COMPARISON OF LEGAL STRUCTURES FOR SOCIAL ENTERPRISES[1]

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1. Comparison of HK, UK and Singapore legal structures

Among all available legal structures, company limited by shares ("**CLS**"), company limited by guarantee ("**CLG**") and charitable trust are the three most popular forms used by social enterprises in Hong Kong ("**HK**"), the United Kingdom ("**UK**") and Singapore. Corporate laws in HK and Singapore have, in general, been modelled after English law. Therefore, the basic legal structures in these three jurisdictions share many similarities.

In 2005, the UK has introduced the concept of community interest company ("**CIC**"), a new type of company designed for social enterprises. While a CIC must be a limited company whether by share or by guarantee (i.e. either established as a CLS or CLG), it has a number of unique characteristics setting it apart from traditional CLSs or CLGs. We will discuss this special type of limited company in Part 3 in detail.

The chart below summarizes the common and distinctive features among CLS, CLG and charitable trust in HK, Singapore and the UK.

Note: "Charity" is a status rather than a specific legal form. The requirements for "charity" status will vary by jurisdiction and this will have an impact on the specific characteristics set out below. For example, entities who wish to acquire a "charity" status will need to include certain essential clauses in its governing instruments. Charitable entities are also subject to additional financial reporting requirements under relevant charity laws. For example, local tax authorities, such as the Hong Kong Inland Revenue Department will, from time to time, call for accounts, annual reports or other documents to review whether the institution's objects are still charitable and its activities are compatible with its objects. For charitable entities, all residual assets on dissolution shall be applied for charitable purposes. Specific local rules will also apply. For example, on the winding up of a HK charitable company or charitable trust, assets must be distributed to charities, beneficiaries or charities of a similar nature.

Table 1 – Comparison of CLS, CLG and Charitable Trust in HK, UK and Singapore

Characteristic	Private Company Limited by Shares	Company Limited by Guarantee	Charitable Trust
Specific Purpose Statement <u>Business consideration:</u> • Social mission preservation • Flexibility in business operation • Branding concerns (i.e. for certain social missions, the public may be more receptive if they are achieved	Not required in general.	Not required in general. A CLG which is a charity must have exclusively charitable objects. Local laws will apply as to what amounts to "exclusively charitable objects".	Required. A charity must have *exclusively* charitable objects. In Singapore, the benefit of a charitable trust should *be wholly or substantially* to the community in

Characteristic	Private Company Limited by Shares	Company Limited by Guarantee	Charitable Trust
through non-profit than for-profit)			Singapore.
Independent Legal Status <u>Business consideration:</u> • Capacity to own assets and assume liability	Yes.	Yes.	No. The trustees of a charitable trust hold the legal title to property personally on trust for the charitable purposes of the trust.
Limited Liability for Founders, Owners, etc.	Yes, limited to the amount of its share capital.	Yes, limited to the guaranteed amount of its members	No, trustees are personally, jointly and severally, liable for debts and other liabilities of the trust.
Access to Funding:			
(I) Government Grants	Eligible. **<u>HK Distinction</u>**: CLSs that meet certain criteria are eligible for government grants and loans through various government programmes, e.g. the "Enhancing Self-Reliance Through District Partnership Programme which is run by the Home Affairs Bureau and "Enhancing Employment of People with Disbelieves through Small Enterprise Project" which is run by the Social Welfare Department, etc. **<u>Singapore Distinction</u>**: CLSs that	Eligible. **<u>HK Distinction</u>**: CLGs that meet certain criteria are eligible for government grants and loans through various government programmes, e.g. the "Enhancing Self-Reliance Through District Partnership Programme which is run by the Home Affairs Bureau and "Enhancing Employment of People with Disbelieves through Small Enterprise Project" which is run by the Social Welfare Department, etc. **<u>Singapore Distinction</u>**: CLGs that	Eligible. **<u>Singapore Distinction:</u>** All exempt and registered charities and IPCs are eligible to apply for funding through the Singapore government's VWOs-Charities Capability Fund[2], which aims to enhance governance and management capabilities of charities.

[2] Note: The funding period is from 1 April 2012 to 31 March 2017.

