Taxation and the not-for-profit sector: Targeted consultation on detailed design

Date: 14 November 2025



Inland Revenue
Te Tari Taake

Making a submission

We invite you to submit on the issues raised in this document, including the specific questions asked and any other issues relevant for us to consider. A complete list of these questions can be found in the Appendix to this targeted consultation paper.

Include in your submission a summary of the major points and recommendations you have made.

The closing date for submissions is **Wednesday 24 December 2025**, however please contact us if you need more time. We would like to have time to review all targeted submissions in January 2026.

Submissions can be made to this email address:

NFPtaxpolicy@ird.govt.nz

Privacy of submissions

Submissions may be requested under the Official Information Act 1982. Please clearly indicate in your submission if you consider that any information should be withheld on the grounds of privacy, or for any other reason. Contact information such as an address, email, and phone number for submissions from individuals will be withheld. Whether any information is withheld will be determined using the Official Information Act 1982.

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Chapter 1 – Introduction

Background

1.1 In November 2024, the Government published its Tax and Social Policy Work Programme. The programme included reviewing elements of charities and not-for-profits. The work programme's objectives included simplifying tax rules, reducing compliance costs, and addressing integrity risks.

1.2 In February 2025 Inland Revenue released an officials' issues paper, "Taxation and the not-for-profit sector" (the February 2025 issues paper).[1] The paper considered the charity business income tax exemption, donor-controlled charities, and several integrity and simplification measures.

1.3 We received over 900 submissions in response to the February 2025 issues paper. We analysed those submissions, met with a number of submitters, and reported to Ministers in August 2025. In September 2025 Ministers made decisions about what work would cease and what work would continue. The Minister of Revenue made a public announcement in October 2025 when he launched the refreshed Tax and Social Policy Work Programme.

1.4 Ministers have asked us to undertake targeted consultation on detailed design for three matters that are addressed in this document:

- integrity measures for donor-controlled charities, including whether donor-advised funds should be treated in a similar way to donor-advised charities, and distributions by private trusts to tax exempt entities
- membership subscriptions and related matters for taxable not-for-profit organisations, and
- donation tax credit simplifications.

1.5 Stakeholders have pointed out that not-for-profit tax changes could have potential impacts on Treaty of Waitangi interests. We have considered how specific proposals could affect Māori in this document.

[1] Taxation and the not-for-profit sector

Document outline

Chapter	Outline
2	Donor-controlled charities
3	Membership subscriptions and related matters for taxable not-for-profit organisations
4	Donation tax credit simplifications
5	Treaty of Waitangi considerations
Appendix	Summary of questions for submitters

Chapter 2 – Donor-controlled charities

Overview

2.1 The February 2025 issues paper sought feedback on a range of not-for-profit matters, including whether integrity concerns associated with donor-controlled charities warrant a policy response. After considering public feedback, the Government has decided to progress work on donor-controlled charity rules. This includes integrity measures to address circular arrangements and non-arm's length transactions, and a minimum distribution requirement to ensure the timely use of tax-exempt funds.

2.2 The scope of the donor-controlled charity work has been extended to also include a review of donor advised funds and a review of private trusts that allocate income to tax-exempt beneficiaries. These issues are related to, but are not limited to, donor-controlled charities.

2.3 This chapter discusses these policy issues further.

2.4 The policy proposals in this chapter draw directly from experiences in Australia, Canada, and the United States. A key principle behind the proposals is that they will not be more stringent than comparable rules in other countries, absent a strong justification.

Defining a donor-controlled charity

Background

2.5 To allow for special rules, the term "donor-controlled charity" first needs to be defined in legislation.

2.6 In New Zealand, "donor-controlled charity" generally refers to a charity registered under the Charities Act 2005 that is controlled by the primary donor, the donor's family, or their associates. Donor-controlled charities are typically referred to in other countries as private foundations.

2.7 To deter behaviour that poses integrity concerns going forward, the definition should include situations when a donor (one person or a group of associated persons) donates to a charity, and then the donor or their associates retain influence or control over how the funds are used. This is because this level of control presents a heightened risk of donor-controlled charities engaging in aggressive tax planning arrangements[2] and the excessive accumulation of tax-exempt funds.

[2] Aggressive tax planning arrangements are discussed further in paragraph 2.31.

Proposal

2.8 It is proposed that the Income Tax Act 2007 contain a new definition of a donor-controlled charity, which would apply to a "tax charity"[3] that is controlled directly or indirectly by any means, by either:

- the primary donor, which may be one person or a group of associated persons, who has contributed amounts totalling more than 50% of the assets of the charity, measured cumulatively up to the time of their last contribution, or
- a person or a group of associated persons, if the person or any member of the group is associated with the primary donor.

2.9 Control can take many forms along a spectrum from legal control to a legally unenforceable understanding. That is why it is proposed that a tax charity that is controlled directly or indirectly by any means by the primary donor, or associated person(s) to the donor, would be a donor-controlled charity. One example of the donor controlling the charity would be the power to appoint and replace the trustees of the charity.

2.10 For the purposes of this proposal, a "person" would follow the meaning in the Income Tax Act, which includes individuals, companies, and trustees. This would ensure that the definition applies when donations come from companies or trusts, and associated individuals to the company or the trust retain control over the charity.

2.11 The definition would apply both to charities that carry out activities that directly further a charitable purpose (or that operate a charity business), and fund-raising charities. However, the definition would not apply to council-controlled organisations or local authorities because they are adequately regulated by the range of additional compliance requirements that apply to those entities. It also would not apply to charities that are controlled by another charity, unless that charity is also a donor-controlled charity.

2.12 Submitters on the February 2025 issues paper raised concerns that a broad definition of a donor-controlled charity could capture iwi entities, particularly those with governance structures linked to Treaty settlements. Our understanding is that these entities would not fall within the proposed definition because of the absence of a contribution of 50% of the assets from a primary donor that controls the charity. However, this is difficult to assess owing to ongoing challenges with the availability and quality of data relating to Māori organisations, and the complexity of Māori organisational structures.

2.13 We are interested in hearing from submitters if our understanding is incorrect. If so, we propose excluding assets received from the Crown to settle a Treaty of Waitangi claim from the definition of a "contribution" for the purposes of the donor-controlled charity

[3] As defined in the Income Tax Act, but excluding non-resident charities.

rules, or excluding Māori authorities from the definition of a "donor" for the purposes of these rules.

2.14 This proposal is similar to Canada's framework for designating charities as private foundations. In Canada, a registered charity may be designated as a charitable organisation, a public foundation, or a private foundation. The private foundation designation takes into account the proportion of funds provided by a donor and whether the donor or their associates maintain control over the charity.

Questions for submitters

Q1. Are there any issues with the definition of donor-controlled charities outlined in this chapter? For example, would it apply to charities that are not donor-controlled? If so, what alternative(s) would you propose?

Minimum distribution requirement

Background

2.15 The policy intention of a minimum distribution requirement would be to address concerns related to the accumulation of tax-exempt funds. Under current settings, donors can donate to their donor-controlled charity and then receive a tax benefit[4] at or after the end of the income year of their donation. However, in some cases, the donated funds are accumulated, and it may take many years before the total value of charitable distributions exceeds the value of the tax benefit received by the donor.

Proposal

2.16 It is proposed that donor-controlled charities be required to distribute a minimum amount each year to further their charitable purposes. The minimum distribution requirement would be calculated as 5% of the market value of the charity's net assets from the previous year, minus any assets that are used directly in the course or furtherance of a charitable purpose. The calculation of the market value is discussed later in this chapter.

2.17 If any assets are subtracted in the calculation of the minimum distribution requirement, then any consequential liabilities in relation to the asset would also be excluded from the calculation of the minimum distribution requirement. This is to prevent the minimum distribution requirement from being reduced twice in respect of such assets.

2.18 The proposal is broadly consistent with minimum distribution requirements in other countries. In Australia, private ancillary funds are required to distribute annually at least

[4] This could be a donation tax credit claim, a gift deduction, or income derived by a trustee and paid to a charity as a beneficiary of the trust and taxed at 0%.

5% of their net assets from the previous year. In Canada, all charities are subject to a disbursement quota, which is 3.5% of the average value of property not used directly in charitable activities or administration up to $1 million, and 5% on any amount that exceeds $1 million. In the United States, private foundations must distribute 5% of their net assets annually, subject to certain adjustments.

2.19 The principle underlying the minimum distribution rate is to strike a balance between ensuring the timely use of tax-benefitted funds for charitable activities and not discouraging genuine philanthropy or disrupting the long-term sustainability of charities.

