Tax Working Group Public Submissions Information Release

Release Document

February 2019

taxworkingroup.govt.nz/key-documents

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.

NEW ZEALAND'S TAXATION IN AN EVOLVING BUSINESS WORLD

A submission to Michael Cullen, KNZM, Chair, Tax Working Group

From Louise Aitken, Chief Executive of the Ākina Foundation

1 November 2018

Introduction

The Ākina Foundation is the principal intermediary supporting social enterprise in New Zealand. Social enterprise is a way of operating a business which prioritises both social and/or environmental outcomes and profit, with the goal being that impact driven by a sustainable business model enables that impact to be delivered more sustainably and at the desired scale.

In recognition of the potential social enterprise has for New Zealand, the Government has recently partnered with Ākina to deliver the Social Enterprise Sector Development Programme: a programme specifically aiming to enable a flourishing social enterprise sector in New Zealand. The Government's commitment to this Programme is a strong signal to the growing potential, in both size and impact, that this sector has.

As part of this Programme, Ākina is exploring barriers that exist within current legal structures in New Zealand for enterprises that are working towards creating social or environmental impact. The Department of Internal Affairs, Charities Services, Inland Revenue Department and the Ministry of Business, Innovation and Employment are all involved in this work, and it is being progressed in communication with the Charities Act review. While our exploration of legal structures is outside of the scope of this Tax Working Group (the **Group**), there is a relationship between legal structures and taxation for social enterprises, so we highlight this work for context.

We are pleased to have the opportunity to participate in a discussion around the tax system in New Zealand, and thank the Group for the opportunity. We are also pleased to see the holistic approach the Group has taken, acknowledging the numerous purposes of tax within society, and the fundamental role it has in underpinning and influencing many aspects of New Zealand's wellbeing.

Reflections on the Group's Interim Report

We largely agree with the Group's comments around both the 'Taxation of business' and 'Charities'. This submission highlights a few areas and opportunities for further conversation: conversations which may lead to our tax system even better enabling the wellbeing of New Zealanders.

Social enterprise is a way of doing business that can, and is, having significant positive impact on New Zealand. Social enterprises achieve positive environmental and ecological outcomes, they support employment outcomes, contribute to housing affordability and help to reduce the inequality which permeates so much of the Interim Report. Whilst the primary sections of the Group's Interim Report that relate to social enterprise are the business and charity sections, it is important to keep in mind the overarching value social enterprises deliver.

Which leads to the question: how can New Zealand's tax system best enable social enterprise?

Impact focus

At the heart of social enterprise is impact. A heart that is also shared by charitable structures in New Zealand. We support the tax exemptions which charities receive in New Zealand, which is granted to charities because of the societal impact they intend to have.

Organisations operating as a social enterprises also intend to deliver societal impact. An important distinction between charities and social enterprises is that social enterprises are able to distribute profits to shareholders and charities are not. Currently, that ability to distribute profits is the key reason social enterprises are excluded from receiving tax benefits. Keeping profits in an organisation is an indicator only, it is not proof that the organisation is achieving positive outcomes. It demonstrates that the organisation is using all of its money pursuing its charitable purpose, not that it is in fact effective in achieving that purpose.

We believe the impact generated by organisations should be considered more effectively in New Zealand, and a conversation had around how to incentivise that work, and the effects any impact generation should have on the taxation benefits an organisation can receive. 'The tax system underpins the living standards of New Zealanders', so it must use effective measures to assess what influence organisations are having on New Zealanders, and therefore what it should be incentivising. We submit that a more relevant factor to consider when determining an entity's entitlement to tax benefits, is evidence of their achievement of social or environmental outcomes or at least that they are on track to achieving those outcomes, as the Living Standards Framework is exploring. We acknowledge the challenges associated with requiring evidence of achievement of social or environmental outcomes, but consider it is a standard worth aspiring to.

We are pleased to see Charities Services recently implementing performance reporting on Charities alongside financial reporting, while noting the capability development which needs to happen within organisations to be able to effectively deliver these reports. We encourage the Group to consider how these performance reports could be used as a basis for assessing suitability for a tax exemption, rather than the blunt instrument of not-for-profit versus for-profit. As the number and impact of social enterprises grows, we encourage the Group to consider how organisations other than 'not-for-profits' can have their impact similarly valued, and tax incentives applied accordingly to reflect the societal benefits they are providing New Zealand.

Impact investment tax relief
Beyond the above comments, we do not think that the taxation of organisations operating as a social enterprise needs to be substantively different to profit oriented business in New Zealand. This is not to say social enterprise shouldn't be incentivised however. It is a transformative way of doing business, and is improving our world, and so we implore the Group to consider appropriate ways taxation can be used to encourage this form of business.

One method we have identified is to incentivise investment into these organisations - i.e. an impact investment - which, by its nature, intends to increase an organisation's scale and impact. The United Kingdom has the 'Social Investment Tax Relief' (SITR) scheme which provides a strong example for how this may be achieved. Individuals making an eligible investment can deduct 30% of the cost of their investment from their income tax liability, with eligible investments being legal entities with a defined and regulated social purpose. Ākina would be happy to provide more specific information on this scheme to the Group,

We encourage the Group to consider how a New Zealand equivalent of the SITR could be implemented (we note that a new legal structure would be the logical eligible entity for such a scheme however this discussion is ongoing and any impact investment tax relief scheme should be considered within existing entities).

Early stage incentives
Like any organisation, social enterprises also particularly struggle at the early stage of their life cycle. Accordingly, any incentives that can be offered during this stage are often catalytic to the future of the organisation. We note the Government's commitment to raising New Zealand's research and development (R&D) expenditure to 2% of GDP over the next 10 years. The R&D Tax Incentive is a strong existing incentive for unlocking innovation within early stage organisations. We also note that Callaghan Innovation recently moved to include social innovation within their innovation mandate.

Accordingly, we recommend that the current R&D review process considers how the definition of R&D can be altered to more intentionally encompass and enable social and environmental innovation alongside its existing technology focus. Not only would doing so assist the Government in reaching their 2% target, it would also unlock more innovation specifically focused on societal impact, and the consequential impact and economic outcomes from this for New Zealand.

Recommendations

In summary, while our tax system already provides a strong foundation for New Zealand, we believe it can be strengthened to better enable organisations who are delivering social and/or environmental impact. We encourage the Group to consider how this can be achieved, and in particular recommend exploring:

1. How the tax system can more effectively incentivise social and environmental impact by focusing on social and environmental outcomes rather than distribution of profits;
2. The introduction of an incentive for impact investing, like the United Kingdom's SITR; and
3. Broadening the definition of R&D to better incentivise early stage impact focused innovation.

Thanks again for the opportunity to be involved in this process, and please feel free to contact us to discuss any of the above. We'd be more than happy to speak to you further about this, and how we can support you to better enable impact in New Zealand.

[1]

Louise Aitken,
Chief Executive, Ākina Foundation