s 9(2)(a)

From: Shouler, Astrid J s 9(2)(a)
Sent: Monday, 31 March 2025 10:32 pm
To: Policy Webmaster
Cc: chairperson@hamiltonoperatic.co.nz
Subject: Taxation and the not-for-profit sector submission - Hamilton Operatic Society

Kia ora,

Please see below the submission in relation to consultation on the taxation and the not-for-profit section on behalf of the Hamilton Operatic Society.
We appreciate your consideration in relation to the below.

Thank you.

Kind regards,

Astrid Shouler (she/her)
Treasurer
Hamilton Operatic Society

Q1. What are the most compelling reasons to tax, or not to tax, charity business income? Do the factors described in 2.13 and 2.14 warrant taxing charity business income?

In Hamilton Operatic Society's view, the most compelling reason not to tax charity business income is to allow charities to be able to use more of the funds they receive towards their charitable purposes, for example, productions and supplying other charities/schools/community groups with resources to assist them in putting on their own productions. Taxing this type of income reduces the amount of funds that charities, such as the Society, can use towards these activities and towards their purpose.

The ability for the Hamilton Operatic Society to accumulate funds tax free has meant it has been able to operate since 1904 as a community-orientated charity putting on productions for the Waikato with assistance from the Waikato community for generations. Like many other charities, the ability to accumulate funds this way has allowed the Society to provide for the long term rather than the short term, building up financial resilience for generations.
The factors described in 2.13 and 2.14, such as competitive advantage and accumulation, do not warrant taxing charity business income, as the benefits for the Society of having this income untaxed far outweighs the perceived detriment to for-profit entities.

Q2. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be the most significant practical implications?

Removing the exemption would most certainly increase both cost and complexity in relation to compliance costs, and the tax on that income would constitute funds channelled away from the charity fulfilling its core operations.

Hamilton Operatic Society derives its income from hire, memberships, sponsorships, and ticket sales, all arguably furthering the charity's core purpose and mission. Without a clear definition of "unrelated business" it is difficult to ascertain the true impact of what taxation on these activities would mean, but likely it would hinder the Society in being able to carry out its current core activities.

Q3. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what criteria should be used to define an unrelated business?

All definitions of related/unrelated business income should be clear and specific, and ideally based on existing definitions. Considerations should be made in the criteria as to the regularity of the income and the materiality to the charity in carrying out its purpose.

Q4. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be an appropriate threshold to continue to provide an exemption for small-scale business activities?

As there is no concise definition of what an "unrelated business" is in terms of this proposal, it makes it difficult to ascertain what impact it would have on charities, and therefore propose a threshold. Proposing a threshold based on already existing financial thresholds, such as the reporting tiers for charities, could be a suitable solution and may limit impact on some of the smaller charities such as Tier 3 & 4 charities.

Ryan Donovan

From: Jan Rodgers s 9(2)(a)
Sent: Monday, 31 March 2025 10:31 pm
To: Policy Webmaster
Subject: Taxation and the not-for-profit sector

To our Government,

As someone who dedicates my life to working in the not-for-profit sector, I thank you for your part in helping us to help others.
We experience being a part in thousands of personal stories each year of precious lives who have had their life's trajectory changed for the better. Even given the hope to live - and to make a difference themselves.

As we can be on the edge of having enough funds to continue each year, facing further compliance or taxation costs could easily mean we can no longer operate.
This would have a significant detrimental affect on our society, let alone the individuals who can be given the hope and experience of being transformed.
Of course, there would be thousands of other not-for-profit organizations that would be in the same position as us.

Please make decisions that facilitate easier and less costly compliance for the sake of the vulnerable members of our nation.

It is a joy to witness people's lives being transformed and equipped to make a difference themselves.

May our nation be a place where all people thrive.

Manaaki Te Atua / God Bless,

Jan Rodgers
Activate Faith Group

Activate Church - Hamilton
visit us at **activatechurch.nz**

My submissions are my own, based on my experience in the not for profit sector and not the position of any of my employers or charities that I am involved in.

Competitive advantage (2.7-2.13)

I'm not sure I entirely agree with the statement that a charity does not have a competitive advantage based on its privileged tax position. Although theoretically true, a for-profit business pays tax because partially that Inland Revenue expects it. For a charity, it can reason that if it puts competitors out of business by continuing to offer lower costs for a number of years, in the long term, the charitable purpose will benefit. There is no Inland Revenue to enforce compliance, and Charities Services would not intervene in that type of scenario (usually – outside a situation where it seemed the propping up of the business itself had become a purpose of the entity). I suspect that this actually manifests, although would require a somewhat detailed analysis of specific cases, but it seems logical to me that say, an entity that owned a number of businesses in an area, would look to where it could consolidate control using any tools at its finger tips.

I think separate to competitive advantage *from* the tax position, I think there are disadvantages, like the ones discussed at 2.13, but think they should be considered separately, and carefully. I think conceptually there is still an advantage that exists, and can be exploited, and in the right set of circumstances offers a genuine advantage to charities operating in certain areas with the right level of capital backing.

I think as with many issues in this space, the advantage arises the larger the entity or set of entities becomes.

What are the compelling reasons to tax charity business income?

I believe that charity business income should be taxed. The most persuasive reason is that its consistent with the underlying broad principles of taxation in New Zealand – particularly equity. A business that sells a product for a profit should pay the same tax.

I don't think that just because one of those businesses is owned by a charity changes that. Both businesses can still donate their profits to charity and thus eliminate their tax bill.

I am also convinced there is a competitive advantage to being a charitable business in some cases (not all cases).

I think it complicates what charity is by blending business and charity in this way, and in turn, impacts on how the public perceive charities in a negative way. You aren't as likely to support the charity with your time or money, if you perceive it is making millions in its side hustle selling vapes.

Not every charity has the resource to generate income in this way, charities compete against charities for income too. If a charity is building resource through its business, can afford funding advisors and separate legal structures so they can then access grant and contract funding, it furthers the inequity across the charitable sector.

A charity that carries out business to be charitable, a hospital that charges for services, seems to me clearly charitable and a different thing altogether. There are always edge cases, but I don't think slight uncertainties around edge cases should prevent an equitable approach to two businesses selling on a street.

The charitable sector in New Zealand is essential, important, under-funded, and more numerous than most countries in a similar boat for good reasons I think more than bad. But the complications of how the sector is funded should be explored in more detail than merely a general tax concession, I think we need directed funding that supports the immense gaps that exist rather than general tax concessions that lower the general pot of taxation that could be used for things like pay equity for social welfare organisations.

If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be the most significant practical implications?

A number of registered charities who exist for fundraising may find themselves in a tricky tax position – where they no longer gain an advantage from being registered. I think Inland Revenue may need to consider some kind of regime to support charities deregistering and entering the taxable space again without essentially suddenly becoming liable to multiple years of tax. They would of course, still need to maintain their assets for charitable purposes in the long term, but it would seem unfair and inequitable and inflexible to essentially force them to remain registered as a charity.

The other major challenge would be edge cases of charities that could argue they have charitable purposes in their methods of business delivery. Charity is generally assessed on purpose not activity, so it could be difficult at times to assess these types of activities. I somewhat diminished this argument in my previous answer to a question but I do think it's a genuine question that will be challenging to answer. Other jurisdictions have answered this though, so I imagine it is not unsurmountable and should not prevent an equitable approach to business income.

If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what criteria should be used to define an unrelated business?

I agree some minor de minimus rules for events that raise funds for charities (especially as these themselves would tend to qualify for promotion of health or social cohesion grounds), op shops (again arguably could qualify with creative interpretation of protection of the environment), church kitchens, etc.

I don't think having volunteers do the work of a business would make a difference – except in the case of very small shops associated with art galleries, museums, community facilities, churches and other like charities.

