Tax Working Group
Te Awheawhe Tāke

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.

Tax relief for charities

A submission to Hon Judith Collins, Minister of Revenue

From Chris Milne, Community Foundations of New Zealand

3 April 2017

Background

Charities play an important role in New Zealand, delivering a range of services to communities and causes that would be difficult for government or the private sector to deliver.

The community benefits provided by charities are recognised and supported by government through government grants, exemption from income tax, and encouraging and rewarding members of the public who provide financial support to charities by providing generous tax credits on donations.

The revenue required by charities to deliver their services is partly sourced from investment income, including dividends from companies.

Imputation credits

Company tax is paid on income earned by New Zealand companies. Income tax paid by companies can be attached to dividends paid to shareholders, in the form of imputation credits.

Company tax is effectively a withholding tax on the portion of company earnings that is paid to shareholders by way of dividends.

Shareholders who are subject to New Zealand tax have to pay tax on dividends they receive, but can use imputation credits to pay all or part of that tax.

The tax issue for charities

The current imputation rules do not provide refunds of imputation credits that cannot be used.

Shareholders who receive imputation credits greater than their tax liability can carry forward imputation credits to use against future tax liabilities.

Tax exempt shareholders have no current or future tax liabilities, and therefore cannot access imputation credits on dividends they receive.

Tax exempt shareholders therefore suffer tax at the company tax rate on dividends they receive from companies. This is contrary to the principle underpinning the imputation system, that shareholders should be treated as if the income earned by the company were earned by them directly.

Tax exempt organisations & impact on optimal investment portfolios

All income received by tax exempt organisations is appropriately exempt from income tax, other than company dividends.

There is therefore an incentive for tax exempt organisations to invest their funds directly in commercial property, 100% owned companies and fixed interest securities where returns are received free of tax (note: RWT or Resident Withholding Tax is refundable).

It is known that tax exempt organisations, once they reach a certain size, avoid investment in listed companies where imputation credits are lost. They do however invest in their own wholly-owned companies, which are, as a result of being wholly-owned, tax free.

The non-recovery of imputation credits therefore incentivises investment portfolio structures that minimise tax. This is unfortunate as such portfolios are unlikely to be optimal in terms of risk and return and therefore such behaviour is likely to harm the longer term investment performance of charities – through sub-optimal asset allocation or reduced diversification.

The fiscal cost of allowing claiming back of imputation credits by charities

The benefit to charities and the fiscal cost to government of allowing refunds of imputation credits to tax exempt organisations is difficult to estimate. A 2004 study of the New Zealand non-profit sector (i) calculated that of the estimated $8.036b revenues of non-profit organisations, about 6% or $478m was from investment income. If the asset allocation of non-profit organisations were appropriately diversified, about $200m might be received from company dividends, and imputation credits attached to those dividends could be about $80m.

Our submission

We ask that legislation be amended so that organisations with tax exempt status be able to obtain refunds of imputation credits attached to dividends received.

Chris Milne

Trustee, Community Foundations of New Zealand
[1]

(i) The New Zealand Non-profit Sector in Comparative Perspective – by Sanders, O'Brien, Tennant, Sokolowski and Salamon - 2004