Clarifying the tax consequences for deregistered charities

An officials' issues paper

July 2013

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CHAPTER 1

Introduction

1.1 This issues paper discusses problems with the current tax treatment of deregistered charities, and suggests a possible solution for clarifying the tax consequences for these entities by prescribing in legislation rules to deal with their new tax-paying status.

Current problem

1.2 A "deregistered charity" refers to an entity that has been removed from the Charities Register by the Department of Internal Affairs – Charities Services (formerly the Charities Commission).

1.3 Recent high-profile cases involving deregistered charities particularly where the entity continues in existence have shown that these entities can face a range of complex tax consequences that can be retrospective, transitional and prospective in nature. These consequences give rise to questions such as when should the entity start its life as a tax-paying entity; how should the entity treat its depreciable property or financial arrangements when it becomes a tax-paying entity, and what tax provisions should apply to the entity going forward.

1.4 The nature and extent of the potential tax consequences ultimately depends on the underlying reason why the entity was deregistered. These consequences may be more onerous (and may involve retrospective tax liabilities) if the deregistered charity is found never to have had a "charitable purpose" or had ceased being charitable in purpose at some time in the past, compared with the situation when a deregistered charity has simply failed to file the required annual return with Charities Services.

1.5 Current tax law does not adequately deal with the full range of tax consequences facing deregistered charities. This gives rise to additional compliance costs and stress for a group that, in general, is under-resourced and unsophisticated in terms of administrative functions.

1.6 For these reasons, and given the significance of the charitable sector in providing social services in New Zealand and the importance of ensuring the associated tax concessions are correctly targeted, we do not consider the status quo to be sustainable.

Suggested solution

1.7 We acknowledge that addressing the problems with the tax treatment of deregistered charities may require a mix of both legislative and operational measures, and that Inland Revenue and Charities Services would need to work together to ensure a seamless and robust process for deregistered charities to follow.

1.8 Given the range and complexity of the potential tax consequences that could face deregistered charities, officials seek feedback on the solution suggested in this paper and, in particular, whether a legislative approach is an appropriate way to address the matter or whether additional measures would be helpful.

1.9 Under the suggested solution, specific legislative rules would:

- clarify how the general tax rules, including the company, trust or other entity - specific regimes, apply to deregistered charities;
- establish the opening values of any depreciable property or consideration for any financial arrangements held by a deregistered charity when it becomes a tax-paying entity;
- prescribe specific timing rules for the application of the taxing provisions; and
- apply from the 2014–15 income year.

1.10 The suggested solution should help to ensure that the charities-related tax concessions are correctly targeted and desired policy intentions are met.

1.11 This means that the majority of former charities that have in good faith tried to meet their registration requirements should find that the solutions proposed will provide them with greater certainty about their tax obligations. On the other hand, the very small minority of deregistered charities that have wilfully refused to meet their registration requirements will face onerous tax consequences under the proposals outlined in this paper.

1.12 Officials invite submissions on the suggested solution and any other proposals that would address the stated problem. Submissions will be taken into account when we make recommendations to the Government on any necessary legislative changes. These changes would be included in a tax bill introduced in Parliament later this year.

Submissions

1.13 Submissions should include a brief summary of major points and recommendations. Submissions should also indicate whether it would be acceptable for officials to contact the submitter to discuss the points raised, if required.

1.14 Submissions should be made by 23 August 2013 and be addressed to:

"Deregistered charities"
C/- Deputy Commissioner, Policy and Strategy
Inland Revenue Department
P O Box 2198
Wellington 6140

1.15 Or emailed to policy.webmaster@ird.govt.nz with "Deregistered charities" in the subject line. Electronic submissions are encouraged.

1.16 Submissions may be the subject of a request under the Official Information Act 1982, which may result in their publication. The withholding of particular submissions on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. Submitters who consider that their submission or any part of it should properly be withheld under the Act should indicate this clearly.

CHAPTER 2

Registration process under the Charities Act

2.1 In New Zealand, registration of charities began on 1 February 2007. Charities Services is responsible for determining whether an entity can be registered as a "charitable entity" under the Charities Act 2005.