If there is a clear link between the business undertaking and the charity, an art shop at a gallery, a church canteen. The link has to be more than marginal connection with charitable purpose, e.g. providing slightly more healthy cereal than some other brands.

It may be simpler just to have a monetary de minimis rule (tier 4 makes sense to me), as well as working with Charities Services on some clear explanation about what qualifies as a charity, generally I'd say recycling/op shops can qualify as protecting the environment – community cohesion events would qualify now post Queenstown Lakes acknowledging social cohesion.

Accumulating business income for charity

I agree with 2.35 that imputation credits could be a solution to permit accumulation.

Donor controlled charities

I agree that there should be a separate regime for private foundations – the risk is genuine (and a brief review of the charities register – would say borne out) for reinvestment into related business – sometimes to the detriment of charity – the Southern Cross Charitable Trust decision bore the hallmark of some of those issues. I have no particular views what form this could take, but requiring arms length transactions seems sensible, and preventing investment in related business if possible. That's obviously already a concern from a charities law perspective, but its not something that can be monitored and addressed comprehensively.

Minimum distribution rule

I agree a minimum distribution rule makes sense for donor-controlled charities. Canada's approach seems most equitable.

Policy changes on NFPs

I do not have a view – although I support increasing the $1,000 deduction for small scale NFPs from the system. $10,000 turnover is very minimal, and would seem sensible for most very micro groups that engage in small scale internal transactions, or run small social groups, but might own a small asset together. In truth, most of these groups probably already wouldn't even realise they were liable for tax. Membership clubs are obviously still relevant in a lot of areas of the country, and operate on very thin margins, but I don't imagine there would be much to tax – but still agree consistent tax treatment should be applied.

Exemption for local and regional promotional bodies

Local and regional promotion bodies cannot be charitable unless they are promoting a deprived region (CDC v CC), or are specifically seeking to beautify, or promote local amenities. Economic development itself is not a charitable purpose. I agree that unless it is a charity, and thus demonstrably for the benefit of the public, I can see no reason why a group seeking, to promote an affluent area should get tax concessions, there is no charitable public benefit in further promoting an area that is already successful, unless its for areas that have been genuinely established to benefit the public – like public amentiies available to all, or to make the area aesthetically pleasing for the benefit of all. A bunch of business getting together to lobby against council environmentally friendly development decisions to benefit themselves, but essentially positioning themselves as a economic development group does not seem something that should be afforded preferential tax treatment.

Herd improvement bodies

As above, if it exists to better an industry it will be charitable, as long as the focus is genuinely public benefit (e.g. the improvement of quality in the industry). It seems unnecessary to have a separate exemption, charities law has moved on in this space.

Scientific and industrial research, and veterinary service bodies

As above – all charitable purposes, as long as they exist for public benefit, and not private, and so should not need separate exemption (and if they offer non-ancillary private benefit – should not be afforded any exemption).

Exemptions for non-resident charities with no charitable purpose in New Zealand

Completely agree – no exemption should be permitted.

FBT

This may add cost to some charities operations – but seems a sensible simplification.

Honoraria

I suspect most honoraria are not declared – and would be too minor to ever bother with. If they are substantial, treatment as salary or wages seems appropriate – but will somewhat go against the heart of what it is to be a volunteer.

Donee organisations

I know about donation tax credits but don't claim them back because of the perceived administration. Life is busy. Anything to simplify seems sensible, but it would seem sensible to not make it automatic – some people may not want to claim donation tax credits back.

Thank you for the short and informative paper laying out the questions and areas for comment – a useful exercise.

Kia Ora,

My name is ChunShing Andrew FAN, and I worship with The Salvation Army at Glenfield for 2 years. I'm writing to share my thoughts on the proposed tax changes affecting charities and not-for-profits.

At our centre, we walk alongside people going through really tough times- whether that's needing food, help with bills, finding housing, or just someone to talk to. A lot of this work is supported by the income we receive through our Family Sore or fundraising.

One mum and her three kids came to us after fleeing family violence.She had nothing but a suitcase and was exhausted. We were able to provide food, clothing, and connect her with housing support and financial mentoring. Today, she's in a warm home, her kids are backing back in school, and she's slowly rebuilding her life. That kind of support is only possible because of the resources we have- and that includes the money our store earns and generous donations we receive from the public.

If the Government starts taxing this income or making the admin more difficult, it will take away time, money, and energy we'd rather be spending on the people who need us. We already work with limited resources- we don't want to spend more of it on red tape.

Please keep these kinds of charities tax-free where the money is clearly being used for good. We're not here to make profit- we don't here to make a difference.

I'm happy to talk more if needed.

Nga mihi,

ChunShing Andrew FAN
Member, The Salvation Army Glenfield Corps

s 9(2)(a)

Volunteer Service Abroad
Te Tūao Tāwāhi

"Taxation and the not-for-profit sector"

26 March 2025

Submission below, emailed to policy.webmaster@ird.govt.nz

General statement

Volunteer Service Abroad Te Tūao Tāwāhi (VSA) appreciates the opportunity to submit feedback on the "Taxation and the not-for-profit sector" issues paper from Inland Review. While "simplifying tax rules, reducing compliance costs and addressing integrity risks" are great objectives, it appears that this is a blanket approach to address a very few charities that IRD believes may be taking advantage of the current tax settings.

There is an absence however of costings to indicate the extent of how bad the issues are or of the compliance cost impacts of the proposed changes. This makes an evaluation of the positive impact of these measures difficult to undertake.

The changes may also very well create unintended consequences whereby the charity sector, which arguably delivers services at the most economically efficient level possible, can't achieve financial self-sustainability if they're not allowed to earn business income under current taxation settings.

There are many not-for-profit organisations who supplement their "traditional" income, from donations and grants, with – for want of a better phrase – consulting income, leveraging their expertise and knowledge to provide advice, most often to other NFPs, at rates well below those of professional consulting firms, which both provides a revenue stream for the provider and otherwise inaccessible or previously unaffordable advice to the recipient.

Conceptually, we believe there would be great benefit in adjusting the approach towards the taxation framework from negative to positive by rephrasing the following statement in the Issues Paper from:

"Every tax concession has a "cost", that is, it reduces government revenue and therefore shifts the tax burden to other taxpayers."

to:

"Every tax concession has a "benefit", that is, it reduces government expenditure by empowering charities to have more impact at lower cost than the government providing an equivalent service and therefore reduces the tax burden to other taxpayers."

Reponses to specific questions

Q1. What are the most compelling reasons to tax, or not to tax, charity business income? Do the factors described in 2.13 and 2.14 warrant taxing charity business income?

Taxing charity business income will discourage charities from being innovative and seeking sustainable income streams. It will increase compliance costs while not actually increasing tax revenue by that much and it perpetuates a view of charity that donations are their only domain.

This could very well be the 'thin edge of the wedge', e.g. taxing passive income from investments in funds which are unrelated to the charity's purposes.

Q2. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be the most significant practical implications?

How to define what is "unrelated" would be very challenging. There are no objectives measures or figures on the proposal, so it is difficult to know the scale of financial benefit if these changes were introduced.

Q3. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what criteria should be used to define an unrelated business?

If this criterion is to be used, it must be well-defined to ascertain whether it is truly unrelated. As mentioned above, would passive investment be defined as business or non-business income and would it be related and unrelated business?

Q4. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be an appropriate threshold to continue to provide an exemption for small-scale business activities?

With no data provided to assess the scale of the current situation, it is very difficult to consider a threshold. If there were a threshold, it should be based on the 'business income' only rather than the total annual income of the charity.

Q5. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, do you agree that charity business income distributed for charitable purposes should remain tax exempt? If so, what is the most effective way to achieve this? If not, why not?

If this were not allowed, then could very well impact on charitable giving from non-charity businesses as well reducing the amount they give.

Q6. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what policy settings or issues not already mentioned in this paper do you think should be considered?

