Hong Kong in all respects to the satisfaction of the then Director of Buildings and Lands.
N (Grantee N)	1990	Not be used for any purpose other than accommodation for the grantee's headquarters, the bus terminus, the telephone exchange and the vehicle park. The headquarters shall include assembly hall, gymnasium, offices, grantee's shop, hostel, dormitory, canteen, staff quarters and such other ancillary accommodation and facilities as shall be approved by the DSW. The grantee shall operate, conduct, manage and maintain the headquarters on a scale satisfactory to the then Governor and in accordance with all Ordinances, Regulations and By-laws relating to the headquarters which are or may at any time in force in Hong Kong.

Source: Lands D records

Note: The lease term commenced from 1888.

Recommendations of the Law Reform Commission Report

The LRC Report contained 18 recommendations on charities, covering aspects on definition and registration of charities, facilitation of good practice, financial reporting by charities, and filing requirements (and requirement of display of registration number) for charitable fund-raising activities. The 18 recommendations are summarised below:

Statutory definition

- (a) there should be a clear statutory definition of what constitutes a charitable purpose;

Categories of charitable purpose

- (b) the statutory definition of what constitutes a charitable purpose that is exclusively charitable should include 14 heads and all of these heads of charitable purpose must be also for the public benefit;

Legal forms of charitable organisations

- (c) the current system of allowing a variety of legal forms of charitable organisations to exist should continue;

Registration of charitable organisations

- (d) all charitable organisations which solicit from the public for the donation of cash or its equivalent; and/or have sought tax exemption should be subject to the requirement of registration. The list of registered charitable organisations should be established and maintained by a B/D and be available for public inspection;

Financial reporting standard

- (e) a specifically formulated financial reporting standard should be adopted for charities in Hong Kong;

Filing requirements

- (f) certain filing requirements should be imposed on charitable organisations in their applications for charitable fund-raising licences or permits;

Information available to the public

- (g) the Government should ensure that tax-exempt charities make information about their operations available to the public by publishing certain documents, such as their financial statements and activities' reports, on their websites;

Enforcement action for non-compliance with filing and disclosure requirements

- (h) the Government should designate a B/D to be responsible for enforcement action in cases of non-compliance with the filing and disclosure requirements;

Standardised application form and conditions

- (i) a standardised application form setting out some common basic requirements (including the requirement for disclosure of certain information about the charity) should be adopted in respect of different types of charitable fund-raising licence or permit applications and the existing function of the information portal under the "GovHK" website should be enhanced by making the information available for public inspection;

Centralised hotline

- (j) the function of the Government's existing 1823 Call Centre should be enhanced or a new telephone hotline should be set up for answering public enquiries and receiving complaints in relation to charitable fund-raising activities;

Display of registration number

- (k) the registration number of charitable organisations involved in all forms of charitable fund-raising activities (including those via the Internet or other electronic means and involving face-to-face solicitation of pledges from donors for regular donations) should be prominently displayed on, among others, any related documents, webpage, message transmitted by electronic means or any means through which appeals for charitable donations are made (as the case may be);

Facilitation of good practice

- (l) charitable organisations should be encouraged to work with institutions/organisations to facilitate good practice and to improve co-operation between charitable organisations and the Government. Good practice guidelines should be issued by a coordinating B/D;

Public education

- (m) the Government, through the coordinated efforts of B/Ds, should engage in more public education on how to become a smart donor and on matters relating to charitable fund-raising activities;

Setting up a platform of coordination

- (n) the Government should set up a platform of coordination in dealing with applications for charitable fund-raising licences among the different departments responsible for the licensing of charitable fund-raising activities;

Allocation of more resources

- (o) more resources should be allocated to Government departments involved in the licensing of charitable fund-raising activities in order to enhance their role in relation to the monitoring of charitable fund-raising activities;

More frequent reviews by the IRD

- (p) the IRD should conduct more frequent reviews of tax-exempt charities to ascertain whether the activities of these charities are compatible with their charitable objects and more resources should be allocated to the IRD for such purpose;

Cy-près doctrine

- (q) the Government should introduce legislation along the lines of the English statutory model of the cy-près doctrine (i.e. to solve the problems which arise when a charitable gift fails because the original purposes of such gift, in whole or in part, cannot be carried out) so as to provide a statutory basis for the doctrine in Hong Kong and to broaden the scope of its application; and

Setting up of a charity commission

- (r) a charity commission should not be set up at this stage. It should be a long-term goal to set up a charity commission or a centralised regulatory authority upon review of the impact and effect of the implementation of the other recommendations made in the LRC Report.

Source: LRC Report

Acronyms and abbreviations

Audit	Audit Commission
B/Ds	Bureaux/departments
CDS	Charitable Donations Section
CR	Companies Registry
CTC	Chinese Temples Committee
CTO	Chinese Temples Ordinance
DLC	District Lands Conference
DoJ	Department of Justice
DSW	Director of Social Welfare
EDB	Education Bureau
ExCo	Executive Council
FEHD	Food and Environmental Hygiene Department
G/IC	Government, Institution or Community
HAB	Home Affairs Bureau
HAD	Home Affairs Department
HKPF	Hong Kong Police Force
IMC	Incorporated management committee
IRD	Inland Revenue Department
IRO	Inland Revenue Ordinance
Lands D	Lands Department
LegCo	Legislative Council
LRC	Law Reform Commission
OZP	Outline Zoning Plan
Plan D	Planning Department
PTG	Private treaty grant
SHAI	Secretary for Home Affairs Incorporated
SWD	Social Welfare Department
TPB	Town Planning Board