

**SECOND REPORT BY THE WORKING
PARTY ON REGISTRATION, REPORTING AND
MONITORING OF CHARITIES**

31 MAY 2002

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SECOND REPORT BY THE WORKING PARTY ON REGISTRATION, REPORTING AND MONITORING OF CHARITIES

BACKGROUND

The Working Party was appointed on 27 November 2001, to make recommendations to the Government on a registration, reporting and monitoring regime for charities and to provide comment on other identified issues. The Terms of Reference are attached as Appendix 3.

In particular we were required to:

- provide recommendations on the type of registration, reporting and monitoring arrangements that should be introduced in New Zealand and how they should be implemented, including identifying the body which will register charities
- comment should we so wish, on the wider impacts of the issue of the public benefit test as discussed in the Taxation of Maori Organisations Discussion Document
- report to the Minister of Finance on our findings.

The Working Party was also invited to comment on:

- the proposal to standardise the various tax assistance rules applying to New Zealand charities with overseas purposes, and
- whether the definition of “charitable purpose” can be improved without altering its overall scope.

Our report on registration, reporting and monitoring of charities was presented to the Minister of Finance on 28 February 2002, and can be found on the Treasury website at www.treasury.govt.nz/charities.

INTRODUCTION & SUMMARY OF RECOMMENDATIONS

We now report on the two outstanding issues which were canvassed in the Government's June 2001 Tax and Charities Discussion Document. These are the rules applying to charities with an overseas purpose and the definition of charitable purpose. We consider that these are very important issues and have therefore accepted the invitation to comment.

Summary of Recommendations - Overseas Purposes

Donee status

We recommend retaining tax assistance for people who donate to charities with overseas purposes, based on those criteria currently used by Parliament as guidelines for determining whether an organisation with overseas purposes should have donee status.

We recommend that the current approval process be changed, so that donee status is granted within the relevant criteria as part of the registration process proposed by us in our 28 February report.

We recommend however that the criteria should be used on a "principally" and not "exclusively" basis, and should be reviewed from time to time. We recommend that the Charities Commission be tasked with responsibility for developing the criteria and determining what level of activity, and what underlying purposes, are within those criteria. However, we consider that the "principally" threshold should be reasonably high.

Income tax

We recommend that no change be made to the income tax rules at present, but that the issue be revisited within the next two or three years. This will allow time for information to be gathered, through the reporting process recommended in our previous report, on the amount of money being sent overseas. At the same time, a full assessment of the likely compliance costs of apportionment and filing should be carried out. This will allow the proper trade off between the fiscal and compliance costs to be assessed.

We recommend that Government should move either to an unqualified income tax exemption, or the discussion document proposal, depending on an assessment of the compliance and fiscal costs. If the Government does proceed with the discussion document proposal, we recommend that there should be a threshold below which the apportionment rules do not apply, i.e., below the threshold there is an unqualified exemption.

GST

We recommend that in future, payments made to New Zealand charities by the Government with a requirement that they be used in overseas programmes be treated as zero-rated for GST purposes. Any part of the payment that is retained in New Zealand should be subject to GST in the normal way.

The Government should carefully consider whether the figures returned for statistical purposes should be GST inclusive or exclusive. We acknowledge that this will depend on the context in which the statistics are used.

Summary of Recommendations - Definition

We believe that the definition of "charitable purpose" can be improved without altering its overall scope. Accordingly, we recommend that the definition set out in this report, which is based on the approach taken by the Australian Review Committee with changes to reflect New Zealand culture and values, should be adopted and set out in legislation.

NEW ZEALAND CHARITIES WITH AN OVERSEAS PURPOSE

Charities whose purposes are exclusively within New Zealand receive benefits through the taxation system in three main ways:

- Income from business activities is exempt from tax.
- Income from general activities such as investment income is exempt from tax.
- The charity has donee status, i.e. individual donors are entitled to a tax rebate, and corporate donors to a tax deduction for their charitable donations, up to prescribed limits.