This will increase compliance cost for both government and charities, reducing funds available for charitable purposes. Labour cost is a significant input expense for any business. Currently many in the charitable sector receive some pro bono or semi pro bono labour. Accordingly, it would be important for charities to be able to claim the true cost of their business in any income tax return. This raises the question as to what the appropriate fair labour costs should be. Currently there is not a level playing field as regards transparency of reporting with for profit businesses, i.e. charities have to currently meet a higher level of public transparency. Failure to address this issue results in charities being at an unfair competitive disadvantage with for-profit businesses.

Q7. Should New Zealand make a distinction between donor-controlled charities and other charitable organisations for tax purposes? If so, what criteria should define a donor-controlled charity? If not, why not?

Unfortunately, we do not feel we have enough understanding around this particular aspect and to comment would not be useful. Again, a lack of context around the scale of the issue which is at the heart of the consideration.

The heart wants to say "no", however we appreciate a more rational response would be of greater use.

Q8. Should investment restrictions be introduced for donor-controlled charities for tax purposes, to address the risk of tax abuse? If so, what restrictions would be appropriate? If not, why not?

It is difficult to provide an informed response to these questions when it is very unclear whether this is currently a major issue or if there are just a few examples or instances. It would need to be carefully considered whether a distinction be helpful or add additional complexity without much real impact.

Q9. Should donor-controlled charities be required to make a minimum distribution each year? If so, what should the minimum distribution rate be and what exceptions, if any, should there be for the annual minimum distribution? If not, why not?

This could well be considered and would bring New Zealand into line with other countries' policy settings, with figures based on the examples in the Issues Paper. A further consideration could be whether this then applies to all charities not just donor-controlled.

Q15. What are your views on the donation tax credit (DTC) regulatory stewardship review findings and policy initiatives proposed? Do you have any other suggestions on how to improve the current donation tax concession rules?

We agree with the recommendations in the Issues Paper, including delink DTCs from income tax to allow for more real-time payments and any other actions that improve the DTC system.

With regard to FBT

If the compliance costs are reduced following the current review of FBT settings, what are the likely implications of removing or reducing the exemption for charities?

While there are certainly some issues around when the application of the exemptions can be applied, the overall impression of the use of FBT exemption is that it is of value to the NFP sector. This is notably in the case of smaller organisations where they can in subsidise staff rewards and remuneration through the provision of services exempt from FBT, assisting them in bringing them in line with the remuneration otherwise available in commercial organisations. Earnings in NFPs are often "discounted" because of the need of the organisation to seek the "cheapest solution" each time they recruit, which puts them at a disadvantage. The current FBT exemptions can assist at times in making the NFP package more competitive and enabling the NFP to attract a higher quality of staff. The advantages of improving the "talent pool" on whcih an NFP can draw and improve the quality of its management and governance cannot be underestimated.

**** END ****

s 9(2)(a)

From: Anna L Muir s 9(2)(a)
Sent: Monday, 31 March 2025 11:36 pm
To: Policy Webmaster
Subject: Taxation and the not-for-profit sector

Hello Policy.Webmaster@ird.govt.nz

The Inland Revenue Department officials' issues paper titled 'Taxation and the not-for-profit sector' that was issued on 24 February 2025 (**the Issues Paper**) is deficient and it does not comply with the Plain Language Act 2022.

The timing and duration of the consultation period ending on 31 March 2025 also undermine the integrity, if any, of the Inland Revenue Department's call for submissions.

RECOMMENDATION

I recommend that none of the proposals in the Issues Paper proceed.

CALL BY THE HON. SIMON WATTS ON 17 MAY 2023 FOR "... A PROPER REVIEW OF THE (CHARITABLE) SECTOR"

I support the call by the Hon. Simon Watts on 17 May 2023 for "a proper review of the (charitable) sector" (refer timestamp 3:38 in the 'Charities Amendment Bill - Second Reading - Video 9' recording published at https://vimeo.com/827552143), as discussed with him at the INFINZ 'Solving Our Economic Future - A Political Discussion' event in Auckland on 15 June 2023, prior to his appointment as the Minister of Revenue.

COMMENTS ABOUT QUESTION 12 AND THE DEFINED TERM IN SECTION CW 41(5)(c) OF THE INCOME TAX ACT 2007

The “non-resident charity tax exemption” terminology in **Question 12** is problematic. Please do not hesitate to contact me if you would like me to explain why.

Page 1 of the letter that was issued by the IRD on 1 May 2024 with reference 24OIA2112 (refer https://www.ird.govt.nz/about-us/publications/responses-to-official-information-act-requests/2024-responses-to-oia-requests) confirmed that the IRD had no data about the number of entities that were coded in the IRD's system as "tax charity" on 1 April 2024 on the basis that the entity/entities, if any, was/were within the scope of the defined term in section CW 41(5)(c) of the Income Tax Act 2007.

Income Tax Act 2007

If you need more information about this Act, please contact the administering agency: **Inland Revenue Department**

CW 41Charities: non-business income

Definition

(5)

Tax charity means,—

(a)

a trustee, a society, or an institution, registered as a charitable entity under the Charities Act 2005:

(b)

a trustee, a society, or an institution (the **entity**), that—

(i)

has started, before 1 July 2008, to take reasonable steps in the process of preparing an application for registering the entity as a charitable entity under the Charities Act 2005; and

(ii)

intends to complete the process of preparing an application described in subparagraph (i); and

(iii)

has not been notified by the Commissioner that the entity is not a tax charity:

(c)

a trustee, 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:

(d)

a person who is removed from the register, in the period starting with the day they are registered on the register and ending with the earlier of the following days:

(i)

the day on which the person does not comply with the person’s rules contained in the register:

(ii)

the day of final decision.

Defined in this Act: amount, business, charitable purpose, council-controlled organisation, day of final decision, exempt income, income, local authority, notify, tax charity, trustee
Compare: 2004 No 35 s CW 34

Section CW 41(5) heading: added, on 1 July 2008, by section 20(2) of the Taxation (Personal Tax Cuts, Annual Rates, and Remedial Matters) Act 2008 (2008 No 36).
Section CW 41(5): added, on 1 July 2008, by section 20(2) of the Taxation (Personal Tax Cuts, Annual Rates, and Remedial Matters) Act 2008 (2008 No 36).
Section CW 41(5): amended, on 1 April 2019, by section 140 of the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 (2019 No 5).
Section CW 41(5)(a): amended, on 29 March 2018 (with effect on 1 July 2008), by section 37(1) of the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018(2018 No 5).
Section CW 41(5)(b): amended, on 29 March 2018 (with effect on 1 July 2008), by section 37(2) of the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018(2018 No 5).
Section CW 41(5)(c): amended, on 29 March 2018 (with effect on 1 July 2008), by section 37(3) of the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018(2018 No 5).
Section CW 41(5)(c): amended (with effect on 14 April 2014), on 30 June 2014, by section 30(2) of the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014 (2014 No 39).
Section CW 41(5)(d): inserted (with effect on 14 April 2014 and applying for a person for the 2014–15 and subsequent income years; and for an income year before the 2014–15 income year, but only for the first income year and subsequent income years for which the person files a return of income on the basis that subsections (1), (2), and (3) of section 30 of the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014 apply for the relevant income year), on 30 June 2014, by section 30(2) of the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014 (2014 No 39).
Section CW 41 list of defined terms **registered as a charitable entity**: repealed, on 1 July 2008, by section 20(3) of the Taxation (Personal Tax Cuts, Annual Rates, and Remedial Matters) Act 2008 (2008 No 36).
Section CW 41 list of defined terms **tax charity**: inserted, on 1 July 2008, by section 20(3) of the Taxation (Personal Tax Cuts, Annual Rates, and Remedial Matters) Act 2008 (2008 No 36).
https://www.ird.govt.nz/-/media/project/ir/home/documents/oia-responses/may-2024/2024-05-01---the-number-of-entities-currently-recognised-by-the-cir-as-a-tax-charity.pdf?modified=20241215221016&modified=20241215221016

