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Rethinking Social Ventures in Hong Kong

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RETHINKING SOCIAL VENTURES IN HONG KONG

By: Bethke, Damian Alexander⁺; Górski, Jędrzej^{#*}

Abstract: Hong Kong has experienced a significant transformation in its understanding of business, which concerns the phenomenon of social ventures that attempt to combine a *make money* and *do good* approach and to apply business skills to address social needs. Social ventures live a mystical existence, as they are fully ignored from a legal perspective despite the recent reform of laws on charitable activities. This causes problems as to their general understanding, which the authors try to address with their own typology, systematically characterizing social ventures. Then the authors examine the legal environment of social ventures in Hong Kong and identify the challenges they face. Hong Kong's company law and related public/administrative law issues are considered. The answer searched for is: what is the appropriate legal vehicle for social ventures, and what are the practical legal questions when a social venture wants to structure its *make money* and *do good* business? As to the first problem, the legal non-existence of social ventures results in coupled privileges—meaning a system which favors traditional business forms such as for-profit and not-for-profit companies and discourages *doing good* approaches by social ventures. The authors identify instances where privileges crediting charitable activities are coupled with not-for-profit status, and propose solutions under which social ventures could be registered and have tax privileges efficiently assigned by a one-stop supervision body. As to the second problem, the situation of social ventures abandoning their mission of *doing good* poses further challenges to the legal system, and the authors propose a regime under which business organizations can easily adopt or abandon a social mission based on a partial application of the *cy-près* doctrine. The authors come to the conclusion that the social venture sec-

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tor bears immense potential for Hong Kong as well as for all of Asia. But in order to use this potential, Hong Kong has to show a more refined understanding and has to be open to a profound discussion.

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*Social venturing “is a business of conscience. The logic of requiring a conscience programme to operate according to the law of the jungle practised in the commercial market is one entwined with great contradictions. Exactly because of this, when we talk about the development of social enterprises, we must think about providing the soil suitable for them.”*¹

¹ *Official Record of Proceedings*, H.K. Legis. Council 8434-35 (June 14, 2006) (statement of Ms. Li Fung-Ying). The author of these words, spoken during legislative works on Charity law reform in Hong Kong, actually used the term “social

INTRODUCTION

The Hong Kong Special Administrative Region (“Hong Kong”) is well known as the hub for typical charitable activities in Asia and has recently experienced an interesting transformation to a new form of social activity which may be best described as “social ventures.” The phenomenon of social ventures brings a *make money and do good* approach together and thereby attempts to apply business skills to address social needs. There are around 350 social ventures in Hong Kong,² with the most renowned among them probably being Diamond Cab, offering affordable taxi carriage services in wheelchair accessible cabs³ and Dialogue in the Dark, offering “the opportunity to interact with and gain a new understanding of the visually impaired.”⁴ The change in the charitable landscape of Hong Kong has been both supported and triggered by an impressive growth of organizations such as Social Ventures Hong Kong,⁵ the HKCSS HSBC Social Enterprise Business Center,⁶ and the Social Enterprise Summit,⁷ which attempt to nurture social change in Hong Kong from an institutional perspective. The subject has also been introduced by local universities—a response which further underlines the importance of this trend.⁸

While this shows that social ventures are well established in Hong Kong, they are simply regarded as non-existent from the local

enterprise” but referred to the problem which we will be further referring in this paper as to “social ventures”. The terms social venture and social enterprise are often used interchangeably. However, in this paper we will refer to social enterprises and social ventures as distinct phenomena. We will further address all terminology complexities that, to some extent, have contributed to insufficient insight into the position of social ventures in Hong Kong’s legal system which, we believe, was overshadowed by the discussion on social enterprises.

² See SOCIAL ENTERPRISE BUSINESS CENTRE, http://www.sebc.org.hk/sits/default/files/general/SE_Directory_2013.pdf (last visited Mar. 5, 2013).

³ See DIAMONDCAB, <http://www.diamondcab.com.hk/en/about.php> (last visited Oct. 3, 2013).

⁴ See DiD HK LIMITED, <http://www.dialogue-in-the-dark.hk/web/subpage.php?mid=10> (last visited Oct. 3, 2013).

⁵ See SOCIAL VENTURES HONG KONG, <http://www.sv-hk.org/about.php> (last visited Oct. 3, 2013). Social Ventures Hong Kong is an organization aiming to provide support to “social purposes organizations” or “social enterprises” in Hong Kong.

⁶ See HKCSS-HSBC SOCIAL ENTERPRISE BUSINESS CENTRE, <http://www.hsbc.com.hk/1/2/cr/community/projects/sebc> (last visited Oct. 3, 2013) (“The HKCSS-HSBC Social Enterprise Business Centre, Hong Kong’s first business centre to promote cross-sectoral collaboration on social enterprise development, was newly launched to offer diverse services to the social enterprises in Hong Kong with participation of business volunteers including HSBC employees as mentors.”).

⁷ See SOCIAL ENTERPRISE SUMMIT, <http://www.ses.org.hk/about/message> (last visited Oct. 3, 2013).

⁸ See *infra* Section 2.1.

legal perspective.⁹ Many in Hong Kong still see the world of business organizations in black and white and solely differentiate between not-for-profit entities, hereinafter referred to as social enterprises, and for-profit entities without a social mission. This does not do justice to the idea of social ventures which entails profit-driven business together with a social mission. Social ventures, therefore, face numerous practical problems such as (i) lack of government commitment in promoting and supporting their development through policy, (ii) lack of clear public understanding and an officially recognized definition, (iii) lack of an appropriate legal and regulatory framework to facilitate the sector's development, and (iv) difficulties in gaining access to finance.¹⁰

Despite these problems, the Hong Kong authorities have largely ignored the needs of the growing local presence of diversified social ventures in terms of a friendly legal environment.¹¹ This seems odd because the Law Reform Commission of Hong Kong ("Law Commission") recently launched the reform of the charity law¹² from which the issue of social ventures, despite some overlapping features with charities, was completely excluded.¹³ Social ventures therefore still are here between Scylla and Charybdis, and still numerous questions as to their legal definition, the appropriate legal vehicle, tax treatment, and specific company law issues all remain unanswered. While the overall outcome of the reform and many detailed new regulations are yet to be announced, it is already clear that the Law Reform Commission missed out on a chance to define a framework for social ventures and thereby place Hong Kong as a pro-active jurisdiction when it comes to dealing with more social approaches to business. Given the

⁹ *Official Record of Proceedings, supra* note 1, at 8434-35.

¹⁰ LEGIS. COUNCIL SECRETARIAT, PANEL ON WELFARE SERVICES, BACKGROUND BRIEF PREPARED BY THE LEGIS. COUNCIL SECRETARIAT FOR THE MEETING ON 9 JANUARY 2012, SOCIAL ENTERPRISE DEVELOPMENT IN H.K., LC Paper No. CB(2)717/11-12(05) at 2, Ref: CB2/PL/WS, (Jan. 3, 2012) [hereinafter PANEL ON WELFARE SERVICES]. A different source considers 1) high production costs, 2) high rental costs, 3) lack of staff, 4) low public awareness, 5) lack of financing channels, 6) difficulties in managing disadvantaged staff and 7) small niche markets as the main difficulties encountered by social ventures. POWER OF GOOD, HONG KONG SOCIAL ENTERPRISE LANDSCAPE STUDY 2012-2013 7.

¹¹ *Official Record of Proceedings, supra* note 1, at 8434-35.

¹² CHARITIES SUBCOMM., THE LAW REFORM COMM'N OF H.K., CONSULTATION PAPER CHARITIES 100 (June 2011) (There are 3,229 approved charities in Hong Kong with the majority of them having an annual income of more than HK\$200,000) [hereinafter CHARITIES SUBCOMM.].

¹³ *Id.* at 2 (In June 2007, the Chief Justice and the Secretary for Justice asked the Law Reform Commission "[t]o review the law and regulatory framework relating to charities in Hong Kong and to make such recommendations for reform as may be considered appropriate" which resulted in the appointment of a sub-committee to review the subject in September 2007).

dynamically evolving landscape of charitable activities toward social ventures as their potentially primary tool in the foreseeable future, we reckon the deficiencies of the reform could undermine the role of Hong Kong as the hub for charitable organizations in Asia.

The aim of this article is to initiate a legal discussion about social ventures in the regional context. Our argument starts by conceptualizing the idea of social ventures unbiased with the features of any specific jurisdiction. In the second section, we identify current problems requiring solutions. We explore the legal environment of social ventures in Hong Kong, as far as there is one, and illustrate how existing social ventures operate in a legal vacuum. In the absence of any specific social venture rules, we examine rules established in other common-law jurisdictions.

Once we identify outstanding problems, we move to analyzing solutions. In the third section, we consider the problem of so-called coupled privileges, meaning a system which offers privileges only to not-for-profit entities, which thereby excludes social ventures. In this respect, we assess tax and administrative law and propose that all privileges be decoupled. Further, we suggest a new system for the registration and supervision of social ventures and granting of privileges that reward their missions. In the fourth section, we answer the far-sighted question of the consequences of social ventures ending their mission in the event that, as we propose, social ventures are granted privileges rewarding their mission as a result of decoupling. We predict that it could be a particularly delicate issue in the case of social ventures that have financially benefited from privileges and thereafter deliberately abandon *doing good*.

In terms of methods, our focus on Hong Kong is supplemented with a comparative examination of rules of other common law jurisdictions, particularly the United States, where the phenomenon of social ventures first emerged in legal scholarship and consequently led to a new branch of law. We partially source the solutions offered from those developments and examine how they could fit into the local system. Our proposition is not to import foreign concepts but to show that there are substantial questions calling for a profound discussion if Hong Kong is to take social ventures seriously.

1. SOCIAL VENTURE CONCEPTUALIZATION

Before we discuss social ventures in the context of Hong Kong's regulatory environment and its deficiencies, we attempt to explain the diffused meaning of the concept of social ventures. Social ventures bear several specific and unique characterizations which we regard as their constituting elements. Instead of putting forward our own defini-

tion,¹⁴ we propose a typology with four features, which are essential for the classification of social ventures in the first subsection. In the second subsection, we discuss incomplete scenarios under which social ventures bear only some of these four features. In the third subsection, for the sake of terminological clarity, we draw the line between social ventures and the very popular term of corporate social responsibility. By doing so, we also intend to elucidate terms like *charity*, *donative charity*, *commercial charity*, and *social enterprise* and to explain how these differ from each other and from the notion of social ventures.

To better illustrate distinctive features of social ventures we will often refer, in different configurations, to a simplistic hypothetical example of a social venture, the business model of which is to produce or trade shoes. On the income and *make money* side, it sells some portion of shoes, and on the mission and *do good* side, it hands shoes to those in need.

1.1. Four Features of Social Ventures

The first feature draws the line between social ventures and all types of charities. Social ventures and charities as organizations distinguish themselves regarding the allotment of surpluses. Charities do not pay out any part of generated surpluses as profits to their stakeholders. In the case of social ventures, there must be some balance between a portion of surplus allotted for *doing good* and a portion being paid out as profits in whatever form.¹⁵

¹⁴ See Christopher C. Archer, Comment, *Private Benefit For The Public Good: Promoting Foundations Investment in the "Fourth Sector" To Provide More Efficient and Effective Social Missions*, 84 TEMP. L. REV. 159 (2011); Symposium, *Corporate Creativity, The Vermont L3C & Other Developments in Social Entrepreneurship: The ROLE of Social Enterprise*, 35 VT. L. REV. 59 (2010) [hereinafter *Corporate Creativity*]; Thomas Kelley, *Law and Choice of Entity on the Social Enterprise Frontier*, 84 TUL. L. REV. 337 (2009) [hereinafter *Law and Choice*]; Thomas Kelley, *Rediscovering Vulgar Charity: A Historical Analysis of America's Tangled Non-profit Law*, 73 FORDHAM L. REV. 2437 (2005) [hereinafter *Vulgar Charity*]; Roger L. Martin & Sally Osberg, *Social Entrepreneurship: The Case for Definition*, STAN. SOC. INNOVATION REV. 29 (2007).

¹⁵ This includes dividends, interests, rents, stock options, salary bonuses or any measurable benefits other than flat salaries. Formally, not-for-profit companies may pay out considerable quasi-profits to their stockholders in some no-dividend forms, especially salaries. Even so, strict constraint on paying out profits by charities often implies that the management's salaries are expected not to be excessive. See *Corporate Creativity*, *supra* note 14, at 95 (2010). Similarly, Hansmann defined a non-profit organization as "in essence, an organization that is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees." See Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 838 (1980).

However, problematically, business organizations can generate so called shared or *blended value* by *doing good* at no expense to their profits.¹⁶ For example, such a *spin-off* effect happens when production methods are implemented primarily in order to reduce production cost, but at the same time, they are not only cheaper but also more environmentally friendly. This is also the case when products are linked to some social mission and the profits are the spin-off of this social approach. Namely, in the case of our hypothetical shoe business, the business organization could perhaps not break entry barriers in developed markets, which were set up by the established brands, if it did not promote itself via its social mission. Again, in such a case, virtually no profits are sacrificed to *do good*. Instead, profits can only be made because the social mission of the business organization is its basic marketing tool. Even so, the *good* is still done, and true social ventures shall be known by the *good* they actually do rather than by the intentions they have.¹⁷

Presentation of the second and the third feature requires that we first introduce the concepts of donations *sensu stricto* and donations *sensu largo*. Donations *sensu stricto* denominate donations in traditional meaning that are deeds of gifts and charitable sales meaning donations in exchange for goods of negligible actual value.¹⁸ Attracting money in such a form is similar to fundraising, as no business methods are involved in it. Charities mostly generate income in such a way and

¹⁶ Shared and blended value are interchangeable terms. We follow Kramer & Porter's approach according to which shared value "involves creating economic value in a way that also creates value for society by addressing its needs and challenges." See Michael E. Porter & Mark R. Kramer, *The Big Idea: Shared Value: How to reinvent capitalism—and unleash a wave of innovation and growth*, HARV. BUS. REV., Jan.-Feb. 2011, at 4. But see Dana Brakman Reiser, *Blended Enterprise And the Dual Mission Dilemma*, 35 VT. L. REV. 105 (2010) (defines blended enterprise as an "entity that intends to pursue profits and social good both in tandem and by making considered choices to pursue one over the other." That is not requiring the social goals to be at no expense of the profits).

