OFFICE OF THE MINISTER OF FINANCE
OFFICE OF THE MINISTER OF REVENUE

The Chair
Cabinet Economic Development Committee

TAX INCENTIVES FOR GIVING TO CHARITIES AND OTHER NON-PROFIT ORGANISATIONS

PROPOSAL

1. This paper seeks the Committee's approval to include several tax proposals resulting from the discussion document *Tax incentives for giving to charities and other non-profit organisations* in the tax bill scheduled for introduction in May 2007. These proposals would remove limitations on the current tax incentives for charitable donations made by individuals, companies and Maori authorities and should facilitate greater giving to charities and other non-profit organisations. Legislative amendments to the Income Tax Act 2004 would be required to give effect to the proposals and it is proposed that the amendments apply to charitable donations made in the 2008-09 income year and subsequent income years.

2. This paper also seeks the Committee's approval of a proposed process and timeframe for further consideration of other matters that were raised in the discussion document.

EXECUTIVE SUMMARY

3. In October 2006 the Government released the discussion document *Tax incentives for giving to charities and other non-profit organisations.* The discussion document canvassed options for improving the current tax incentives for charitable donations. It included the consideration of enhancements to the current tax relief mechanisms for charitable donations, the charitable tax incentives used in other countries, and other ways of promoting philanthropy and charitable giving such as public awareness campaigns, donor leadership and donor education.

4. Feedback from consultation confirmed that the discussion document was seen as a genuine commitment by the Government to develop and support the charitable, community and voluntary sector in New Zealand. The proposals received overwhelming support from a wide range of individuals and organisations. It was generally agreed that although tax incentives do not provide the whole answer in encouraging generosity, a tax system that is supportive of philanthropy would be beneficial.

5. Those consulted also considered that enhanced incentives are justified by the contribution that charities and other non-profit organisations make to New Zealand society. They felt that as donations are an important part of this contribution, donations should be recognised and rewarded, and therefore encouraged by appropriate tax incentives. The Government was strongly encouraged to seize the opportunity to introduce bold initiatives that will encourage greater philanthropy and giving to charities and other non-profit organisations.

6. We propose removing the limitations on the current tax incentives for charitable donations made by individuals, companies and Maori authorities. The proposals include:

- removing the rebate threshold limit for charitable donations made by individuals (the current limit is $1,890);
- removing the deduction limit for charitable donations made by companies and Maori authorities (the current limit is 5 percent of the net income of the company or Maori authority); and
- extending the company deduction for charitable donations to close companies (companies with five or fewer shareholders) not listed on a recognised stock exchange. Unlisted close companies are currently not eligible for the company deduction for charitable donations.

7. The proposals would send a clear signal that the Government is committed to creating an environment that facilitates greater giving to charities and other non-profit organisations. They also represent a radical departure from the existing policy approach of making incremental increases to the existing tax relief for charitable donations, while maintaining a cap on eligible donations and limits on overall eligibility. The proposals would be included in the tax bill scheduled for introduction in May 2007 and would apply to charitable donations made from the 2008/09 income year.

8. The revenue cost of removing the individuals' rebate threshold limit is estimated to be $15 million in 2008/09 and $25 million per annum in subsequent years. It should be noted that due to the under-reporting of donations made by individuals and the fact that behavioural changes have not been accounted for, this revenue cost is likely to be underestimated.

9. Our analysis of the current level of corporate and Maori authority giving indicates that companies and Maori authorities are giving well below the current deduction limits applying to charitable donations. Maori authorities are giving on average 3 percent of their net income, while companies seem to be giving less. This suggests that the current deduction limit of 5 percent of net income does not appear to constrain giving. It also implies that removing the deduction limits is not likely to result in significant revenue costs, assuming there are no behavioural changes. The revenue cost of removing the deduction limits could potentially be significant if companies and Maori authorities were to increase their giving substantially, but as

we consider this to be unlikely, removing the deduction limit for companies and Maori authorities should have no impact on the Government's operating balance.

10. It is proposed that other matters raised in the discussion document be dealt with as follows:

- further policy work and consultation should be undertaken on the options for streamlining the tax treatment of reimbursements to volunteers and honoraria recipients. Any legislative amendments arising from this work would be timed for inclusion in the tax bill scheduled for introduction in November 2007;
- a discussion document on the design and implementation of a pre-tax payroll charitable giving scheme should be issued in November 2007;
- no further work should be undertaken on the volunteers' rebate or the alternative of a grant for voluntary organisations based on volunteers' time;
- further policy work and consultation should be undertaken on the options relating to the gift aid scheme, the deductibility of non-monetary donations, Australia's prescribed private funds regime, and the other suggested tax mechanisms for delivering tax relief on charitable donations. The results of this work would be reported to the Minister of Finance and the Minister of Revenue in March 2008; and
- the non-tax measures raised in feedback on the discussion document relating to promoting charitable giving and volunteerism in New Zealand should be referred to the Minister for the Community and Voluntary Sector for consideration and action.