Design features

2.20 The minimum distribution requirement would apply to each individual charitable entity, rather than to a parent entity of a consolidated charity group. Each donor-controlled charity within the group would be required to independently calculate the market value of its net assets and meet its own minimum distribution requirement.

2.21 There would be no minimum distribution requirement in the first year in which the rules come into effect. This is because charities would need to estimate the market value of their assets from the previous year to calculate the required minimum distribution. The rules would also not apply to charities in the first year the charity has been registered as it would not have any assets to calculate their minimum distribution.

2.22 Donor-controlled charities could apply to Inland Revenue for a reduction in, or exemption from, the minimum distribution requirement if the distribution would be inconsistent with a specific charitable purpose. For example, an exemption could be granted to a donor-controlled charity whose purpose is to benefit the community by gifting a CT scanner to a public hospital, if accumulating funds over multiple years is necessary to raise funds to purchase the scanner. Any reduction or exemption would apply to a specified income year or period and might be subject to conditions.

2.23 A donor-controlled charity could choose to average its minimum distribution requirements over a three-year period. Under this method, the minimum distributions required would be equal to the sum of the charity's minimum distributions for each year in the period. Each three-year period would be a discrete period rather than rolling periods because rolling periods could result in a lower distribution requirement than if the charity did not choose to average their distributions over three years, and it would be more difficult to monitor.

2.24 Once a charity opts to use this method, this would establish the first year of the three-year averaging period. Charities would not need to get approval from Inland Revenue to apply this rule.[5]

2.25 If a charity failed to meet its minimum distribution requirement, the charity would pay tax on the "undistributed amount" by filing a tax return. The undistributed amount would be the difference between the amount the charity was required to distribute, and the amount distributed. For example, if the donor-controlled charity was a charitable trust, then the tax rate would be the trustee income tax rate of 39%. This could be accompanied by shortfall penalties if, for example, the charity has not taken reasonable care in calculating their minimum distribution requirement.

Example 1: Averaging minimum distribution requirements

The Kikorangi Family Foundation, a donor-controlled charity, opts in to average its minimum distribution obligation over a three-year period, beginning in 2028. It calculates its minimum distribution requirements for 2028, 2029, and 2030 to be $100,000, $110,000, and $140,000 respectively. This means the Kikorangi Family Foundation must distribute a total of $350,000 over the 2028–2030 period.

The Kikorangi Family Foundation makes charitable distributions of $20,000 in 2028, and $80,000 in 2029. Therefore, the foundation must distribute $250,000 in 2030 to meet its minimum distribution requirements for the three-year period.

Example 2: Exemption to minimum distribution requirements

The Whero Charitable Trust is a donor-controlled charity established to raise funds for the construction of a new mental health centre serving a low-income community. The trust applies to Inland Revenue for an exemption from the minimum distribution requirement for the relevant income year, on the basis that not distributing during this period is in line with its charitable purpose of accumulating capital to purchase a charitable asset.

Inland Revenue grants the exemption, because the asset is furthering the entity's charitable purpose. As a result, the Whero Charitable Trust is not required to meet the minimum distribution requirement for that income year.

[5] The Australian Treasury has recently consulted on allowing ancillary funds to smooth their distribution requirement over a three-year period. These would be three discrete periods, and ancillary funds would need to only inform the Commissioner that they are using the method.

What is a "distribution"?

2.26 It is proposed that a "distribution" for the purposes of the minimum distribution requirement would be a "transfer of value"[6] from a donor-controlled charity to another registered charity that is not a donor-controlled charity, or a donor-advised fund.[7] The policy intent is that a distribution would include not only settlements, grants or donations to other charities, but also other forms of benefit provided by the donor-controlled charity. For example, if a donor-controlled charity lends money to a registered charity at a discount to the market interest rate, the charity would be providing a transfer of value to the registered charity equal to the difference between the market interest rate and the actual interest rate.

2.27 The definition would also include any expenditure incurred in the direct course or furtherance of the charity's charitable purpose. The purpose of this is to ensure that any operating expenses incurred to deliver charitable services are recognised as a distribution. However, expenditures that do not directly further a charitable purpose, such as the purchase of shares or other investments intended to generate future returns, would not count as a distribution under the minimum distribution requirement.

Example 3: Below-market loan is a distribution

The Snoopy Family Foundation, a donor-controlled charity, provides financial assistance to a registered charity that provides social housing for low-income families. The Snoopy Family Foundation loans $500,000 to the housing charity at an interest rate of 1%, while the market interest rate for such a loan would typically be 5%.

The difference between the market interest rate and the actual rate, which is equivalent to $20,000, is treated as a distribution and included in the Snoopy Family Foundation's minimum distribution calculation.

Example 4: Expenditure incurred in direct course or furtherance of charity's purpose is a distribution

The Snowy Foundation, a donor-controlled charity, has a charitable purpose of improving adult literacy in low-income communities. Instead of providing grants to other charities, it delivers services directly by running weekly literacy workshops.

Expenditure incurred for these activities, such as tutor wages, rent, and material costs, will be recognised as a distribution because they are incurred in the direct furtherance of the charity's purpose.

[6] As defined in section YA 1 of the Income Tax Act 2007.
[7] Donor-advised funds are discussed in more detail at paragraph 2.63.

Valuations

2.28 It is proposed that donor-controlled charities would have to determine a reasonable estimate of the market value of their assets and liabilities annually for the purposes of calculating their minimum distribution. This approach is consistent with the valuation method used to determine a charity's deregistration tax liability under current rules.[8] It is also consistent with the approach in Australia, where private ancillary funds are required to estimate the market value of their net assets annually to calculate their minimum distribution requirement.[9]

2.29 A separate market value estimation is required because a charity's assets and liabilities in their financial statements are often based on accounting standards which allow for historical cost valuations. The market value of a charity's assets would give a more accurate reflection of the donor-controlled charity's financial position and its capacity to make distributions. Any estimate would be required to be based on reasonable, objective and supportive data, and the valuation methodology should be documented in the charity's records.

2.30 The trustees (or directors, in the case of a company), of a donor-controlled charity could estimate the market value of the charity's net assets themselves or engage another appropriate, qualified person to do so. In many cases, the market value would be readily available and relatively simple to calculate, for example, in the case of cash, term deposits, or publicly listed shares or bonds. However, if a donor-controlled charity holds unlisted shares or property, then it might be preferable to engage a qualified valuer or another appropriate person to undertake the valuation.

Questions for submitters

Q2. If New Zealand adopts a minimum distribution of 5% of net assets for donor-controlled charities we would be similar to Australia and Canada. Do you agree this is appropriate in the New Zealand context? If not, what alternative would you propose and why?

Q3. Are there any issues with the proposal to require donor-controlled charities to estimate the market value of their net assets annually for the purposes of the minimum distribution requirement? If so, what alternative would you suggest?

Q4. Are there any issues with the policy design of a minimum distribution requirement for donor-controlled charities as outlined in this chapter that we should consider?

[8] Section HR 12 of the Income Tax Act 2007.
[9] Aside from land, which can be valued once every three years.

Integrity measures

Background

2.31 The policy intention of introducing specific integrity measures for donor-controlled charities is to clearly define the government's future expectations for donor-controlled charities that benefit from tax concessions. These measures would seek to deter the following behaviours and minimise potential integrity concerns:

- Circular arrangements, when the donor donates funds to their donor-controlled charity and claims a donation tax credit (DTC) or gift deduction. Then the donor-controlled charity loans the money back to the donor or invests it in a company (for example, by acquiring shares in the company carrying on the business) controlled by the donor or their associates. Although the loan or investment might pay a market rate of return, typically the return is accrued, and no cash is actually paid to the charity for many years (if at all).
- Circular arrangements involving private trusts, when the private trust makes an income allocation to a donor-controlled charity, resulting in the income being tax-exempt rather than taxed at the trustee rate. The charity then loans the money back to the trust (or individuals associated with the trust) or invests the funds in a company associated with the trust. Again, the return might be accrued but no cash is paid.
- Non-arm's length transactions, for example when the donor-controlled charity purchases assets or regularly acquires goods or services from the donor or their associates at above-market rates.

2.32 Inland Revenue has greater visibility than the charity regulator over all entities involved in these arrangements and can monitor tax concessions claimed by donors, which the charity regulator cannot access. Inland Revenue also has broader information gathering powers than the charity regulator. However, current anti-avoidance provisions have been difficult to apply in most of these scenarios, and it is resource intensive to attempt to do so.

Policy options

2.33 To mitigate the integrity concerns outlined above, officials are seeking submitters' feedback on the following options. These options are not necessarily mutually exclusive.