¹⁷ See *Fire Ins. Patrol v. Boyd*, 120 Pa. 624 (1888); Anup Malani & Eric A. Posner, *The Case for For-Profit Charities*, 93 VA. L. REV. 2064(2007); *Vulgar Charity*, *supra* note 14, at 2472 (2005).

¹⁸ In Hong Kong, such meaning of charitable sales has been reflected in Summary Offences Ordinance, (2000) Cap. 228, 1, §§ 4(17)(i)-(ii) (H.K.). Under the section heading, "Nuisances and Miscellaneous Offences", it specifies that: "Any person who without lawful authority or excuse- (. . .) (17) organizes, provides equipment for, or participates in any collection of money or sale or exchange for donations of badges, tokens or similar articles in a public place except under and in accordance with a permit issued- (i) for a collection, sale or exchange for charitable purposes, by the Director of Social Welfare; Or (ii) for a collection, sale or exchange for any other purpose, by the Secretary for Home Affairs; (. . .)".

may be called *donative charities*.¹⁹ In turn, donations *sensu largo* describe a price premium that consumers agree to pay over the market price for products or services because of their conscience about the social mission of these products. It implies that attracting money in such form is part of their business method and charities generating income mostly in this way may be called *commercial charities*.²⁰

Thus, the second feature draws the line between social ventures and donative charities. As noted in the previous paragraph, the income of a donative charity is typically completely derived from donations *sensu stricto*. Social ventures, on the other hand, just like commercial charities, would usually take a price premium that clients of such businesses agree to pay over the market price. Clients in developed markets may want to pay more for shoes being aware of the social mission pursued by the seller which is offering shoes to individuals residing in developing markets for free or at a discount.²¹

The third feature draws the line between social ventures and for-profit business organizations without any mission by differentiating between them as to the source of their income. Income of social ventures and charities is, partially or wholly, made up of donations *sensu largo*. In contrast, income of ordinary business organizations is generally completely generated by charging market prices for products or services.

The fourth feature distinguishes between social ventures and any other organization *doing good*. Social ventures would typically create *good* and not simply buy it. This may happen by offering discounted prices or by offering services meeting social needs that otherwise would not be offered at all. In our hypothetical case, a social venture would offer the shoes below cost of production and thereby create a market that meets social needs and that would not exist at all if shoes were offered at market price. In turn, a charity, either operating a business or not, would typically buy *good* by making pecuniary donations and giving shoes in developing markets for free. Interestingly, if we look at the phenomenon of *venture philanthropy* or *socially responsible investment* (SRI),²² some investment firms prefer to invest in so-

¹⁹ With regard to not-for-profit organizations, similar differentiation has been offered by Hansmann, who proposed that not-for-profits, which receive their income mostly in the form of donations, should be referred to as *donative*; whereas those receiving their income mostly as prices charged for services, should be referred to as commercial. See Hansmann, *supra*, note 15, at 840.

²⁰ *Id.* at 840-41.

²¹ In fact, there are many other non-obvious ways in which social ventures can receive donations, for instance, employees agreeing to work below market wages. See *Corporate Creativity*, *supra* note 14, at 93.

²² See generally, Alicia E. Plerhoples, *Can an Old Dog Learn New Tricks? Applying Traditional Corporate Law Principles to New Social Enterprise Legislation*, 13

cial ventures and agree to lower profit rates or greater risk rather than simply donate to social projects based on a similar conviction. Obviously, the creation of *good* does not strictly imply that the goods or services are being distributed for free, or at lower costs, but can also be characterized so that closer attention is being paid to social or ecological sustainability in their supply chains, purchasing sustainable products or services with eco-labels,²³ or by improving conditions of employment.

The interesting question in this context is whether we should only regard businesses as social ventures that address needs which are relatively new to the general developments in a given society and which have the potential to address social change. Consider the example that orthopedic shoes for children are not discounted: offering them in poor markets still brings real change while in most emerging markets it does not any more. Moreover, if we look at, for example, the entire healthcare sector, and specifically at nursing homes or hospices, these meet very old social needs. There are both for-profit organizations and commercial charities that operate in these sectors. Suppose both offer exactly the same social services to the same extent subsidized with governmental money. While a commercial charity would be seen as pursuing a social mission, the for-profit, or partly-for-profit, organization would probably not deserve being called a social venture. So the answer to this question is probably yes, social ventures are expected by the public to bring more change than commercial charities.

Another very valid question is how tightly the business methods and the pursued mission should be linked. Probably no one would object if our hypothetical social venture sold other products in developed markets, but still with a view to providing free or affordable shoes elsewhere. Say, instead of selling shoes it could generate income on the sales of t-shirts in the developed markets and, by doing so, it could finance its social mission focused on shoes for the developing or undeveloped markets. Where and how this money is being generated may be any method within the boundaries of the law. It should be irrelevant whether an entity produces organic vegetables, tobacco, generates atomic energy or, as in our hypothetical example, produces shoes. The criterion should be that the business organization makes money to support its mission. How it makes this money is not of issue.

TENN. J. BUS. L. 221 (2012) (on the concept of “venture philanthropy”); Betsy Brill & Susan Winer, *The Changing Philanthropic Landscape: What It Means for Advisors*, J. PRACTICAL ESTATE PLANNING 33 (2008-2009) (on the concept of “venture philanthropy”); Benjamin J. Richardson, *Fiduciary Relationships for Socially Responsible Investing: A Multinational Perspective*, 48 AM. BUS. L. J. 597 (2011) (on SRIs).

²³ See *Corporate Creativity*, *supra* note 14, at 89, 100. (A good example of such an approach would be Honest Tea and Guayaki in the United States).

1.2. *Imperfect Social Ventures*

The strong presence of three of these four features, with the remaining one not being fully developed or completely absent, would still always qualify an entity as a social venture. We call them imperfect social ventures. In the first scenario, a social venture may charge only market prices without any price premium (donations *sensu largo*) for shoes in developing countries. However, it can still allot a significant portion of its surplus to offer those products at discounted prices elsewhere, if their margin profitability in developed markets is high enough.

In the second scenario, suppose a social venture accepts donative payments from benefactors from time to time and does not charge any price premiums. Donations made to a social venture are then only *sensu stricto*. Even so, the revenue of a social venture is mostly generated on sales of shoes at market prices. Some portion of the generated surplus combined with the mentioned donations *sensu stricto* can subsidize discounts on shoes offered in developing markets.

In the third scenario, there can be a significant imbalance between a portion of surplus paid out as profits to stakeholders and a portion devoted to *doing good*. The only requirement is that the portion of surplus paid out as profits to stakeholders can never be equal to zero, but it might be close. In any case, a charity always ends up as a social venture where profits are to be paid out. In contrast, on the other side of the spectrum, the portion of surplus allotted to *do good* can equal zero when *doing good* is achieved by generating perfect *blended value*.

In the fourth scenario, a social venture could buy *good* rather than generate *good*. It could distribute shoes for free in developing markets or reimburse those in need for such purchases instead of creating a new market for affordable shoes. Yet if we look at the preceding scenarios, we will see that the model way is to offer discounts for shoes instead of distributing them for free.

As in the first scenario, in the fourth scenario, our hypothetical shoe business would not rely on any price premiums on the income side and would allot probably insignificant portion of its surpluses for pecuniary or in-kind donations. It would rather constitute a kind of *corporate philanthropy*, meaning an ordinary business with a spin-off charity.²⁴ As in the second scenario, in the fourth scenario, our hypothetical entity would be a donative charity. Its actions would come down to transferring money from donors to those in need whereby no business methods at all are used to *do good*.

²⁴ See *Law and Choice*, *supra* note 14, at 347 (distinguishes between corporate philanthropy, socially responsible businesses, and social ventures); Plerhoples, *supra* note 22, at 228-29 (elaborates on the social enterprise spectrum).

The third and the fourth scenarios need to be considered in two variants. If profit distribution is close to zero, such an organization would hardly be distinguishable from a commercial charity, at least for external observers. In turn, when all *good* done is consumed in the form of *blended value*, it would partly make again a kind of *corporate philanthropy* whereby some portion of *good* is created at no expense and some presumably insignificant portion of surplus is allotted to buy *good* instead of being paid out as profits.

1.3. *Social Ventures versus Socially Responsible Business*

For the sake of clarification it also should be stated that social ventures partially overlap with the widely used notion of corporate social responsibility (“CSR”) and the terms are usually distinguished by reference to their business strategy.²⁵ Businesses are only considered to be social ventures when the social mission is an inherent part of the business model.²⁶ In the opposite, if the social mission is only part of a short term, or at best medium term strategy, the venture cannot be classified as a social venture.²⁷ While this is true in principle, it does neglect large corporations with integrated social considerations, social ventures which abandon their mission,²⁸ and those that adopt one long after they are established. If we were inclined toward any theory at all, it would be—as summarized by Katz and Page—the criteria of size, meaning that CSR generally refers to large and established businesses and social ventures to developing enterprises.²⁹

Some confusion is also added by using different words with the same meaning. But, to be clear, terms such as *blended value*, *triple bottom line*, *fourth sector*, or *hybrid organizations* are mostly interchangeable with the notion of social venture and usually carry the same meaning.³⁰

²⁵ See Dana B. Reiser, *For-Profit Philanthropy*, 77 FORDHAM L. REV. 2437, 2450 (2009).

²⁶ See *id.* at 2451; see also *Law and Choice*, *supra* note 14, at 351-53.

²⁷ Cf. Reiser, *supra* note 25, at 2451-52 (“Google Inc. has social commitments, perhaps more than most companies of its age and size. Yet, in the general range of its business, these do not have an equal place with building a financially successful company. Profit and business imperatives figure too strongly in Google Inc.’s overall decision making to view the entire company as a social enterprise.”) (foot note omitted)

²⁸ See *infra*, Part VI.

²⁹ Antony Page & Robert A. Katz, *Is Social Enterprise the New Corporate Social Responsibility?*, 34 SEATTLE U. L. REV. 1351, 1379 (2011).

³⁰ See Archer, *supra* note 14, at 159-60.

1.4. Conclusion

In this section we have presented social ventures as a concept which brings a *make money* and *do good* approach together that can be realized with divergent business models. We proposed that social ventures, in principle, can be characterized by (i) the equilibrium between its surpluses allotted for paying out profits and for pursuance of its mission; (ii) some reliance on widely comprehended donations, especially price premium; (iii) non-reliance on strictly comprehended donations like charitable sales; and (iv) the creation of *good*, usually along with creative and innovative approaches to solve social problems bringing actual social change. We have also clarified the notion of charities, which are mission-driven entities that do not pay out profits, do not incorporate business methods, and mostly rely on donations *sensu stricto*.

2. CHALLENGES FOR HONG KONG

We have seen in the previous section that social ventures are, in their most basic understanding, a seemingly contradictory complex entity which attempts to *make money* while at the same time also attempts to *do good*. As such, it needs to find its place in the regulatory environment of the jurisdiction in which it operates. The traditional bipolarity of the company law strictly and rigidly differentiates between a company which is for profit and a company which is not for profit. This is still the case in Hong Kong. Social ventures, however, need to operate exactly within these two different approaches and are neither purely not for profit nor simply for profit.

In this section, we examine the development of the social venture sector in Hong Kong and explore the local government's position towards social ventures. We show that Hong Kong has not yet caught up with the development and still has an unrefined understanding of social ventures. Then, in the second section, we move to identifying actual problems that need to be solved. We explore the legal environment of social ventures in Hong Kong, as far as there is one, and illustrate how existing social ventures operate in a legal vacuum. We examine the different options social ventures have when choosing the appropriate legal vehicle and describe the dilemma they face. In the absence of any specific rules as to social ventures in Hong Kong, we offer examples of other common-law jurisdictions. In the third section, we explore the legal dimension of *doing good* and ask the question of how *good* is recognized by the law. We conclude that Hong Kong is highly restrictive in this regard and does apply unfavorable tax measures when businesses attempt to combine a *make money* and *do good* approach. Finally, we make a suggestion as to what a system taking these aspects into consideration could look like.

2.1. *Ambiguous Approach of the Government and Legislative Council*

The first governmentally supported efforts in the social venture arena date back to 2001 when the Social Welfare Department launched a program to enhance employment of people with disabilities through small social ventures.³¹ A delegation was sent abroad in 2007 to study the subject of social ventures³² and conducted comparative research on policies abroad.³³ Further efforts followed by the Commission on Poverty between 2005 and 2007 which attempted to integrate unemployed persons into the job market.³⁴ In 2006, the government formulated the promotion of social ventures as a new policy agenda³⁵ and a forum on social ventures was organized by the Home Affairs Bureau in 2007 which confirmed further support in this direction.³⁶ The Legislative Council of the Hong Kong Special Administrative Region (“Legislative Council”) took up the issue for the first time in 2006 and passed a motion concerning the promotion of social ventures by means of, among others, raising awareness and eliminating administrative barriers.³⁷ The first summit on social enterprises initiated by the government was organized in 2008 and has since become an important annual event with global outreach.³⁸ An advisory committee was set up in 2010 and a start-up funding program and a cross-sector col-

³¹ LEGISL. COUNCIL SECRETARIAT, LEGISL. COUNCIL OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION, SUBCOMM. TO STUDY THE SUBJECT OF COMBATING POVERTY: DEV. OF SOCIAL ENTER., at 3, LC Paper No. CB(2)2385/06-07(01) (July 6, 2007).

³² LEGISL. COUNCIL SECRETARIAT, LEGISL. COUNCIL OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION, DELEGATION OF THE SUBCOMM. TO STUDY THE SUBJECT OF COMBATING POVERTY, REPORT ON THE DUTY TO VISIT TO STUDY THE EXPERIENCE OF THE DEV. OF SOCIAL ENTER. IN SPAIN AND THE U.K., at 1, LC Paper No. CB(2)393/07-08 (Nov. 28, 2007) [hereinafter DEVELOPMENT OF SOCIAL DEV.].

³³ *Id.*

³⁴ DEVELOPMENT OF SOCIAL ENTER., *supra* note 31, at 3.

