

Tax Working Group Public Submissions Information Release

Release Document

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Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

- [1] 9(2)(a) - to protect the privacy of natural persons, including deceased people;
- [2] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [1] appearing where information has been withheld in a release document refers to section 9(2)(a).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

30 April 2018

Tax Working Group Secretariat
PO Box 3724
Wellington 6140

Emailed to: submissions@taxworkinggroup.govt.nz

Dear Members of the Secretariat,

Re: MAS submission to the Tax Working Group

Thank you for the opportunity to submit to the Tax Working Group. We submit on behalf of Medical Assurance Society New Zealand Limited and its related companies (**MAS**). At this stage, our interest in the Working Group and our submission is focussed on tax considerations for business charities.

About MAS

MAS is a mutual group of companies that provide financial services. As a mutual, we are owned by and accountable to our membership, rather than to shareholders. MAS was founded in 1921 by a group of doctors, and has since broadened its membership to other professionals to include doctors, dentists, vets, engineers, lawyers, architects, accountants and their families. MAS' product offering to its members includes general insurance, life and disability insurance, and investment products including KiwiSaver.

We believe members of the public increasingly demand more of the businesses they interact with. It is no longer enough to provide quality products and services to attract discretionary spend. Consumers want the organisations they trade with to be able to explain what their values and beliefs are, and to show how those organisations are adhering to and promoting those values and beliefs.

MAS has recently formed a proposal to put to its membership. The proposal is to establish a charitable trust to direct MAS' profits towards charitable causes including health research, health education and health promotion. Because MAS will be registered as a charity, the money that MAS would otherwise have paid in income tax will also be available to be redirected to the charitable trust. In adopting this business structure, MAS' members will be able to see how their choice of financial services provider can align with their support of charitable causes acting for the greater good.

We support tax exemptions for business charities

New Zealand's current tax rules allow business charities to support the charitable sector by way of tax exemption. As above, MAS has formulated a proposal to put to its members that rely on these tax rules continuing. We support continued tax exemptions for businesses which distribute their profits for charitable purposes for the following reasons.

Tax exemption allows the private sector to give significant amounts of capital directly to the charitable sector. We believe this is the most efficient way of allocating that capital to support the social policy objectives of both the government of the day and the public. By permitting exemption, the stakeholders of business charities (Members, in MAS' case) can see how their discretionary spending choices directly benefit the charitable causes supported by the business, rather than by proxy through government redistribution of income tax.

The charitable sector is perennially underfunded and needs appropriate support, particularly in terms of ease of access to capital. Two key points to note are:

1. Charities cannot raise traditional equity capital because of the limit on private pecuniary profit. While this makes raising capital harder for charities, that difficulty is partially offset by the tax exemption for

charities. We see the tax exemption as an important and appropriate tool available for charities to access capital.

2. Many charities must rely on annual funding rounds and compete for limited amounts of capital. Business charities can offer greater certainty to charities' cashflow from year to year.

In our view it should not matter how capital is generated (i.e. whether generation of capital is related to a charitable purpose or not) if that capital is ultimately directed to a charitable purpose.

For this reason, we do not support business charities' use of charitable status to avoid income tax. We understand some business charities will direct a meagre proportion of their profits towards the charitable sector, and instead allow the bulk of those profits to accumulate within the business. In the first instance we support clear problem identification and option analysis before changing the relevant tax rules, but on the face of things we submit that the relevant regulators – Charities Services and Inland Revenue – should have appropriate tools to discourage tokenism in the name of charity.

However, we do not think it would be appropriate to set firm rules about what proportion of profits that firms must distribute to charity. We note:

1. A business charity's only option is to distribute the funds it accumulates towards charitable purposes. The funds cannot be siphoned off for other purposes. This is better than the counterfactual, where funds never make it to the charitable sector because a business does not register for charitable status in the first place and
2. Business charities must be permitted the flexibility to make their own decisions about prudent retention of capital. It is not possible to generalise about appropriate proportions of capital to retain versus distribute to charity. Businesses must retain capital to reinvest to ensure they remain sustainable, and must also retain capital to buffer financial shocks. This is particularly important for insurance business like MAS, which can experience years of volatile profitability due to large loss events like earthquakes and other natural disasters.

We understand there are some stakeholder concerns about distinguishing the profits of businesses that conduct activities unrelated to charitable purposes (but give their profits to charity), and business that conduct charitable activities and generate profit. This distinction is complex and there are a range of businesses that operate within that spectrum. The complexity and variety of business activities make it difficult to draw a clear line or clearly define what types of activity are related to charitable purposes, and what are not. As above, in our view, if the profit can only go to the charitable sector for a charitable purpose, then there is no need to draw additional legislative boundaries. All that would serve to do is generate an additional administrative burden for the professional advisers to government and business charities.

Finally, we support a robust financial reporting framework for charities. This will promote transparency and accountability, which in turn will generate trust and confidence among the public. It will also allow for better debate about tax exemption rules applicable to business charities, because stakeholders will be able to better understand the flow of capital in to the business charity and back out to the charitable sector.

We do not support punitive tax rules for businesses that deregister as charities

Under the existing rules, an entity that was previously tax paying and then obtained tax exempt status as a charity would, where it is deregistered, include in the deregistration tax calculation any assets that it accumulated prior to obtaining that tax-exempt status.

We understand the intention of the rule is to claw back the tax that would otherwise have been paid on amounts accumulated while the entity enjoyed tax exempt status. However, there is significant over-reach in the current legislation as the deregistration tax also applies to the value of assets that were owned by an entity prior to it becoming a charity. There does not appear to be a clear rationale, and in our view this rule is unnecessarily punitive.

We agree that charitable assets should be used for charitable purposes. We agree that assets accumulated by an entity while it has charitable status should be subject to deregistration tax. However, we do not agree

that accumulated assets should be taxed twice – once when those assets were accumulated before the entity had charitable status, and once again on deregistration.

Contact us for more information

We welcome the opportunity to discuss these points in greater depth with the Tax Working Group and the Secretariat. Please contact our General Counsel Nick Mereu on [1] or at [1] if you would like to discuss further with us.

Yours sincerely,
[1]

[1]

Matthew Judge
CFO

 **Nick Mereu**
General Counsel