Option 1: Arm's length transactions rule

2.34 This option would require donor-controlled charities to only enter into arm's length transactions,[10] or transactions that are on terms more favourable to the charity, when dealing with donors or their associates. For example, if a donor-controlled charity lends money to the donor or a person associated with the donor, then the interest rate on the loan must be the arm's length interest rate or higher. This rule would not affect transactions with persons or entities not associated with the charity because these are assumed to be on arm's length terms.

2.35 The donor-controlled charity would be assumed to be in the business of lending money when the arm's length rate for loans is determined. Therefore, when lending money to the donor, the donor-controlled charity would be required to act as if it was a commercial lender and the loan should be on commercial terms.

2.36 Australia and Canada have similar arm's length transaction requirements. In Australia, the private ancillary funds guidelines require private ancillary funds to ensure that investments are made and maintained on an arm's length basis, and that any loans or other forms of financial assistance are on arm's length terms, or on terms more favourable to the charity. In Canada, private foundations must receive a minimum return on non-qualified investments, such as a low-interest loan, when the issuer is a related party or the issuer will be liable for a tax equal to the shortfall. The minimum return is the lesser of the amount of interest assuming the foundation had been dealing with the donor on arm's length terms and carried on the business of lending money, or a prescribed rate set in legislation.

2.37 The consequences for engaging in a non-arm's length transaction would include a tax at 100% of the value of the "undue benefit" provided to the donor or the associated person. The undue benefit would be calculated as the difference between the arm's length terms of the transaction and the actual terms applied. For example, this could be the difference between an arm's length interest rate, and the actual interest rate charged. The tax would be payable by the recipient of the undue benefit.

2.38 This rule might not be effective in deterring behaviour that raises integrity concerns in donor-controlled charities. This is because it can be difficult and resource intensive for Inland Revenue to dispute what should be a fair arm's length rate.

[10] An arm's length transaction is one in which the parties act severally and independently in forming the bargain and in which neither of the parties has the ability to exert personal influence or control over the other. The price agreed would be what a disinterested independent party would agree to pay in normal competitive market conditions.

Option 2: Prescribed rate for loans to related parties or shares held in related companies

2.39 This option would set a prescribed rate in legislation, based on market interest rates, that applies when a donor-controlled charity loans funds to the donor or an associate. If the interest rate charged on the loan is below the prescribed interest rate, then the recipient of the loan would have a tax liability at 100% of the difference between the prescribed rate and the interest rate charged.

2.40 The prescribed rate could align with the prescribed rate used to calculate fringe benefit tax on low-interest loans provided by employers to employees.[11] This rate is currently 6.67%.

2.41 This option could also apply to shareholdings in closely held companies. A prescribed dividend rate could be set for the investment. If the dividends paid to the charity were below the prescribed dividend rate, then the donor would have a tax liability at 100% of the difference between the prescribed dividend rate and the dividends actually paid. The prescribed rate for dividends could be lower than the prescribed rate for interest.

2.42 This would be accompanied by a "pay in money" rule requiring any interest or dividends owed to the donor-controlled charity to be actually paid. For example, interest would need to be paid on the loan no later than 30 days after the end of the tax year to avoid a tax liability. This is because interest might otherwise be accrued, with no cash being received by the charity and available for charitable purposes, even though the borrower may claim a tax deduction for the interest with no income tax consequence for the donor-controlled charity. It is also more in line with an arm's length lending arrangement.

2.43 One benefit of this option is that it reduces the uncertainty and administrative costs associated with determining arm's length rates. However, there is a risk that a prescribed rate would not accurately reflect the market rate in some situations.

2.44 As mentioned in Option 1, Canadian legislation uses a prescribed rate for loans to related parties and shares held in companies linked to the donor. The prescribed rate is set quarterly, based on the average yield of treasury bills sold during the first month of the preceding quarter. The prescribed rate is also used for calculating the taxable benefit on low-interest loans provided by employers to employees. The prescribed rate for dividends is two-thirds of the prescribed rate in legislation.

[11] The rate, used since 1995, is based on Reserve Bank floating first mortgage new customer housing interest rates published on the last day of each month. The rate is calculated as the average interest rate for the surveyed institutions, weighted on each institution's share of total lending for housing purposes. This is intended to be an indication of general market interest rates.

Example 5: Loan below the prescribed rate

The Parāhi Foundation makes a loan of $500,000 to its primary donor. The annual interest rate on the debt is 4%, or $20,000 per annum.

The prescribed rate of interest set in legislation is 6.67%, which equates to $33,350 per annum. Because the donor has only paid $20,000 of interest on the debt, the donor has a tax liability of $13,350.

Option 3: Reduce donation tax concessions in certain loan or share purchase arrangements

2.45 Under this option, the value of donations for tax purposes would be reduced by certain loan or share purchase arrangements involving donor-controlled charities.

2.46 It is proposed that a loan or share purchase arrangement would be deemed to occur if, within five years before or after a donor makes a donation, a donor-controlled charity:

- makes a loan to the donor or an associated person of the donor, or
- acquires shares in a company associated with the donor.

2.47 If a loan is made or the shareholding is acquired up to five years before the donation, and the loan is still outstanding or the shares are held at the time of the donation, then the value of the donation for tax purposes would be reduced by the unpaid balance of the loan or the market value of the shares. For example, if a loan made by a donor-controlled charity to the donor had an unpaid balance at the time of the donor's donation, and the loan was made within the five-year period, then the donation for tax purposes would be the difference between the value of the donation and the value of the outstanding loan. Because the donation for tax purposes would be reduced, any DTC for the donation would be paid on the reduced amount.

2.48 If the loan is made or the shareholding is acquired within five years after the donation, the donor would be required to include the amount of the loan or shareholding, up to the value of the original donation for tax purposes, as deemed income in the income year in which the loan or share purchase agreement occurs. This deemed income would be taxed at the same rate as the tax benefit from the original donation.[12]

2.49 Alternatively, the DTC could be treated as an excess tax credit that is required to be repaid, or a company or trust's tax return (and assessment) for the relevant income year could be amended so the tax benefit is reversed. Although conceptually simpler, it is

[12] If the donation came from an individual, this would be equivalent to the rate of the DTC (33⅓%). If the donation came from an income allocation from a private trust, or a company, then this would be equivalent to the trustee tax rate or the company tax rate.

likely to be administratively complex and would provide a shorter period for the tax concession to be repaid.

2.50 An ordering rule is proposed to ensure that the value of a loan or share purchase is only accounted for once in the loan or share arrangement rules when multiple donors or donations are involved. The rule would apply the amount of the loan or share purchase to donations based on their proximity to the loan or share purchase, with those closest to the time of the loan or share purchase being reduced first. Any outstanding amount of the loan or share purchase not offset against that donation would then be applied to the next closest donation, until the full amount has been accounted for.

2.51 The rules would apply prospectively. They would not apply to any loan or share purchases that existed before the application date of any legislation.

Example 6: Loan before one donation

On 13 October 2028, The Freester Family Foundation, a donor-controlled charity, lends $500,000 to the Freester Family Trust. The Freester Family Trust is the primary donor to the Freester Family Foundation.

On 5 February 2029, the trustees of the Freester Family Trust make an income allocation of $500,000 to the Freester Family Foundation. At the time of the allocation, the balance of the loan is $500,000.

Because the loan was made within five years of the donation being made, and the loan remains outstanding, this is a loan arrangement.

The Freester Family Trust's income allocation of $500,000 will be taxed at the trustee tax rate of 39%, instead of the tax rate of the charity of 0%.

Example 7: Share purchase after one donation

On 20 July 2028, Ellenhall Family Investments Limited donates $500,000 to the Ellenhall Charitable Trust, a donor-controlled charity. Ellenhall Family Investments Limited claims a gift tax deduction of $500,000 for the donation in its income tax return for the 2028–29 income year. Ellenhall Family Investments Limited is an associated company to the primary donor to the Ellenhall Charitable Trust.

On 28 August 2030, the Ellenhall Charitable Trust purchases $1,400,000 of shares in Ellenhall Family Investments Limited.

This is a share purchase arrangement because the shares were purchased within five years of a donation. As a result, Ellenhall Family Investments Limited would be required to return $500,000, the value of the acquired shareholding, as deemed income in the income year in which the share purchase occurred.

Example 8: Multiple donors donating after a loan

Dunnaval Charitable Trust is a donor-controlled charity established in 2018 by a group of primary donors: James Dunnaval, Dunnaval Limited, and Dunnaval 2 Limited. The three primary donors are all associated.

On 29 September 2028, the Dunnaval Charitable Trust loans $1,250,000 to Dunnaval Limited. On 20 November 2029, James Dunnaval donates $1,000,000 to the Dunnaval Charitable Trust. On 15 January 2030, Dunnaval 2 Limited donates $200,000 to Dunnaval Charitable Trust. On 2 February 2030, Dunnaval Limited donates $300,000 to the Dunnaval Charitable Trust.