³⁵ *Id.* at 4.

³⁶ *Id.* at 3; see also *Advisory and Statutory Bodies Under the Purview of the Sec. for Home Affairs*, HOME AFF. BUREAU, http://www.hab.gov.hk/en/related_departments_organizations/asb50.htm (last updated Oct. 25, 2013).

³⁷ *Official Record of Proceedings*, *supra* note 1, at 8414. Further motions were made later. See LEGIS. COUNCIL OF H.K. SPECIAL ADMIN. REGION, MOTION ON “URGING THE GOV’T TO MAKE EFFECTIVE USE OF THE SURPLUS AND PLOUGH IT BACK INTO THE CMTY.” (JAN. 24, 2007) (Statement of the Hon. SIN Chung-kai). *Official Record of Proceedings*, H.K. Legis. Council, at 2554 (Dec. 5, 2007) (Motion on Promoting social enterprises).

³⁸ See generally *Background*, SOC. ENTER. SUMMIT, <http://www.social-enterprise.org.hk/ses2012/en/background.html> (last visited May 4, 2013); *Message from the Chair*, SOC. ENTER. SUMMIT, <http://www.ses.org.hk/about/message> (last visited Oct. 3, 2013).

laboration program were launched in 2006 and 2008 respectively.³⁹ Among all these efforts, around HK\$500 million in total were provided in the form of start-up funds for the support of social ventures.⁴⁰ This governmental support has boosted initiatives at the social venture frontier and raised the number of social businesses from 222 in 2007 to 406 in 2013.⁴¹ The social objectives of social ventures in Hong Kong mainly concern the creation of jobs and the training of disadvantaged persons.⁴² The most renowned among them is probably Dialogue in the Dark HK, Ltd., which attempts to empower people with visual impairment and operates globally as a franchised business of Dialogue Social Enterprise.⁴³ Other examples of social ventures include Diamond Cab;⁴⁴ Fullness Christian Social Enterprise, which helps delinquent youth re-socialize through Christianity and vocational education;⁴⁵ and Green Monday, which promotes an environmentally friendly lifestyle, especially by advocating a green diet.⁴⁶

This growth has been supported by two other noteworthy organizations: Social Ventures Hong Kong⁴⁷ and the HKCSS HSBC Social Enterprise Business Centre,⁴⁸ which provide support to meaningful businesses and nurture social change in Hong Kong. Meanwhile, the study of social ventures has also been implemented in the curricula of local universities which reflects a growing need of talents for the social venture market. “The Road to Social Entrepreneurship” at Chinese University of Hong Kong,⁴⁹ the “Social Innovation Academic Series”⁵⁰ or the lectures on “Management for Social Enterprises” taught at Hong

³⁹ Legis. Council Panel on Welfare Servs., *Development of Social Enterprise*, at 1-2, LC Paper No. CB(2)1429/10-11(04) (April 11, 2011); *see also*, PANEL ON WELFARE SERVS., *supra* note 10, at 3.

⁴⁰ This consists of the following: HK\$50 million for enhancing employment of people with disabilities; HK\$150 million for the launch of a “Enhancing Self-Reliance Through District Partnership Programme”; and HK\$300 million for promoting the development of “social capital.” *See* LEGISL. COUNCIL SECRETARIAT, LEGISL. COUNCIL OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION, SUBCOMM. TO STUDY THE SUBJECT OF COMBATING POVERTY: REPORT ON DEV. OF SOC. ENTER., at 6-7 LC Paper No. CB(2)2390/07-08 (June 27, 2008).

⁴¹ *See* POWER OF GOOD, *supra* note 10, at 3.

⁴² *Id.* at 4.

⁴³ DiD HK LIMITED, *supra* note 4.

⁴⁴ DIAMOND CAB, *supra* note 3.

⁴⁵ FULLNESS SALON, <http://www.fullness.salon.hk> (last visited May 3, 2013).

⁴⁶ GREEN MONDAY, <http://www.greenmonday.org.hk> (last visited May 3, 2013).

⁴⁷ SOCIAL VENTURES HONG KONG, *supra* note 5.

⁴⁸ HKCSS-HSBC SOCIAL ENTERPRISE BUSINESS CENTRE, *supra* note 6.

⁴⁹ *See* GESC 2230 *The Road to Social Entrepreneurship*, SHAW COLLEGE, http://www.shaw.cuhk.edu.hk/index.php?option=com_content&view=article&id=168%3Agesc-2230-the-road-to-social-entrepreneurship&catid=8&Itemid=464&lang=en (last accessed Mar. 5, 2013).

Kong University are such examples.⁵¹ The Hong Kong Social Enterprise Challenge (HKSEC) also targets university students and tries to inspire their involvement in the sector by means of competition.⁵²

Despite this tremendous increase in significance of social ventures in Hong Kong, social ventures have been largely ignored and treated as simply non-existent in the recent charity reform.⁵³ To date, the reform process has been mostly content with identifying elements which Hong Kong does not have but other common law jurisdictions do have. Specifically, the absence of statutory definitions of a charity and charitable purposes,⁵⁴ and the lack of a concise system to register,⁵⁵ supervise,⁵⁶ regulate, and enforce penalties⁵⁷ were identified as major flaws of the previous system. The resulting patchwork collection consists of rules devised for not-for-profit companies and for-profit companies and raises doubts as to the rule of law for social ventures.

⁵⁰ See SONOVA INSTITUTE, <http://www.sv-hk.org/sonova-institute.php> (last visited Mar. 5, 2013).

⁵¹ See *Management for Social Enterprises*, UNIV. HONG KONG, http://www.hksef.org/files/files/SocialEnterprise_Course.pdf (last visited Mar. 5, 2013).

⁵² See *About HKSEC*, HONG KONG SOCIAL ENTERPRISE CHALLENGE, <http://hksec.hk/page/about-hksec> (last visited Mar. 5, 2013); see also *Social Enterprise Challenge a Rare Chance for Students and Fresh Graduates to Shine*, SOUTH CHINA MORNING POST, September 27, 2010.

⁵³ CHARITIES SUBCOMM., *supra* note 12, at 2. (In June 2007, the Chief Justice and the Secretary for Justice asked the Law Reform Commission "To review the law and regulatory framework relating to charities in Hong Kong and to make such recommendations for reform as may be considered appropriate." which resulted in the appointment of a sub-committee to review the subject in September 2007.)

⁵⁴ Hong Kong's understanding of charity has still been mostly shaped by the 1892 decision of the House of Lords in *Pemsel* - which categorized charitable purposes into (i) the relief of poverty, (ii) the advancement of education, (iii) the advancement of religion, and (iv) any other purpose not falling under these three heads (*Income Tax Special Purposes Commissioners v Pemsel* [1891] AC 531, at 583 (HL)). The changing landscape of charitable activities made many charities fall within the last, vague category. Hence, the Recommendation 2 of the Consultation Paper proposed that prospective statutory definition of charitable purposes should also include, among many others, the advancement of health, the saving of lives, the advancement of citizenship or community development, the advancement of the arts, heritage, culture or science, the advancement of environmental protection or improvement, or the advancement of animal welfare etc. CHARITIES SUBCOMM., *supra* note 12, at 2.4-2.7, 12-13, point 3.5-3.7, 12, chap. 5, 42-80.

⁵⁵ *Id.* at point 2.17-2.18, 16, point 3.8-3.9, 24; and chap. 7, 91-101, Recommendation 4, 102.

⁵⁶ *Id.* at point 2.24-2.41, 18-22, point 3.10-3.12, 25, chap. 8, 103-119. and chap. 12, 166-178; see also *id.* at Recommendation 6, 111, Recommendation 7, 112, Recommendation 8, 114, Recommendation 13, 135-36.

⁵⁷ *Id.* at point 8.44-8.51, 116-118; see also *id.* at Recommendations 9, 10 and 11, 116-118.

Needless to say, this *status quo* does not correspond with the picture that Hong Kong legislators and policy makers want to see. What we suggest is a more sensitive understanding of the topic, not a *tabula rasa*, but a fresh approach that takes the particularities of social ventures into consideration.

This general enthusiasm for support programs offered to social ventures surprisingly does seem to comply with the immature and unrefined understanding of social ventures in Hong Kong's legal circles. An early definition by the Legislative Council conceived social ventures as a simple not-for-profit business organization,⁵⁸ yet self-contradictorily equated social ventures with for-profit firms fulfilling a business, environmental, and social role.⁵⁹ The same authority later regarded a social venture as "a business with primarily social objectives [in which] . . . surpluses are mostly reinvested for that purpose in the business or in the community, rather than maximizing profit for shareholders and owners."⁶⁰ It did not put forward a definition of social ventures but recognized three constituent features: "(a) pursuit of social objectives through adopting entrepreneurial strategy and business model; (b) engagement in business/trading activities: social enterprises should provide goods and services in return for income; and (c) social enterprises should primarily be positioned to achieve social objectives, and reinvest the profits in the enterprises."⁶¹ In turn, former Chief Executive Donald Tsang put forward another definition which, despite being very descriptive, probably expresses quite accurately how social ventures are conceived in the Hong Kong context:

Social enterprises can be developed in multiple ways, and successful social enterprises share three common features: Like commercial interests, a social enterprise has to be run in such a way as to generate revenue from the provision of services or products. It should be business-minded, operate on a continuous basis and adapt to market changes to be financially self-sustained; social enterprise sets specific social objectives, such as providing products or services for the elderly or the poor. They create employment and training opportunities for the socially disadvantaged. They protect the environment, or fund other social services organizations through the profits earned; profits should principally be reinvested in the business or in the community to help achieve specific so-

⁵⁸ *Id.* at 2.

⁵⁹ *Id.*

⁶⁰ REPORT ON DEV. OF SOC. ENTER., *supra* note 32, at 4.

⁶¹ *Id.*

cial objectives. Maximizing profit is not the ultimate goal of a social enterprise.⁶²

These exemplary attempts reflect the yet unrefined understanding of social ventures in Hong Kong. It is a constituting criterion of social ventures that these are partly for-profit and partly not-for-profit with the inherent mission to create social change. The definitions given above, however, ignore that social ventures are neither of the two. They are a mixture in between, a combination of the two and not exclusively for-profit and also not exclusively not-for-profit. There are principal differences between the two, and being either for-profit or not-for-profit has significant implications on a social venture. However, the definitions suggested by the Legislative Council and by the former Chief Executive of Hong Kong still incorrectly equate social ventures with simple not-for-profit companies. The social objectives pursued by social ventures also leave too much room for interpretation and it is unclear what objectives are critical for a social mission. The definitions are too unrefined and do not acknowledge their constituting characteristics.

2.2. *Dilemma of Appropriate Legal Vehicle*

Choosing the right vehicle is one of the most essential, and most complicated, legal questions when social ventures structure their *make money and do good* business. The problem is that the Hong Kong company law does not offer any legal vehicle that can accommodate such a dual business approach. In bipolar understanding, business organizations have traditionally been classified—*tertium non datur*—as either for or not-for-profit.⁶³

In the following section, we compare the different legal vehicles available for social ventures by first juxtaposing for-profit entities with not-for-profit entities. In the second and third step, we explore different ways of combinations between for-profit and not-for-profit entities as options to circumvent the *numerus clausus* of company law.

2.2.1. *For-Profit versus Not-For-Profit Entity*

The dilemma caused through this black and white approach is that social ventures, while being in fact partly for-profit, or wholly (if *doing good* is achieved only by generating blended value),⁶⁴ are stigmatized with typically being deemed for-profit irrespective of their social mission. This has implied their ineligibility for special tax

⁶² See Hong Kong Social Entrepreneurship Forum, *What is a Social Enterprise in the Hong Kong Context?*, SOC. ENTREPRENEURS NEWSLETTER, Dec. 18, 2010, at 9.

⁶³ See Julie Battilana, Cheryl Dorsey, Matthew Lee, & John Walker, *In Search of the Hybrid Ideal*, 10 STAN. SOC. INNOVATION REV. 51 (2012).

⁶⁴ Malani & Posner, *supra* note 17, at 2020.

treatment, public fundraising, governmental supports, accurate branding of their social cause, and other benefits enjoyed by charities.⁶⁵ Furthermore, donors have not been able to agree to compensate talented managers with share profits of entities they support, and their managers have not been able to motivate their employees to work harder without similar incentive.⁶⁶ Operating social ventures within the for-profit legal framework has also brought up corporate law issues such as the duty to maximize profits of directors towards their investors⁶⁷ or the preservation of social mission in the event of takeovers.⁶⁸ In order to benefit from the non-profit status, social ventures may adopt a not-for-profit vehicle in the early stage of operation when they do not generate much income anyway. In that case, however, they would encounter the most difficult problem of limited access to capital because they cannot attract equity investors.⁶⁹ It is therefore not surprising that the lack of any legal recognition has widely been identified as the gravest obstacle to the development of for-profit social entrepreneurship elsewhere, especially in the US.⁷⁰ Nevertheless, due to the on-going trend towards social entrepreneurship, Hong Kong has built up some experience of how traditional legal forms can be used to operate for a social mission. The result is a variety of options which all have some pros as well as some cons.

On the one side of the spectrum, there are a number of vehicles tailored for running charities that can be classified in two groups, purely donative charities and commercial charities. While purely donative charities, such as unincorporated associations⁷¹ or Chinese Temples,⁷² cannot accommodate all business operations, they are not suited for social ventures and therefore fall outside of our analysis.

⁶⁵ *Id.*

⁶⁶ *Id.* at 2019.

⁶⁷ CHARITIES SUBCOMM., *supra* note 12, at 6.34.

⁶⁸ *Id.*

⁶⁹ See *The Hauser Institute for Civil Society*, HARVARD UNIV., <http://www.hausercenter.org/chinapo> (discussing the start-up process for a social enterprise) (last visited Dec. 28, 2013).

⁷⁰ Malani & Posner, *supra* note 17, at 2020.

⁷¹ Associations of this kind have no legal entity and therefore cannot enter into contracts, sue or be sued, in the association's name or on its behalf therefore a business activity cannot be operated within their framework. CHARITIES SUBCOMM., *supra* note 12, at 90.