The situation differs however if charities distribute part or all of their income overseas:

- Income from business activities that charities distribute overseas is taxed.
- Other income remains exempt from tax.
- Charities that distribute proceeds overseas do not have donee status, unless approved by Parliament.

The types of purposes Parliament has used in deciding whether a charity with overseas purposes should be approved for donee status are:

- the relief of poverty, hunger, sickness or ravages of war or natural disaster, or
- to assist the economy of developing countries, as recognised by the United Nations, or
- raising the educational standards of a developing country.

Comment on Discussion Document Proposal

The Government's Discussion Document proposed to standardise the various assistance rules applying to charities with overseas purposes. The proposal referred to is set out in Chapter 10, page 46, of the June 2001 Tax and Charities discussion document, as follows:

- 10.6 The approaches to all forms of tax assistance to charities with overseas purposes would be standardised. The criteria currently used in respect of donee status, described earlier, would be applied in determining eligibility for both the income tax exemptions and for donee status.
- 10.7 This means that in respect of the general income tax exemption (CB 4(1)(c)), the eligibility criteria would be tightened, because income applied for some overseas purposes would no longer be eligible for the exemption. However, the eligibility criteria would be liberalised in respect of a charity's business activities (CB 4(1)(e)) because income applied for some overseas purposes would then be eligible for the exemption.
- 10.8 For a charity to comply with this requirement, the overseas charitable purposes of the organisation would have to be approved, as currently happens with donee organisations.
- 10.9 All charities would be required to report how much they were distributing overseas. If a charity did not meet the criteria in relation to its overseas purposes, but was also undertaking charitable purposes within New Zealand, the amount of income that would be exempt would be determined by apportionment.
- 10.10 There is no intention to tax the donation income of an entity when it becomes taxable in respect of income it applies overseas.

We agree in principle with the proposal in the Discussion Document to standardise the tax treatment between business and other income distributed overseas, and donee status. However, we have some concerns about compliance costs, which are discussed later in this report. This may mean that complete standardisation may not be desirable.

Donee status - guidelines

As noted above, when Parliament determines whether a charity with purposes outside New Zealand should have donee status, the criteria it uses are limited to:

- the relief of poverty, hunger, sickness or ravages of war or natural disaster, or
- assisting the economy of developing countries, as recognised by the United Nations, or
- raising the educational standards of developing countries.

These criteria are, broadly, in line with New Zealand's overseas aid policy. Donee status provides specific public benefits through the taxation system. It is therefore appropriate that the Government sets the parameters within which it gives tax relief, just as the Government has the right to set its own foreign policy.

The Government has established certain principles for funding development assistance by voluntary (charitable) agencies through the Voluntary Agency Support Scheme. These principles include separating any religious proselytising from the development work that is funded by the agency. This does not stop an agency being involved in religious activity, however the development activities being funded must be open to all and not be used to coerce or entice people to participate in a particular religious practice.

We recommend retaining tax assistance for charities with overseas purposes based on those criteria currently used by Parliament as guidelines for determining whether an organisation should have donee status. New Zealanders recognise that they are part of a global community and have obligations to help people in other countries. The Government also has binding obligations under international agreements and charitable organisations play a role in assisting the Government in meeting its goals.

However we consider that the criteria that are currently applied should be updated. We agree with the overseas development focus, and recommend that the Charities Commission should have an ongoing role in developing the criteria to be applied for determining donee status. These criteria should be developed between the Charities Commission, the Ministry of Foreign Affairs and Trade, and the Council for International Development.

Donee status - process

We recommend that the current approval process be changed, so that charities that meet the criteria should not have to be approved by Parliament in order to have donee status. Donee status should be able to be granted (or revoked, as may be appropriate) based on the registration and reporting processes proposed by us in our 28 February report.

This would mean that the criteria would be set out in legislation or regulation, and the Charities Commission would use them as guidelines when an organisation applied to be registered as a charity. The Commission would confer donee status or not, depending on whether the organisation's activities were within the guidelines. Charities would not receive donee status if the funds they distribute overseas were not used for purposes consistent with the criteria.