The balance of the loan at the time of each donation remains at $1,250,000.

The loan arrangement rules would first apply to reduce the value of James' donation for tax purposes, because his donation was made closest to the time of the loan between the Dunnaval Charitable Trust and Dunnaval Limited. The value of James' donation is zero for tax purposes, because his donation is less than the amount of the loan. James would not be entitled to a DTC for his donation.

The rules would next apply to Dunnaval 2 Limited, because Dunnaval 2 Limited's donation is the next closest to the time of the loan. Because there is still $250,000 outstanding from the loan that has not been previously considered for the loan arrangement rules, Dunnaval 2 Limited's $200,000 donation is reduced to zero for tax purposes. This means Dunnaval 2 Limited's donation is not eligible for a gift tax deduction.

The rules would also apply to reduce the value of Dunnaval Limited's $300,000 donation by the remaining $50,000 from the loan that has not previously considered for the loan arrangement rules.

Example 9: Multiple donors donating before a loan

Wōnati Family Foundation is a donor-controlled charity established in 2018 by a group of primary donors: Emma Wōnati, Wōnati Family Trust, and Emma Wōnati Developments Limited. The three primary donors are all associated.

On 30 July 2030, the Wōnati Family Foundation loans $1,000,000 to the Wōnati Family Trust.

The following donations are made within the five years preceding the loan:

- On 1 July 2028, Emma donates $1,000,000 to the Wōnati Family Foundation and claims a $333,333 DTC for the donation.
- On 19 October 2029, the trustees of the Wōnati Family Trust donate $500,000 through an income allocation to the Wōnati Family Foundation. The income is taxed at 0%, the tax rate of the Foundation.

- On 29 November 2029, Emma Wōnati Developments Limited donates $250,000 and claims a gift tax deduction for the donation.

All three donations are considered for the loan arrangement rules.

The loan arrangement rules would first apply to require Emma Wōnati Developments Limited to return $250,000 in deemed income in its income tax return for the 2029 income year, because their donation was made closest to the time of the loan between the Wōnati Family Foundation and the Wōnati Family Trust.

The rules would next apply to the trustees of the Wōnati Family Trust because their donation is the next closest to the time of the loan. Because there is still $750,000 dollars remaining on the loan that has not been previously considered for the loan arrangement rule, the trustees of the Wōnati Family Trust must return $500,000 in deemed income in its income tax return for the 2029 income year.

The rules would also apply to Emma Wōnati, because her donation is the next closest to the time of the loan. Emma must return $250,000, the outstanding amount of the loan not previously considered, as deemed income in its income tax return for the 2029 income year. The deemed income would be taxed at 33⅓%, the rate of the DTC.

2.52 This option has the strongest integrity focus of the three options by removing the tax benefit for loan or share purchase arrangements that present a high risk of tax abuse.

2.53 Canada has a similar rule that applies to loanback arrangements. In Canada, a loanback occurs when a donor makes a gift to a private foundation, and within five years of making the gift, either of the following situations occur:

- the private foundation holds a non-qualifying security (such as debt or a share in a company that is linked to the donor) that it acquired within five years before the gift was made, or
- the donor, or a person associated with the donor, uses the private foundation's property under an agreement made or modified after the time that is five years before the gift was made, and the property was not used by the private foundation in its charitable activities.

2.54 In Canada, if a loanback has occurred, then the fair market value of the gift is reduced for income tax purposes.

2.55 Canada's loanback provisions apply on a taxpayer-by-taxpayer basis. If a loanback occurs, then the fair market value of the gifts made by each donor could be reduced for income tax purposes.

Questions for submitters

Q5. Which of the three integrity options outlined in this chapter (Option 1: Arm's length transactions rule; Option 2: Prescribed rate for loans to related parties or shares held in related companies; Option 3: Reduce donation tax concessions in certain loan or share purchase arrangements) does the best job of addressing integrity issues without adversely affecting genuine philanthropy. Why?

Q6. Are there any other issues with any of the options outlined in this chapter that we should consider?

Alternative proposal: Donation tax concessions cap

Background

2.56 An alternative proposal to address the integrity concerns outlined in this chapter is to decrease the value of donation tax concessions for donations to donor-controlled charities. This would reduce the financial benefit of tax-aggressive arrangements in donor-controlled charities and help mitigate policy concerns with the accumulation of tax-exempt funds going forward because fewer tax concessions would be available. Therefore, reducing donation tax concessions could be an alternative to the minimum distribution requirement and the integrity options for donor-controlled charities.

Proposal

2.57 It is proposed that a cap is set on the amount of DTCs an individual can claim for donations made to donor-controlled charities. For example, the cap could be set between $50,000 and $100,000 worth of annual donations and still mitigate integrity concerns in donor-controlled charities. Based on current donation behaviour to both donor-controlled charities and other donee organisations, a DTC cap of $50,000 would affect up to 900 donors, and a DTC cap of $100,000 would affect up to 300 donors. We expect the number of donors affected by the cap would be lower because many of these donations are not made to donor-controlled charities.

2.58 To complement this measure, it is also proposed that caps are applied to:

- the amount of income that private trusts could allocate to donor-controlled charity beneficiaries without paying tax at the trustee rate, and
- the amount companies could claim as a tax deduction for donations made to donor-controlled charities.

2.59 For example, if the DTC cap was set at $50,000, then trustee income distributions would also be capped at $50,000. If a private trust allocated $150,000 of trustee income to donor-controlled charities, the trust would be liable for income tax at the trustee rate on donation amounts above the cap, which would be the excess $100,000.

2.60 These additional measures are necessary because donors can make donations through private trusts and companies that they control. A DTC cap alone would not mitigate the financial benefit for donations through these entities, so it would not address circular arrangements involving these entities.

2.61 The donation tax concession caps would also apply to donations made to charities if the donation results in the charity becoming donor controlled. For example, if an individual donated to a charity, and as a result of their donation the charity became donor controlled, the tax credit for the donation would only be available up to the DTC cap.[13]

2.62 It is also proposed that there would be a specific anti-avoidance provision to address arrangements designed to circumvent being classified as a donor-controlled charity. This is because donation tax concession caps would pose a heightened risk of donors structuring around the rules.

Example 10: Donation to a charity that becomes donor-controlled

Clark makes an initial contribution of $2 million to a newly established charity, the Kaharore Family Foundation. Clark and his partner Joanne are the sole trustees of the charity and retain full control over the charity's operations.

The Kaharore Foundation meets the definition of a donor-controlled charity at the time of Clark's donation. Therefore, the DTC cap applies, and Clark is only eligible to claim a DTC up to the DTC cap.

Questions for submitters

Q7. What are the consequences of reducing the individual DTC cap for large donations to donor-controlled charities? What could be the impact on the charitable sector more generally?

Q8. If the DTC cap was reduced for donations to donor-controlled charities, should there also be a cap on the amount of income that private trusts can allocate to donor-controlled charities, and a limit to the donation tax deduction for companies?

Donor-advised funds

Background

2.63 Donor-advised funds are philanthropic vehicles established within a registered charity. Each donor-advised fund comprises contributions made by individual donors. The donors can contribute to their donor-advised fund and receive a donation tax concession in the tax or income year of the donation. The donors can provide ongoing,

[13] Or it could be less if the donor's taxable income is less than the value of the donation.

non-binding recommendations on how the funds are spent over time. While the registered charity retains legal control over the funds, it would typically follow the donor's recommendations.

2.64 There is a concern that donor-advised funds could be used as substitutes for donor-controlled charities. If integrity measures such as a minimum distribution requirement or a donation tax concession cap applied to donor-controlled charities, then donors could instead use donor-advised funds to avoid these rules.

Proposal

2.65 We are considering whether the same rules for donor-controlled charities should apply to donor-advised funds. For example, if there were a cap on the amount of DTCs a person could claim for donations to donor-controlled charities, this could also apply for donations to donor-advised funds.

2.66 If these funds were subject to a minimum distribution requirement or other integrity measures, then the registered charity that the fund is held within would be responsible for complying with these rules, and for any tax liability that would arise for breaching these rules. This is because the donor can only advise on distributions, and it is ultimately the responsibility of the registered charity as to when and how the funds are spent.

2.67 A donor-advised fund would be defined as a segregated fund within a registered charity, that comprises contributions made by a donor, or a group of donors that are associated persons, and when the donor can provide ongoing recommendations on payouts from the donor-advised fund.

"Wholly or mainly" test for donee status

2.68 There is also a policy concern that donor-advised funds can be used to circumvent the "wholly or mainly" test for donee status under section LD 3(2)(a) of the Income Tax Act.