Characteristic	Private Company Limited by Shares	Company Limited by Guarantee	Charitable Trust
	meet certain criteria are eligible for general government grants and loans for enterprises. Companies can apply through SPRING Singapore, an agency under the Singapore Ministry of Trade and Industry.	meet certain criteria are eligible for general government grants and loans for enterprises. Companies can apply through SPRING Singapore, an agency under the Singapore Ministry of Trade and Industry.	
(II) Equity Finance	Eligible.	Not eligible, due to lack of share structure.	Not eligible, due to lack of share structure.
(III) Debt Finance	Eligible, preferred by lenders due to independent legal status.	Eligible, preferred by lenders due to independent legal status.	Eligible, but not preferred due to lack of independent legal status.
(IV) Public Donations	Eligible, if local requirements for registration and solicitation of public donations in each jurisdiction are met. In Singapore, for example, additional requirements include application for fund-raising permits or licences.	Eligible, if local requirements for registration and solicitation of public donations in each jurisdiction are met. In Singapore, for example, additional requirements include application for fund-raising permits or licences.	Eligible, if local requirements for registration and solicitation of public donation in each jurisdiction are met. In Singapore, for example, additional requirements include application for fund-raising permits or licences.
Asset-Locking Requirements The asset-lock provisions are aimed at protecting / preserving a social enterprise's assets (including its profits) for specific purposes.	None unless specified in the constitutional documents or unless applying for charitable status generally.	None unless specified in the constitutional documents or unless applying for charitable status generally. Profits must be used for charitable purposes for charities.	Yes, profits must be used for the purposes of the charitable trust. For example, in HK, profits must be used for charitable purposes and should not be expended substantially outside HK.
Management Flexibility	Directors have general fiduciary	Directors have general fiduciary	Trustees of charitable trusts have a

Characteristic	Private Company Limited by Shares	Company Limited by Guarantee	Charitable Trust
Business consideration: • Prioritize social missions over financial goals when in conflict	duties to act in good faith and best interests of the CLS. In addition, local legislation such as the UK Companies Act, the Hong Kong Companies Ordinance and the Singapore Companies Act also set out certain "statutory" director duties, such as a duty of care and diligence.	duties to act in good faith and best interests of the CLG. In addition, local legislation such as the UK Companies Act, the Hong Kong Companies Ordinance and the Singapore Companies Act also set out certain "statutory" director duties, such as a duty of care and diligence.	general fiduciary duty towards the beneficiaries of the trust. In general, there are four key fiduciary duties under English, HK and Singapore law: (i) a fiduciary must not place himself in a position where his/her own interests conflict with those of the beneficiary; (ii) a fiduciary must not profit from his position at the expense of a beneficiary; (iii) a fiduciary owes undivided loyalty to his beneficiary; and (iv) a fiduciary must use or disclose information obtained in confidence from a beneficiary for the benefit only of the beneficiary.
Stakeholder Involvement Business consideration: • Flexibility in providing rights to stakeholders in a company's constitution (e.g. the right to attend and vote at annual meetings and to elect management committee) • Flexibility in appointing stakeholders onto advisory groups whose advice assists but does not bind the management's decision.	Not compulsory but it is possible to provide for stakeholder involvement in the constitution of UK, HK and Singapore CLS. In general, directors must act in the way they consider, in good faith, would be most likely to promote the success of the company, for the benefit of its shareholders/members as a while. In doing so, the directors must have regard, among other matters to interests of other "stakeholders", in addition to the	Not compulsory but it is possible to provide for stakeholder involvement in the constitution of UK, HK and Singapore CLG. In general, directors must act in the way they consider, in good faith, would be most likely to promote the success of the company, for the benefit of its shareholders/members as a while. In doing so, the directors must have regard, among other matters to interests of other "stakeholders", in addition to the shareholders/members, such as the	Not compulsory but it is possible to provide for stakeholder involvement in the constitution of UK, HK and Singapore CTs. In general, directors must act in the way they consider, in good faith, would be most likely to promote the success of the company, for the benefit of its shareholders/members as a while. In doing so, the directors must have regard, among other matters to interests of other "stakeholders", in addition to the shareholders/members, such as the