We recommend however that the criteria should be used on a "principally" and not "exclusively" basis, and should be reviewed from time to time.

Many charities that operate overseas have some purposes and activities that are outside the criteria – for example, religious activities. We do not mean to suggest that those organisations be excluded from donee status in respect of their overseas activities, but wish to reinforce that donee status for overseas purposes and activities should be focused on “overseas aid” purposes and activities that are within the criteria.

Setting a threshold as to what “principally” means in this context is a very difficult task and we have felt constrained by time and information. We recommend that the Charities Commission be tasked with the responsibility for developing the criteria and determining what level of activity, and what underlying purposes are within those criteria. However, we consider that the “principally” threshold should be reasonably high.

Currently, organisations with overseas purposes apply to be listed separately in section KC 5 of the Income Tax Act. There are two issues relevant to this. First, we understand that some of the organisations listed are no longer active, so the Government might like to review the list. Secondly, we recommend it is no longer necessary to actively retain that legislative process in relation to charities once the Charities Commission approval process is in place.

Income tax

We consider in principle that both passive and business income, and charitable donations that are sent overseas, should be treated in the same way.

This would mean apportioning passive and business income of a charitable organisation and taxing the income that is applied to overseas purposes not within the donee status criteria. However, we are concerned about the compliance costs charities would face, including filing a tax return, if this approach were adopted.

We recommend therefore that no change be made at present, but that the issue be revisited within the next two or three years. This will allow time for information to be gathered about the amount of money being sent overseas. The reporting process recommended in our previous report would assist this and the cost to the government of exempting this income from taxation will then be clear.

At the same time, a full assessment of the likely compliance costs of apportionment and filing should be carried out. This will allow the proper trade-off between the fiscal and compliance costs to be assessed.

We recommend that, depending on the outcome of those inquiries, the Government should move either to an unqualified exemption for both passive and business income, or to apportionment based on the donee status criteria. Further, if the Government does proceed with standardisation that leads to apportionment, we recommend that

there should be a threshold below which the apportionment rules do not apply, i.e., below the threshold there would be an unqualified exemption.

Goods and Services Tax

Current treatment

When the government makes payments or grants to New Zealand charities, these are subject to GST and the GST is included in the amount of the payment. This is normally included in the next GST return filed by the charity and the GST content is returned to the government. When the government makes direct grants to overseas aid programmes, these are zero-rated for GST purposes, so no GST is paid or returned.

Some of the grants made to New Zealand charities by the government are tagged by the government for overseas programmes, and are sent overseas by the New Zealand charity. Currently these payments are treated as grants to a New Zealand charity, and are therefore subject to GST.

We consider that this is not an appropriate treatment. Further, we understand that the government uses the GST inclusive amount when returning statistics for inter-governmental use.

Proposal

We recommend that in future, payments made to New Zealand charities by the government with a requirement that they be used in overseas programmes be treated as zero-rated for GST purposes. Any part of the payment that is retained in New Zealand should be subject to GST in the normal way.

The Government should carefully consider whether the figures returned for statistical purposes should be GST inclusive or exclusive. We acknowledge that this will depend on the context in which the statistics are used.

DEFINITION OF CHARITABLE PURPOSE

We have already stated in our report of 28 February that we believe that the definition of “charitable purpose” should be set out in legislation. We are also going to take the opportunity to indicate what we believe that definition should be.

In 1891 Lord Macnaghten classified charitable purposes under four heads (Pemsel case):

- the relief of poverty
- the advancement of education
- the advancement of religion
- other purposes beneficial to the community.

This classification has been extensively used since, but it does not comprise a definition.

In general the Courts still use the Pemsel heads but have endeavoured to update their interpretations to reflect current social and economic circumstances. To be recognised as “charitable” a purpose must be analogous to the purposes spelled out in the preamble to the Statute of Elizabeth, or to any purpose that has since been determined by the Courts to be charitable.