2.69 To qualify for donee status, a donee organisation must apply its funds wholly or mainly to charitable, benevolent, philanthropic, or cultural purposes within New Zealand. Inland Revenue's safe harbour threshold is met if an organisation applies 75% of their funds to charitable, benevolent, philanthropic or cultural purposes within New Zealand over a three-year period.[14] This test currently applies at the level of the registered charity, not to each individual donor-advised fund within it.

2.70 We have observed that some donor-advised funds are meeting the safe harbour threshold individually. However, if the registered charity that the donor-advised fund is established within is meeting the wholly or mainly test due to other funds applying all

[14] Inland Revenue has released guidance on the meaning of "wholly or mainly applying funds to specified purposes in New Zealand", which can be found here: Income tax - donee organisations – meaning of wholly or mainly applying funds to specified purposes in New Zealand.

their funds within New Zealand, then the donor can still claim DTCs for donations to its donor-advised fund that applies its funds outside New Zealand.

2.71 It is proposed that the wholly or mainly test apply to each donor-advised fund, instead of each registered charity as a whole. Each donor-advised fund would have to ensure that it is applying its funds wholly or mainly to charitable purposes within New Zealand to maintain donee status.

2.72 If a donor-advised fund did not meet the requirements of the wholly or mainly test, then the donor-advised fund would not be able to benefit from the charity's donee status. This could also result in Inland Revenue requiring the repayment of past DTC refunds for donations to the donor-advised fund.

Example 11: Donor-advised fund not meeting wholly or mainly test

Joe donates $1 million to his donor-advised fund that is established within the Waiporoporo Giving Trust, a registered charity that operates donor-advised funds.

Joe recommends that his donor-advised fund pays out $500,000 in grants over the next three years to an overseas charity that carries out charitable purposes in Mozambique. No other grants are made in the three-year period.

Joe's donor-advised fund does not meet the requirements under the wholly or mainly test because it is not applying its funds wholly or mainly to charitable purposes within New Zealand. Therefore, the donor-advised fund does not qualify for donee status and Joe cannot claim DTCs for donations to the fund.

Inland Revenue would review Joe's past DTC refunds for donations to his donor-advised fund, which could require Joe to repay these DTC refunds.

Questions for submitters

Q9. Should donor-advised funds be subject to the same rules as donor-controlled charities (such as a minimum distribution requirement and other integrity measures)? Why or why not? What impacts might this have on the broader philanthropic environment?

Q10. What are the implications of applying the wholly or mainly test for donee organisations under section LD 3(2)(a) of the Income Tax Act to donor-advised funds, instead of the fund-holding charity?

Trust income allocations to tax-exempt beneficiaries

2.73 Under current law, the trustees of a trust can allocate income to a beneficiary while not actually paying it or notifying the beneficiary that income has been allocated to them. This poses integrity risks when the beneficiary is a tax-exempt entity, for example a

registered charity, because the allocated income receives a tax exemption despite not being paid to the charity and available to be used for charitable purposes.

2.74 A "pay in money" rule is proposed that would require trustees to pay in money[15] any income allocated to a tax-exempt beneficiary by the later of six months after balance date, or the earlier of the actual or required filing date of the trust's tax return. If the trust uses a tax agent with an extension of time, then this would be on 31 March in the year after balance date.

2.75 If the income has not been paid in money to the beneficiary, then the income would be treated as having never been allocated to the beneficiary, and it would instead be taxed at the trustee rate. This timeframe is consistent with the current timing rules for the allocation of beneficiary income.

Example 12: Trust allocation to charity not paid within six months after balance date

The Ōrangitea Charitable Trust (a registered charity) is a discretionary beneficiary of the Ōrangitea Family Trust. The trustees of the Ōrangitea Family Trust earn $500,000 in investment income for the income year ended 31 March 2028.

The trustees of the Ōrangitea Family Trust allocate $200,000 of the income to the Ōrangitea Charitable Trust, and journal entries are made recording the allocation. The trustees use a tax agent who has an extension of time to file the 2028 return until 31 March 2029, and the return is filed on 31 March 2029.

The trustees of the Ōrangitea Family Trust make a payment in money of $200,000 to the Ōrangitea Charitable Trust on 5 May 2029. Since the income allocation was not paid in money by the date the return is filed, the $200,000 is treated as trustee income and taxed at the trustee rate of 39%.

Questions for submitters

Q11. Do you agree that there should be a "pay in money" rule for trustee allocations to tax-exempt beneficiaries? Why or why not?

Q12. Are there any policy design issues that we need to consider?

Application date

2.76 We propose that the changes set out in this chapter apply from the 2027–28 tax year. We believe this application date would provide sufficient time for affected entities to

[15] For the purposes of the proposed rule, money will mean currency authorised as a medium of exchange by the law of NZ.

fully understand the changes being made and their implications, and to apply any necessary changes to systems and processes.

Questions for submitters

Q13. Does the application date of 1 April 2027 for changes proposed in this chapter give affected entities and trusts sufficient time to implement any changes to their processes? If not, what date do you propose and why?

Chapter 3 – Membership subscriptions and related matters for taxable not-for-profit organisations

Overview

3.1 This chapter deals with issues concerning taxable not-for-profits and covers several policy design matters including:

- a proposal to clarify the circumstances when membership subscriptions and levies could be exempt
- a proposal to raise the annual tax-free threshold from $1,000 to $10,000 and target it towards small not-for-profits
- a proposal to require taxable not-for-profits to have simplified income tax return filing requirements.

Membership subscriptions

3.2 In addition to the February 2025 issues paper, Inland Revenue released a detailed draft operational statement, ED0265 "Mutual transactions of associations (including clubs and societies)" (the draft operational statement) in April 2025.

3.3 The draft operational statement reiterated Inland Revenue's current position that member trading transactions (for example, food and drinks at a club) are taxable. It also outlined Inland Revenue's updated view that membership subscriptions, fees and levies may be taxable. This is a departure from Inland Revenue's current position that membership subscriptions are not taxable under the mutuality principle.[16]

3.4 Submitters on the February 2025 issues paper and the draft operational statement strongly opposed imposing tax on membership subscriptions. Many submitters stated that if the updated view is confirmed, it would place a significant amount of financial pressure on not-for-profits and could cause smaller not-for-profits to close on the basis that they would no longer be financially viable.

3.5 Most submitters said that a law change should be considered to ensure that member subscriptions remain non-taxable in recognition of the significant benefits not-for-profits provide to their communities.

3.6 The Government has asked us to consider the circumstances in which subscriptions and levies could remain non-taxable.

[16] The common law mutuality principle provides that an association of people does not derive taxable income from transactions within its circle of membership, based on the idea that persons cannot make a profit from trading with themselves.

3.7 Not-for-profits are organisations that do not have a purpose of making a profit for their members and have a constitution (set of governing rules) that prohibits distributions of property to those members. If the entity makes a profit, that profit is taxable after allowing for a statutory deduction (of up to $1,000).

3.8 As explained in the draft operational statement, for the most part the mutuality rule may not apply to not-for-profits because the mutuality principle requires that members both contribute to and continue to have a financial interest in the assets of the association. By definition, those prohibited from making distributions (that is, not-for-profits) do not meet this criterion.

3.9 To determine the circumstances in which membership subscriptions could remain non-taxable, we need to distinguish between membership subscriptions and payments that are for goods or services.

Proposal

3.10 Currently, there is no definition of a membership subscription, and it is possible for goods or services to be included in what people consider to be a membership subscription despite them being member trading transactions. This leads to confusion as to whether all or part of a membership subscription should be treated as taxable or non-taxable.

3.11 We propose a new definition of membership subscription to clarify amounts which would be non-taxable to the extent that they fall within that definition. Payments as part of a membership subscription for provision of goods or services would remain taxable according to ordinary rules.

3.12 The new definition would seek to differentiate non-taxable payments that entitle a person to core membership benefits from taxable payments that entitle a person to identifiable direct valuable benefits in the form of goods or services (albeit labelled as a membership subscription).[17]

3.13 Our initial thinking is that core membership benefits received in exchange for a membership subscription would normally include:

- the right to vote at meetings of the body and to participate in elections of officers or office holders, and
- the right to receive notices of decisions and the financial and other regular reports of the body, including regular updates of the activities of the not-for-profit.