Regards

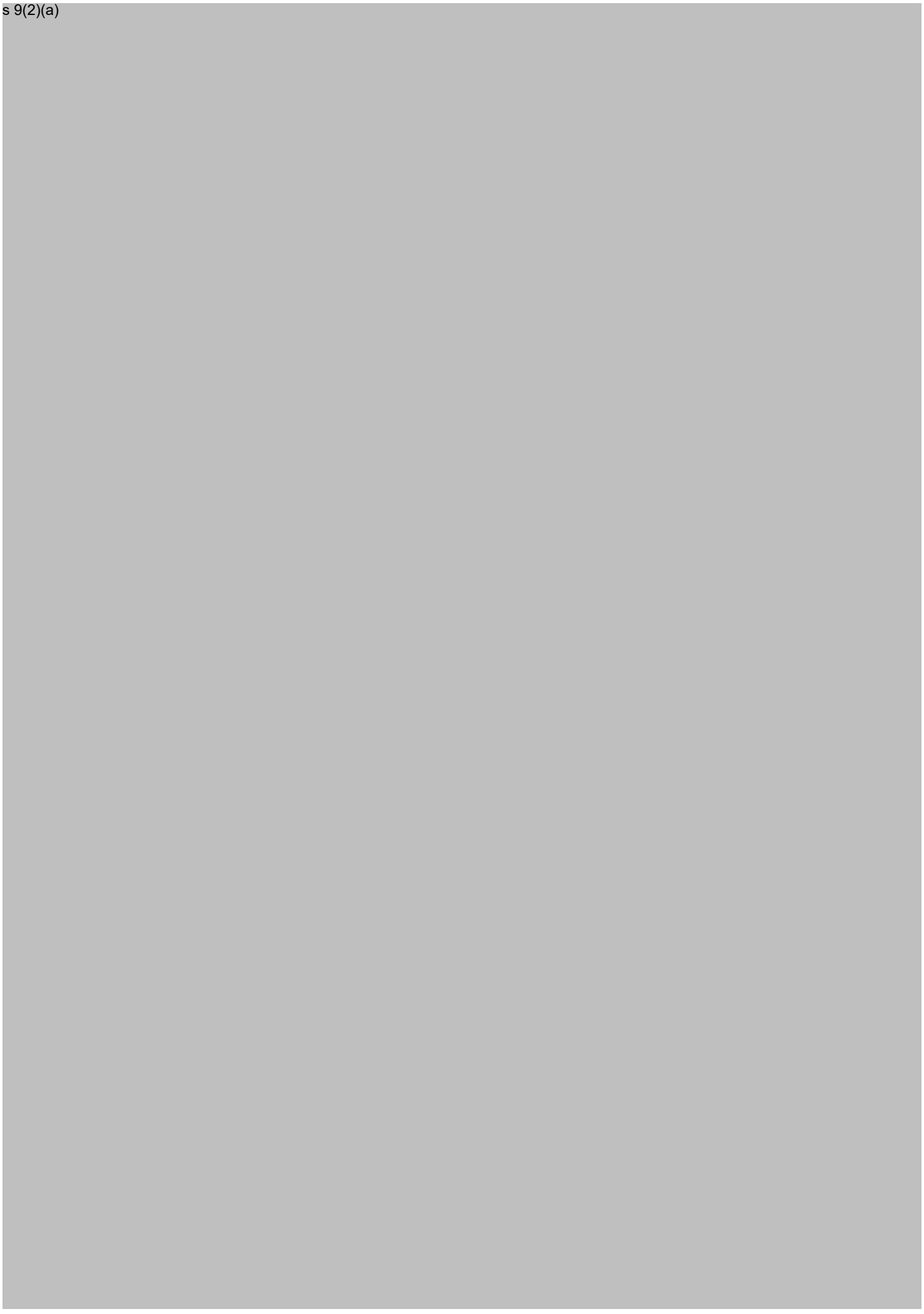
Anna Muir
Auckland
Not in scope

Not in scope

Not in scope

Not in scope

s 9(2)(a)



Taxation and the not-for-profit sector

The Role of Tax

Income Tax compels individuals and corporations to contribute from their income and profit to the greater good of the nation. GST does similarly, but as a tax on consumption and productivity, it is structured so that tax accumulates where the greatest 'value add' is created.

Fundamentally, the point of taxation is to raise funds to distribute on behalf of the people into activities and services that they wouldn't freely give to—specifically, government operations, national infrastructure, national defence, and social programs such as healthcare, education, and support for the most vulnerable.

The Role of Charities

Charities exist to fill the gaps where government support is limited or inappropriate. The priorities of our communities extend beyond what the government should or can provide, so individuals step up to support causes they believe in. Unlike taxation, charitable giving is voluntary, and people choose which organizations and causes align with their myriad of interests and values. The four pillars defining charitable purposes encompass many community-valued but economically unviable activities:

1. **Relief of poverty**
2. **Advancement of education**
3. **Advancement of religion**
4. **Other purposes beneficial to the community**

Tax Treatment of Charities

The government regulates which organizations can rightfully call themselves charities and currently incentivizes charitable giving through tax credits. Since most income has already been taxed via PAYE, these tax credits conceptually and effectively amplify charitable giving by returning to charities the money the government previously collected in tax. This ensures that the full value of the charitable donations purpose is respected, not diverted to alternative purposes through taxation of the giver, the gift, or the receiver.

Should Charity Income Be Taxed?

There is no compelling reason to tax charity income. Any concern over taxing a charity's business activities misses the key point: the final income or profit is bound to charitable purpose. Many charities operate with donated labour, equipment, premises, capital, and non-optimal inputs, producing results that far exceed financial returns. Taxing this environment would simply take advantage of altruism, diverting funds from their intended purpose. If a charity runs a successful business and directs its profits to charitable purposes, there is no societal benefit in taxing that activity—there could even be harm.

Examples

1. **Sanitarium**

- Whether or not one agrees with all aspects of their religious practices and beliefs, their business operations align with their charitable objectives.
- In line with their values, they produce high-quality, healthy food at reasonable prices, benefiting all New Zealanders.
- Their profitability reflects decades of collective investment and employee efforts, and if profits are distributed in line with charitable purposes, they should not be diverted by government via taxation simply because they have been commercially successful.

2. **Destiny Church**
    - While Destiny Church has been a polarizing presence in New Zealand, it is fundamentally a Christian church and falls within the established charitable purpose of advancing religion.
    - Some of its leadership's actions and statements have been controversial and may not align with mainstream public sentiment. However, an organization's charitable status should not be determined by its popularity or alignment with prevailing public opinion.
    - The Charities Commission has the authority to ensure that any activities beyond religious and community support—such as political lobbying—are properly managed and separated from the organization's charitable purposes.
    - Good governance and a clear alignment with charitable purposes should justify Destiny Church's designation as a charity. This includes not only their religious activities but also their work in areas such as poverty relief, education, and counseling services for those seeking recovery from addiction, domestic violence, criminality, and other challenges. Ensuring compliance with charitable objectives is the role of the Charities Commission, and any concerns about governance or activities beyond these purposes should be addressed through proper regulatory oversight rather than public pressure or subjective opinion.
    - Investigations and legal action should be pursued if there is evidence of unlawful behavior, but decisions regarding charitable status must be based on objective criteria, not political or media pressure.
    - If Destiny Church were to lose its charitable status due to public sentiment rather than clear regulatory breaches, it would set a precedent that could put other religious organizations—such as Anglican, Methodist, Catholic, Jewish, and Muslim institutions—at risk of similar scrutiny based on subjective measures.
3. **Donor-Controlled Charities**
    - If an individual has done well enough to establish a charitable trust, whether in their own name or not, and if that charity operates within its charitable purposes, there is no reason for the government to seek tax revenue from it.
    - Distinguishing between tax-avoidant structures and genuinely charitable organizations is important, but taxation is not the best tool to address bad actors.