2.2 Although registration is voluntary and non-registration does not mean that the entity is not charitable in purpose, there are a number of benefits to registration. In particular, registered charities can qualify for charities-related tax concessions in the Income Tax Act 2007, and they may be eligible for greater funding as some funders have policies that only support charities that are on the Register.

Registration requirements

2.3 To be registered as a "charitable entity" an entity must meet the requirements in section 13 of the Charities Act 2005. It must:

- be established and maintained for exclusively charitable purposes. A "charitable purpose" is defined in section 5(1) of the Charities Act and includes:

  "...every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community.";

- not be carried on for the private financial benefit or profit of an individual;
- restrict its distributions upon winding-up to charitable purposes;
- have a legal name that is not misleading or offensive; and
- have proposed officers that are qualified by virtue of section 16 of the Charities Act 2005.

2.4 The Charities Act 2005 also requires all registered charities to file an annual return with Charities Services. An annual return includes both a complete annual return form and financial accounts.

On-going monitoring processes

2.5 Registration under the Charities Act 2005 is not necessarily a permanent status. An entity must continue to qualify for registration in order to remain on the Charities Register. Charities Services assesses the eligibility of entities to remain registered if there is cause to open an investigation or a monitoring review.

2.6 Charities Services may open an investigation in response to specific information – for example, a complaint, adverse information received about an entity's activities, a negative media report, a Court judgment relating to a similar type of charity, or concerns identified by Charities Services at the time of registration. Charities

Services also proactively monitors entities it identifies to be a medium to high-compliance risk, some of which proceed to investigation.

2.7 Alternatively, Charities Services may open an investigation because of information provided by the entity itself. This includes:

- notification of changes to its rules which mean its purposes are no longer charitable;
- notification of changes to its winding-up clause which means the winding-up clause no longer meets on-going registration qualification criteria;
- an annual return that shows spending on activities that are not related to its charitable purpose; and
- an annual return that indicates someone is receiving a private financial benefit.

2.8 In Chapter 3 we discuss the importance and significance of registration as a charitable entity for tax purposes.

CHAPTER 3

Charities-related tax concessions

3.1 As mentioned earlier, one of the benefits of registration is that the entity will be entitled to charities-related tax concessions under the Income Tax Act 2007.

3.2 The charities-related tax concessions are:

- an income tax exemption;
- a fringe benefit tax exemption; and
- recognition as a "donee" organisation for the purposes of the donation tax relief provisions. This means donors to a registered charity are eligible to receive certain tax credits on their donations.

3.3 Although Charities Services determines whether an entity qualifies for registration as a charitable entity, Inland Revenue administers charities-related tax concessions. Generally, Inland Revenue accepts Charities Services' decision so that registration will, in most cases, lead to tax-exemption or "donee organisation" status.

Income tax exemption

3.4 A charity must be a "tax charity" to be eligible for an income tax exemption on charitable grounds.

3.5 A "tax charity" is defined in section CW 41(5) of the Income Tax Act 2007 as the following:

A trustee or trustees of a trust, a society, or an institution, registered as a charitable entity under the Charities Act 2005;

A trustee or trustees of a trust, a society or an institution who, before 1 July 2008, commenced the process of registering with the Charities Commission but had not completed its registration; or

A trustee or trustees of a trust, a society, or an institution that is or are non-resident and carrying out its or their charitable purposes outside New Zealand, and which is approved as a tax charity by the Commissioner in circumstances where registration as a charitable entity under the Charities Act 2005 is unavailable.

3.6 Under section CW 41 of the Income Tax Act 2007 a tax charity is exempt from income tax on its non-business income. In general, a registered charity will be treated by Inland Revenue as qualifying for this exemption because the requirements of registration correspond to the requirements of section CW 41.

3.7 Under section CW 42 a tax charity is exempt from income tax on business income it derives either directly or indirectly so long as that income is applied to charitable purposes within New Zealand, and no person with some control over the business

activities of the charity is able to direct or divert income derived from the business to their benefit or advantage. Registration as a charitable entity is not therefore sufficient in itself to qualify for the business income tax exemption. Registered charities must also meet the "in New Zealand" and "no direct control" requirements.