THE DISCUSSION DOCUMENT

11. The Government's October 2006 discussion document *Tax incentives for giving to charities and other non-profit organisations* put forward a number of options for encouraging the giving of money and time to charities and other non-profit organisations and for making it easier to give to these organisations. These options included:

- enhancements to the current tax incentives for donations made by individuals, companies and Maori authorities;
- a rebate or grant that recognises the time and skills provided by volunteers to charities and other non-profit organisations;
- streamlining the tax obligations of volunteers in receipt of reimbursement payments and honoraria recipients; and
- tax incentives offered by other countries, such as a gift aid scheme, payroll giving, deductibility of non-monetary donations, and a specialised charitable trust regime.

12. The discussion document also sought people's views on what further initiatives can be employed to encourage increased generosity and to support any tax measures that may arise out of this discussion document.

Consultation and submissions process

13. To support the discussion document, a series of consultation workshops were held in five centres: Auckland, Hamilton, Wellington, Christchurch and Dunedin. A total of 300 people attended these workshops.

14. A total of 229 written submissions were received on the discussion document. A wide range of people and organisations made submissions, including individual donors, charities and other non-profit organisations, sector advisors, tax specialists crown entities, and overseas organisations involved in the charitable community.

15. Feedback from submissions strongly supported most of the options that were put forward in the discussion document. Feedback strongly encouraged the Government to substantially increase the tax relief available for charitable donations, introduce bold initiatives that would make it easier for people to give, and also facilitate greater giving. While it was generally agreed that tax incentives do not provide the whole answer in encouraging generosity, a tax system that is supportive of philanthropy was perceived to be beneficial.

16. A summary document of the feedback from the consultation has been prepared. It will be posted on Inland Revenue's website at the same time as the proposed legislative amendments in this paper are announced.

TAX PROPOSALS FOR CHARITABLE GIVING

Individuals' rebate

17. At present, individuals can claim a tax rebate at a set 33 1/3 cents in the dollar up to a maximum of $1,890 for cash donations made to donee organisations.[1] The maximum rebate is therefore $630. The rebate is not available for donations which exceed the maximum amount. In addition, the sum of the donations for which the rebate is claimed cannot exceed the taxable income of the individual in the year in which the rebate is claimed.

18. The discussion document considered raising the rebate threshold limit, increasing the rate, and a combination of both. The discussion document also canvassed the idea of replacing the rebate mechanism with a deduction mechanism.[2]

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[1] A donee organisation is an entity or trust whose activities are not carried out for the private pecuniary profit of any individual and whose funds are applied principally for charitable, benevolent, philanthropic or cultural purposes in New Zealand. Some of the major donee organisations include churches and social service organisations.

[2] A deduction mechanism would allow donations to be deducted from a donor's taxable income before the imposition of tax, thereby reducing the ultimate tax liability of the donor.

19. Feedback from consultation strongly supported retaining the current rebate because it was viewed as a fair and simple mechanism for delivering tax relief on charitable donations. Removing the rebate threshold limit was perceived to provide a strong incentive for people to give more, especially wealthy donors. It was also noted that removing the rebate threshold limit would align the New Zealand tax treatment of charitable donations for individuals with that of other OECD jurisdictions such as Ireland, Australia and the United Kingdom, equate the individuals' tax treatment of charitable donations with that available to trusts, and support the implementation of a pre-tax payroll giving scheme.

20. We agree with the consultation feedback and propose that the existing individuals' rebate be retained and the rebate threshold limit of $1,890 be removed. Under the proposals, individuals would be entitled to a tax rebate at the rate of 33/13 percent on all the charitable donations they make. The amount of donations for which the rebate can be claimed would be limited by the amount of a donor's taxable income.

21. Removing the rebate threshold limit would increase the tax benefit for people who donate more than $1,890 a year, without them having to change their giving behaviour. In 2005, at least 20 percent of people who claimed the rebate made donations of $1,890 or more and claimed the maximum rebate of $630.

22. We do not propose to change the rebate rate at this time. The rebate rate would be considered again as part of the review of a pre-tax payroll giving scheme.

Company deduction for charitable donations

23. Companies are entitled to a deduction for charitable donations made to donee organisations. Currently, the deduction cannot exceed 5 percent of the company's net income. The deduction is not available to close companies not listed on a recognised stock exchange.