⁷² In Hong Kong, Chinese Temples operate under Cap 153 (Chinese Temples Ordinance) specifically tailored for them and can only generate revenue, apart from accepting donations the purpose of worship cultivation or communication with spirits or fortune-telling, by selling joss candles or incense sticks. See Chinese Temples Ordinance, (1997) Cap. 153, 2, § 6(c) (H.K.); see also Societies Ordinance, (1997) Cap. 151, 2, § 2(b) (H.K.) which is a sort of charitable sales rather than offering services.

Commercial charities, on the other side, which can be either registered societies,⁷³ not-for-profit corporations, or charitable trusts,⁷⁴ fall under the restriction of Section 88 of the Inland Revenue Ordinance.⁷⁵ Accordingly, these entities can only be officially recognized as charitable organizations if the majority of the benefits and profits derived from business or trade are applied towards charitable purposes and are not expended substantially outside of Hong Kong.⁷⁶

On the other side of the spectrum there are a wide panoply of legal vehicles originally meant to be for-profit, some of which might be used to *do good*. Sole proprietorship, for example, is a business carried out by a single person for gain.⁷⁷ Partnerships, either general or limited, also exist to make a profit.⁷⁸ Companies can be established for any lawful purpose, whether the company has been established for or not-for-profit.⁷⁹ The specific form of a company limited by guarantee is predominantly used as a vehicle for pursuing charitable objectives.⁸⁰ But, in order to be officially recognized as charities, companies need to conform to the Inland Revenue Ordinance, and thus have to be established as not-for-profit. Similarly, the purpose of a trust is flexible: it is, by definition, a trustee holding property for the benefit of beneficiaries or for some purposes permitted by law.⁸¹ In order to officially qualify as a charitable trust, however, it must only be established for charitable purposes, not for anybody's profit.⁸² Even though these principally for-profit entities could theoretically be registered as charities, they lose one of their essential characteristics, the ability to distribute profits back to the investors, a necessary part of the concept of social ventures.

⁷³ See CHARITIES SUBCOMM. *supra* note 12, at note 6.6, 82; see generally Societies Ordinance, (1997) Cap. 151 (H.K.).

⁷⁴ See CHARITIES SUBCOMM., *supra* note 12, at pt. 6.12-6.13. 83-84; see generally Trustee Ordinance, (1997) Cap. 29 (H.K.) (the ordinance governing the use of trusts); Business Registration Ordinance, (1997) Cap. 310, 3, § 3(5) (H.K.) (the ordinance governing general rules for the registration of business including trusts).

⁷⁵ See Inland Revenue Ordinance, (2012) Cap. 112, 154, § 88 (H.K.).

⁷⁶ *Id.*

⁷⁷ See Business Registration Ordinance, (1999) Cap. 310, 3, § 3(1)(a) (H.K.).

⁷⁸ See Limited Partnerships Ordinance, (1997) Cap. 37, 2, § 6 (H.K.); Partnership Ordinance, (1997) Cap. 38, 1, § 3(1) (H.K.).

⁷⁹ See Companies Ordinance, (2008) Cap. 32, 6, § 4(1) (H.K.).

⁸⁰ *Id.* at § 4(2)(b); see also VANESSA STOTT, HONG KONG COMPANY LAW, 5-6 (8TH ED. 1998).

⁸¹ There is statutory definition of a trust in Hong Kong. See FINANCIAL SERVICES AND THE TREASURY BUREAU, CONSULTATION PAPER: REVIEW OF THE TRUSTEE ORDINANCE AND RELATED MATTERS 5, ¶ 1.1 (JUNE 2009), for how a trust is understood under common law.

⁸² See Inland Revenue Ordinance, (2012) Cap. 112, 154, § 88 (H.K.).

Membership clubs, which are in principle established for the benefit of their members, may nonetheless be capable of pursuing a social mission. Membership clubs in Hong Kong, formed either as societies or corporations, or under special statutes, are in principle meant to afford their members facilities for social interaction or recreation.⁸³ Along with these primary goals, these clubs also pursue charitable purposes, as exemplified by the Hong Kong Jockey Club.⁸⁴ Despite this very laudable approach, this should not be regarded as a social venture, even though the management receives salaries instead of profits and the members in effect buy services instead of holding shares.⁸⁵

Vehicles accommodating cooperative movements that emerge to solve social problems via mutually organized self-help are even more problematic to assess. Co-operative societies⁸⁶ have as their object "the promotion of the economic interests of [their] members in accordance with co-operative principles."⁸⁷ Based on these goals, including the Rochdale Principles,⁸⁸ only limited interest on capital contributions can be distributed back to members.⁸⁹ Moreover, based on Hong Kong law, cooperatives can contribute up to ten per cent of their annual net profits to any charitable organizations.⁹⁰ Similarly, credit unions, being a kind of cooperative organization, are established to receive savings from and make loans to their members.⁹¹ To ensure that paradigms of limited gains on capital and also of social mission are met, dividends and loan interest rates are statutorily limited to six per cent yearly⁹² and one per cent monthly.⁹³ However, unless cooperatives also buy *good* with their profits for their non-members, cooperatives are unlikely to qualify as social ventures.

⁸³ See Business Registration Ordinance, (2011) Cap. 310, 1, § 2(1) (H.K.).

⁸⁴ The HKJC is a company limited by guarantee and promotes horse racing. It also pursues a social role and contributes an average of HK\$1.2 billion per year back to the community through its charitable trust (The Hong Kong Jockey Club Charities Trust). See *The Hong Kong Jockey Club Charities Trust*, THE HONG KONG JOCKEY CLUB, <http://www.charities.hkjc.com> (last visited Mar., 4 2013).

⁸⁵ *Id.*

⁸⁶ See *generally* Co-Operative Societies Ordinance, (1997) Cap. 33, 1, § 1 (H.K.) (the ordinance governing co-operative societies in Hong Kong); THE INTERNATIONAL CO-OPERATIVE ALLIANCE, STATEMENT ON CO-OPERATIVE IDENTITY (1996).

⁸⁷ See Co-operative Societies Ordinance, (1997) Cap. 33, 2, § 4 (H.K.).

⁸⁸ See INTERNATIONAL CO-OPERATIVE ALLIANCE, THE ROCHDALE PRINCIPLES OF CO-OPERATION (1937) available at www.uwcc.wisc.edu/ica/orgs/ica/pubs/studies/The-Present-Applications-of-the-Rochdale1/The-Rochdale-Principles-of-Co-operation-1.html.

⁸⁹ *Id.*

⁹⁰ See Co-operative Societies Ordinance, (1997) Cap. 33, 7, § 34 (H.K.).

⁹¹ See Credit Unions Ordinance, (1997) Cap. 119, 2, § 3 (H.K.).

⁹² See *id.* at 10 § 46(1).

⁹³ See *id.* at § 41(1).

It could also be questioned whether collective non-altruistic and self-help effectively fall within the meaning of *doing good* at all. But similar to entrepreneurs who treat social goals as a tool to make some moderate profits but still resolve social problems, we could answer that fruits of their activities matter more than their intentions.

2.2.2. *For-Profit and Not-For-Profit Entity*

Another way through the “law of the jungle”⁹⁴ is to build specific multi-entity organizations, contractually linking for-profit organizations with charities, issuing different classes of shares or drafting tricky shareholders’ joint venture or side agreements.⁹⁵ These options are confined to theoretical existence because grassroots social entrepreneurs cannot afford legal advice on the formation of any of these variants.⁹⁶ Combinations of for-profit and not-for-profit companies are another option but seem excessively arduous, timely, costly, and legally uncertain, and, therefore, unsuitable for social ventures.⁹⁷

2.2.3. *For-Profit in combination with a Not-For-Profit Entity*

A brief comparison with the legislation of the United States (“U.S. legislation”) shows, once again, that Hong Kong is not aware of the dimension of social entrepreneurship. Over the last few years, three different legal entities which are specifically designed for social ventures were adopted: the low-profit limited liability company, the benefit corporation, and the flexible purpose corporation. A low-profit limited liability company, or L3C, is a for-profit company with a “non-profit soul.”⁹⁸ It merges elements of a for-profit entity with elements of a not-for-profit entity, meaning the ability to distribute profits to investors together with a charitable or educational purpose.⁹⁹ The benefit corporation, while a for-profit entity, tries to make a beneficial impact on the public.¹⁰⁰ It offers several interesting provisions, such as rules as to the purpose, accountability, transparency, and right of action, which are specifically defined to foster the work of social entre-

⁹⁴ In the same words of Ms. Li Fung-Ying. See *Official Record of the Proceedings*, *supra* note 1 (statement of Ms. Li Fung-Ying).

⁹⁵ See *Law & Choice*, *supra* note 14, at 365.

⁹⁶ See *id.* at 365-66.

⁹⁷ See *id.* at 341.

⁹⁸ Integrated Care Management L3C, *What is the L3C?*, www.icm3.org/_PDFs/L3C.pdf, (last visited Mar. 4, 2013).

⁹⁹ See Robert A. Katz & Antony Page, *The Truth About Ben and Jerry's*, *STAN. SOC. INNOVATION REV.*, (2012) at 39, 42; see generally *Law and Choice*, *supra* note 14, at 371-75; Katz & Page, *supra* note 29, at 1362-1365.

¹⁰⁰ Katz & Page, *supra* note 29, at 1362.

preneurs.¹⁰¹ Based on these provisions, directors are liable to the stakeholders and shareholders if they fail to pursue the beneficent impact.¹⁰² The third option, the flexible purpose corporation, serves as a watered down version of the benefit corporation. It simply requires the corporation to carry out a special purpose, such as a charitable, scientific, or religious mission.¹⁰³

In summary, and as a short answer to our previous question, social ventures may choose any legal vehicle available for their incorporation but each has some significant detriments. A combination of for-profit and not-for-profit is possible, but not realistic because of the anticipated costs in the legal set-up.¹⁰⁴ Specific legal entities, such as the low-profit limited liability company from the U.S., as a combination of for-profit with not-for-profit entity is another option but does not exist in Hong Kong.¹⁰⁵ Thus, the dilemma remains of choosing the appropriate legal vehicle for social ventures.

2.3. *Purposes versus Objects of Activity*

Based on the current legal framework, it is unclear how *doing good*, in other words the social mission, of social ventures can be understood and characterized. People regard *doing good* differently. Some might say that giving kids in need free shoes, as in our hypothetical social venture, is not really *doing good*, while others might still regard it as such. There also are social activities that are not *good* enough. It is therefore clear that not any *good* qualifies as *good* in the context of social ventures.¹⁰⁶ But then, what is *good* ultimately and how can *doing good* be conceived in a legally relevant form?

A short digression into the Hong Kong charity law is helpful for such a characterization. Section 88 of the Inland Revenue Ordinance states that the trade or business carried out by a charity needs to express the objectives of the charity.¹⁰⁷ A charity needs to work towards its charitable objectives, which in a traditional way pertains to the promotion of charitable purposes. The definition of “Charitable purposes” in turn relies upon the fossil decision of 1892 by the House of Lords in

¹⁰¹ See Angus Loten, *Can Firms Aim to Do Good if it Hurts Profit?*, WALL ST. J. (April 10, 2013, 8:23 PM), <http://online.wsj.com/news/articles/SB100014241278873240107>. See generally, *What is a Benefit Corp.?*, BENEFIT CORP. INFO. CTR., <http://www.benefitcorp.net> (last visited Mar. 4, 2012).

¹⁰² Loten, *supra* note 101; BENEFIT CORP. INFO. CTR., *supra* note 101.

¹⁰³ *Corporate Creativity*, *supra* note 14; *Law and Choice*, *supra* note 14; *Vulgar Charity*, *supra* note 14; Plerhoples, *supra* note 22, at 248-50.

¹⁰⁴ *Law and Choice*, *supra* note 14, at 347.

¹⁰⁵ *Vulgar Charity*, *supra* note 14, at 2463.

¹⁰⁶ See *infra* section 3.5 (The qualification of the social mission is also important under the section of Registration).

¹⁰⁷ Inland Revenue Ordinance Advance Rulings (1999) Cap. 112, § 84(a) (H.K.).

Income Tax Special Purposes Commissioners v. Pemsel, which classified charitable purposes into (i) the relief of poverty, (ii) the advancement of education, (iii) the advancement of religion, and (iv) any other purpose not falling under these three heads.¹⁰⁸ The Law Commission recently updated these charitable purposes and suggested the inclusion of the advancement of health, the saving of lives, citizenship or community development, art, heritage, culture or science, environmental protection, and the improvement or advancement of animal welfare.¹⁰⁹

The landmark case *Church Body of the Hong Kong Sheng Kung Hui v. Commissioner of Inland Revenue*, however, confused the practical differentiation between charitable objectives and charitable purposes.¹¹⁰ In this case, the Anglican Episcopal Church (Hong Kong Sheng Kung Hui)¹¹¹ and its subsidiary foundation (The Hong Kong Sheng Kung Hui Foundation)¹¹² disposed of luxury apartments raising questions as to the resulting tax bill amounting up to HK\$180 million.¹¹³ The High Court obscurely rejected the very legitimate argument that the criterion must pertain to whether the charity used its revenue solely for charitable purposes, which in this case was the advancement of religion.¹¹⁴ Behind this reasoning lays the wrong opinion that the activities carried out by *Sheng Kung Hui* must be qualified as an activity for the “purposes of trading or business,” rather than advancement of religion.¹¹⁵ This, however, is not the case.¹¹⁶ The business purpose merely pertains, as implied above, to whether the business organization is for or not-for-profit, or less conservatively, to whom surpluses are distributed (to shareholders or for social mission).¹¹⁷

The decision is interesting on another level because it shows that Hong Kong does not welcome the combination of a *make money and do good* approach. Indeed, the court applied quasi-Unrelated In-

¹⁰⁸ *Income Tax Special Purposes Commissioners v Pemsel* [1891] A.C. 531 (H.L.) 583.

¹⁰⁹ CHARITIES SUBCOMM., *supra* note 12, at ch. 2.4-2.7, 3.5, 3.7, 5.5.

¹¹⁰ *Church Body of the Hong Kong Sheng Kung Hui v. Comm’r of Inland Revenue*, [2009] 3 H.C.I.A.

