



Public Governance Guidance Note

Introduction

The purpose of this second guidance note of the Public Governance Interest Group (PGIG) is to reiterate some of the important themes developed under the first guidance note worthy of emphasis, and to continue our hypothetical case study to consider the initial issues and steps that a person (in our case study, a director) should consider in setting up a non-governmental organisation (NGO) based on the advice of the company secretary as a champion of good governance.

The focus for the company secretary would be:

- to listen carefully to the facts and think laterally
- to advise the director on how to obtain tax-exempt status for his NGO, and
- to advise the director on the structures available when setting up an NGO.

Themes worthy of emphasis

In our first guidance note, we honed in on some of the qualities required of those at the helm of running public governance including: selflessness; integrity; objectivity; accountability; openness; honesty; and leadership. We explained that NGOs typically have far more stakeholders than a commercial enterprise, and the leader of an NGO needs to be attentive to the concerns of different stakeholders. It follows that it may not be an easy task to fulfil all stakeholder needs, particularly since resources are usually limited. The

priority should always be to deliver 'public good'. This should serve as a useful anchor to measure the NGO's performance in balancing stakeholders' interests when it comes to the difficult decisions that need to be made regarding the delivery of services or best use of the NGO's resources and funds.

Hypothetical case study

In our first guidance note, we examined some key issues in NGO governance via a hypothetical scenario of a director coming to you as company secretary stating his desire to be involved in an NGO for budding musicians. You reminded your director of the fundamental issues identified above and advised him to avoid conflicts of his personal interest with those of the NGO in general.

Your director now comes to you and says that your previous advice has been useful – his involvement with the NGO has had its challenges but also its rewards, particularly when he sees budding musicians being nurtured. He is now thinking of setting up an NGO of his own, focused on running an international exchange programme for talented budding musicians. This would require:

- recruiting those aligned with your director into leadership positions within the NGO
- defining what exactly is the 'public good' the NGO would like to deliver
- setting up the NGO under an appropriate legal structure

- establishing proper governance
- fundraising
- investing the funds in renting or buying premises and equipment, and
- delivering on the promise to do public good via the NGO.

Your director also wants to have an annual show at the end of each year, maybe during thanksgiving as your director is a US citizen. This event would bring together the musicians involved in the exchange programme to perform in a finale to the annual efforts of the NGO.

The ability to listen and to think laterally

As company secretary, you need to have the ability to listen to the facts of a matter and to think laterally. Listening to the facts presented to you, you point out to the director that, as a US citizen, there may be US-centric issues to consider, including the need for filing tax returns and the application of the US Foreign Corrupt Practices Act. Therefore, your director may need some US legal and tax advice on any proposed arrangements. You can only provide him with input as to the Hong Kong aspects. Thinking laterally, you explain to your director that he could have his company sponsor the exchange programme. If this is treated as a branding exercise, it could well be that the expenses incurred in running the programme could amount to legitimate business expenses¹. There would then be control of the exchange programme, as well as enhancement of the brand of the company, which could be a win-win situation. However, there may be a lesser overall societal impact as the project would be regarded as a private business matter. But this approach could allow for business expense deductions, even if the exchange programme is not deemed a charitable project.

The charitable status

You explain to your director that unless he is thinking of company funding for his NGO, achieving tax-exempt status would probably be important to his NGO to attract donations and not to pay tax on them. Your director says that this is desirable as he already has a few large donors that he wants to invite to help run the charity and make donations. In this connection, you inform your director that the Inland Revenue Department (IRD) had issued *A Tax Guide for Charitable Institutions and Trusts of a Public Character*²

(Guide) relating to tax exemption under s.88 of the Inland Revenue Ordinance which allows for taxation exemption for charities. The Guide states that the reference to an NGO does not mean that there is no tax payable. The IRD must designate the organisation as s.88 tax exempt to have tax-exempt status.

The Guide makes it clear that at law, a charity must be established for any of the following exclusive charitable purposes to benefit the public or a class of the public, namely:

1. relief of poverty
2. advancement of education
3. advancement of religion, and
4. other purposes of a charitable nature beneficial to the community not falling under any of the preceding heads.

While the purposes under the first three heads may be in relation to activities carried on in any part of the world, those under the fourth heading will only be regarded as charitable if they are of benefit to the Hong Kong community. The tax advantages accorded to charities are that they are exempt from tax, and to the extent that they carry out trade or business, their profits are also exempt from tax if carried out in the course of carrying out the charitable objects (like selling religious sound tracks for religions) substantially for use in Hong Kong. There would also be exemption from business registration fees.

Calling an organisation an NGO does not necessarily mean that it will be considered a charity with s.88 tax-exempt status. The only way to know if the organisation is a charity is to check whether its name is within the public list kept by IRD³. Further, the exchange programme would unlikely be solely for the benefit to the Hong Kong community under the fourth heading above, given the intention to bring in overseas budding musicians under the exchange programme. After consulting you, and to achieve the maximum social impact which requires his NGO should be regarded as a charity, your director decides that the NGO will be used to establish a quarterly talent show (QTS) programme, which will organise quarterly events to bring budding Hong Kong musicians together.

Available legal structures for the NGO

You point out to your director, that under the Guide, his NGO could be:

- a trust
- a society established under the Societies Ordinance
- a company under the Companies Ordinance (including a company limited by guarantee), or
- a statutory body.