We believe that some of the problems that have arisen in the past regarding the definition of charitable purpose are less to do with the definition itself and more to do with how it is applied. If an organisation wants to challenge a ruling on the definition they face costs that can be prohibitive.

The Charities Commission should be able to interpret and advise on a definition of charitable purpose that is set out in legislation. We believe this will help organisations overcome some of the problems related to the definition that they have faced in the past.

In our view, there ought to be a strong degree of compatibility between whatever definition is adopted in New Zealand and those to be adopted in other common law countries. Decisions of the Courts in those countries have already influenced the decisions of Courts in New Zealand and are likely to continue to do so.

We are aware of the extensive Inquiry into the Definition of Charities and Related Organisations undertaken in Australia during 2001. We are also aware that reviews are being undertaken in other parts of the Commonwealth with similar legal frameworks to New Zealand, and we recommend that the outcome of those reviews be considered carefully.

We have taken the liberty of modifying the definition recommended by the Australian Committee of Inquiry so that it better suits New Zealand. We recommend that the Government consider adopting this definition. The modified definition is attached as Appendix I.

We do not see the introduction of a formal statutory definition as marking a significant change to the current understanding of “charitable purpose” or as a major departure from the Preamble, the Pemsel Heads, or existing case law. In that sense, we do not believe that our recommended definition alters the overall scope of current understanding of what is charitable. Rather we see it as clearly stating the position that has developed through four hundred years of case law.

We propose some changes, however we believe these clarify the definition rather than depart from current law. These changes are discussed below:

We understand that currently, the advancement of culture is seen as part of the advancement of education. We believe that it justifies a separate specific heading. Furthermore, we believe that the preservation of New Zealand heritage is commonly understood to be a charitable activity and should also be listed specifically. In this regard, we agree with and are following the recommendations of the Australian Committee of Inquiry.

The practice and development of Tikanga Maori and Te Reo Maori is included as part of the advancement of culture and heritage. We believe these purposes to be within the spirit of the Treaty of Waitangi and in line with current values and attitudes in New Zealand.

A further addition to the definition is the advancement of the natural environment and the promotion and protection of civil and human rights. In this regard, we are following the recommended Australian definition. We believe that this addition also reflects current New Zealand societal attitudes and values.

We have added "advocacy" to the clause defining "advancement" with the intention that advocacy for any cause that is itself charitable in terms of the definition, should also be regarded similarly. This would continue to exclude the promotion of a political party or a particular candidate for political office.

Whilst not specifically included in the definition, the report of the Australian Committee of Inquiry makes it clear that in their view, such advocacy “is consistent with furthering a charity’s dominant purpose.” In this regard, the

report is not dissimilar from the position taken by the UK Charities Commission (*UK Charities Commission CC9 – Political Activities and Campaigning by Charities*). We agree with this position and believe it should be implemented in New Zealand, broadly in accordance with the guidelines contained in the UK Charities Commission publication.

We have not included any reference to the care and support of the families of the Armed Forces as the Australian proposal does, as those purposes appear to be covered by other parts of the definition.

The definition relates to the purposes for which an entity is established. For an entity to benefit from an exemption from income tax, it must be established for charitable purposes, and meet several other criteria. These are:

- the entity is not established or operated for personal pecuniary gain
- the purposes must be altruistic and carried out for the benefit of the public or a reasonably wide section of the public
- the purposes and activities should not be illegal or contrary to public policy, and
- the activities of a charity must further or be in aid of its charitable purposes.

Whilst not part of the definition, we consider that these criteria should continue to be applied.

We have already recommended that the current public benefit test be eased so that the existence of a relationship created by blood ties shall not disqualify an entity from recognition as a charity, provided that the other criteria are met.

In our view this definition represents the position that is likely to be taken by the New Zealand courts in the twenty-first century. The slow rate of development of case law owes more to the reluctance of charities to enter into litigation than to an unchanged environment or understanding of the term.