Governance and Accountability

- **Lazy Endowments and Stockpiled Reserves**: Trustees should be encouraged to actively manage resources to maximize impact. A requirement to use a minimum percentage (e.g., 2%) of endowment funds for investments in impact or national infrastructure projects could be beneficial. However, this must not be about stripping charities of their assets to fund government spending.
- **Business Activities Unrelated to Charitable Purpose**: The key issue is whether the organization is legally bound by charitable purposes. If so, taxing their revenue is inappropriate. New Zealand maintains a clear distinction between for-profit companies and charities, and this clarity should be preserved.

    1. **Shops Selling Second-Hand Goods**
    The difference between a 'business' and a 'charity' is the final arbiter of the funds for distribution. If the organisation is bound by charitable purpose and is approved and regulated by the Charities Commission, then it is inappropriate to tax its income. However, if a private individual or company is the final 'owner' of the funds (profits), then it should remain under the oversight of the IRD. Most charities operate on the goodwill of volunteers and donations (whether current or from historic endowment), and taxing such donations effectively over-taxes the generous.

    Op Shops are a very effective way of redistributing unwanted items, reducing waste, providing goods at vastly reduced prices for those in need, and providing a small amount of useful funds for charities to support their operational costs and charitable activities. It is therefore counterproductive to tax their income. It is also inaccurate as many would contend that they are exchanging goods for a donation rather than purchasing goods in the commercial sense. For example, one wouldn't expect a warranty or 'consumer goods guarantee'.

    2. **Social Enterprise**
    A social enterprise is a business with a social purpose or impact fundamental to its operations (for example, a food producer committed to supporting the disabled or other disadvantaged individuals into employment). The key differential between a social enterprise and a charity is whether the organisation is established as a company or as a charity. A social enterprise may choose to compromise post-tax profit for social benefit, believing its business will remain financially viable in the marketplace.

    A registered charity, however, fulfils its charitable purpose, and its profitability is likely to be focused on long-term viability and impact rather than personal profit for owners or shareholders. If employees of a charity create value to reward themselves with excessive incomes, this would be subject to PAYE anyway. If they operate lavishly against the principles of 'charity,' the Charities Commission has tools to encourage them to focus more deeply on their charitable objectives rather than the IRD forcing the diversion of charitable funds through taxation.

Supporting Innovation and Economic Development

Excellence and innovation require confidence, a comfort with risk, and an environment that allows for both success and failure. Creating space for such experimentation is crucial to building confidence in risk-takers and innovators within our economy. If organisations are serving "NZ Inc.," they should be encouraged to explore, innovate, and take chances, even when the odds are narrow.

A more enthusiastic, bold, and self-confident nation will rise, with even a few successes benefiting all.

For this reason, I support tax exemptions for economic development, tourism, industry improvement bodies, and similar initiatives where general public benefit can be foreseen. I also believe it is appropriate to extend tax exemption support to science and research organisations, including those in industrial, horticultural, and agricultural fields, as well as experimental, start-up, and innovation organisations. It is important that the commercial application of such innovations should commit to supporting our national economy, ensuring that the flow of tax income remains in Aotearoa New Zealand and not taken offshore for private benefit at public expense.

Operational Costs and Efficiency

- The largest expense for most charities is wages and salaries, and it is only right that workers are fairly compensated, especially where specific skills and consistent service are required.
- Running a modern organization comes with significant overhead costs, including governance and strategic oversight; staff and volunteer management; telecoms and media; computers, software and apps; financial, banking and audit services; many types of regulation & compliance, including HR, health & safety, food safety, insurance, professional certifications, vehicles, property, local government, environment; funding applications and community engagement.
- Consolidation and efficiency are desperately needed within the community and charity sectors. The current financial and tax rules, along with the funding environment, do not incentivize cooperation and the pooling of resources across charities. There is a lack of effective data collection and minimal visibility of costs and their impact on community benefit. This absence of transparency means that there is no 'marketplace' where costs and prices can be considered when selecting services, leading to a situation where good service providers can remain invisible, while poor service providers may succeed merely because they are good at writing funding applications.
- **Data, data, data.** Local communities require valid and timely information to understand the opportunities and threats to their wellbeing. If we want our communities to truly thrive, we need effective charities that are fulfilling their charitable purposes and making a real impact. This requires a shift toward transparency, better data collection, and a system that encourages collaboration rather than competition among charities. Only through this approach can we unlock the full potential of charitable organizations to make a lasting difference in the lives of those they serve.

Encouraging Community-Led Solutions

It is foolish to think that taxation and redistribution through central government programs can do a better job than supported and engaged local communities. Charities are uniquely positioned to address social, economic, and environmental challenges in ways that large bureaucratic systems cannot. Supporting charities through tax incentives ensures that resources are used effectively by those closest to the issues, communities supporting their own.

Conclusion

Charities are vital to New Zealand's social fabric and economic wellbeing. Their tax-exempt status must be preserved to sustain their role in society. Instead of burdening them with taxation, we should focus on strengthening governance, improving transparency, and fostering an environment where charities can thrive and uplift our communities.

Without healthy charities, many in our communities will continue to struggle to thrive. Where there is a failure to thrive, there is an increase in survival behaviour, which is very often socially suboptimal: Misery, despair, sickness, hunger, addiction, violence and theft are often the result, certainly not productivity and wellbeing. Downward spirals in emotional, mental and physical health leave our communities depleted in economic energy, social cohesion, and community wellbeing.

By empowering charities, we support community led engagement and wellbeing. By empowering charities, people and resources self-organise within our communities to meet needs such as providing ancillary health care, food security, sport and leisure activities, art and music, education and training, and caring for the young, the old, the sick and the disabled. By empowering charities, we spark upward spirals of hope, purpose and belonging to meet seen and unseen needs in our community. By empowering charities, we inspire a renaissance of community engagement throughout Aotearoa New Zealand.

Submitted by:

Cathie Gould
s 9(2)(a)

Ryan Donovan

From: Emily Ren s 9(2)(a)
Sent: Monday, 31 March 2025 11:50 pm
To: Policy Webmaster
Subject: Charity Tax submission

External Email CAUTION: Please take CARE when opening any links or attachments.

To whom this may concern,

Here are my submissions regarding the charity tax. I am an auditor for about 150 charities in NZ, most of these charities are doing fantastic work to support the NZ community and needy places in other parts of the world. Introducing charity tax would place a lot more pressure on small to medium sized charities who should have focusing more on the actual work they do. We should look at the amount of tax to be collected versus the cost of compliance (for charities) and regulation (government) to see if it is efficient to have the charity tax revamp. The consultation is only open in such a short window, between 24th Feb to 31st March which somehow collides with accountants' tax year ends. I believe there are many more accountants like me who have seen the good work and the good financial reporting, financial management done by the charities. However many accountants like us won't have the time to write a submission, because of the set up of the consultation timeline. I am only able to respond to a selective questions because of the above reason.

Q1. What are the most compelling reasons to tax, or not to tax, charity business income? Do the factors described in 2.13 and 2.14 warrant taxing charity business income?
The reason for not taxing charity business income is that business income is the only source of income that is in a charity's control. If charity's business income is taxed, it will significantly discourage charities to be more self-sufficient and will require more fundings from government and funders for its operation.
I believe the factors described in 2.13 and 2.14 only applies to some minorities only, as most of the charities in NZ are small to medium sized charities who are not aiming to gain a larger market share by lowing their price, but rather earning the business income to support their charitable purposes.