24. The discussion document considered increasing the company deduction limit and extending the company deduction to close companies not listed on a recognised stock exchange.

25. Feedback from consultation on the company deduction options strongly supported the removal of the 5 percent limit on corporate donations. It was considered that this measure would remove a significant barrier to corporate giving and align the tax treatment of sponsorship payments with donations made to charities and other non-profit organisations. The cost to these organisations is greater in a sponsorship funding arrangement than with philanthropic giving, both in terms of time and resources. As sponsors often require brand loyalty and significant promotional opportunities, sponsorship tends to benefit larger charities.

26. We agree with the consultation feedback and propose removing the current 5 percent limit on the deduction for company donations.

27. Feedback from consultation also supported extending the company deduction to close companies not listed on a recognised stock exchange. Unlisted close companies were seen as a potentially significant source of financial support for charities and other non-profit organisations, as the majority of New Zealand companies are close companies.

28. We note that extending the company deduction to unlisted close companies should be considered in the context of any changes to the rebate for individuals. If the rebate threshold limit is retained and the company deduction is extended to unlisted close companies, shareholders of close companies would gain a tax advantage (both as an individual and by way of their corporate form) not available to others. This is because of the close association between a close company and its shareholders. On the other hand, if the individuals' rebate threshold limit is removed, this inconsistency would not occur as the tax benefit available to all individuals would already be unlimited. Given our recommendation to remove the individuals' rebate threshold limit, we propose to extend the company deduction to close companies not listed on a recognised stock exchange.

Maori authority deduction for charitable donations

29. Maori authorities are currently entitled to a deduction for charitable donations, but the deduction cannot exceed 5 percent of the Maori authority's net income.

30. The discussion document discussed increasing the Maori authority deduction limit. For reasons of consistency, feedback from consultation supported aligning the Maori authority deduction limit with any proposed change to the company deduction limit.

31. We agree with the consultation feedback and propose to remove the 5 percent deduction limit for Maori authority charitable donations. We also note that it was an explicit decision to model the Maori authority deduction for charitable donations on the company deduction. This decision was made in 2003 when the new rules for Maori authorities, which were based on the company imputation rules, were introduced. Therefore, any change in the company deduction limit should be reflected in the Maori authority deduction limit.

OTHER MATTERS RAISED IN THE DISCUSSION DOCUMENT

32. The proposed process and timeframe for further consideration of other matters raised in the discussion document is outlined below.

Options relating to volunteers

33. Feedback from consultation supported some form of acknowledgement of the contribution that volunteers make but questioned whether a rebate based on volunteers' time was the best way of achieving this. The rebate was generally viewed as a noble idea that sends a clear message that community involvement is a valued part of New Zealand's culture. However, there were major concerns that the rebate would be so small an amount as to be inadequate or even insulting, administratively burdensome, potentially inequitable and, some felt, out of step with the spirit of volunteering.

34. Due to the number and nature of the concerns with the volunteers' rebate, we do not propose further work on either the volunteers' rebate or the alternative of a grant.

35. Streamlining the tax treatment of reimbursements to volunteers and honoraria recipients and reducing their compliance costs was the most pressing issue for the charitable, community and voluntary sector. Feedback from consultation considered this issue more important than the volunteers' rebate (and the alternative of a grant), and recommended that it be addressed as a matter of priority.

36. We propose that further policy work be undertaken to streamline the tax treatment of reimbursements to volunteers and honoraria, and that any proposed changes be timed for inclusion in the tax bill to be introduced in November 2007. This timeframe should enable sufficient time for further consultation with voluntary organisations and volunteers on the issues concerning the discussion document options for exempting from income tax reimbursements below a specified threshold and allowing the payer of an honorarium to determine what portion of the honorarium is exempt from income tax. We will report back on this matter by the end of September 2007 on any proposed legislative changes resulting from this work.

Other tax incentives for delivering tax relief on charitable donations

37. The views expressed in workshops and in submissions supported further investigation of the following tax incentives: the gift aid scheme, payroll giving, tax relief for non-monetary gifts, and a private charitable trust regime. There was also specific support for tax incentives to encourage the giving of shares, significant objects and art works to cultural institutions such as museums and art galleries, as well as further investigation of the tax incentives offered in the United States.

38. We consider that priority should be given to further policy work on a pre-tax payroll giving scheme. Of all the incentives, this scheme received the most support. The main reasons for this were the scheme's simplicity, convenience and effectiveness in promoting giving in other jurisdictions such as Australia. We propose to release a discussion document on the design and implementation of the pre-tax payroll giving scheme in November 2007. This measure would further signal the Government's commitment to supporting charitable giving to charities and other non-profit organisations.