¹¹¹ *Hong Kong Shen Kung Hui Found. Ordinance*, (1999) Cap. 1157, § 4 (H.K.).

¹¹² *Id.* at Cap. 1159 § 4 (H.K.).

¹¹³ See PATRICK CHEUNG & PATRICE MARCEAU, A.B.A., FOREIGN LAWYERS FORUM, NAT’L REPORT HONG KONG 2010 16-17.

¹¹⁴ *See id.*

¹¹⁵ *See id.*

¹¹⁶ *See id.*

¹¹⁷ *See id.*

come Business Tax¹¹⁸ (“UBIT”) commerciality doctrine, holding that charitable organizations engaging in commercial activities can risk their special status if their business activities become too large in relation to their charitable activities.¹¹⁹ This is, in fact, nothing more than a selective taxation by which charitable organizations are discouraged from engaging in large and profitable business.¹²⁰ Malani and Posner, amongst others, have also emphasized that the purpose of UBIT is to deprive not-for-profit organizations of tax advantages when they compete against for-profit firms in commercial markets.¹²¹ Clearly, concerns about the general protection of a tax base drove the adoption of this tax.¹²² These arguments may as well serve as the actual rationale in *Sheng Kung Hui*.

The narrowness of either the for-profit or not-for-profit system has another problem which is usually referred to as the wealth maximization paradigm or Revlon Rule. Admittedly, this is not yet of relevance for Hong Kong. However, with the social venture sector now rapidly growing in Hong Kong, this problem could occur. Since Hong Kong lacks relevant case law, we will illustrate the problem with one story particularly exploited in American literature. In 1919, Ford Motor Company chaired by Henry Ford lost a court case against the Dodge brothers, the latter being minority shareholders and opposed to cutting T-model prices at the expense of decreasing dividends.¹²³ In contemporary terms, one could call Henry Ford a model social entrepreneur generating good and addressing social needs via the creation of affordable cars. His mission was hampered, however, by the Michigan Supreme Court ruling that Mr. Ford owed a duty to the shareholders to maximize the business organization’s profits rather than to generate benefits for the community or the employees.¹²⁴ The Supreme Court of Delaware later repeated this ruling in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* when it stated that the rule that during an unavoidable sale or winding up of a business organization, the shareholders of the purchased entity shall receive the best price available for their shares.¹²⁵ The U.S. legislation took this aspect into

¹¹⁸ I.R.S. Pub. 598 (March 2012), available at <http://www.irs.gov/pub/irs-pdf/p598.pdf>.

¹¹⁹ James Colombo, *Commercial Activity and Charitable Tax Exemption*, 44 WM & MARY L. REV. 487, 491 (2002).

¹²⁰ *Corporate Creativity*, *supra* note 14, at 79, 82; see also Reiser, *supra* note 16, at 6.

¹²¹ Malani & Posner, *supra* note 17, at 2026-27.

¹²² *Id.*

¹²³ *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919).

¹²⁴ See *id.*

¹²⁵ *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* 506 A.2d 173, 182 (Del. 1986). For an interpretation of *Revlon*, see Plerhoples, *supra* note 22, at 243-47.

consideration when it adopted special legal entities for dual purpose businesses, which thereby made wealth maximization claims against directors obsolete.¹²⁶ We, however, do not advance this direction for Hong Kong as we prefer a more flexible system than one which offers a variety of different legal vehicles and thereby even further complicates the *status quo*.¹²⁷

This whole confusion surrounding charitable objects and charitable purposes eventually triggered the question of whether it would not be more appropriate to base the charitable status on charitable purpose instead of charitable objects.¹²⁸ This, as suggested, would give charities more independence when choosing the most effective charitable activities and thereby allow them to achieve the charitable objects in the most flexible and innovative ways.¹²⁹ If the criterion is the social activity pursued by the business organization, the business of our hypothetical social venture would certainly not be regarded as a social activity. Is selling shoes a social activity at first glance? The criterion of objects would lead us into an endless discussion around different valuations which, ultimately, would not even improve the current situation. Consequently, we suggest a different approach.

Our proposal is the following: first, the bipolarity of for-profit and not-for-profit business purpose must be abandoned and social ventures as a blended form of for-profit and not-for-profit approach must be added. This will permit social ventures to pursue their business with a dual approach and at the same time allow profits to be partially distributed to the investors and partially reinvested into their social mission. In the case of our hypothetical social venture, it would need to be stated that the business organization aims to relieve poverty in poor countries by distributing shoes for free and also at profits from selling shoes in rich countries which will be partially distributed to the investors and partially used for their social mission. This would then need to be further refined in the charitable objects. As to the social purpose of social ventures, it must comply with the charitable purposes offered by the charity law. This will help to streamline the registration of social ventures as suggested below and will contribute to a better characterization of *doing good*.¹³⁰

¹²⁶ Plerhoples, *supra* note 22, at 243.

¹²⁷ *Id.*

¹²⁸ CHARITIES SUBCOMM., *supra* note 12, at ch. 5.49, 56.

¹²⁹ *See id.* at 109 (revealing some incoherence) (“A registered charitable organization should be required to file annually an activity report stating any change of charitable objects and the main activities carried out to fulfill the charitable objects.”).

¹³⁰ *See id.* at 24.

2.4. Conclusion

We initiated this section by addressing the ambiguous approach to social ventures by the authorities in Hong Kong. Explanations put forward by the Legislative Council and the former Chief Executive Officer are too unspecific, and it is unclear what objects qualify for a social mission. They also show that social ventures are incorrectly being equated with not-for-profit companies. We moved on to tackle the question of the appropriate legal vehicle for social ventures and examined that social ventures in Hong Kong may either incorporate as a for-profit or not-for-profit business organization but both options are not ideal and result in a legal dilemma. We then briefly introduced the option of combining a for-profit and not-for-profit business organization by means of contractual arrangements. Specific legal entities, such as the low-profit limited liability company, were next introduced to give an example on the approach taken by the U.S. legislature. In the last section we scrutinized how *doing good* is being conceived by the legislator and show that Hong Kong has built up barriers for social ventures as exemplified in the landmark case of *Church Body of The Hong Kong Sheng Kung Hui v. Commissioner of Inland Revenue* (2009). We finished this section by calling for a more straightforward system under which the bipolarity of the company law would be abandoned.

3. DECOUPLING COUPLED PRIVILEGES

The deficiencies of an unfriendly regulatory environment for social ventures in Hong Kong are not limited to the lack of appropriate business vehicles meeting their needs, as discussed in the previous section. These extend to all other areas of law under which traditional not-for-profit organizations are credited for *doing good* and under which social ventures are not, leaving the latter at a grave disadvantage. The only option we see of how to cure the situation is to decouple privileges by means of complex reform, the basic assumption of which we put forth in this section.

We start this section by identifying areas in which such benefits have been granted and move to a step-by-step analysis of how the granting of these benefits could better correspond with actual needs of both commercial charities and social ventures without penalizing social ventures for their for-profit legal status.

3.1. Bunch of Privileges?

From the discussion so far, one might infer that the lost income tax exemption of social ventures compared with officially recognized not-for-profit charities enjoying this privilege is, apart from lack of an appropriate legal vehicle, the only further injustice that social ven-

tures meet. This problem is, however, not limited to income tax breaks, and charities registered in Hong Kong enjoy many further privileges from which social ventures are barred. In this subsection, we identify three such areas of privileges.

First, Hong Kong offers tax deductions on donations to officially recognized Section 88 charities up to thirty-five per cent of either assessable profits of legal entities or individuals carrying on a trade, profession, or business,¹³¹ or thirty-five per cent of assessable income of income of individuals.¹³² In 2008-09, this amounted to HK\$8.04 billion in total.¹³³ Obviously, no donations to for-profit social ventures qualify for the privilege of tax deductions. As a result, potential donors are simply discouraged from making any donations to social ventures because they cannot deduct what they would pay in.

Second, social ventures are also disadvantaged in raising funds in public places.¹³⁴ Under the Summary Offences Ordinance, any person collecting money or organizing a charitable sale in a public place for a charitable purpose must first apply for a public subscription permit from the Social Welfare Department.¹³⁵ This permit covers two kinds of actions: flag days and general charitable fundraising.¹³⁶ While flag days can only be organized by Section 88 entities, general charitable fundraising can be, in theory, operated by entities without charitable status.¹³⁷ Such status, however, might be taken into consideration during the review of application for public subscription permit.¹³⁸ Finally, any organization could apply for non-charitable fund raising authorization from the Home Affairs Bureau, which is mostly

¹³¹ See Inland Revenue Ordinance, (2012) Cap. 112, 40, §16D(2)(d) (H.K.); see also CHARITIES SUBCOMM., *supra* note 12, at 143.

¹³² See Inland Revenue Ordinance, (2012) Cap. 112, 87, § 26C(2A)(c); see also CHARITIES SUBCOMM., *supra* note 12, at 143.

¹³³ See CHARITIES SUBCOMM., *supra* note 12, at 143.

¹³⁴ Summary Offences Ordinance, (2012) Cap. 228, 1, § 2(l) (H.K.) (defining “public place” as: “all piers, thoroughfares, streets, roads, lanes, alleys, courts, squares, archways, waterways, passages, paths, ways and places to which the public have access either continuously or periodically, whether the same are the property of the Government or of private persons.”).

¹³⁵ See *id.* at 3, § 4(17)(i) (H.K.); see also CHARITIES SUBCOMM., *supra* note 12, at 120.

¹³⁶ See generally Gov’t of H.K. Special Admin. Region, Social Welfare Dep’t, *Conditions of Public Subscription Permit for Holding Territory-wide Flag Days in 2012-13* (2011) (Flag days are a traditional form of occasional charitable fundraising in Hong Kong. Applications are filed in September, considered in October and days are finally allocated in November for the consecutive year).

¹³⁷ See Gov’t of H.K. Special Admin. Region, Social Welfare Dep’t, *Public Subscription Permit Application Form and Explanatory Notes on Application for Public Subscription Permit* (revised May 2012).

¹³⁸ *Id.*

used by political organizations.¹³⁹ But in such a case, the public fundraising could not be advertised as being for a charitable purpose. Therefore, public fundraising is also an activity in respect to which social ventures have difficulties with fulfilling the respective requirements.

Coupling in the case of flag days is particularly strict. While we will refer in the following subsections to establishing multi-entity organizations comprising of both a for-profit and not-for-profit entities as a tool to circumvent coupling, such hybrid structures could be pretty useless in the case of flag days. The Social Welfare Department, for example, arbitrarily considers applications from charitable organizations, which are associated with commercial organizations to be ineligible for this kind of fundraising.¹⁴⁰

Third, recognized charities have also been offered an exemption from the obligation to register under the Business Registration Ordinance¹⁴¹ even though they conduct business operations.¹⁴² This is, in our opinion, a rather thorny distortion of reality because commercial charities are, to some extent, usual business organizations. These entities also compete with social ventures, yet get unjustifiably preferential governmental treatment. As we have emphasized, commercial charities, like social ventures, are business organizations which use business methods. The distinction lies in the fact that the latter has a more entrepreneurial spirit, and entrepreneurship in service of others should be affirmed rather than camouflaged.

As a word of caution, we want to mention a proposal to couple privileges in the area of government procurement that was discussed in the Legislative Council but fortunately has not been adopted. Namely, the Legislative Council considered reserving a certain percentage of the procurement of government goods and services for social ventures in order to provide room for their development.¹⁴³ If the proposal had been adopted then, again, the status or the form of an organization would be rewarded rather than how much *good* the organization actually generated.¹⁴⁴

¹³⁹ See Summary Offenses Ordinance, (2012) Cap. 228, 3, § 4(17)(ii) (H.K.); see also CHARITIES SUBCOMM., *supra* note 12, at 120-22.

¹⁴⁰ See Flag Days, Social Welfare Dep't, www.swd.gov.hk/doc/Control-of-Char/FD%20eligibility%20criteria%2020110401e.pdf (last visited Mar. 4, 2013).

¹⁴¹ Business Registration Ordinance, (1997), Cap 310. (H.K.).

¹⁴² *Id.*

¹⁴³ *Official Record of Proceedings*, *supra* note 1, at 8444-8445; PANEL OF WELFARE SERVS., *supra* note 9, at pt. 5.1 (f), 26.

¹⁴⁴ Not to mention potential non-compliance with WTO Government Procurement Agreement (GPA) to which Hong Kong has been a member party since 1997, if the value of the contracts were in excess of SDR 130,000 (USD 190,000-200,000). Above that threshold, Hong Kong's public procurers are obliged to offer national

3.2. *Fetish of Profits Tax*

The profits tax seems to be the *leitmotif* and a kind of fetish in the discussion on commercial charities and social ventures elsewhere, and we also have not escaped this narrative in our argument. However, before making new propositions or applauding old ones, we should first consider whether income tax breaks and tax exemptions are the right approach at all. There are some doubts that need to be discussed.

First, profits tax breaks work like subsidies.¹⁴⁵ Subsidies are not a rare phenomenon, but governments support specific activities of businesses in line with governmental policies regardless of their status or legal form.¹⁴⁶ That is not the case of general privileges offered to charities where just the status is credited. *In effect*, general privileges allow unfair competition towards entities which do not enjoy these tax breaks; therefore these privileges must be conceptually queried.¹⁴⁷ Subsidies in the form of general profits tax could drive predatory pricing when a commercial charity sells products at lower prices than competitors and thereby drives them out of the market. This can be illustrated with a very efficient commercial charity generating a lot of blended value. It cannot distribute its surpluses as profits to shareholders and therefore spends surpluses on undercutting prices.¹⁴⁸

Second, profits tax breaks are not fair toward taxpayers. For example, Oleck in the early 1970s described tax breaks for some charities as a kind of unjust burden that generally encumbers all taxpayers,¹⁴⁹ and doubted whether granting tax breaks to churches, for instance, is fair to believers of other religions, not to mention agnostics or atheists.¹⁵⁰ Nowadays, we could ask whether it is fair to subsidize organizations at the expense of the miser that might pay less in taxes if the overall scale of subsidies via tax breaks was reduced. Only provocatively could we further ask whether it is fair to subsidize organizations taking care of animal welfare while there are some taxpayers absolutely indifferent to the well-being of animals, or even more pro-

treatment to suppliers of the other GPA parties and therefore preferences for domestic section 88 organizations would be a violation of this obligation.