Q4: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be an appropriate threshold to continue to provide an exemption for small-scale business activities?
Tier 3 and tier 4 entities form significant part of the charities in NZ, these are the small to medium sized charities who usually struggle with obtaining sufficient amount of funding and still doing the good work of serving the community. So I believe it would be best not to tax tier 3 and tier 4 entities because these entities will most likely have very small or non taxable business income. The addition charity tax compliance will most likely jeopardize the ability of these charities to be more self-sufficient.

Q5. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, do you agree that charity business income distributed for charitable purposes should remain tax exempt? If so, what is the most effective way to achieve this? If not, why not?
Yes – funds distributed for charitable purposes should be encouraged, as there are huge needs in not just NZ but other country in area such as health care, financial support, poverty resolving, education etc. One way I can think of to achieve this is to include a brief Note to the charity's Performance Report, to show the breakdown of the distribution of business Income.

Emily Ren
Director at Charity Integrity Audit Ltd
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Our Ref: KEN332-2068

31 March 2025

Dear Sir

Taxation and the not for profit sector

1 Introduction

1.1 Dentons New Zealand ('**Dentons**' or '**we**') welcomes the opportunity to comment on New Zealand Inland Revenue's ('**IRD**'s) officials' issues paper: *Taxation and the not-for-profit sector* ('**Issues Paper**').

1.2 Given the short consultation period, our submission is limited to the content of Chapters 2 and 3 of the Issues Paper, which relate to charities.

1.3 A brief summary of our recommendations is set out in paragraph 2 below. Our detailed reasoning for our submissions is set out in Appendix A **below** our detailed reasoning for our submissions above. We offer a general comment in paragraph 3 below.

2 Executive Summary

2.1 We strongly recommend that the proposals in Chapters 2 and 3 **do not go ahead**. The is no compelling argument for the proposals.

2.2 Instead, we recommend the relevant Governmental departments and regulators ought to focus their efforts on:

a enforcement of current legal and regulatory requirements, which provide adequate means for dealing with the issues identified in the Issues Paper;

b enhancement of the understanding of the same, through improved guidance and training; and

c a holistic review and update of the Charities Act 2005 ('**Charities Act**') (please see our general comment on this point in paragraph 3 below).

3 General comment

3.1 While we welcome an opportunity to submit on the Issues Paper, we are of the view that a piecemeal approach to the change of the settings for the not-for-profit sector which we have seen in the recent years (including in particular the Charities Amendment Act 2023) and which continues with the current Issues Paper, are damaging to the sector. Important decisions that greatly affect the sector are being made on basis of assumptions that are not fully tested and thought through and where time for consultation with stakeholders is sorely lacking. By DIA's own admission, the Charities Amendment Act 2023 is based on inadequate consultation, inadequate problem definition and a lack of evidence to support the proposals.[1] The Issues Paper is likewise riddled with these same issues.

3.2 Charities law issues are complex and their impact on the sector and on the society as a whole is far-reaching. The charities legal framework is intertwined with other areas of law and regulation and as such, caution is warranted. Before we make any more piecemeal changes, we need to ensure that the fundamentals of the charities law framework are sound. To make any changes to the tax settings for charities now would therefore not only be premature but would risk making the situation for charities significantly worse: any tax changes should be deferred until a proper, independent, review of the Charities Act has taken place.[2] Such a review would assist the IRD with a deeper understanding of not just the Charities Act but of the applicable common law and other laws and regulations that apply to New Zealand charities. This will ensure that any changes to tax law are consistent with, and do not cut across, fundamental charities law principles.

3.3 If implemented, the proposals set forth in Chapters 2 and 3 of the Issues Paper will necessitate putting in place a complex set of tax rules which will be difficult to enforce. They will require expenditure of scarce taxpayers' and charities' resources, and may not achieve the desired outcomes, such as generating additional tax revenue.

3.4 Please do not hesitate to contact us if you have any questions in relation to our submission.

Yours faithfully

s 9(2)(a)

Silvia McPherson
Consultant
Dentons

s 9(2)(a)

[1] See Te Tari Taiwhemua / Internal Affairs *Regulatory Impact Statement: Modernising the Chariteis Act* (Report, 19 October 2021) at 3,6, 9, 10, 45, 53 and 120.
[2] The majority of the submitters called for the Charities Amendment Bill to be withdrawn, and for the Labour Party to honour its manifesto commitment to carry out a proper, first principles, post-implementation review of the Charities Act, one carried out independently of the DIA. We note that the Bill was opposed by every non-Labour Party MP in Parliament.

Appendix A

Chapter 2: Charities business income tax exemption

1 Q1: What are the most compelling reasons to tax, or not to tax, charity business income? Do the factors described in 2.13 and 2.14 of the Issues Paper warrant taxing charity business income?

1.1 The Issues Paper contains a number of suggestions implying that charitable trading entities have some advantages over their for-profit counterparts, putting these forward as valid reasons to tax charity business income in order to 'level the playing field'. None of these perceived advantages withstand scrutiny when considered more fully:

a Advantage in relation to expansion due to being able to accumulate funds tax fee: The main assumption that is put forward is that the business income tax exemption for charities gives charities an unfair competitive advantage in terms of an ability to grow a business faster through an ability to accumulate funds tax-free[3] and that New Zealand is an international outlier in this respect.[4] This is not quite the case. Australia has looked closely at its business income tax exemption for charities on a number of occasions, and consistently found that it should remain in place, disproving any merit of the perceived advantage in relation to expansion.[5] In Canada, calls have recently been made to return to an approach along the lines adopted in Australia[6] and New Zealand, due to the stress the charitable sector in Canada is experiencing around the funding gap. As a result, more Canadian charities are looking at ways to earn income through commercial activities to help them raise the resources needed, and the authorities are considering dispensing with taxation of charity business income in order to assist the charities sector.[7] It would be unwise to follow the Canadian example precisely at a time when they have gone full circle and are looking to Australia and New Zealand for solutions.[8] The funding gap in New Zealand would be even more acutely felt than in Canada (a country with population and a tax base many times the size of New Zealand), if we were to tax charity business income of any kind.

b No tax compliance costs: The Issues Paper suggests that charitable trading entities may have an 'advantage' over non-charitable trading entities in that they do not face the compliance costs associated with a tax obligation, which arguably lowers their relative costs of doing business.[9] We disagree. Registered charities are in fact required to incur significant compliance costs in preparing the comprehensive transparency and accountability information required under the financial reporting rules. This information must be made publicly available on the charities register. Taxpaying businesses are not generally subject to the significant compliance costs associated with these comprehensive disclosure obligations. Charities are also subject to the compliance costs of tax obligations such as PAYE and GST. There is no evidence to suggest that charities have lower relative costs of doing business. If anything, given their financial

[3] Issues Paper, paragraphs 2.7
[4] Issues Paper, paragraph 2.4
[5] As summarised in the submission to the Deputy Commissioner, Policy, IRD on *Taxation and the not-for-profit sector*, Sue Barker Charities Law, 23 March 2025 at paragraphs 127 – 151.
[6] Report of the Special Senate Committee on the Charitable Sector, *Catalyst for Change: A Roadmap to a Stronger Charitable Sector*, June 2019 at 88 - 92
[7] Report of the Special Senate Committee on the Charitable Sector Catalyst for Change: *A Roadmap to a Stronger Charitable Sector* June 2019 at 127
[8] Advisory Committee on the Charitable Sector *Report #3 – Towards a federal regulatory environment that enables and strengthens the charitable and non-profit sector*, July 2021.
[9] Issues Paper, paragraph 2.13

reporting obligations, the relative costs for charities are likely to be higher than for their for-profit counterparts.

c Advantage by virtue of non-refundability of losses for taxable businesses: This assumption is based on the proposition that the non-refundability of losses for taxable businesses can result in a disadvantage for such business relative to tax-exempt businesses, resulting in a higher relative rate of return for non-tax paying businesses over time when there has been a loss in one year,[10] but omits to note that taxpaying businesses in fact have an advantage in that they are able to carry forward losses to be offset against future income.[11]

d Advantage through lower capital raising costs: Another assumption that is made in the Issues Paper is that the charities' ability to accumulate funds tax-free may give them lower costs in raising capital.[12] No evidence is cited in support of this statement. Although the Issues Paper acknowledges that charities generally cannot raise equity capital (as private investors cannot receive a return),[13] it does not acknowledge that charities' ability to access debt capital is also limited. Charities often fail conventional lending criteria. They don't have guarantors to call on and debt capital from the government or private funders is scarcely available. Arguably, the advantage rests with the for-profit sector, not the other way around. The ability to accumulate pre-tax funds merely offsets significant disadvantages that charities face in their ability to access sufficient capital to expand to an optimal size.[14]

1.2 It is disappointing that the above perceived advantages were not better analysed for the purposes of the Issues Paper.