3.8 For completeness, the business income tax exemption can apply to income derived by the registered charity either directly (in other words, the business activities are carried out by the charity itself) or indirectly (where the business activities are carried out by an entity separate from the charitable entity). These separate entities do not need to be registered under the Charities Act 2005. The registered entity is not itself conducting the business operation, but the operation is being run, for example, by a company that carries on the business solely for the registered entity's benefit. Although these companies are not also required to be registered, if they also have charitable purposes, they may do so.

Fringe benefit tax exemption

3.9 Registered charities may also be entitled to an exemption from fringe benefit tax (FBT) on non-cash benefits paid to their employees who are employed in the non-commercial operations of the charity.

3.10 Under section CX 25 of the Income Tax Act 2007 a "charitable organisation" that provides fringe benefits to its employees will in general not need to pay FBT unless:

- the employee receives the benefit mainly in connection with their employment; and
- the employment involves a business whose activity is outside a charity's benevolent, charitable, cultural or philanthropic purposes.

3.11 A "charitable organisation" is an association, fund, institution, organisation, society or trust to which section LD 3(2) or schedule 32 of the Income Tax Act 2007 applies. In other words, a "donee organisation" qualifies as a charitable organisation for the purposes of the FBT exemption.

3.12 In theory, all registered charities could meet the requirements of "donee organisation" status and so they could qualify for the exemption from FBT.

Recognition as a "donee organisation"

3.13 Donors who make cash donations to donee organisations are entitled to tax concessions based on their donation. These concessions are contained in section DB 41 (the company donation deduction), section DV 12 (the Māori authority donation deduction) and section LD 3(2) (the individuals' donation tax credit) of the Income Tax Act 2007.

3.14 A "donee organisation" is defined in section YA of the Income Tax Act as:

An entity described in section LD 3(2) or an entity listed in schedule 32 of that Act.

3.15 In section LD 3(2) a donee organisation includes any society, institution, association, organisation, or trust that is not carried on for the private pecuniary profit of an individual, and whose funds are applied wholly or mainly to charitable, benevolent, philanthropic, or cultural purposes within New Zealand. Schedule 32 contains a list of 80 organisations whose charitable purposes are largely carried out overseas.

3.16 As previously mentioned, most registered charities will meet the requirements to be a donee organisation, provided their funds are applied to charitable purposes mainly in New Zealand (or overseas, if the entity is a schedule 32 entity).

3.17 In Chapter 4 we discuss the implications when an organisation no longer meets the criteria of a "charitable entity" and becomes deregistered.

CHAPTER 4

Deregistration process

4.1 Section 32 of the Charities Act sets out the grounds for deregistration. Charities Services may deregister a charitable entity if:

- it is no longer "qualified for registration";
- there has been a "significant or persistent failure" to comply with its obligations under the Charities Act or any other Act;
- there has been a "significant or persistent failure by any one or more of the officers of the entity to meet their obligations under the Charities Act;
- it has engaged in "serious wrongdoing"; or
- it has requested that it be deregistered.

4.2 However, deregistration will not happen without the entity being given the chance to have its say on the matter.

What is meant by "qualified for registration"?

4.3 A charity is no longer qualified for registration if it fails to meet any one of the requirements of registration specified in Chapter 2.

What is meant by "significant or persistent failure"?

4.4 A charity may be deregistered if there has been a "significant or persistent failure" by the entity, or one or more of its officers, or one or more of its collectors to meet its obligations under the Charities Act or any other Act.

4.5 The obligations specified in the Charities Act include the duty:

- of telephone and internet collectors to disclose the charity's registration number when asked for it (section 39);
- to notify changes to the Charities Unit (section 40);
- to provide annual returns that include both a complete annual return form and financial accounts (section 41); and
- to assist Charities Services when it asks for information while carrying out its functions (section 51).

4.6 The obligations specified under any other Act may relate to matters that indicate a significant failure by an entity in its operation as a charity.

4.7 The most common reason for compliance action in relation to "significant or persistent failure" is the failure to file an annual return (annual return form and a set of financial accounts).

What is meant by engaged in "serious wrongdoing"?