¹⁴⁵ Malani & Posner, *supra* note 17, at 93.

¹⁴⁶ *Id.*; see also *Vulgar Charity*, *supra* note 14, at 2463.

¹⁴⁷ Howard L. Oleck, *Proprietary Mentality and the New Non-Profit Corporation Laws*, CLEV. ST. L. REV. 20 (1971) 154; Reiser, *supra* note 16, at 7.

¹⁴⁸ I.R.S. Pub. 598 (March 2012), available at <http://www.irs.gov/pub/irs-pdf/p598.pdf>; *Vulgar Charity*, *supra* note 14, at 2463-64 (arguing that there was absolutely no evidence that these phenomena occurred because commercial charities use tax break premiums to subsidize their social mission than to subsidize predatory pricing).

¹⁴⁹ Oleck, *supra* note 147, at 154.

¹⁵⁰ *Id.*

vocatively whether some antidemocratic taxpayers like the idea of subsidies to organizations advancing citizenship. This *per se* futile discussion illustrates some difficulties that governments face when determining taxpayers' preferences. Such dilemmas result in encouraging taxpayers to support specific social actions of the private sector pursuant to the choices made by governments instead of the taxpayers themselves and that are often contrary to the views of some.¹⁵¹ Without diving into this discussion, encouraging non-governmental charity by granting general tax breaks does not seem the right tool, for it partially contravenes the very idea of private charity which should be far from governmental influences.

Third, for some authors, tax erosion and tax loss resulting from tax breaks is a grave problem.¹⁵² We, however, believe that the essential question is whether *good* generated on the basis of tax breaks would otherwise be generated by means of direct public spending. This problem seems to be already partially addressed in Hong Kong, as charitable expenditures of tax exempted organizations are to be substantially expended in Hong Kong.¹⁵³ Because of this constraint, such expenditures are more likely to be made for the purposes of which, even in their absence, the government would spend money anyway. To the extent they do, they could off-set any tax loss. Finally, some try to defend income tax breaks by observing that commercial charities are unable to raise capital. This is correct as to the equity market but capital can still be raised over the debts market.¹⁵⁴

All in all, it is apparent that there is no good cause for offering or maintaining profits tax exemption for charitable organizations. Admittedly, tax advantages crediting legal status might not be particularly detrimental to the competition in markets, where both exempt and non-exempt entities operate because commercial charities might not be cost-efficient enough to take advantage of these benefits. Even so, commercial charities might not be cost-efficient enough, because they are dispirited by tax advantages, which constructs a vicious circle. Therefore, a general profits tax exemption might result in stifling innovation in the charitable landscape. As such, the legitimacy of these exemptions is highly questionable.

That is not to say, however, that exempted business organizations should be simply deprived of their tax advantages and left alone without being offered *quid pro quo* or other forms of support. In the next subsections we attempt to sketch an alternative system based on an approach of decoupling deductions, donations, constraining non-

¹⁵¹ *Id.*

¹⁵² *See id.*; Columbo, *supra* note 119, at 532-34.

¹⁵³ *See* Inland Revenue Ordinance, (2012) Cap. 112, 154, § 88 (H.K.).

¹⁵⁴ Malani & Posner, *supra* note 17, at 2040.

distribution, and the registration of mission-driven business organization. This will show that our proposal is more straightforward and highlights the need for a reconsideration of the current system.

3.3. *Limited Deductibility of Social Expenditures*

A deductibility of expenditure incurred by social ventures in relation to its social mission poses a much more important role than profits tax exemption. Suppose all expenditures are deductible, social ventures can easily circumvent the lack of profits tax exemption while commercial charities do not need one at all. Namely, surpluses can be reinvested on a continuous basis resulting in a surplus at the end of the accounting period with a cost of close or equal to zero. There is no taxable profit and profits tax breaks would therefore be immaterial.¹⁵⁵

There are two counterarguments against such a claim. First, it is not the purpose of social ventures to reach break-even point and they need to *make money*, at least in the long term. We will address this problem later on where we propose flexible non-distribution constraint.¹⁵⁶

Second, not all expenditures that social ventures make (or that commercial charities would have to make if they were deprived of profits tax exemption) are deductible, and therefore, for the time being, do not constitute an actual alternative for profits tax exemption. As a matter of fact, a business organization based in Hong Kong can deduct all outgoings and expenses from assessable income, other than expenses of a domestic or private nature and capital expenditure, wholly, exclusively, and necessarily incurred in the production of the assessable income.¹⁵⁷ By way of reminder, legal entities can deduct charitable expenses even up to thirty-five per cent of their assessable profits/income but only in the form of donations *sensu stricto* under Section 88.¹⁵⁸ Theoretically, this might imply that organizations not exempted under Section 88 should not do *good* at all. We consider to what extent this is an issue in practice in the following paragraphs.

Business organizations with social missions that generate perfect blended value do not need to deduct costs of social missions because there are no costs at all. They do not bear any costs of social missions as only ordinary expenses are being incurred in the course of business operations. In such cases, there may remain a surplus which would typically be taxable as profit, and there is no good reason why it should be tax-exempt. This preliminary remark implies that tax breaks are irrelevant for social ventures which generate *good* at no

¹⁵⁵ *Id.* at 2043.

¹⁵⁶ *See infra*, Section 3.4.

¹⁵⁷ Inland Revenue Ordinance, (2010) Cap. 112, 30, § 16(1) (H.K.).

¹⁵⁸ *Id.* at § 16D.

cost; but *a contrario* they are relevant for social ventures which generate *good* at a cost. They are also relevant for business organizations which only create little blended value and at the same time buy *good* as is typical for organizations such as corporate philanthropies.

Suppose next that social ventures do not generate perfect blended value and need to devote some portion of means to produce *good* that otherwise would increase profit. In practice, tax authorities, of course, would not question expenses like higher wages for blue-collar workers than would normally be offered on the market. Likewise, authorities are not likely to interfere with zero margins on the sale of shoes in poor communities, or to refugees coming to Hong Kong by saying that the low margin is *de facto* a donation either.

However, the hypothetical social venture is walking on thin ice when it begins to offer shoes for free or almost for free and does not do so in conspiracy because it needs to address its offer to those in need publicly. In that case, expenses attributable to these particular items are not incurred in the production of the assessable income and should not be deducted. Put otherwise, only expenses incurred with a view to make profit are deductible while gratuitous transfers are not.¹⁵⁹ It is also a clear position of the Hong Kong Inland Revenue Department that expenditures should be properly apportioned, so that separate parts of expenditures are allotted to making profits, and other parts are devoted to some other ends, such as offering them for free.¹⁶⁰ If expenses are incurred for dual purposes, they should be fairly allocated on a proportionate basis.¹⁶¹ In essence, charitable expenses of for-profit organizations should therefore not compensate surpluses generated by for-profit business operations. Put otherwise, the surpluses generated by for-profit business operations should first be taxed before net profits can be paid out. This approach is pragmatic, straightforward, and also in line with *Sheng Kung Hui v IRD*.¹⁶²

Suppose then that social expenditures are nondeductible, whereupon our social venture decides to set up a spin-off Section 88 organization to allow operation as a hybrid of two entities, one being for-profit and one not-for-profit. Such structure would allow the venture to allocate surplus devoted to donations in the tax-exempt charity and to leave the remaining portion in the for-profit vehicle with a view

¹⁵⁹ *Id.*

¹⁶⁰ INLAND REVENUE DEP'T, PROFITS TAX APPORTIONMENT OF EXPENSES, DEPARTMENTAL INTERPRETATION AND PRAC. NOTES NO. 3 (REVISED) ¶ 3 (2008).

¹⁶¹ *Id.* at ¶ 4-5.

¹⁶² *Church Body of the Hong Kong Sheng Hung Hui v. Comm'r of Inland Revenue*, HCIA 2/2009 (C.F.I. Jan. 27, 2010) (Legal Reference System) (H.K.); *see also* Malani & Posner, *supra* note 17, at 2025 (observing legal entity as being irrelevant).

to pay it out as profits. Taxable income would be only the latter. Nonetheless, further problems would appear.

First, donations to charitable organizations in Hong Kong can only be made in money and not in kind.¹⁶³ This has the rather unusual result that our hypothetical social venture would have to donate money to its subsidiary so that the former can sell shoes to the latter, instead of donating the shoes directly. Here the legislator, with all force and without good cause, prefers buying *good* to generating *good* and makes futile attempts to preserve the world of business organizations that are, at most, involved in corporate philanthropy by making money transfers to traditional charities.

Second, the ceiling of allowed deductible donations to Section 88 organizations set at thirty-five per cent imposes star ratios for *doing good* and prevents the more ambitious efforts that social ventures may have. If social ventures intended to allocate twice as much of the surplus to *doing good* than to *making money* (about 66.6 per cent against 33.3 per cent), it could only deduct the maximum approved limit of thirty-five per cent.¹⁶⁴ As a result, the hypothetical organization would assign less for its mission, reconsider the donation, or be pushed into sham transactions between the two entities constituting the hybrid. Hong Kong apparently prefers business organizations reinvesting one-third of their surpluses in their social missions to organizations with a more eager approach.

Yet more problems would emerge if new markets were created to meet social needs outside Hong Kong, where shoes are offered at symbolic prices. Establishing related foreign for-profit subsidiaries would not work in this case because they might immediately raise eyebrows as to transfer prices among related business organizations and result in income adjustment.¹⁶⁵ Two-entity hybrids would not work either because the one that is a charity still must be based in Hong Kong and spend a significant portion of its funds in Hong Kong.¹⁶⁶

The poor deductibility of charitable expenditures bolsters the monopoly of donative and commercial charities instead of facilitating the operation of social ventures. While social ventures using a for-profit vehicle need to be attentive to how to lawfully deduct their social

¹⁶³ INLAND REVENUE DEP'T, CONCESSIONARY DEDUCTIONS: SECTION 26C APPROVED CHARITABLE DONATIONS, DEPARTMENTAL INTERPRETATION AND PRAC. NOTES NO. 37 (REVISED) ¶ 5 (2006).

¹⁶⁴ *Charitable Donations and Tax-Exempt Charities*, INLAND REVENUE DEPARTMENT (H.K.) (June 28, 2013) <http://www.ird.gov.hk/eng/tax/ach.htm>.

¹⁶⁵ See generally INLAND REVENUE DEP'T, TRANSFER PRICING GUIDELINES; METHODOLOGIES AND RELATED ISSUES, DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES NO. 46 (2009).

¹⁶⁶ See Inland Revenue Ordinance, (2012) Cap. 112, 154, § 88 (H.K.).

expenses, exempted non-profit commercial charities do not need to at all. Therefore, the deductibility of expenses in the present form is not an appropriate substitute for income exemption.

Therefore, we propose that all business organizations with an approved social mission can deduct socially-oriented transfers, whether pecuniary or in kind. Third party donors can deduct their charitable transfers to such business organizations. Deductions by social ventures would then—using the language of the Inland Revenue Ordinance—consist of all outgoings and expenses, other than expenses of a domestic or private nature and capital expenditure, wholly, exclusively, and necessarily incurred in the production of the assessable income as well as all outgoings and expenses incurred in pursuance of their approved social mission. However, this requires amendments to the system of (i) deductibility of donations, (ii) no-distribution constraints, and (iii) registration/supervision. The details of this proposal are presented below.

3.4. *Decoupling Donations*

Section 88 should not be restricted to not-for-profit organizations and donations *sensu stricto*. It needs to be more responsive to the needs of commercial charities and social ventures (if the latter were granted with the right to receive deductible donations) because both typically rely on price premiums that donors currently cannot deduct. Therefore, deductible donations made by third party donors could also be price premiums that donors agree to pay over the market price for the shoes because of their social mission. The latter would require, however, that business organizations are allowed to apportion the amount between market price and effectively paid price.

Currently, if a donor receives any benefit, such as a pair of shoes, in exchange for any portion of the total payment, then nothing can be deducted from the donor's assessable income in Hong Kong. The exception would be charitable sales whereby badges, flags, tokens, etc. are not of material consideration but merely the acknowledgements of donations.¹⁶⁷ But they are still regarded as donations as they are without any material consideration.¹⁶⁸ The reason for Hong Kong's firm position is that the whole transfer has to be donative and no apportion-

¹⁶⁷ Payments for gave spaces, purchases of raffle tickets, admission fees to charity film shows, and the cost of tickets for charity balls and concerts, etc. See INLAND REVENUE DEP'T, CONCESSIONARY DEDUCTIONS SECTION 26C APPROVED CHARITABLE DONATIONS, DEPARTMENTAL INTERPRETATION AND PRAC. NOTES, NO. 37 (REVISED) ¶ 4 (2006).

¹⁶⁸ *Id.* at ¶ 3.

ment between commercial and charitable components of the price is possible.¹⁶⁹

Consequently, decoupling of fundraising privileges and apportionment would need to be allowed. As shown by the American example of Malani and Posner, transfers made up of components paid for material consideration and as gifts proved to be divisible in the sense that issuing separate bills for commercial considerations and receipts of charitable payments is feasible in practice.¹⁷⁰ Our hypothetical social venture would then simply offer two receipts, one for the donation which is also usable for the tax deduction and one for the product itself. Of course, *de minimis* value thresholds are usually applicable and this would be set at HK\$100 in Hong Kong, below which no donation can be deducted by donors for practical reasons.

3.5. Exempted Income

Now that we have addressed how the system of deductible donations should be structured, we now make the claim that only income received as approved charitable donations should be tax exempt,¹⁷¹ and that no organization should be generally exempted, regardless of its social mission, of its for or not-for-profit status, and even regardless of whether it operates as a business or not. Purely donative charities would maintain their *status quo* as their revenue would be generated from exempted income only. All business organizations with social missions, however, would, in principle, pay profits tax on their business operations. It might seem controversial whether social ventures and commercial charities should pay taxes equally but we believe that the answer is yes for at least two reasons.

First, commercial charities now pay profits taxes imposed in a chaotic way. As mentioned, this problem has been approached with so-called commerciality taxes imposed either via statutory arrangements like UBIT in U.S. legislation or *de facto* via judicial decisions in Hong Kong.¹⁷² Needless to say, this is detrimental to practical business needs and results in incidental and unpredictable tax-kicking based on unclear rules.