1.3 Nor were they counter-balanced by putting forward any advantages that for-profit trading enterprises have against their charitable counterparts. Other than those already touched on above, taxpaying businesses have an important advantage of being able to utilise imputation credits: the fact that imputation credits are non-refundable means that charities effectively are subject to income tax on their investments in New Zealand companies.

2 Q2: If the tax exemption is removed for charity business income that is unrelated to charitable purpose, what would be the most significant practical implications?

2.1 The issues paper acknowledges that distinguishing between related and unrelated businesses would increase the compliance costs for affected charity businesses, and could be difficult in practice unless the legislation and associated guidance is clear.[15] However, this may be too much of an over-statement. The experience of other jurisdictions indicates otherwise. Any attempt to draft around the arbitrary distinction between the two is in fact fraught with difficulty.[16] Any such arbitrary line would require constant adjustment with further arbitrary rules to fill gaps and address unintended consequences. The net result will be ever-increasing spiral of complexity.

[10] Issues Paper, paragraph 2.13
[11] As is in fact noted at paragraph 2.11 of the Issues Paper
[12] Issues Paper, paragraph 2.13
[13] Issues Paper, paragraph 2.13
[14] See also the discussion in Austaxpolicy: Tax and Transfer Policy Blog *Do Businesses Run by Charities Have a Competitive Advantage*? 17 November 2021
[15] Issues Paper, paragraphs 2.21 and 2.19.
[16] See S Barker *Focus on purpose - what does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3, chapter 5. See also Report to the Treasurer, *Australia's future tax system: Part 2 – Detailed analysis*, December 2009, Pt 2 vol 1: <treasury.gov.au/review/the-australias-future-tax-system-review/final-report at 212.

2.2 It would force charities to spend resources on cutting through that complexity – resources that are better spent on furthering their charitable purposes.

2.3 Contrary to the suggestion in the Issues Paper that there are many international precedents for New Zealand to follow in terms of taxing the unrelated business income of charities,[17] we urge caution. When critically evaluated, the experience of other jurisdictions demonstrates that attempts to tax the unrelated business income of charities are in fact fraught with difficulty, don't always work (see the example of Canada above), and result in rather complex and costly rules to follow.[18]

Chapter 3: Donor-controlled charities

3 Q7: Should New Zealand make a distinction between donor-controlled charities and other charitable organisations for tax purposes? If so, what criteria should define a donor-controlled charity? If not, why not?

3.1 We submit that it is not necessary to create a new and necessarily arbitrary category of charity, upon which new rules restricting investments and imposing minimum distribution requirements would be imposed, in order to have adequate oversight over charities' accumulation, distribution and investment (or any other) activities. If an individual charity is genuinely abusing its privileges, as further explained in paragraph 4 below, existing rules already provide adequate protections that can achieve the desired outcomes on an exceptions basis without resorting to arbitrary, blanket rules. Such rules simply need to be used (supported by the comprehensive information now made available by the charities register) and enforced.

4 Q8: Should investment restriction be introduced for donor-controlled charities for tax purposes, to address the risk of tax abuse? If so, what restrictions would be appropriate? If not, why not?

4.1 Arguably, no legislative response is required to address the perceived risk of tax abuse. As explained below, existing provisions already provide adequate protection.

4.2 In relation to charities' business income, section CW42(1)(c) and (5) – (8) of the Income Tax Act 2007 provides adequate control. It nullifies the business income tax exemption if a person with some control over the business is able to direct or divert an amount derived from the business to their benefit or advantage.

4.3 In any event (and in relation to non-business income), the current (non-tax) law already provides safeguards which are more than adequate (they just need to be enforced as and when necessary). Persons who run charities (be they trustees, directors or members of governing boards, all of whom meet the definition of 'charity officers' in the Charities Act)[19] have important fiduciary duties they are subject to, pursuant to laws governing the legal form they take.[20] Turning to the examples given in the Issues Paper[21], it is very unlikely that a charity could purchase assets from a related party at non-market prices without breaching a fiduciary duty. Similarly, a charity could not invest money in a business controlled by one of its charity officers unless to do so was in the best interests of the

[17] Issues Paper, paragraph 2.21
[18] As summarised in the submission to the Deputy Commissioner, Policy, IRD on *Taxation and the not-for-profit sector*, Sue Barker Charities Law, 23 March 2025 at paragraphs 244 – 337.
[19] Per Subpart 1A of the Charities Act 2005
[20] See, for example, Trusts Act 2019, sections 22-38, Incorporated Societies Act 2022 sections 54 - 61 and Companies Act 1993 sections 131 – 137.
[21] Issues Paper at paragraph 3.6.

charity's charitable purposes. Every decision made by every registered charity must be made in good faith in the best interests of its stated charitable purposes.

4.4 Acting in breach of fiduciary duty is unlawful, and therefore already constitutes 'serious wrongdoing' under the Charities Act,[22] which in turn is grounds for Charities Services to take action, including deregistration.[23]

4.5 Charities must also undergo a rigorous process in order to register as a charity in the first place, including addressing the issue of conflicts of interest. This is strictly monitored by Charities Services[24]. Additionally, charities Services provides extensive guidance on this topic in a dedicated part of its website.[25]

4.6 The Issues Paper does not mention, let alone analyse, any of the above existing provisions.

5 Q9: Should donor-controlled charities be required to make a minimum distribution each year? If so, what should the minimum distribution rate be and what exceptions, if any, should there be for the annual minimum distribution? If not, why not?

5.1 No, they should not. The minimum distribution requirements are fraught with difficulty. This is evident from the strong opposition by submitters to the review of the Charities Act. In its October 2019 regulatory impact statement ('**RIS**'), the DIA summarised that that the submitters thought that this option was "*inflexible, did not recognise the careful planning and responses by charities, is an arbitrary intervention to an arbitrary problem, and would have significant adverse consequences on funding arrangements and behaviour*". DIA noted that "*[l]ack of stakeholder buy-in will make it difficult to enforce*".[26]

5.2 Other objections to the imposition of minimum distribution requirements included the following:[27]

a If a charity is unable to meet the minimum requirements with surplus funds, they would have to use reserves or sell assets which will impact their ability to achieve their charitable purpose;

b It is inflexible to external influences outside of charities' control and how a charity may need to operate to achieve long-term goals;

c It may encourage charities to distribute the minimum, even if thy could do more, or encourage riskier investments to generate higher returns;

d It could lead to damage to perpetual funds by requiring distribution of more funds than is available per year;

e Any minimum distribution requirement is arbitrary and does not reflect the objectives and careful planning undertaken by Māori charitable organisations;

f Restricting the ability to accumulate funds will adversely impact efforts to support the long-term prosperity of iwi; and

[22] defined in section 4(1) of the Charities Act.
[23] Under section 32(1)(e) of the Charities Act.
[24] See Charities Services, *Conflicts of interest and registering as a charity*: https://www.charities.govt.nz/news-and-events/blograngitaki/conflicts-of-interest-and-registering-as-a-charity
[25] See https://www.charities.govt.nz/im-a-registered-charity/running-your-charity/conflict-of-interestpanga-rongorua
[26] RIS at paragraph 44.
[27] RIS at paragraph 39.

g "net assets" is not an appropriate indicator for various reasons, and the proposed five per cent baseline is short-sighted, and too high given the current low interest and low return market.