39. We propose further policy work on the options relating to a gift aid type scheme, deductibility of non-monetary donations, Australia's prescribed private funds regime, and the other suggested tax mechanisms for delivering tax relief on charitable donations. We also propose that the results of this work be reported to the Minister of Finance and the Minister of Revenue in March 2008.

Non-tax measures for promoting charitable giving and volunteering

40. The general consensus was that the Government should take a lead role in promoting generosity and volunteerism in New Zealand, not just through the tax system but also by funding education programmes and promotional campaigns. It was noted in feedback from consultation that New Zealand is lagging well behind other Commonwealth countries in promoting a culture of giving. The countries which have been most successful in increasing generosity among their citizens have been those where there has been an active partnership between the charitable, community and voluntary sector and the Government.

41. As these non-tax measures relate to the promotion of charitable giving and volunteerism in New Zealand, they should be considered by the appropriate portfolio Ministers. One possible approach is to refer these options to the Minister for the Community and Voluntary Sector for consideration and action.

CONSULTATION

42. The Department of Internal Affairs, the Ministry for Culture and Heritage, the Ministry of Economic Development, the Ministry of Maori Development, the Office for the Community and Voluntary Sector, Sport and Recreation New Zealand (SPARC), and the Charities Commission were involved in the initial stages of the policy advice formation. However, these agencies were not consulted in the preparation of this paper due to the budget sensitive nature of the proposals.

REVENUE COST IMPLICATIONS

Removing the individuals' rebate threshold limit

43. The impact on the Government's operating balance of removing the individuals' rebate threshold limit is shown below[3]:

	$m – increase/(decrease)				
	2006/07	**2007/08**	**2008/09**	**2009/10**	**2010/11& Outyears**
Removing the individuals' rebate threshold limit	–	–	(15)	(25)	(25)

[3] The estimated fiscal cost of removing the individuals' rebate threshold limit is $25 million per annum. The estimated fiscal cost in 2008/09 is $15 million because over the past five years, an average of 63% of donation rebate claims for each year are lodged in the June quarter immediately following the end of the (March) tax year.

44. This estimate is based on donation amounts reported in the rebate claim form for the 2005 tax year. It should be noted, however, that the reported donations data might not provide an accurate picture of the individuals' total giving because the data shows a high proportion of donors having reported donations at or near the maximum donation threshold of $1,890. This suggests that some donors might actually have given more, but because of the donations limit, they only recorded in their rebate claim form the maximum donation permitted. Therefore, the estimated revenue cost for removing the individuals' rebate threshold limit is likely to be underestimated. Estimating the revenue cost is further complicated because of the requirement that an individual must have sufficient taxable income (ie cannot be in a loss position) in order to claim the individuals' rebate.

Removing the limit on the company deduction for charitable donations

45. There are difficulties in estimating the revenue cost of removing the company deduction limit. First, there is no readily available information on the amount of the deductions claimed by companies for donations, because Inland Revenue does not collect this specific information. Second, some companies use sponsorship rather than donations to support their charitable activities.[4]

46. Based on a review of the financial information of a small number of listed companies, the level of charitable donations as a percentage of net income before tax appears to be insignificant. We are also not aware of any companies giving in excess of 5 percent of their net income. Given this and what we know about Maori authority giving behaviour (as discussed below), corporate giving does not appear to be constrained by the current company deduction limit of 5 percent of net income. This suggests that even if the deduction limit was increased or removed, the revenue cost is not likely to be significant, assuming that there are no behavioural changes.

47. The fiscal cost of removing the deduction limit could potentially be significant if companies were to increase their giving substantially due to factors such as corporate image enhancement. In an extreme scenario where 10 percent of companies give 10 percent of their net income, the fiscal cost of raising the company deduction limit to 10 percent is estimated to be $40 million per annum.[5]

48. We also note that increasing the company deduction limit could change companies' behaviour by encouraging them to "convert" their sponsorship arrangements into donations. In such a case, there would not be any additional revenue cost even if donations were to increase, because sponsorship expenses are currently already deductible.

49. On the balance of all these considerations, we consider that any increase in or removal of the deduction limit is unlikely to impact on the Government's operating balance.

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[4] From a tax perspective, companies would prefer sponsorship arrangements because all sponsorship expenditure is deductible, unlike the current 5 percent limit for charitable donations.

[5] The revenue cost is calculated on the assumption that there are 10 percent of companies giving 3 percent of their net income.