The use of a trust structure is common for religious bodies. The trustees normally have very high personal responsibilities at law. The ruling council should be registered under the Registered Trustees Incorporation Ordinance. Registering as a society under the Societies Ordinance is common for clubs, companies not established under the Companies Ordinance, partnerships or associations of persons⁴. The most appropriate structure that could be used for your director's QTS programme would be a company limited by guarantee as this could accommodate more than 50 members. Companies limited by shares can only have 50 or less shareholders⁵. Your director agrees that a company limited by guarantee would be the best way to establish the QTS NGO, and he understands that this means that the company will not have any shareholders, but will otherwise be subject to the compliance requirements of the Companies Ordinance.

Other related matters

You explain that after incorporating the company limited by guarantee, with regard to the application for tax-exempt status, under the Guide there would need to be:

- an application letter
- the Articles of Association
- the list of activities to be carried out, or carried out over the previous 12 months, and
- a copy of the latest accounts (if the organisation has been established for 18 months or more).

These should be sent to the Commissioner of IRD, GPO Box 132, Hong Kong. If the tax-exempt status is obtained, QTS can obtain donations from the public, but it should keep

clear records of them and provide receipts to donors. The Guide has more information on this topic.

Additionally, thinking laterally, you note that your director should consider commissioning the design of a logo and trademark for future publicity and donation purposes to the extent that there are supplies of goods and services. Under the Trade Marks Ordinance, a trademark is any sign capable of distinguishing the goods or services, and needs to be distinctive to be registered. The trademark would be registered under certain classes in accordance with the Nice Classification. The Intellectual Property Department⁶ provides a helpful website and normally the registration is handled by a law firm or trademark agent.

Requirements for incorporation

Your director now turns to you for advice on the steps to incorporate a company limited by guarantee, along with some of the major compliance requirements under the Companies Ordinance. You list the requirements for incorporating a company limited by guarantee (see sidebar 'Incorporation of a local limited company') and promise to prepare a further memo to him as to the major compliance requirements under the Companies Ordinance.

Conclusions

The hypothetical case scenario discussed above explores the myriad of issues that need to be considered when setting up an NGO. To achieve impact and to attract donations on tax-free basis, the key issue to consider is how to achieve tax-exempt status. A variety of structures are available to set up an NGO with tax-exempt status, but generally a company limited by guarantee is the preferred vehicle due to its ability to accommodate a larger number of members and to minimise the personal liabilities of the directors. 

Incorporation of a local limited company

1. Introduction. A company limited by guarantee has no share capital, but states that it has a number of members under its Articles of Association (Articles) and that their liabilities are limited.

2. Choosing a name. Start the incorporation process by choosing a name for the NGO.

- The name could be in English and/or Chinese, but not a single mixed English/Chinese name.
- Then conduct an electronic search at the Companies Registry to see if the name has already been taken or appears too similar to an existing name.
- Also, conduct an electronic search at the Trademark Register to see if the proposed name is similar to a registered trademark, which could lead to legal issues with the trademark owner.
- Check if the name requires approval under the Words and Expressions in Company Names Order (Cap 622A) – like with the use of words 'trust' and 'chamber of commerce'.
- It is for the Companies Registrar to accept a name or to reject it (s.100 Companies Ordinance).
- A licence from the Companies Registrar would be required to drop the word 'limited' from a company name (s.103 Companies Ordinance). The company without 'limited' in the name would not be allowed to pay any dividend.

3. Prepare your Articles. There is a standard form of Articles for a company limited by guarantee under the Companies (Model Articles) Notice (Cap 622H). Items required include:

- name of the company
- objects of the company where

the word 'limited' was approved by the Companies Registrar to be omitted from the name of the company

- charitable objects of the company if s.88 tax-exempt status is being sought
- a statement that the liability of the members is limited
- a statement as to how much each member is liable to contribute to the company
- all paragraphs in the Articles need to be numbered consecutively, and
- the Articles needs to be signed by the founder member(s).

4. Prepare incorporation form – Form NNC1G. The form would require, among other matters, the following:

- The proposed name of the company. This could be in English and/or Chinese.
- The proposed address of the registered office. A post box address is not acceptable.
- An optional e-mail address.
- The number (s.114 Companies Ordinance) and liability of members. The liability of the member to contribute a specified amount towards the winding up of the company needs to be set out. The liability lasts until one year of ceasing to be a member (ss.9 and 84 Companies Ordinance).
- Details of the founder members.
- Details of the company secretary (this could be a corporation incorporated in Hong Kong or with a registered place of business in Hong Kong or a natural person ordinarily resident in Hong Kong over 18 (s.474 Companies Ordinance),

who could be one of the directors.

- An optional e-mail address of the company secretary should be provided.
- Details of directors – at least two (s.453 Companies Ordinance) or more for a company limited by guarantee and they must be natural persons over 18 (ss.456 and 459 Companies Ordinance).
- The residential address needs to be provided.
- Consent to Act as Director by the director(s) of the company.
- Signature of the founder member signing for all founder member(s).

Note: The information under the Form NNC1G and the Articles should be consistent. The Articles must be delivered with the form. Please ensure that the register of directors (s.641 Companies Ordinance), and members (s.628 Companies Ordinance) are kept at the registered office or a prescribed place and updated.

5. Notice to Business Registration Office (IRBR1). Any person who applies for incorporation of a company under the Companies Ordinance is deemed to have made a simultaneous application for business registration, and is required to pay a levy for Business Registration.

6. Using electronic incorporation. It is easier to use the Companies Registry's electronic incorporation as there are strict paper formats and other requirements when using hard copies for incorporation. Please refer to the 'Publications and Press Releases' section of the Companies Registry website for further information: www.cr.gov.hk/en/publications/information.htm.

Source: Companies Registry, Incorporation of Local Limited Company, www.cr.gov.hk/en/publications/docs/4-e.pdf.

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