Characteristic	Private Company Limited by Shares	Company Limited by Guarantee	Charitable Trust
	shareholders/members, such as the company's employees as well as the impact of the company's operations on the environment, the community, customers, suppliers etc. Note, however, that the legal enforceability and enforceability of the wider "stakeholder interest" provisions is still unclear and uncertain.	company's employees as well as the impact of the company's operations on the environment, the community, customers, suppliers etc. Note, however, that the legal enforceability and enforceability of the wider "stakeholder interest" provisions is still unclear and uncertain.	company's employees as well as the impact of the company's operations on the environment, the community, customers, suppliers etc. Note, however, that the legal enforceability and enforceability of the wider "stakeholder interest" provisions is still unclear and uncertain.
Voting Structure (for private CLS) and other decision –making mechanisms Business consideration: mitigating the influence of investors in creating mission drifts • Flexibility in creating non-voting shares for passive equity investors • Flexibility in retaining the right of social entrepreneurs to select a set number of board members	A CLS may have various classes of shares, e.g. voting and non-voting shares.	Although there are no shares in a CLG, it is possible to include decision making mechanisms amongst members of the CLG in a CLG's constitutional/governing documents.	Decision-making mechanisms can be built into the trust instrument.
Altering the Articles of Association or Constitutional Documents Business consideration: Preserving the rights to amend key provisions (such as social mission clause) to a supermajority of shareholders/members.	Alteration of articles of association of a CLS must be approved by a special majority of shareholders by way of special resolution (at least 75% approval).	Alteration of articles of association of a CLG must be approved by a special majority of shareholders by way of special resolution (at least 75% approval).	Arrangements for the alteration of the trust instrument will be set out in the trust instrument.
Self-Disclosure and Other Major	Statutory reporting requirements	Statutory reporting requirements	A trust with a charitable status is

Characteristic	Private Company Limited by Shares	Company Limited by Guarantee	Charitable Trust
Compliance Requirements	such as filing of annual returns and financial accounts.	such as filing of annual returns and financial accounts.	subject to financial reporting and other disclosure requirements under relevant charity laws.
Asset Transferability Upon Conversion, Winding-up or Dissolution Business consideration: restrictions in transferring out assets (including privacy data) obtained when operating as a non-profit.	Any asset not subject to distribution to creditors and in accordance with local insolvency laws will be distributed amongst shareholders, in accordance with the constitutional/governing documents.	Any asset not subject to distribution to creditors and in accordance with local insolvency laws will be distributed amongst shareholders, in accordance with the constitutional/governing documents.	All residual assets on dissolution shall be applied for charitable purposes.
Tax Benefits	No tax benefits for non-charities in general. Charitable organizations enjoy tax exemptions in various jurisdictions as set out below: **HK Distinction:** A charity is generally exempt from profits tax and business registration fees, and can receive donations or investments free of tax. Donors can make gifts free of stamp duty and receive tax exemptions for cash gifts. **Singapore Distinction:** A registered charity is an organization set up for charitable purposes and registered with the Commissioner of Charities under the Singapore Charities Act (Chapter 37 of Singapore). Registered charities enjoy automatic income tax exemption under the Singapore Income Tax Act and do not need to file income tax returns. An "Institution of Public Character" ("IPC") is an organization approved by the Commissioner of Charities to receive tax deductible donations. This means that donors are given tax deduction for donations made to these organizations. Note that charities are required to register for goods and services tax in Singapore if their annual taxable supplies exceed S$1 million even if they are engaged mostly in non-business activities. For further details and updated information, please visit the website of the Inland Revenue Authority of		

Characteristic	Private Company Limited by Shares	Company Limited by Guarantee	Charitable Trust
	Singapore: https://www.iras.gov.sg/irashome/Other-Taxes/Charities/Charities/IPCs-and-Taxes/. **UK Distinction:** A charity benefits from corporation tax relief on profits, capital gains tax and stamp duty land tax. A charity can also obtain rate relief at a mandatory 80% from unified business rates plus potentially a further 20% at the local authority's discretion where they wholly or mainly occupies property for charitable purposes.		

2. Principal Legal Forms in US

While the structure of the company law in the United States ("**US**") differs in many ways, its principal legal forms share many similar features with their counterparts in HK, the UK and Singapore.