Extending the company deduction to close companies

50. The donations made by close companies and their individual shareholders are likely to be interchangeable, as close companies could donate directly or simply distribute money to their shareholders to donate on their behalf. As a result, extending the company deduction to close companies should not result in any additional revenue cost on top of the cost of removing the threshold limit for the individuals' rebate.

Removing the limit on the Maori authority deduction for charitable donations

51. The reported Maori authority data for the 2005 year showed that 55 Maori authorities (2 percent of Maori authorities) claimed a deduction for charitable donations in the 2005 year. The average donation was 3 percent of the net income of the authority. Most of these donations were made by high-income earning Maori authorities.

52. Based solely on this information, as Maori authorities are giving below the current deduction limit of 5 percent of net income, the current limit does not appear to constrain Maori authorities' giving. This suggests that any increase in the deduction limit is unlikely to result in significant revenue costs, assuming that there are no behavioural changes. Even if Maori authorities' giving were to increase substantially, the revenue cost of raising the limit to 10 percent is still unlikely to be significant. For instance, if 10 percent of Maori authorities gave 10 percent of their net income, the estimated fiscal cost would be $0.5 million per annum.

53. Therefore, on the balance of all these considerations, we consider that any increase in or removal of the deduction limit would not impact on the Government's operating balance.

ADMINISTRATIVE COST IMPLICATIONS

54. The set up costs of implementing the proposed legislative amendments is estimated at $144,000. Ongoing costs are unlikely to be significant. These costs would be met from existing baselines.

COMPLIANCE COST IMPLICATIONS

55. Overall the compliance costs associated with the proposed legislative amendments would be minimal.

HUMAN RIGHTS IMPLICATIONS

56. The proposed legislative amendments contained in this paper are consistent with the rights and freedoms affirmed in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

LEGISLATIVE IMPLICATIONS

57. Implementing the proposed legislative amendments will require changes to the Income Tax Act 2004. We recommend that these amendments be included in the tax bill scheduled for introduction in May 2007 and take effect from the 2008-09 income year.

REGULATORY IMPACT AND BUSINESS COMPLIANCE COST STATEMENT

58. A Regulatory Impact Statement is not required because of the exemption that applies to budget decisions where the decision is to repeal, impose or adjust tax. A business compliance cost statement is not required for these amendments as they do not impose any additional compliance costs on business.

PUBLICITY

59. We recommend that the legislative amendments and the proposed process for dealing with the other matters raised in the discussion document be announced as part of Budget 2007. Also, Inland Revenue will publish details of the new legislation in a *Tax Information Bulletin* once it is enacted.

RECOMMENDATIONS

60. We recommend that the Cabinet Economic Development Committee:

1. **Agree** that the Income Tax Act 2004 be amended to give effect to the following proposals:

    1.1 Removal of the individuals' rebate threshold limit for charitable donations.

    1.2 Removal of the company deduction limit for charitable donations.

    1.3 Removal of the Maori authority deduction limit for charitable donations.

    1.4 Extension of the company deduction to close companies not listed on a recognised stock exchange.

2. **Note** the following changes as a result of the decision in recommendations 1.1 to 1.4, with a corresponding impact on the operating balance:

	$m – increase/(decrease)				
	2006/07	**2007/08**	**2008/09**	**2009/10**	**2010/11& Outyears**
Tax incentives for encouraging charitable giving	-	-	(15)	(25)	(25)
Total	-	-	(15)	(25)	(25)

3. **Agree** that legislative amendments for giving effect to recommendations 1.1 to 1.4 be included in the May 2007 taxation bill.

4. **Agree** that the legislative amendments for giving effect to recommendations 1.1 to 1.4 take effect in respect of charitable donations made in the 2008-09 income year and subsequent income years.

5. **Agree** that further policy work and consultation should be undertaken on the options for streamlining the tax treatment of reimbursements to volunteers and honoraria recipients, and that any legislative amendments arising from this work should be timed for inclusion in the November 2007 taxation bill.

6. **Agree** that a discussion document on the design and implementation of a pre-tax payroll giving scheme be issued in November 2007.

7. **Agree** that further policy work and consultation should be undertaken on the options relating to the gift aid scheme, the deductibility of non-monetary donations, Australia's prescribed private funds regime, and the other suggested tax mechanisms for delivering tax relief on charitable donations, and that the results of this work be reported to Ministers in March 2008.

8. **Agree** that the non-tax measures relating to promoting charitable giving and volunteerism in New Zealand be referred to the Minister for the Community and Voluntary Sector for consideration and action.

9. **Invite** the Minister of Revenue to instruct Inland Revenue to draft legislation so as to give effect to the proposals contained in this paper.

Hon Dr Michael Cullen
Minister of Finance

Hon Peter Dunne
Minister of Revenue