3.14 We propose that if a membership subscription payment, in addition to entitling the person to core membership benefits (as above), also entitles the member to identifiable

[17] This wording borrows from the definition of "unconditional gift" in section 2 of the Goods and Services Act 1985.

direct valuable benefits,[18] that part of the subscription would not be treated as a membership subscription and would be taxable to the not-for-profit. This should be the case even if those additional benefits are not separately identified in the charge or invoice. In its guidance in the context of "unconditional gifts" in a GST context, Inland Revenue considers that an "identifiable direct valuable benefit" means an advantage or gain to the payer (or a person associated with the payer) in the form of a supply of goods or services that is:

- clearly able to be defined or identified
- sufficiently closely connected to the payment
- useful, important and of real value
- capable of being valued, and
- not of only nominal worth.[19]

3.15 Examples of identifiable direct valuable benefits included as part of a membership subscription could include meals, training, conferences, certification, and the right to use facilities (such as a gym).

3.16 Incorporated societies and other not-for-profits serve a diverse range of purposes, such as trade unions, advocacy groups, resident associations, drama clubs, industry groups, marae, and many others. This diversity means that some degree of judgement will be needed to draw the line between payments that are taxable and those that are non-taxable. We are interested in your feedback on what "core membership benefits" should include.

Member transactions

3.17 The draft operational statement also mentioned that a transaction, (for instance, sales of goods and services) between an organisation and its members has long been considered taxable by the Commissioner of Inland Revenue (the mutual association provisions in the Income Tax Act 2007 override the mutuality principle in the case of trading with members, when those principles would otherwise apply.

3.18 For example, clubs that operate a restaurant or bar must treat member purchases in the same way as those by non-members. Income from members and non-members such as rents, interest and dividends remain taxable, though not-for-profits are entitled to a $1,000 deduction (see below) in addition to other deductible expenses.

3.19 We anticipate that the proposal relating to the tax treatment of membership subscriptions will help to clarify the position on member trading transactions, given that

[18] In the form of a supply of goods and services to that member or any person associated with that member
[19] IS20/09: GST - unconditional gifts - https://www.taxtechnical.ird.govt.nz/-/media/project/ir/tt/pdfs/interpretation-statements/is-20-09.pdf?modified=20211123220054

some membership subscriptions may include taxable payments for services. The normal tax rules as to what constitutes taxable income will apply to those and other payments from members of the organisation.

Questions for submitters

Q14. Does the proposed definition of a membership subscription for not-for-profits describe the type of payments we want to relieve from tax? Are there likely to be any unintended consequences?

Q15. Does this test sufficiently distinguish payments for core membership benefits from payments made for other benefits received by a member? If not, why?

Q16. What types of benefit do you think should fall outside the concept of a membership subscription? Would this include, for instance, advocacy services on behalf of an industry or a group of workers?

Q17. The proposed approach requires potential apportionment of some membership subscriptions. Would you prefer a simpler test that required all of the membership subscription to be treated as taxable instead, if it included any identifiable direct valuable benefits? Are there any other approaches we could use?

Q18. When a payment contains both taxable and non-taxable elements, would a test like a principal purpose or wholly or mainly test to determine the degree of taxability be appropriate?

Tax-free threshold

3.20 While exempting subscriptions that solely relate to core membership benefits will help, we recognise that many not-for-profits may nevertheless earn small surpluses in some years. One of our goals is to minimise the overall impact of the tax system on not-for-profits without creating excessive integrity risks (which could happen if we simply exempted all income).

3.21 Currently, not-for-profits with constitutions that prohibit distributions to members (for example, incorporated societies) are entitled to a tax-free threshold of $1,000, that is, they can deduct up to $1,000 against their income. The threshold has not changed since 1979.

3.22 To reduce compliance costs for not-for-profits, especially those small not-for-profits that may not have paid tax on member transactions in the past, the February 2025 issues paper raised the question of increasing and/or redesigning the current $1,000 tax-free threshold to continue to remove small-scale not-for-profits from the tax system.

Proposal

3.23 It is proposed that the current $1,000 tax-free threshold be increased to $10,000. This is consistent with suggestions from many submitters who indicated that a $10,000 threshold was an appropriate level.

3.24 However, to target the threshold to small not-for-profits (and limit the fiscal cost of the proposal) rather than all not-for-profits, we are considering a "cliff face" threshold. This means that if an entity has net income of more than $10,000, the tax-free threshold would not apply to them. Without the cliff face, an entity with income of $10 million would be eligible for the deduction, which we do not consider appropriate.

3.25 We considered and dismissed the option to apply an abating threshold, because it would be complex to administer and the fiscal cost of the proposal would increase.

3.26 We acknowledge that at the margin, the cliff-face proposal could be seen as unfair. For example, a not-for-profit entity with a surplus of $9,000 would not pay any income tax, whereas a not-for-profit entity with a surplus of $11,000 would pay income tax on its total surplus. However, the proposal to increase the threshold to $10,000, together with the exemption of subscription payments, would keep a relatively large group of not-for-profits in a non-taxpaying situation.

3.27 As is currently the case with the $1,000 tax-free threshold, a $10,000 tax-free threshold would apply to each entity, and not to individual branches. Any tax-free threshold not used in a year could not be carried forward to subsequent years.

Questions for submitters

Q19. If the tax-free threshold is increased to $10,000 it would apply to each entity (not to individual branches) and the proposal is for a cliff face threshold, that is, it would not apply to any entity with a net profit greater than $10,000. Do you agree this proposal would reduce compliance costs for small not-for-profits?

Q20. What design changes do you recommend to improve the proposal?

Q21. Are there likely to be any unintended consequences of a cliff face threshold?

Resident withholding tax exemption

3.28 Currently, not-for-profits with net income under $1,000 are entitled to a resident withholding tax (RWT) exemption. The exemption means that RWT is not deducted at source from interest and dividends paid to them. However, it does not mean that the interest and dividends are not subject to tax. Rather, this income needs to be included in the not-for-profit's income tax return.

3.29 Not-for-profits are required to advise Inland Revenue when they no longer meet the criteria for the RWT exemption (this is an annual test), for example, because their net

income exceeds $1,000. We are aware that there is some non-compliance in this area and that some not-for-profits consider that the RWT exemption means they do not pay tax on interest income. It is difficult for Inland Revenue to effectively address this non-compliance because, currently, payers of interest and dividends are not required to tell Inland Revenue about the investment income paid to holders of RWT exemptions – including not-for-profits.

Proposal

3.30 Currently, payers of interest and dividends are not required to tell Inland Revenue about the investment income paid to holders of RWT exemptions, including not-for-profits. It is proposed that the tax-free threshold is increased to $10,000, so it is also proposed that financial institutions be required to provide Inland Revenue with not-for-profits' financial information. This will enable Inland Revenue to enforce the current requirement that the RWT exemption must be removed when a not-for-profit earns income above the tax-free threshold.

Questions for submitters

Q22. What issues are there with requiring financial institutions to provide Inland Revenue with not-for-profits' financial information?

Filing requirements

3.31 Currently, Inland Revenue does not require taxable not-for-profits to file tax returns if they qualify for the $1,000 tax-free threshold and have net taxable income of $1,000 or less. However, this approach is not supported by the current legislation, which requires all taxable not-for-profits to file income tax returns even if they have no taxable income.

3.32 Of the approximately 26,000 taxable not-for-profits on Inland Revenue's system, currently only 4,000 file income tax returns. If the current legislation were enforced, the remaining 22,000 non-filing not-for-profits would be required to file tax returns.

Proposal

3.33 Filing requirements for not-for-profits should balance the objective of reducing compliance costs with the need for appropriate integrity measures, particularly when a significant tax concession is being provided.

3.34 The filing requirements for smaller not-for-profits should be reduced. However, we do not believe the requirement to file should be removed entirely. Exempting smaller not-for-profits from filing tax returns does not give Inland Revenue any assurance that officers of not-for-profits have turned their mind to whether their annual taxable income is below the tax-free threshold. The filing exemption can, in some circumstances,

perpetuate the misunderstanding that all not-for-profits are tax exempt and do not have any tax obligations.

3.35 Therefore, we propose that smaller not-for-profits would not be required to file full tax returns and instead would file a short-form tax return. The short-form return would essentially be an annual confirmation that a not-for-profit qualifies for the $10,000 tax-free threshold, and that they have income under that amount (see Example 13). Our initial view is that for simplicity, eligibility for reduced filing requirements should be aligned with eligibility for the effective tax-free threshold.

3.36 Changes in filing requirements in this way can be made without the need for a legislative amendment. Inland Revenue can use its existing ability to prescribe the form of a tax return so that the information smaller not-for-profits are required to provide annually is not onerous.

3.37 We propose that the standard late filing penalty would apply. In addition, the RWT exemption would be based on the not-for-profit's previous year's income, therefore failure to provide a return would mean that the not-for-profit is not entitled to an RWT exemption in the following year.

Example 13: Short form filing question

Is your net taxable income $10,000 or less? If so, tick yes and go straight to question X and sign the return.