Developing the Definition

Further changes to the definition may well be deemed necessary as the Government considers the recommendations emerging from other Commonwealth countries. Implementing and operating a system for registering charities in New Zealand and monitoring their activities may also highlight desirable changes to the definition.

The Community and Government Sector Steering Group concluded that there is a need for a wider definition to be introduced to reflect the need to modernise the purposes regarded as being charitable given that views have changed significantly since 1601.

The UK Charities Commission adopts a two step process when considering new charitable purposes (*RR1a - Recognising New Charitable Purposes*). The steps are:

- is the purpose analogous to a purpose previously accepted as charitable, and
- does the purpose satisfy the public benefit test.

We recommend that the Charities Commission use a similar process to interpret the definition and we believe the Courts will also continue to do so.

APPENDICES

Appendix 1 - Charitable Purposes

Charitable purposes shall be:

- the advancement of health, which includes the prevention and relief of sickness, disease or human suffering
- the advancement of education
- the advancement of social and community welfare, which includes:
 - the prevention and relief of poverty, distress or disadvantage of individuals or families
 - the care, support and protection of the aged and people with a disability
 - the care, support and protection of children and young people, and
 - the promotion of community development to enhance social and economic participation.
- the advancement of religion
- the advancement of culture and heritage, which includes:
 - the promotion and fostering of culture
 - the care preservation and protection of New Zealand heritage
 - the practice and development of Tikanga Maori, and
 - the practice, development and protection of Te Reo Maori.
- the advancement of the natural environment, and
- other purposes beneficial to the community, which include:
 - the promotion and protection of civil and human rights, and
 - the prevention and relief of suffering of animals.

In the above context, “advancement” includes protection, maintenance, support, research, improvement, enhancement and advocacy.

Appendix 2 - Members of the Working Party

Sidney Ashton, (Chairperson), former Chief Executive Officer of Te Runanga o Ngai Tahu

Frank Claridge, Treasurer of the Royal New Zealand Foundation for the Blind, member of the Federation of Voluntary Welfare Organisations national executive

Gordon Copeland, Chair of the Inter Church Working Party on Taxation, Financial Administrator of the Catholic Archdiocese of Wellington

Pat Hanley, Manager of the Association of Non Governmental Organisations of Aotearoa and Chair of the Social and Civic Policy Institute

Hemi-Rua Rapata, Chairman of the Federation of Maori Authorities o Aotearoa; the Taitokerau Federation of Maori Authorities; the Matauri X Incorporation

Judith Timpany, Chair of Philanthropy New Zealand, Executive Director of the Whanganui Community Foundation

Pat Webster, Former Executive Director of the Council for International Development, Executive Member the Association of Non Governmental Organisations of Aotearoa, Trustee of the Social and Civic Policy Institute.

Appendix 3 - Terms of Reference

Working Party on Registration, Reporting and Monitoring of Charities

Functions

The Working Party has been appointed to make recommendations to the government on the design of a method of registration, reporting and monitoring for charities, and to provide comment on other identified issues.

The functions of the Working Party will be:

- i to provide recommendations on the type of registration, reporting and monitoring arrangements that should be introduced in New Zealand and how they should be implemented
- ii to comment (if it wishes) on any wider impacts of the issue of the public benefit test as discussed in the Taxation of Maori Organisations Discussion Document
- iii to report to the Minister of Finance on its findings.

The Working Party is also invited to comment on:

- whether the definition of "charitable purpose" can be improved without altering its overall scope, and
- the proposal to standardise the various tax assistance rules applying to New Zealand charities with overseas purposes.

Context

The Government acknowledges the enormous contribution the charitable sector makes to New Zealand society. The work of these groups is highly valued by both government and the community.

The current government has initiated work focusing on improving the relationship between government and the community and voluntary sector, but also recognises that the legal and regulatory environment in which charities operate is in need of review.