4.8 Section 4(1) of the Charities Act 2005 defines "serious wrongdoing" as:

(a) unlawful or a corrupt use of the funds or resources of the entity;

(b) an act, omission, or course of conduct that constitutes a serious risk to the public interest in the orderly and appropriate conduct of the affairs of the entity;

(c) an act, omission, or course of conduct that constitutes an offence; or

(d) an act, omission, or course of conduct by a person that is oppressive, improperly discriminatory, or grossly negligent, or that constitutes gross mismanagement.

4.9 Charities Services considers that the types of activities that may be considered to be serious wrongdoing under section 4(1)(b) and (d) to include:

- persistent failure to keep proper financial records;
- filing financial reports that are largely inaccurate;
- inability to account for the way public donations are used;
- presenting largely inaccurate information to the public about the charity's purpose or activities;
- money laundering;
- allowing funds to be used to assist illegal activities or terrorism;
- making or allowing private financial profit;
- persistently working outside the rules of the charity; or
- knowingly allowing an officer who does not qualify in terms of the Charities Act to remain as an officer, unless a waiver has been granted.

Notice of deregistration

4.10 Under section 33 of the Charities Act, Charities Services must give the entity notice in writing of its intention to remove it from the Register. The notice must include the reason and give the entity at least 20 working days after the date of the notice to reply with an objection. If Charities Services proceeds to deregister the entity, it will advise it in writing, fully explaining the decision.

4.11 A deregistration decision applies going forward. It is not possible to set an effective date of deregistration retrospectively.

4.12 The following details will be shown on the Register after an entity has been deregistered:

- the name of the charity and its registration number;
- the reason for deregistration; and
- the effective date of deregistration.

4.13 In all cases when a charity wishes to go back on the Register after it has been deregistered, it will need to follow the application process in full.

Deregistration – statistics

4.14 Since the Charities Register opened, 3,902 charities have been deregistered. The table below provides statistics on Charities Services' deregistration decisions, as at November 2012.

Deregistration decisions	Number
Failure to file annual return	2,489
Voluntary deregistration	1,375
Non-charitable purposes	24
Serious wrong-doing	3
Did not meet the registration requirements	4
Did not produce evidence of charitable purposes	7

4.15 Although the most common reason for deregistration is the failure to file an annual return, there are likely to be fewer instances of these types of deregistration in the future. Until recently, Charities Services automatically deregistered charities if they had failed to file one annual return.

4.16 Under a new approach, registered charities will be given more opportunity to file their annual returns. They will be served with two reminders before being issued a Notice including all of the relevant measures that might be taken if the annual return is not supplied. This would include the $200 administrative penalty, publication of a notice on the Register (or elsewhere) and, in cases of "significant or persistent failure" to comply with the Charities Act, deregistration. If at the expiry of that further time, an annual return is still not filed, the processes for each of the relevant measures can be implemented (such as the imposition of the administrative penalty or the issuance of the Notice of Intention to Remove).

4.17 In the next chapter we describe the tax consequences of deregistration.

CHAPTER 5

Tax consequences of deregistration

5.1 In general, the tax consequences that arise when a charity is deregistered depend on the reasons for deregistration. As mentioned earlier, a charity can be deregistered for a variety of reasons. Consequently, it is important to take account of the specific circumstances of each deregistration in order to determine the likely tax consequences.

5.2 The possible consequences for income tax, fringe benefit tax (FBT) and donee organisation status are set out below.

Income tax consequences

5.3 Once deregistration has occurred we need to determine *what* income tax provisions apply to deregistered charities and *when* they apply.

What tax provisions apply?

5.4 In general, the tax treatment of an entity follows its legal form, and the activities that it undertakes. In the absence of another tax exemption applying to the entity, corporate entities will be subject to the company rules and trustees of a trust will be subject to the trust rules. An entity can also elect to become a Māori authority if it meets the relevant criteria.

5.5 There are also transitional income tax consequences when a tax-exempt entity becomes a tax-paying entity. These include determining the opening value of any depreciable property and consideration for any financial arrangements.