Questions for submitters

Q23. Do you agree with the approach proposed in this chapter to introduce a short form return? If not, what do you suggest? What should be the consequences of a not-for-profit not filing a return (either a short form or full return)?

Application date

3.38 We propose that the changes set out in this chapter apply from the 2027–28 tax year. This date would allow sufficient time for legislative change to provide certainty on the treatment of membership subscriptions and for entities to implement changes (for example, if a not-for-profit needs to register as a charity). Also, we expect that this date would align with the release of Inland Revenue's guidance on member transactions.

Questions for submitters

Q24. Does the proposed application date give not-for-profits sufficient time to implement any changes to processes? If not, what date do you propose and why?

Chapter 4 – Donation tax credit simplifications

Overview

4.1 The donation tax credit (DTC) is a longstanding policy mechanism designed to encourage philanthropy by allowing individuals to claim a 33⅓% tax credit on donations made to schools and approved donee organisations.

4.2 In 2023–2024 Inland Revenue conducted a DTC regime regulatory stewardship review[20] that identified opportunities to improve the regime by reducing compliance burdens and encouraging philanthropy.

4.3 As outlined in the February 2025 issues paper, the policy-related recommendations were:

- moving away from annual DTC claims to allow for more real-time payments, for example when DTCs are refunded before year-end and closer to the time a donation is made
- allow Inland Revenue to collect data from donee organisations to pre-fill DTC claims and streamline the DTC claiming process, and
- introduce a three-month grace period so donee status is retained if a deregistered charity is re-registered within three months.

4.4 The pre-fill DTC claims proposal is not progressing. While a majority (55%) of submissions on this issue supported the proposal, there were concerns that it would shift compliance costs from the donor to the donee organisation because new systems would be needed to gather and store information.

4.5 The grace period proposal is also not progressing. There are concerns that deregistered charities could retain their donee status even when becoming taxable. Such a situation would be open to abuse. In addition, we considered that an arbitrary three-month grace period is unlikely to be justified when most deregistered charities have failed to meet their filing requirements under the Charities Act for at least two consecutive years.

Proposed changes

4.6 Two key proposals have emerged from this review. The first would allow Inland Revenue to refund DTCs during the year instead of waiting until after year-end. The second would allow donors to allocate their DTC directly back to the charity they donated to.

4.7 These proposals are slightly different to what was canvased in the February 2025 issues paper. We consider that they would support philanthropic giving.

[20] DTC regime regulatory stewardship review findings and response

4.8 Both changes would take advantage of new capabilities in the Inland Revenue computer system.

DTC in-year refunds

4.9 This proposal would allow in-year refunds, enabling individual donors to receive refunds closer to the time of donation. This simplification would apply to schools and approved donee organisations.

4.10 This could be implemented by allowing for DTC claims to be made within the year.

4.11 Shifting to an "in-year" model may help Inland Revenue progress the claims quicker, making the DTC more accessible and timely for donors, which may encourage greater and more frequent philanthropic giving.

4.12 Our proposal is that DTC in-year refunds would have the following key features:

- Individuals who have reportable income will benefit from this proposal.[21]
- Individuals with reportable and non-reportable income could make use of this change up to the value of any reportable income earned in the year.
- In-year claims would be made through myIR.
- In-year claims made by tax agents would be eligible if individual donation details and receipts were uploaded to myIR.
- Inland Revenue would process the refunds periodically throughout the year.
- Consistent with current processes, the DTC would be limited to a third of the individual's reportable income earned in the year to date. If at the time of the donation, the donor's reportable income is less than the donation, they may need to wait to claim the DTC until later in the year.

4.13 Here are some limitations with the proposal, which we think are necessary to minimise Inland Revenue administrative costs and work within system constraints:

- Individuals with only non-reportable income would need to file an income tax return to claim their DTC.
- Paper-based claimants would not be able to access in-year refunds.
- Donee organisations would not be required to provide receipts to donors more frequently, but they may face pressure to do so. Receipts would still need to be provided when claims are made because donors cannot claim the credit until receipts are issued. This may impact when donee organisations issue receipts.

[21] Reportable income includes salary and wages and other income types that are reported to Inland Revenue by third parties, for example, interest and dividends.

4.14 Our current proposal is that donations eligible for the DTC are capped at the donee's reportable income. We recognise this is inconsistent with the DTC claims that are limited to taxable income, rather than reportable income.

Questions for submitters

Q25. Do you believe the proposal for donors to claim in-year DTCs, as described in this chapter, would benefit donors and charities?

Q26. What design changes do you recommend to improve the proposal?

Allocating DTCs directly to donee organisations

4.15 This proposal would allow donors to allocate their DTC directly to the donee organisation they supported, simplifying the process for donors and encouraging further charitable giving.

4.16 Currently, when a donation is made the donor is the only eligible recipient of the DTC. This means that if the donor wants the charity to receive the DTC, they must manually donate it back to the charity.

4.17 While this was not consulted on in our February 2025 issues paper, many submissions proposed that the ability for donors to allocate their DTC to the donee organisation be reinstated.

4.18 Our proposal for allocating DTCs directly to donee organisations would have the following key feature – if the donor elects, Inland Revenue will refund the DTC to the donee organisation that received the original donation.

4.19 Here are some aspects of the proposal you may need to consider:

- When a donor donates to more than one donee organisation, they will be able to have their DTC allocated to each donee organisation.
- When the donor has overdue tax obligations, this would still be covered before any remaining credit is allocated to the donee organisation.
- The allocation of the DTC to the charity would not qualify as an additional donation by the donor (that is, it would not qualify for a DTC).
- Donee organisations will need to set up an account with Inland Revenue to receive the DTC, otherwise the donor will receive the DTC refund.
- The donee organisation will not be able to identify the donor of the DTC when it is refunded back to the donee organisation.

Questions for submitters

Q27. Do you believe the proposal for donors to allocate DTCs to the charity they donated to, as described in this chapter, would benefit donors and charities?

Q28. What design changes do you recommend to improve the proposal?

Application date

4.20 We propose that the changes set out in this chapter would have an application date of 1 April 2027.

Questions for submitters

Q29. Does the application date of 1 April 2027 give donee organisations sufficient time to implement any changes to their processes? If not, what date do you propose and why?

Chapter 5 – Treaty of Waitangi considerations

Overview

5.1 The Government's Treaty of Waitangi and Tiriti o Waitangi (Treaty) responsibilities relating to matters raised in this document require consideration of Treaty interests and, when Treaty interests may be impacted, engagement with the principles of the Treaty of Waitangi. This chapter discusses the potential impacts of the proposals on Treaty interests.

5.2 We do not have access to comprehensive data on Māori donors or Māori not-for-profits and cannot accurately state how many of those persons, trusts or entities may be affected by reform. In the absence of comprehensive data, information in this chapter has been informed by limited data and recent engagement with Māori.

Relevant treaty interests

5.3 There are a variety of Treaty interests in the tax system generally. We consider that the interests that are particularly relevant are:

- Māori individuals or entities who are donors, officers or beneficiaries of donor-controlled charities, donor-advised funds or donee organisations.
- Māori trustees who allocate beneficiary income to donor-controlled charities, donor advised funds, or tax-exempt entities.
- Māori involved with taxable not-for-profit entities and taxable charitable trusts that have obligations under the Income Tax Act 2007 and the Tax Administration Act 1994.

5.4 The legal characteristics of Māori donors, officers, beneficiaries, and trustees are largely the same as other entities. Although our understanding is that these Māori individuals, entities or trustees would be affected, the extent of that impact remains unclear.

5.5 Some Māori submitters on the February 2025 issues paper noted the importance of understanding the wider context in which Māori operate, including their cultural responsibilities to whānau, hapū, marae and iwi, and relevant legislation or government processes that regulate how Māori can govern, manage or develop their resources. These factors can influence the impact of any likely tax compliance costs. For example, the Māori Land Act 1993 provides for the retention of Māori land in Māori ownership, rules for succession to land interests and trusts for management purposes. These provisions can add complexity to the way in which land may be used and developed by Māori, which can then exacerbate the impact of any likely tax compliance costs.

Treaty settlement commitments

5.6 We are not aware of any Treaty settlement commitments that establish obligations on tax settings.

5.7 We acknowledge that some post-settlement governance entities have expressed a view that Treaty settlement commitments could give rise to obligations in respect of taxation and not-for-profit settings. However, that view was expressed in relation to proposals that are now not being progressed. It is, therefore, unclear what the views of these entities would be on the current proposals.

Treaty principles

5.8 The Treaty principles relevant to matters raised in this document include active protection and partnership. Active protection requires the Crown to give appropriate priority to, and take reasonable steps to protect, Māori interests. Partnership requires the Crown and Māori to act reasonably and in good faith.