Second, as we have already proposed, business organizations *doing good* would also be able to deduct even gratuitous transfers made in pursuance of their social mission as well as to apportion charitable premiums to be excluded from their assessable business income. As a result, these organizations would only pay taxes on surpluses

¹⁶⁹ *Id.*

¹⁷⁰ Malani & Posner, *supra* note 17, at 2063.

¹⁷¹ This also includes other types of specific contributions to other non-charitable or for profit organizations, like contributions to political parties.

¹⁷² See *Vulgar Charity*, *supra* note 14, at 2439.

which they want to accumulate or pay out, rather than to reinvest those in their social mission. Thus, commercial charities would be encouraged to spend more on their social missions—that is how decoupling of privileges in practice should be understood.

The merit of our proposal is that tax law is one of high complexity and that our approach does not further complicate this system. We already live in a reality where various types of revenues are included or excluded from assessable profits of businesses. For instance, damages received from third parties would constitute business income for the purposes of income tax assessment if these compensate for lost profits (*lucrum cessans*), but not if these damages compensate for actual loss (*damnum emergens*). In addition, very often the total amount of compensation must be properly apportioned between these two categories. Classification of expenses is even more complicated with some expenses being deductible at once, some subject to amortization, depreciation, or some not deductible until particular assets are resold (especially securities). Further, some revenue and expenses for income tax purposes are booked on either cash or accrual basis. This is to say that bookkeeping for tax purposes has always been complicated, and, against this background, our proposal is straightforward.

3.6. *Flexible Non-Distribution Constraint*

Social entrepreneurs cannot benefit personally from the support they receive from the public. In the case of commercial charities, this has been approached very rigidly with an absolute non-distribution constraint and not-for-profit status. We, however, see a much more flexible solution that abandons this bipolar thinking. Why do we not consider a mechanism whereby any limitations on payment of profit are strictly related to the amount of support received in the form of officially recognized deductible donations? Put otherwise, we make the proposition that surplus minus donations can be distributed to stakeholders.

How would it work in practice? Let us first confine the analysis to premiums, keeping in mind that donations *sensu stricto* still need to be addressed below. Suppose it costs 12 monetary units on average to produce one pair of shoes and the market price in Hong Kong that affluent clients can afford is 18 without any charitable price premium (18 is the market price). The surplus generated on the commercial sales of one pair is then 6. So, if the social venture gives one pair of shoes for free in poor communities per each two sold to affluent clients, it can reach break-even point. But, if it gives for free one per three items sold, it earns two monetary units on each pair of shoes sold and can distribute the profits accordingly. In turn, if it tried to attract price premiums, say 6 monetary units per a pair of shoes and the total price were 24, it could generate reasonable surpluses on each item regard-

less whether it gave one for free per two or three pairs of shoes (surplus per sold pair respectively 6 and 8). Under the current system, however, the social venture still could not pay out any money because the non-distribution constraint would reflect the amount of accepted deductible donations if it gave one pair of shoes per each two sold (surplus and non-distribution constraint both being 6 per sold pair would mutually cancel against each other). If it gave one pair of shoes per each three sold, it could pay out profit being 2 per each sold pair but it could face criticism of carrying out too limited a dimension of *doing good*.

What a clever social entrepreneur might consider doing is to sell a single pair of shoes at the same price of 24 but report more on the commercial receipt (19 instead of 18) and less on the charitable one (5 instead of 6), which is possible in the case of affluent clients purchasing in the general ambit of *doing good*. That is the only way in this model that the social venture can “employ” two and not three pairs of shoes sold to work for one handed out for free, and still be profitable. It also appears that this solution may generally prevent potential attempts to deduct commercial transfers from purchasers as charitable ones, as the more transfers the social ventures would accept as charitable the less it could pay out as profits.

This system would also improve efficiencies of commercial charities. Since a commercial charity only aims at reaching break-even point, if it does the same job as our hypothetical social venture, it is as efficient with a production cost equal to 12. Thus, it could offer both lower total prices and show higher numbers on charitable receipts and, as a result, would probably outnumber any social venture in the sale of shoes. This shows that efficient commercial charities, if such existed, could benefit even more than social ventures from apportionment and flexible non-distribution constraint as a part of a decoupling package.

To sum up, we make the claim that our proposal on taxation and on distribution constraint has no loopholes. In particular, a kind of bookkeeping reserve equating to the amount of total received approved donations would accrue over the years but it could now grow endlessly. So, it should be further analyzed how quickly this reserve should be amortized, as otherwise, no profits could be paid out after some time (although this is more of an accountancy issue). We believe that the proposed system does not leave more space for scams and abuses in terms of tax incentives offered to charitable organizations than the current system, designed only for not-for-profit organizations, does.

3.7. Registration

The proposed system of substantive corporate and tax solution needs to work in tandem with a new registration system that embraces all organizations *doing good*. It is necessary that social mission

objectives are first pre-assessed for taxation and consumer protection reasons. Then, any pre-assessed organization could flexibly, from time to time or at random, *do good* and take advantage of the substantive solutions that we have offered. The question is how to fit these postulates under the current system of charities registration in Hong Kong.

Currently, a not-for-profit organization seeking tax exemption under Section 88 must apply for the recognition of the Commissioner of Inland Revenue Department.¹⁷³ It must attach a number of documents supporting the argument that it has been established merely for a charitable purposes and for the public benefit. These documents include memoranda and articles of associations of the business organization, constitution of association, deed of trust (or respective drafts if not yet established), a list of planned activities for the upcoming 12 months, and, if applicable, such a list for the preceding 12 months as well as accounts for the last financial year.¹⁷⁴ Once an organization is approved as charitable within the meaning of Section 88, its status may be verified on the basis of accounts or annual reports.¹⁷⁵

In practice, this system of recognition has proved to be discretionary in the sense that the IRD had full discretion in approving the application and no opportunity to file a claim against a rejected application is available. Similarly, the only existing *ad hoc* review criteria have been enclosed in non-binding and rather simplistic “best practice guidelines” prepared by the Corruption Prevention Department.¹⁷⁶ There is no single piece of legislation specifically governing all different charitable organizations.¹⁷⁷ During the discussions on the charity law reform, it was aptly emphasized that the current system only embraces organizations which seek tax exemption under Section 88.¹⁷⁸ Other institutions, such as Chinese Temples,¹⁷⁹ Chinese Permanent Cemeteries,¹⁸⁰ schools,¹⁸¹ hospitals,¹⁸² numerous statutorily established entities,¹⁸³ and a category of non-governmental organizations

¹⁷³ Inland Revenue Ordinance, (2012) Cap. 112, 154, § 88 (H.K.).

¹⁷⁴ *Id.*

¹⁷⁵ *A Tax Guide for Charitable Institutions and Trusts of a Public Character*, INLAND REVENUE DEPARTMENT (H.K.) (June 28, 2013) http://www.ird.gov.hk/eng/tax/ach_tgc.htm.

¹⁷⁶ ICAC CORRUPTION PREVENTION DEP'T, BEST PRACTICE CHECKLIST – GOVERNANCE AND INTERNAL CONTROL IN NON-GOVERNMENTAL ORGANISATIONS 6, *available at* http://www.icac.org.hk/filemanager/en/content_1031/ngo_e.pdf.

¹⁷⁷ CHARITIES SUBCOMM., *supra* note 12, at 103, ¶ 8.3.

¹⁷⁸ *Id.* at 98-99.

¹⁷⁹ Register kept by The Social Welfare Department. *Id.* at 92.

¹⁸⁰ Register kept by The Home Affairs Bureau. *Id.* at 93.

¹⁸¹ Register kept by The Education Bureau. *Id.* at 94.

¹⁸² Register kept by The Hospital Authority. *Id.*

¹⁸³ CHARITIES SUBCOMM., *supra* note 12, at 94.

receiving public subsidies¹⁸⁴ are regulated under specific statutes and exempted from Section 88.¹⁸⁵ Some rules are contained in the Companies Ordinances, under which most of the Section 88 organizations have been established, requiring disclosure and regular filings of financial accounts to the Companies Registry.¹⁸⁶ The same requirements apply to associations¹⁸⁷ and charitable trusts.¹⁸⁸ Together, this shows several regulatory overlaps.

To our great surprise, some serious voices in the discussion on reform have asked for a uniform approach to the registration of charities,¹⁸⁹ which would mean the introduction of a special vehicle to replace the existing panoply.¹⁹⁰ Even though the idea of a uniform approach remains an open question, the undertone of the Consultation Paper ran against it.¹⁹¹ While we make a dauntless proposal on decoupling, which offers much more flexibility to for-profit and not-for-profit organizations, we firmly disagree with that idea because we disagree with special inflexible vehicles meant to accommodate social ventures.

What has been proposed to address registration issues, as a highlight of the reform, is to establish, as far as possible, a “one-stop” authority, a centralized charities commission performing functions currently ascribed to various bodies.¹⁹² This body would be responsible not only for registration and monitoring of charitable organizations and keeping the public register,¹⁹³ but also for granting all permits related to public fundraising.¹⁹⁴ The future centralized authority would register only not-for-profit organizations seeking donations in public places while organizations not engaged in such fundraising activity would not be subject to registration.¹⁹⁵

Again to our great surprise, it has been almost conclusively proposed that powers to grant tax exemption under Section 88 of the IRO should remain with the IRD. Any organization would first need to apply for general recognition as a charitable organization to the proposed body and then apply, if it were interested, to the IRD for income

¹⁸⁴ Register kept by The Home Affairs Bureau. *Id.* at 93-94.

¹⁸⁵ *See generally id.* at 92-94.

¹⁸⁶ *Id.* at 92.

¹⁸⁷ *Id.* at 92-93.

¹⁸⁸ *Id.* at 93.

¹⁸⁹ CHARITIES SUBCOMM., *supra* note 12, at 90.

¹⁹⁰ *Id.*

¹⁹¹ *Id.*

¹⁹² *Id.* at 99, 188-67.

¹⁹³ *Id.* at 172.

¹⁹⁴ *Id.*

¹⁹⁵ CHARITIES SUBCOMM., *supra* note 12, at 98-99.

tax exemption.¹⁹⁶ In fact, the commission suggests a complicated two-stage approval system with necessary approval of two governmental departments, one of the IRD and another of the proposed centralized body. This two-stage approval system leaves essential questions unanswered. First, the role of the IRD in this system is unclear if the proposed body were the one to decide the charitable status of the applicant. Second, it is also unclear which department makes an organization eligible to receive deductible donations from donors. If the final approval of the IRD grants the applicant the opportunity to issue tax deduction receipts, the approval of the proposed centralized body would only be *pro forma* without any material effect. Consequentially, any donations received before the approval of the IRD would not be deductible. If, in turn, the right to receive deductible donations had already been granted with the approval of the proposed centralized body, the applying entity would then pay taxes on already approved and deductible charitable donations (if it did not separately apply for a Section 88 exemption), which can hardly be a serious proposition. As proposed, this two-step approval system has some flaws which need to be corrected. We suggest a more convenient and realistic multi-stage registration, but still a truly one-stop system, which, beside charities, also takes social ventures into account.

This multi-stage registration system is based on the proposition, as elaborated above, that general income, which also includes charitable donations, is exempted from taxes. Profits generated on business activities are still included, but all charitable expenses are deductible. Under this registration system, a social venture could first apply for recognition of its charitable goals, then apply to be allowed to deduct gratuitous transfers linked to these charitable goals and optionally apply to be allowed to receive deductible donations. In contrast, a donative charity which typically relies on donations would apply for all privileges at one time.

Under this system, application for recognition of charitable goals may not be deemed necessary, as it is not linked with some direct privileges. The mere recognition of mission is, however, very important in the context of branding and labeling. Malani and Posner, and separately Hansmann, observed that when donors cannot properly assess the actual quality of mission pursued by a given charitable organization due to information asymmetries, the not-for-profit form of an organization is itself a kind of assurance of such quality.¹⁹⁷ However, because for-profit entities are not eligible for charity status, a factual characteristic upon which the social mission of the entity could be as-

¹⁹⁶ *Id.* at 150-51, 173.

¹⁹⁷ Hansmann, *supra* note 15, at 845; see also *Corporate Creativity*, *supra* note 14, at 70.

sessed would be missing unless the social mission is recognized independently of the legal structure solely on the basis of *doing good*.

Suppose our hypothetical social venture does not have a spin-off charitable effect collecting money to subsidize its operations, does not organize flag days, and requires beneficiaries to pay a symbolic premium for the shoes which might not be seen as a charitable mission by everybody. Without proper branding of its mission via the appropriate vehicle, it would, by no means, attract as many donors to pay the price premium as it would with such a vehicle in place.¹⁹⁸ Of course, particular products or services offered by for-profit businesses commonly bear private labels indicating social goals. In the absence of any guidelines and rules, whether governmental or from business industry, this labeling can be misleading and wrongfully induce customers. The application for recognition of the charitable goals by public authorities would efficiently address this question outside consumer policy law.

As to the practical reasons, we can briefly address the most vital. The criteria for determining the eligibility for privileges should be the social goals as stated in the articles of association and as effectively perceived by the entity. More privileges may imply more reporting, disclosure, and paperwork obligations. Frankly, what we refer to as the “degrees of privileges” could, in practice, come down to a simple application system under which certain answers are checked with “yes” or “no” and submitted together with all relevant attachments, such as annual reports and receipts. Official approval of the recognition of the charitable goals should take place *ex ante* before the commencement of every year and should make the business organization eligible to call itself a social venture for the duration of the coming year. The privilege to make deductions would be effective after approval is granted, and any deductions of charitable expenditures would have to be specifically documented in the profits tax declaration of the relevant year. Issued receipts for donors would have to be duly registered and cross-checked with deductions reported by donors in their profits/salaries tax declarations.