5.6 The Income Tax Act 2007 provides transitional tax rules in certain circumstances. These are:

- *When a "charitable trust" is no longer eligible for income tax exemption on charitable grounds* – A charitable trust is a trust whose income has been or is exempt from income tax under sections CW 41(1) or CW 42(1). Section HC 31 specifically provides that income derived on or from the date on which the charitable trust loses its charitable status will be subject to tax. The provision also requires a calculation to be made in order to establish the cost price of property and to determine any consideration for financial arrangements. The calculation is required to be undertaken on the date on which the charitable trust "lost" its charitable status. (Determining when a charitable trust has "lost" its charitable status is discussed below.)

- *When a trust or company elects to become a Māori authority*. Section HF 9 provides for the consequences of a change in entity status for the purposes of the Māori authority rules. In general, any retained earnings, accumulated profits and capital reserves held by the trust or company on the date of change will not be subject to tax when it is subsequently distributed.

5.7 The current tax rules in the Income Tax Act 2007 do not adequately provide for the full range of transitional scenarios for deregistered charities. In particular:

- Section HC 31 is limited in that it does not apply to charitable trusts that never had a charitable purpose.
- There is no equivalent section HC 31 provision for incorporated entities and so it is unclear how incorporated bodies should transition to the general tax rules.
- Section HF 9 has the effect of exempting from income tax the accumulated "charitable income" of a deregistered entity but we question whether this is the appropriate policy outcome in all cases involving deregistered charities. (See discussion later in this chapter on the accumulation of charitable income.)

When do the taxing provisions apply?

5.8 In most cases, the taxing provisions will apply from the effective date of deregistration – that is, the date the entity is removed from the Charities Register.

5.9 However, it may sometimes be necessary to apply the taxing provisions from an earlier date. This will arise when the underlying reason for deregistration is because the entity was found never to have had a "charitable purpose". In these circumstances, the taxing provisions can be applied from the date on which the entity was established.

5.10 In deciding whether to apply the taxing provisions from the date on which the entity was found never to have had a charitable purpose, Inland Revenue will take into account the specific circumstances surrounding the entity's charitable status before the "tax charity" rules (which included the registration requirement) were introduced from 1 July 2008. This would include, for example, did the entity receive confirmation from Inland Revenue that it was entitled to the charities-related income tax exemption before 1 July 2008. Inland Revenue will also look at voluntary deregistrations when there is concern that the deregistered charity may never have had a charitable purpose or may have ceased to be qualified for registration at some point in the past.

5.11 We consider that clearer guidance is required to allow deregistered charities to determine when the taxing provisions should apply.

Fringe benefit tax exemption consequences

5.12 The FBT consequences for a deregistered charity depend on the reasons for deregistration. It is possible that the FBT exemption could continue to apply to the deregistered charity without interruption.

5.13 If a deregistered charity is found not to have a charitable purpose either by Charities Services or the Courts, Inland Revenue's current practice is to accept that the charity does not have a charitable purpose for tax purposes. This means the deregistered charity must meet the other requirements implicit in the definition of "charitable organisation" for FBT purposes. If the deregistered charity has a benevolent, cultural

or philanthropic purpose, or meets the requirements to be added to schedule 32, it will likely continue to be eligible for the FBT exemption.

5.14 If the deregistered charity was deregistered because it has persistently failed to file an annual return (in the absence of specific investigation into its activities) it may continue to be eligible for the FBT exemption, as registration per se is not a requirement of the FBT exemption.

5.15 The continued application of the FBT exemption when a deregistered entity has engaged in "serious wrong-doing", as described in Chapter 4, has been raised as a concern. Even so, we consider that the current requirements of the FBT exemption (that there is no private pecuniary gain) and the penalties regime in the Tax Administration Act 1994 should allow Inland Revenue to revoke the FBT exemption and to effectively deal with deregistered charities that continue to engage in "serious wrong-doing". We also note that the number of cases that have involved serious wrong-doing is small.

Donee organisation consequences

5.16 Similarly, there is always a possibility that a deregistered charity can continue to qualify for donee organisation status even after deregistration. The donee organisation consequences for a deregistered charity depend on the reasons for deregistration.

5.17 If a deregistered charity is found not to have a charitable purpose either by Charities Services or the Courts, the entity may still be a donee organisation if it meets the other donee organisation requirements. This includes, for example, if it has benevolent, cultural or philanthropic purpose, or meets the requirements of being added to schedule 32.