5.9 There are no statutorily recognised Treaty principles in tax law.

Treaty implications

5.10 The potential Treaty implications of the proposals are discussed below.

Donor-controlled charities

5.11 The problem definition and objectives for reform are outlined in Chapter 2.

5.12 Submitters on the February 2025 issues paper raised concerns that a broad definition of a donor-controlled charity could capture iwi entities, particularly those with governance structures linked to Treaty settlements. Our understanding is that these entities would not fall within the proposed definition. This is discussed further in Chapter 2.

5.13 We consider that the specific proposals that could have Treaty implications are:

- the proposal to require private trusts to pay beneficiary income allocated to a tax-exempt entity within the later of six months from balance date or the due date for filing an income tax return, and
- the proposal to apply the donor-controlled charity rules to donor-advised funds.

5.14 The impacts of the two proposals above are not anticipated to be unique for Māori. Although the impact of the first proposal is expected to be positive, the impact of the second proposal could be negative. More specifically, on the latter (the proposal to apply donor-controlled charity rules), the impact would depend on whether Māori donors hold donor-advised funds and are distributing below the minimum distribution requirement; if they are, they could be negatively impacted. Māori could also be negatively impacted if

the DTC cap for donor-controlled charities is extended to donations to donor-advised funds.

Membership subscriptions and related matters for not-for-profit organisations

5.15 The problem definition and objectives for reform are outlined in Chapter 3.

5.16 We consider that the specific proposals that could have Treaty implications are:

- The proposal to raise the not-for-profit tax-free threshold from $1,000 to $10,000 but remove the tax-free threshold for not-for-profits with a net surplus greater than $10,000. On balance, this proposal would be positive for Māori involved with taxable not-for-profit entities and taxable charitable trusts. It might mean fewer taxable not-for-profits pay tax.
- The proposal to introduce a short form return for not-for-profits who benefit from the $10,000 deduction. On balance, this proposal would address the concerns raised by Māori in submissions on the previous consultation, that there is a need for compliance obligations to be simplified. It would mean fewer taxable not-for-profits would have to file long form income tax returns. Introducing a short form return is expected to make it easier to comply with filing requirements.
- The proposal to exempt some membership subscriptions would make it clear which payments should be treated as income for tax purposes, which is expected to assist with compliance.

5.17 We consider that some marae would be impacted by the proposal to raise the not-for-profit tax-free threshold from $1,000 to $10,000. Marae have particular cultural significance and, of the approximately 780 marae in New Zealand, about 40% (about 300) are not registered as charities. Of those marae that are not charities, we anticipate 12% (about 40) would benefit from this proposal. This assumption, however, is based on income earned by charitable marae, which we have assumed would be like non-charitable marae.

Donation tax credit simplifications

5.18 The problem definition and objectives for reform are outlined in Chapter 4.

5.19 Although we consider that there could be a number of proposals that might impact Māori individuals or entities who are donors, officers or beneficiaries of donee organisations, the proposals that could have treaty implications, are:

- The proposal to allow donors to allocate their DTC to the donee organisation they donated to. On balance, this proposal is anticipated to be positive for Māori donors and donee organisations. For example, donors to marae that are registered charities and donee organisations will be able to request Inland Revenue to pass their DTC directly back to the marae.

- The proposal to allow in-year refunds, enabling individual donors to receive refunds closer to the time of donation. On balance, this proposal is anticipated to be positive for Māori groups. Although donee organisations would not be required to provide receipts to donors more regularly during the year, this proposal could increase compliance costs for Māori donee organisations if they face pressure to provide receipts to donors more regularly. However, we expect that these additional compliance costs for Māori donee organisations would be outweighed by the benefit of individuals donating more to Māori donee organisations. International research indicates that donors would donate more if a DTC were refunded closer to the time of the donation.

Questions for submitters

Q30. Do you agree that the proposals identified in this chapter would have direct impacts for Māori?

Q31. Do you agree that the impacts are articulated appropriately? If not, what impacts do you believe the proposals are likely to have on Māori?

Appendix: Summary of questions for submitters

Discussion questions

Chapter 2 – Donor-controlled charities

Q1. Are there any issues with the definition of donor-controlled charities outlined in this chapter? For example, would it apply to charities that are not donor-controlled? If so, what alternative(s) would you propose?

Q2. If New Zealand adopts a minimum distribution of 5% of net assets for donor-controlled charities we would be similar to Australia and Canada. Do you agree this is appropriate in the New Zealand context? If not, what alternative would you propose and why?

Q3. Are there any issues with the proposal to require donor-controlled charities to estimate the market value of their net assets annually for the purposes of the minimum distribution requirement? If so, what alternative would you suggest?

Q4. Are there any issues with the policy design of a minimum distribution requirement for donor-controlled charities as outlined in this chapter that we should consider?

Q5. Which of the three integrity options outlined in this chapter (Option 1: Arm's length transactions rule; Option 2: Prescribed rate for loans to related parties or shares held in related companies; Option 3: Reduce donation tax concessions in certain loan or share purchase arrangements) does the best job of addressing integrity issues without adversely affecting genuine philanthropy. Why?

Q6. Are there any other issues with any of the options outlined in this chapter that we should consider?

Q7. What are the consequences of reducing the individual DTC cap for large donations to donor-controlled charities? What could be the impact on the charitable sector more generally?

Q8. If the DTC cap was reduced for donations to donor-controlled charities, should there also be a cap on the amount of income that private trusts can allocate to donor-controlled charities, and a limit to the donation tax deduction for companies?

Q9. Should donor-advised funds be subject to the same rules as donor-controlled charities (such as a minimum distribution requirement and other integrity measures)? Why or why not? What impacts might this have on the broader philanthropic environment?

Q10. What are the implications of applying the wholly or mainly test for donee organisations under section LD 3(2)(a) of the Income Tax Act to donor-advised funds, instead of the fund-holding charity?

Q11. Do you agree that there should be a "pay in money" rule for trustee allocations to tax-exempt beneficiaries? Why or why not?

Q12. Are there any policy design issues that we need to consider?

Q13. Does the application date of 1 April 2027 for changes proposed in this chapter give affected entities and trusts sufficient time to implement any changes to their processes? If not, what date do you propose and why?

Chapter 3 – Membership subscriptions and related matters for taxable not-for-profits

Q14. Does the proposed definition of a membership subscription for not-for-profits describe the type of payments we want to relieve from tax? Are there likely to be any unintended consequences?

Q15. Does this test sufficiently distinguish payments for core membership benefits from payments made for other benefits received by a member? If not, why?

Q16. What types of benefit do you think should fall outside the concept of a membership subscription? Would this include, for instance, advocacy services on behalf of an industry or a group of workers?

Q17. The proposed approach requires potential apportionment of some membership subscriptions. Would you prefer a simpler test that required all of the membership subscription to be treated as taxable instead, if it included any identifiable direct valuable benefits? Are there any other approaches we could use?

Q18. When a payment contains both taxable and non-taxable elements, would a test like a principal purpose or wholly or mainly test to determine the degree of taxability be appropriate?

Q19. If the tax-free threshold is increased to $10,000 it would apply to each entity (not to individual branches) and the proposal is for a cliff face threshold, that is, it would not apply to any entity with a net profit greater than $10,000. Do you agree this proposal would reduce compliance costs for small not-for-profits?

Q20. What design changes do you recommend to improve the proposal?

Q21. Are there likely to be any unintended consequences of a cliff face threshold?

Q22. What issues are there with requiring financial institutions to provide Inland Revenue with not-for-profits' financial information?

Q23. Do you agree with the approach proposed in this chapter to introduce a short form return? If not, what do you suggest? What should be the consequences of a not-for-profit not filing a return (either a short form or full return)?

Q24. Does the proposed application date give not-for-profits sufficient time to implement any changes to processes? If not, what date do you propose and why?

Chapter 4 – Donation tax credit simplifications

Q25. Do you believe the proposal for donors to claim in-year DTCs, as described in this chapter, would benefit donors and charities?

Q26. What design changes do you recommend to improve the proposal?

Q27. Do you believe the proposal for donors to allocate DTCs to the charity they donated to, as described in this chapter, would benefit donors and charities?

Q28. What design changes do you recommend to improve the proposal?

Q29. Does the application date of 1 April 2027 give donee organisations sufficient time to implement any changes to their processes? If not, what date do you propose and why?

Chapter 5 – Treaty of Waitangi considerations

Q30. Do you agree that the proposals identified in this chapter would have direct impacts for Māori?

Q31. Do you agree that the impacts are articulated appropriately? If not, what impacts do you believe the proposals are like to have on Māori?