The chart below provides a high-level summary of the comparable characteristics of two commonly-seen legal structures, namely corporation and limited liability company.

Note 1: In Part 3, we will briefly discuss a new genre of corporation specifically designed for social enterprises in US – benefit corporations. Benefit corporations differ from traditional C corporations in purpose, accountability, and transparency, but generally not in taxation. Under US federal income tax law, a C corporation refers to a corporation that is taxed separately from its shareholders. Unless otherwise specified, the summary below applies to C corporations organized in the United States only. Similarly, there have been some legislative efforts in developing tailor-made limited liability company statutes for social enterprise, e.g. low-profit limited liability company legislation in a number of US states. We limit our discussion below to traditional limited liability companies organized in the United States only.

Note 2: An organization described under Section 501(c)(3) of the US Internal Revenue Code generally is not subject to US federal income tax. Similar to the "Charity" concept in HK, the UK and Singapore, recognition as an organization described under Section 501(c)(3) is a tax status, rather than a specific legal form. A social enterprise may find it advantageous to be recognized by the IRS as described under Section 501(c)(3). For example, donors may be able to receive a tax deduction for a donation made to such an organization that is organized in the United States. Although certain tax advantages exist for an entity that is recognized as described under Section 501(c)(3), there are specific requirements and significant restrictions on the organization and operation of such an entity. A social enterprise may find it unfeasible to satisfy these requirements and restrictions. Some social enterprises have sought to create a "hybrid structure" that provides certain benefits of both a tax–exempt organization and a for-profit organization. A discussion of such hybrid structures is beyond the scope of this summary. You are encouraged to consult your own legal advisor regarding the US federal income tax considerations related to recognition as an organization described under Section 501(c)(3) and the potential creation of a "hybrid structure."

Table 2 – Summary of Principal Legal Forms

Characteristic	Corporation[3]	Limited Liability Company[4]
Specific Purpose Statement Business consideration: • Social mission preservation • Flexibility in business operation • Branding concerns (i.e. for certain social missions, the public may be more receptive if they are achieved through non-profit than for-profit)	Not required in traditional corporations. Most benefit corporation statutes require the company to declare a general benefit purpose and, in some case, a specific benefit purpose.	Not required in traditional LLCs.
Independent Legal Status Business consideration: • Capacity to own assets and assume liability	Yes.	Yes.
Limited Liability for Founders, Owners, etc.	Yes, shareholder's liability is generally limited to the amount of capital contributed.	Yes, member's liability is generally limited to the amount of capital contributed.
Access to Funding: • Equity contribution • Debt financing • Government grant • Public donation	A corporation can raise fund through equity (such as capital stock) or debt instruments. Certain small business, particularly those in high tech/R&D fields, may qualify for government small business grants.	An LLC can raise fund through equity (such as membership interests) or debt instruments. Certain small business, particularly those in high tech/R&D fields, may qualify for government small business grants.
Asset-Locking Requirements The asset-lock provisions are aimed at protecting / preserving a social enterprise's assets (including its profits) for specific purposes.	None unless specified in the constitutional documents or unless applying for charitable status generally.	None unless specified in the constitutional documents or unless applying for charitable status generally.
Management Flexibility Business consideration:	Corporate law imposes fiduciary duties on directors. In the context of traditional	An LLC has the flexibility to define management powers and responsibilities in its

[3] Every state and territory has its own basic corporate code in the United States. In most cases, a state corporate code either follows the Delaware General Corporation Law or the Model Business Corporate Act, which is prepared by the Committee on Corporate Laws of the Section of Business Law of the American Bar Association.

[4] Uniform LLC Act was approved by the ABA in 1996, which has yet to be adopted in many states in the U.S.