5.18 The concern raised above about the FBT exemption being applicable even in cases of serious wrong-doing is equally applicable here.

5.19 There may be flow-on consequences for donors who have made cash donations to a deregistered charity. If the entity does not meet or has never met the donee organisation requirements then these donors should not have been eligible for any donation tax relief that had been claimed. Under current tax law, Inland Revenue can reverse previous donation tax relief claims. In practice, this requires Inland Revenue to approach each donor for evidence of the amount and circumstances of their gift, which can be onerous.

5.20 In deciding whether to reverse donation tax claims, Inland Revenue may consider the circumstances around the charity's deregistration and the donor's knowledge of those circumstances, as well as a variety of other factors. These could include the amounts involved, the capacity of Inland Revenue's audit and collections staff, and the implications for current and future compliance, and integrity of the tax system for all taxpayers.

5.21 We consider it appropriate that Inland Revenue should continue to have the discretion to make decisions on whether to reverse donation tax relief claims in deregistration

situations. Even so, we are interested in your views on the specific circumstances in which it would be appropriate to reverse donation tax claims.

Periods of non-registration

5.22 There have been cases when an entity has been deregistered and then subsequently re-registers with Charities Services, giving rise to periods of registration and non-registration. Under current tax law the deregistered charity is required to file tax returns for any periods of non-registration.

5.23 This gives rise to both complexity and costs for deregistered charities and Inland Revenue.

Consequences of deregistration – accumulation of income

5.24 We have also identified a problem where the assets of a deregistered charity can be applied towards non-charitable purposes without giving rise to a taxable event. This problem arises because the current tax law (legislation and case law) supports the ability of charities to accumulate their income for future use, and there is no symmetry required between the income tax exemption and the payments to charitable purposes, either in amount or timing.

5.25 Although there is a requirement for a deregistered charity that "winds-up" to distribute its assets and income to charitable purposes, there is no such requirement when a deregistered charity continues its operations. In part this question obviously revolves around what use the assets are put to after deregistration.

5.26 Other countries specifically addressed this problem by requiring deregistered charities to apply any accumulated "charitable income" (and assets) to charitable purposes or risk being subject to tax. In Canada, when a charity is deregistered, it must transfer all its remaining property to a donee organisation within one year or be subject to a revocation tax. In Australia, all charitable income amounts must be transferred to another donee organisation.

5.27 This issue raises the question of the appropriate treatment to apply to a deregistered charity. There is a range of possibilities for addressing this issue and we welcome submissions on this specific point.

CHAPTER 6

Suggested solution

6.1 This chapter explores a possible solution to address the current tax consequences for deregistered charities identified in the previous chapter.

6.2 Our suggested solution is for a specific set of rules to deal with the income tax treatment of deregistered charities where the entity continues in operation. The suggested new rules would:

- clarify how the general tax rules, including the company, trust and other specific entity regimes apply to deregistered charities;
- establish the opening values of any depreciable property or consideration for any financial arrangements held by a deregistered charity when it becomes a tax-paying entity;
- prescribe specific timing rules for the application of the taxing provisions; and
- apply from the 2014–15 income year.

6.3 A specific set of rules is preferred for reasons of clarity and coherency.

Clarifying the general tax rules

6.4 Section HC 31 of the Income Tax Act 2007 provides a useful model for formulating rules to clarify how the general tax rules, including the various entity regimes, could apply to deregistered charities. This provision specifically deals with circumstances when an existing trust enters the tax base.

Establishing the opening values for depreciable property and financial arrangements

6.5 Section HC 31 of the Income Tax Act 2007 also provides a useful model for formulating rules for establishing the opening values of any depreciable property or consideration for any financial arrangements held by a deregistered charity when it becomes a tax-paying entity.

Prescribing specific timing rules

6.6 In most cases, the taxing provisions will apply from the effective date of deregistration – that is, the date the entity is removed from the Charities Register. This date usually applies on a prospective basis. However, it may sometimes be necessary to apply the taxing provisions from an earlier date. This will arise from the following circumstances:

- when the underlying reason for deregistration is because the entity was found never to have had a “charitable purpose” by Charities Services or the Courts, or

- when the charity has voluntarily deregistered and Inland Revenue has concerns that it was never charitable in purpose or ceased to be charitable at some point in the past.