3.8. Conclusion

In this section, we faced the challenge of how to decouple privileges of *doing good* efforts, which are currently exclusively linked to the status of not-for-profit organizations, and came up with a straightforward suggestion of how this could be done. First, we identified those provisions which link the status of the business organization to the availability of privileges and proposed that they should be decoupled. These privileges are: (i) profits tax, (ii) tax deductions, (iii) fundraising

¹⁹⁸ *Corporate Creativity*, *supra* note 14, at 92.

through donations, (iv) non-distribution constraint, and (v) registration/supervision of business organizations. Then, we found that general profits tax exemptions appeared to be an inappropriate solution in general and should not be sustained even for not-for-profit organizations. The same applies to the limited deductibility of social expenditures which is incoherent in its application and therefore is questionable as well. On the general principle that all socially-oriented transfers can be deducted, we then proposed a practical system in which parts of the generated profits can be distributed to stakeholders when non-distribution constraints are designed with more flexibility. We completed our proposal with a multi-stage registration system which allowed the implementation of these propositions.

4. ENDING A MISSION

Many of the social ventures now operating in Hong Kong will at some point abandon their mission, not only because of take-over attempts and dilution of ownership, but also because the original founders may retire or their socially-oriented motivation may become exhausted. Social ventures now both managed and owned by socially-driven founders will seek capital raising opportunities and will gradually become diluted. Some will seek private investors, while others will go public and may be exposed to frequent take-over attempts.¹⁹⁹ Brands recognized as socially responsible tempt potential purchasers and risk abandoning the social mission after the takeover.²⁰⁰ The business model that initially works well may eventually not work so well and, with a lack of new ideas, some social ventures will face winding up too.²⁰¹ These scenarios will not be foreign to Hong Kong if the social venture sector keeps its enthusiasm and growth. Hong Kong is the headquarters and hub for transnational profit driven “Goliaths” that compete with socially driven “Davids.” The former might be eager to devour brands built by the latter. Ideally, it is the market that sets the pace for generational change among social entrepreneurs and social projects, particularly in Hong Kong, the world’s freest economy.²⁰² We therefore do not see anything inherently wrong if social ventures, even

¹⁹⁹ See generally James E. Austin & Herman B. Leonard, *Can the Virtuous Mouse and the Wealthy Elephant Live Happily Ever After?*, 51 CAL. MGMT. REV. 77 (2008).

²⁰⁰ Consumers prefer socially responsible and environmentally sustainable products and services. See Plerhopes, *supra* note 22, at 235 (noting that profit-maximizing companies expand by acquiring established companies rather than starting their own).

²⁰¹ See *Corporate Creativity*, *supra* note 14, at 219-20 (referring to the challenges to “long-term survival of for-profit social enterprises”).

²⁰² *2013 Index of Economic Freedom*, THE HERITAGE FOUNDATION, <http://www.heritage.org/index> (last visited Mar. 4, 2013) (noting that Hong Kong is ranked number one in economic freedom among countries around the world).

landmarks, disappear from Hong Kong. In that event, however, we examine some specific problems in the following.

A case to learn from abroad is the well-known story of the acquisition of premium ice-cream producer Ben & Jerry by Unilever in 2000.²⁰³ Since the early 1980s, Ben & Jerry has been a social venture with a multi-faceted mission covering policies against growth hormone in stock raising, eco-friendly packaging, usage of fair-trade certified products, payment of decent wages for employees, support for same sex marriages, and donating 7.5% of pre-tax profits to charity.²⁰⁴ Decreasing stock prices resulting from clients averting from fatty products and reconsidering the company's commitment to social mission invited take-over bids by larger players in 2000.²⁰⁵ Among those, Unilever's offer was the highest, although it was less promising in terms of sustaining the social mission.²⁰⁶

Whether the shareholders' wealth maximization paradigm duties under *Revlon* required Ben & Jerry's founders to sell or whether the offer was simply too tempting to resist has dominated the transaction's legal discourse.²⁰⁷ Katz and Paige, who strongly argued for a distinction between the prevention against hostile takeovers and the preservation of a social mission,²⁰⁸ concluded that none of the premises triggering the *Revlon* duties occurred in this *de facto* case that forced Ben & Jerry's management to accept Unilever's offer. According to them, two scenarios were likely. First, Ben & Jerry's management accepted the highest offer in fear of personal liability because "constituency statutes" shielding against *Revlon* duties had not yet been tested in courts.²⁰⁹ Constituency statutes allow directors to take other factors into consideration, such as employees, suppliers, customers, the economy of the region, and community. They also include the "possibility that these interests may be best served by the continued independence of the corporation" which *de facto* overruled the *Revlon*

²⁰³ Plerhoples, *supra* note 22, at 236 (analyzing the purchase of Ben & Jerry's by Unilever).

²⁰⁴ *Corporate Creativity*, *supra* note 14, at 219-223.

²⁰⁵ *Id.* at 225-26 (referring to offers by Dreyer's, a competing ice cream manufacturer, and Hot Fudge Partners).

²⁰⁶ *See id.* at 225-228 (referring to willingness to donate pretax profits to charity for a minimum of five more years).

²⁰⁷ *See id.* at 235-36 (stating that none of the *Revlon* triggers to maximize shareholder value applied to Ben & Jerry's).

²⁰⁸ *Id.* at 249.

²⁰⁹ *Corporate Creativity*, *supra* note 14, at 236-37, 241 (referring to a lawsuit that could potentially go to the Vermont Supreme Court where Ben & Jerry's might lose).

duties.²¹⁰ In the second scenario, the founders accepted the tender with the risk of abandoning the social mission.²¹¹ Yet, a possible scenario is not possible to prove.

Interestingly, Ben & Jerry's mission was mostly sustained after the takeover. Generally, environmental considerations were upheld, while more costly social missions were gradually abandoned.²¹² Although a portion of Ben & Jerry's mission has been lost, its expansion by Unilever potentially generates more *good* than had been possible prior to the acquisition.²¹³

What are the lessons we can draw from this case for Hong Kong? Suspension of the social mission is nothing bad and may come naturally as social ventures further establish their market presence. An acquisition of a *make money and do good* business might lead to a compromise between *making money* and *doing good*, naturally favoring the money approach, but in turn may also support the expansion of the ability for *doing good*. Unless the Hong Kong government offers any special privileges to social ventures, the government's concern should not go beyond mere wishes that these socially contributing enterprises may be able to preserve their mission in the best possible way. But, in the current situation, where social ventures are discouraged rather than encouraged from a legal point of view, there is nothing to worry about if *doing good* is suspended. Ending the mission is their private matter.

However, if, as under our proposal, the legislator introduced a more encouraging system for social ventures which allowed a decoupling of privileges,²¹⁴ the situation would be different. In that case, social ventures enjoy special privileges and could no longer be seen as purely proprietary to their founders, as even though the public does not own any shares in the social ventures, it holds some kind of stake in them.²¹⁵ This stake, let's call it reliance-stake, has the same

²¹⁰ See *id.* at 236 (stating that many states passed constituency statutes that required directors to consider the interests of non-shareholder stakeholders regardless of the benefit to shareholders); see also Plerhoples, *supra* note 22, at 238 (discussing Vermont's constituency statute that preempted the acquisition and application of shareholder wealth maximization norms because of the potential loss of business and jobs in Vermont).

²¹¹ See *id.* at 243 (suggesting that Ben & Jerry's sale failed to ensure that the social mission would survive).

²¹² See *id.* at 244-48 (referring to Ben & Jerry's continued involvement in progressive initiatives, such as voter registration and reduction of its carbon footprint contrasted to the abandonment of corporate donations to charities).

²¹³ *Id.* at 250 (referring to the "pro-social equilibrium in the ice cream market that generates greater social value . . . than the status quo.").

²¹⁴ See *supra*, section 3.4.

²¹⁵ Admittedly, in very general terms which cannot be further specified here.

value as that from which the social venture has benefitted in the form of tax reductions from the government.²¹⁶ Thereby, it is not the absolute reliance-stake, but the relative reliance-stake which the social venture enjoyed in proportion to its overall revenue. In other words, assets accumulated as a result of privileges should not be paid out to owners when the social venture is being wound up or relinquishes its mission.

Problematically, however, in the bipolar world of entities where for-profit entities are proprietary and not-for-profit entities are not, partly-proprietary vehicles do not exist.²¹⁷ With the preferences of social ventures of choosing a for-profit entity as their vehicle, all remaining assets, if any, would naturally fall back to the shareholders after the business organization was liquidated. This is further problematic in the case of hybrid companies, where the for-profit entity is connected with the not-for-profit company in such a way that it could grab its assets back in case the not-for-profit company is being liquidated. The business organization could then pursue its social mission as a new not-for-profit company without being liable for the reliance-interest. In this context, mission driven for-profit projects like google.org²¹⁸ have been scrutinized for being advertised as charitable even though its parent company Google, Inc. could merge its asset back at any moment.²¹⁹ Nevertheless, again, as long as google.org does not enjoy any privileges, there is no point in resenting at such plausibility.

In contrast, traditional charities in principle are subjected to special regimes precluding stakeholders, managers, or directors from appropriating outstanding assets. In common law jurisdictions, this instance is generally governed by the *cy-près* doctrine which in Hong Kong, unlike many countries elsewhere, has not yet been converted into statutory regulation.²²⁰ Originally developed for charitable trusts, the *cy-près* doctrine sets forth that if the trust can no longer carry out the purposes for which it initially was established, the court can order that the property of the trust be used for a purpose nearest to the intention of the donor.²²¹ This doctrine has been applied in the way that entities approved under Section 88 need to mandate the distribution of

²¹⁶ See *supra*, section 3.6.

²¹⁷ See *Corporate Creativity*, *supra* note 14, at 67.

²¹⁸ See *About*, GOOGLE.ORG, <http://www.google.org/about.html> (last visited Apr. 3, 2013).

²¹⁹ See *Law & Choice*, *supra* note 14, at 361. See also Malani & Posner, *supra* note 17, at 2019-22.

²²⁰ See CHARITIES SUBCOMM., *supra* note 12, at 152, pt. 11.2 & 156, 11.15.

²²¹ See *id.* at 152, pt. 11.3.

remaining assets to other Section 88 organizations in case of liquidation.²²²

The Law Commission also considered this topic and proposed that the *cy-près* doctrine shall trigger if (i) property transferred for a specific charitable purpose has failed, and the donors are either unknown or have waived their rights to have the property returned; (ii) property is transferred for a specific charitable purpose in response to a solicitation stipulating that in the event of the solicited purposes failing, *cy-près* doctrine would apply as if the property were transferred for general charitable rather than specific purposes; or (iii) a charitable body has dissolved.²²³

If the *cy-près* doctrine or similar statutory solutions were to be applicable to social ventures, one important issue would need to be resolved. In what proportion the remaining assets have to be apportioned, what portion should be subjected to the *cy-près* regime, and what could be paid back to the shareholders? Put otherwise, it would need to be resolved how this doctrine can be applied partially. In the case of British law, for instance, it has been decided that upon dissolution of such vehicles, investors would only be entitled to get back their original capital contributions²²⁴ which Katz and Page compared to holding preferred stock.²²⁵ That is a practical and easy solution, but not sufficiently flexible to cover the whole spectrum of social ventures, because it would again discourage investors who seek investment opportunities with decent reasonable return.

Instead, we propose that in the case of the suspension of *doing good*, the assets should first be divided with regards to the reliance-interest as proposed above, and then the *cy-près* regime would only be applied to the proportion qualified as reliance-interest stake. This would apply in both cases of a liquidation following a simple suspension of the social mission as well as a liquidation following an insolvency proceeding. In the first case, upon suspension of the business or loss of official social ventures status, the social venture would be obliged to transfer the reliance-interest stake to other recognized charitable organizations in Hong Kong. The business organization could then pursue the new money-driven mission vested in the old entity. In the second case, the reliance-stake would probably be awarded the

²²² INLAND REVENUE DEPARTMENT, TAX INFORMATION: CHARITABLE DONATIONS AND TAX-EXEMPT CHARITIES: A TAX GUIDE FOR CHARITABLE INSTITUTIONS AND TRUSTS OF A PUBLIC CHARACTER, pt. 9.

²²³ CHARITIES SUBCOMM., *supra* note 12, at 165, Recommendation 17.

²²⁴ As it is the case with the Community Interest Company. *See* The Community Interest Company Regulations, 2005, S.I. 1788, art. 6, 23 (U.K.).

²²⁵ Katz & Page, *supra* note 29, at 1371; *see also* Dana Brakman Reiser, *Charity Law's Essentials*, 86 NOTRE DAME L. REV. 1, 37 (2011).

same creditor treatment as the shareholders and no distinction is suggested to be made between them. If necessary, both stakes would be proportionately reduced. Reliance-stake, if any, would be transferred to the other charitable organization, and the stake of the equity holder, if any, would return to them.

CONCLUSION

Social ventures live a mystical existence in Hong Kong. Nonetheless, we attempted to bring some clarity to this phenomenon which has been until now a fully ignored subject of law. We gave an overview on the social venture sector in Hong Kong and examined that it is full of ambition and filled with potential once the legal problems are solved. These problems are complex and numerous and we tried to treat them in three chapters.

In the first chapter, we identified three basic problems as to social ventures in Hong Kong: the lack of a correct definition of *making money*, the confusion around the charitable objects, and the meaning of *doing good*, on which social ventures can pursue their mission. Based on this, we put forward a typology of social ventures comprising four features: the source of income, the concept of donation, the distribution of profits, and the creation of *good*. Further, we identified imperfect social ventures, where these four features are not equally present and argued that the presence of three features is sometimes sufficient to constitute a social venture.

Then, we looked into the second major problem which social ventures operating in Hong Kong experience and under which we examined the phenomenon of coupled privileges. We found that the current system of profits tax and deductions which are coupled with the legal status of an entity does not take social ventures into consideration and argued that every business organization should, in principle, pay profits tax but, in turn, deduct gratuitous transfers and charitable premiums. As a result, profits tax would only be paid if profits of a social venture are distributed to the investors and not reinvested in their social mission. Following this perception, we elaborated a system under which social ventures can be registered and taxation privileges efficiently assigned by a one-stop supervisory body.

In the last chapter, where we looked at the instance of social ventures abandoning their mission of *doing good*, we developed a system under which business organizations can easily adopt or abandon a social mission based on a partial application of the *cy-près* doctrine. This, as we argued, is essential, when social ventures want to enjoy governmental privileges and specifically be able to make tax deductions as put forward in our proposal.