• Prioritize social missions over financial goals when in conflict • Directors/employee compensation	corporations, it is widely accepted that the directors have an obligation to act in the best interest of shareholders, including maximizing their financial gains. Some states have passed “constituency” statutes, which permit directors and officers to consider non-financial interests when making decisions. By contrast, benefit corporations expand the fiduciary duty of directors to require them to consider non-financial stakeholders as well as the financial interests of shareholders. This gives directors and officers some legal protection to pursue interests for other stakeholders.	operation agreement. In Delaware, for example, an LLC may modify or eliminate the traditional fiduciary duties contractually in its operating agreement.
Self-Disclosure and Other Major Compliance Requirements	A corporation, private or public, is generally required to file its financial documents with the secretary of state in the state where it is incorporated. Securities laws impose additional business, financial and other public disclosure obligations on public companies. Most benefit corporation statutes require disclosure of social benefit performance in form of an annual or biannual benefit report.	In general, an LLC allows more privacy compared to a corporation. For example, in the State of Delaware, the Secretary of State requires very little information in order to file an LLC. Securities law may require specific disclosure in connection with a securities offering.
US Federal Income Tax Treatment	For US federal income tax purposes, a corporation generally can be either a C Corporation or an S Corporation. A C Corporation is a corporation that generally is subject to US federal income tax on its net income. Shareholders of a C Corporation generally are also subject to US federal income tax when the C corporation makes a distribution to such shareholders.	For US federal income tax purposes, an entity that is an LLC under state law may be treated as a disregarded entity, a partnership or a corporation under certain “check-the-box” entity classification regulations. An LLC with two or more owners will be classified as a partnership unless it elects to be classified as a C corporation. An eligible entity with one owner will be disregarded unless it elects to be

	An S corporation is a corporation that elects to pass corporate income, losses, deductions, and credits through to its shareholders for US federal income tax purposes. Shareholders of an S corporation report the flow-through of income and losses on their personal US federal income tax returns and are assessed U.S. federal income tax at their individual income tax rates. This allows an S corporation to avoid double taxation on the corporate income. An S corporation is responsible for US federal income tax on certain built-in gains and passive income at the entity level. To qualify for S corporation status, the corporation must meet specific requirements, including not having (i) more than 100 shareholders; (ii) shareholders other than individuals, estates, certain trusts and certain tax-exempt organizations; (iii) shareholders that are non-residents of the United States; and (iv) more than one class of stock.	classified as a C Corporation. A partnership must file an annual information return to report the income, deductions, gains, losses, etc., from its operations, but it does not pay US federal income tax. Instead, it "passes through" any profits or losses to its partners. Each partner includes his or her share of the partnership's income or loss on his or her tax return. A disregarded entity is an entity disregarded as separate from its owner for US federal income tax purposes, and the disregarded entity's activities should be reflected on its owner's US federal income tax return.

3. Legal Innovations in US and UK

3.1 UK – Community Interest Company

Compared to a traditional limited company by shares, a Community Interest Company ("CIC") under UK law has the following key added features:

(a) Disclosure: In addition to the company accounts, a CIC must prepare an annual company interest report, which shows that the CIC satisfies the community interest test.

(b) Asset lock: A CIC cannot transfer its assets (including any profits or other surpluses generated by its activities) for less than market value unless transferring them to another CIC or charity or if the transfer is for the benefit of the community it was set up.

(c) Distribution restrictions: The maximum aggregate dividend cap should be retained at 35% of distributable reserves; and the maximum interest rate for performance related interest should be 20% (the underlying debt being regarded as similar to equity).

The principal legislative intent behind these requirements and restrictions was to make sure that a CIC is genuinely a social enterprise and is not abusing public trust. In absence of a similar legislation in HK, a social enterprise formed as a limited company by shares in HK is largely self-regulated in terms of the adherence to its social mission and therefore may adopt these features as it deems appropriate for its business operation and corporate governance.

3.2 US – Benefit Corporation

The structure of a benefit corporation is generally modelled after the traditional C corporation, but with additional features aiming to facilitate the long-term social mission alignment. As of January 12, 2017, 30 US states and the District of Columbia have enacted a benefit corporation statute. Certain states named the benefit corporation differently, e.g. Public Benefit Corporation in Delaware and Social Purpose Corporation in California.

Similar to UK's disclosure requirement, most benefit corporation statutes require a social enterprise to disclose its social benefit performance in form of an annual or biannual benefit report.

However, unlike UK's CIC model which focuses on curbing private profit motive, the US benefit corporation model follows a different school of thought. It emphasizes the importance of transparency and accountability by introducing, among other things, a third-party assessment standard and an enforcement proceeding for failure to create general or specific public benefit to improve the transparency and accountability.

<u>End Notes</u>