In these circumstances, the taxing provisions can be applied from the date on which the entity was found not to have a charitable purpose.

6.7 In deciding whether to apply the taxing provisions from the date on which the entity was found not to have a charitable purpose we should also take into account the specific circumstances surrounding the entity's charitable status before the "tax charity" rules (which included the registration requirement) were introduced from 1 July 2008. This would include, for example, whether an entity had received confirmation from Inland Revenue that it was entitled to the charities-related income tax exemption before 1 July 2008.

6.8 We suggest prescribing specific timing rules for the application of the taxing provisions. These timing rules would cover five distinct circumstances.

Situation	**Timing**
A charity that came into existence after 1 July 2008 has been deregistered by Charities Services.	Deregistered charities in this situation would be subject to tax on income earned from the effective date of deregistration.
A charity that came into existence after 1 July 2008 has been deregistered because it was found by Charities Services or the Courts not to have a charitable purpose.	Deregistered charities in this situation would be subject to tax on income earned from the date on which the entity was found not to have a charitable purpose.
A charity that came into existence after 1 July 2008 has voluntarily deregistered and Inland Revenue has found the entity not to have had a charitable purpose.	Deregistered charities in this situation would be subject to tax on income earned from the date on which the entity was found not to have a charitable purpose.
Before 1 July 2008 Inland Revenue had confirmed that the charity was entitled to the charities-related income tax exemption *and* Charities Services (or its predecessor) has either declined its application or deregistered the charity, after 1 July 2008.	Deregistered charities in this situation would be subject to tax on income earned from 1 July 2008.
Before 1 July 2008 the charity made a self-assessment that it was eligible for the charities-related income tax exemption *and* Charities Services (or its predecessor) has either declined its application or deregistered the charity after 1 July 2008.	Deregistered charities in this situation would be subject to tax on income from 1 July 2008. Such charities might be required, however, to provide evidence to Inland Revenue that they were eligible for the charities-related income tax exemption before 1 July 2008.

6.9 These rules do not address the specific issue that arises when a charity is deregistered solely because Charities Services (or its predecessor) formed a view that the entity was charitable in purpose but later changed its mind and deregistered the entity. For reasons of equity and consistency, an entity should be able to rely on the prevailing view of Charities Services, if it has in good faith complied with all of the information requirements of registration and no other reason for deregistration exists. This would suggest limiting deregistration to the date on which Charities Services changed its view, with the consequential effect of minimising retrospective tax liabilities.

6.10 In addressing this issue, however, it is important to balance these equity considerations with protecting the revenue base and the integrity of the charities registration process. Charities Services (and Inland Revenue) should retain the ability to enquire into deregistration situations in order to determine if there had been any disqualifying behaviour on part of the charity. We are interested in submitters' views on how this issue could be addressed while ensuring that there are adequate mechanisms in place to protect the revenue base.

Periods of non-registration

6.11 The suggested solution would apply to determine the tax treatment to apply to periods of non-registration.

Other possible solutions

6.12 The suggested solution focuses solely on improving the existing tax rules in the Income Tax Act to ensure they can effectively deal with the current problems with the tax treatment of deregistered charities. Even so, we acknowledge that a mix of both legislative and operational measures may be required, and that Inland Revenue and Charities Services may need to work closely together to ensure a robust process for deregistered charities. This might involve giving Charities Services a wider range of tools to apply during the deregistration process. This could include, for example, the ability to set a retrospective date of registration such as to deal with broken periods of registration in appropriate circumstances.

Questions for submitters

We welcome your views on the following specific matters:

- Whether legislating for the suggested solution outlined in this paper is an appropriate way to address the current problems with the existing law?
- What other solutions are there for resolving the current problems for deregistered charities?
- Whether the prescribed timing rules cover all potential deregistration scenarios?
- How should we deal with deregistration situations where a deregistered charity has acted in good faith and has complied with all of the information requirements of registration and is later found not to have a charitable purpose?
- How should the issue of accumulated income and assets of a deregistered charity be addressed?
- What specific circumstances would warrant a reversal of donation tax relief in deregistration situations?