Successive governments have expressed an interest in reform but have also expressed concerns about the degree to which the tax exemption for charities can be used for tax

avoidance. These same concerns have at times been expressed from within the community and voluntary sector itself.

New Zealand is not alone in considering changes to the charities legal environment. A number of Commonwealth countries are considering reforms of the charitable sector, and we expect to follow developments in those countries closely.

The Government released a discussion document in June 2001 canvassing various options for change related mainly to tax issues. The document highlighted that there is a lack of information available about the charitable sector, including who benefits, and how, from the tax assistance the government provides.

The discussion document generated a large number of submissions from a wide range of individuals and groups within and associated with the charitable sector. From submissions it is clear that there is general support for a registration, reporting and monitoring system.

As a first step, therefore, the Government has decided on a package, which includes proceeding with a registration, reporting and monitoring system. It has set up this working party to work with officials in developing a simple cost effective system that is suitable for New Zealand.

This leaves several issues still to be considered, some of which were raised in the discussion document. The working party has been asked to comment on some of these, but the government acknowledges that there is further work to be done over the next few years. It is hoped that the information gathered through the reporting and monitoring system to be introduced, as well as observation of other jurisdictions, will contribute to an informed debate on the wider issues, and to reform that will assist the sector in its vital role within New Zealand society.

Purpose

In his press statement of 16 October the Minister announced:

"A decision in principle has also been taken to introduce registration, reporting and monitoring requirements for charities claiming tax-free status. This is common in overseas jurisdictions and, from the feedback we have received, is broadly accepted here.

"To ensure the new system works well and has wide acceptance, the government has agreed to consult the charitable sector on the design details - including ways to reduce the compliance costs for smaller charities.

"A working party comprising sector representatives will be appointed and asked to come back to the government with recommendations."

The Working Party will concentrate on the operational aspects of a registration and reporting system that is workable for charities and useful to the Government and the public. Their recommendations will form the basis of advice to the Government in this area.

Ideally the system should be simple, efficient, fair and reliable. It should not impose unnecessary compliance costs on charities, as the resources of the sector, including the time of employees and volunteers should be focused on the valuable work they do, rather than on administration.

Task of the Working Party

The Working Party will:

- identify the body which will register charities
- propose a clear, simple, cost efficient and straight-forward method of registering charities
- recommend a system for the on-going collection and monitoring of information from the sector having regard to the purposes for which that information is collected.

The Working Party is invited to:

- comment on whether the definition of "charitable purpose" can be improved without altering its overall scope
- comment on the proposal to standardise the various tax assistance rules applying to New Zealand charities with overseas purposes
- comment on the wider implications of the issue of the public benefit test as it applies to Maori organisations.

The recommendations on registration and reporting need to be sufficiently particular to provide a clear idea of the actual legislative change and operational policies that they would require, including any enforcement policies.

With the exception of their comments on the definition of "charitable purpose" and on overseas charitable purposes, the Working Party will submit its report to the Minister of Finance by the end of February 2002. The working party will provide its comments on those other issues by the end of May 2002.

Process expectations

The Government will make available officials, and will expect them to contribute significantly in assisting the Working Party. It is likely that officials will provide a formal liaison between the Working Party and the relevant government departments.

A large number of submissions were received by the government on the Tax and Charities discussion document. The Working Party may have regard to those submissions, to the extent they are relevant to its work on registration, reporting and monitoring.

Both officials and the Working Party will keep Ministers informed of the progress of the Working Party.

The Working Party will liaise with the Community and Government Sector Steering Group. The Government will consider the recommendations of the Working Party, and indicate publicly its views on those recommendations by mid April 2002, with a view to introducing a package of legislation into the House in May 2002. The package will include the other charitable taxation issues on which decisions have already been taken, and a clarification of the definition to ensure that charitable purposes of any organisation must be ongoing for the tax exemption to be available.

Acknowledgements

The Committee would like to recognise the efforts of Rosemary Cook, Murray Shadbolt and Justin Brownlie of the Treasury in helping us produce this report.