5.3 Most countries do not impose minimum distribution requirements, and instead simply require disclosure of financial information, including surplus, and rely on public scrutiny to ensure funds are applied in pursuit of charitable purposes in a timely manner.[28] New Zealand already has a comprehensive set of transparency and accountability requirements for charities.

5.4 A key difficulty with any minimum distribution requirement is the complexity around how it will be calculated and the elaborate definitions that will be necessary for a calculation that will be easy to understand, fair and equitable.

5.5 To impose a minimum distribution requirement, it would first be necessary to decide the *base figure* for the calculation, on which the percentage will be calculated. This may raise the following issues:

a If based on net assets (as proposed by the DIA), what methodology should be used for their valuation, so that it is consistent across the board? What if the charity does not have sources of liquid assets to meet the percentage figure and the only asset they have is illiquid? What if all or most of their net assets are held as 'endowments' and charities cannot legally sell them (because they don't have a power to dispose of the endowment / capital)? As an aside, the costs of valuations and compliance would be a significant expense.

b The Canadian charities struggled to meet the minimum distribution requirements, resulting in authorities having to adjust their approach and provide flexibility for ad-hoc and discretionary exceptions.[29] However, these tend to introduce subjectivity, additional complexity and administrative cost.

c Another issue is whether the calculation is to be repeated for each 'sub-fund' a charity holds (such as on basis of a restricted gift to fund a particular project, or award) or collectively.[30]

d Even a net income/surplus base is not without a challenge. It can have a distortionary effect, by incentivising charities to place their investments in high growth, low-yield assets, to reduce the calculation base. It can also prevent charities from establishing endowments and/or erode their capital base.[31]

5.6 The *percentage figure* would need to be low enough to take account of different economic conditions and the particular circumstances of the whole range of affected charities, to ensure charities' capital base is not gradually weakened, and to protect their ability to operate in perpetuity (assuming the need for their services remains).[32]

[28] Ann O'Connell "Taxation and the Not for profit Sector globally: common issues, different solutions" in Matthew Harding (ed) *Research Handbook on Not-for-profit law* (Edward Elgar 2018) 388 at 410.
[29] Ontario Law Reform Commission Report on the Law of Charities (Toronto, 1996) at 275, 305 and 376.
[30] Evelyn Brody "Reforming tax policy with respect to nonprofit organisations" in Matthew Harding (ed) *Research Handbook on Not-for-profit law*, (Edward Elgar 2018) 484 at 499.
[31] These were particular problems identified in Canada, leading to the change to an investment assets basis – see Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 280 and 284.
[32] Ontario Law Reform Commission Report on the Law of Charities (Toronto, 1996) at 278

5.7 On the other hand, a low percentage figure may act as an arbitrary target (especially if resources will need to be spent on compliance with this target) and disincentivise charities from spending more than the minimum.[33] It may well be counter-productive.

5.8 Finally, care would need to be taken to define what *expenditure* would qualify for the minimum percentage distribution – would a distribution to another charity qualify? Would any related or unrelated expenses qualify, such as legal or accounting costs to help with meeting these requirements?

5.9 An additional issue is when the calculation and the relevant valuations ought to take place, and whether excess/shortfalls can be carried forward, whether expenditure could be calculated on basis of an average expenditure over a number of years and so forth.[34]

5.10 The rules imposing minimum distribution requirements in other jurisdictions provide a cautionary tale, not least because they were introduced in a different time and in a different context to address perceived problems that may not exist in New Zealand.[35]

5.11 In particular, a key factor driving mandatory distribution requirements in other jurisdictions has been a desire to prevent abuses, on the basis that endowed (i.e. privately funded) charities were not subject to the same level of scrutiny as entities that receive donations from the public.[36] However, all New Zealand charities, without exception, are already subject to comprehensive transparency and accountability requirements,[37] providing tools of disclosure that enable scrutiny by government agencies and the public that was simply not available in countries such as Canada, Australia and the US when the minimum distribution requirements were imposed.[38]

[33] Ontario Law Reform Commission Report on the Law of Charities (Toronto, 1996) at 367 and 304
[34] Ontario Law Reform Commission Report on the Law of Charities (Toronto, 1996) at 367.
[35] *Submission to the Deputy Commissioner, Policy, IRD on Taxation and the not-for-profit sector*, Sue Barker Charities Law, 23 March 2025 at paragraphs 418 – 429.
[36] Ontario Law Reform Commission Report on the Law of Charities (Toronto, 1996) at 261 and 273; Ann O'Connell "Taxation and the Not for profit Sector globally: common issues, different solutions" in Matthew Harding (ed) Research Handbook on Not-for-profit law (Edward Elgar, 2018) 388 at 411. See also: http://archive.boston.com/news/nation/articles/2003/10/09/some_officers_of_charities_steer_assets_to_selves/.
[37] Sections 42AB and 42AC of the Charities Act, inserted by the Charities Amendment Act 2023, allow regulations to be made permitting a small subset of very small charities to be exempted from the requirement to comply with External Reporting Board standards and instead require only minimum financial information. However, as at the date of writing, no such regulations have been made and appear unlikely ever to be made. For a fuller discussion, see Barker et al *The law and practice of charities in New Zealand* 2ed (LexisNexis, 2024).
[38] See for example: https://www.philanthropy.org.au/stories-anniversary-of-reform.

Taxation and the Not-for-Profit Sector Submission

My name is Fiona Richardson I am proud to work at The Salvation Army (TSA). My role is EA to the Territorial Director of Community Ministries, located at Territorial Headquarters in Wellington. I have worked for TSA for over seven years.

I am writing to share my thoughts on the proposed tax changes impacting charities and not-for-profit organisations.

The Salvation Army reaches out to Aotearoa New Zealand to provide help and support to many of our most vulnerable whānau. These services include food support, access to housing, life skills training, financial mentoring, counselling and drop-in centres providing a warm place and company for the lonely and vulnerable. Without all the income we receive from our generous donors, from our Family Stores and other social enterprises we would not be able to continue with all these services.

The Government contract funding has been reduced resulting in the loss of key social work kaimahi and many other charities and not for profit organisations providing similar services to the community have also been seriously impacted by these reductions.

The need for these services is growing, however removing tax emptions along with the current Government funding cuts will undoubtedly put access to these services at further risk.

I believe that charitable and not-for-profit organisation business income should not be taxed because those funds are used not for profit but to help those in need in Aotearoa.

Ngā mihi

Fiona Richardson

IRD Consultation on Taxation and the Not-For-Profit Sector

Submission on behalf of Girls' Brigade New Zealand

Introduction & Background

Girls' Brigade New Zealand is an organization that has been working, here in New Zealand, to improve the lives of girls and young women for almost 100 years since it began in 1928. Girls' Brigade New Zealand is part of an international movement where it is now found in over 50 countries and, internationally, has been operating for over 130 years.

Through camps, workshops and leadership programmes along with local weekly programmes, we aim to foster resilience, confidence and a strong sense of community among our members (both girls and leaders) throughout the length and breadth of New Zealand. We aim to support girls (from 5 to 18 years), no matter their geographical location, ethnicity or socio-economic situation, to extend their abilities through spiritual, physical, educational and social learning and activities

Girl's Brigade is also a registered Charity.

Submission

While we do not have business activities that are unrelated to our core charitable purposes, we believe there may be implications, down the track, even for Charities like ours. Hence, we felt it important to give our thoughts on this subject.

Question 1 asks what the most compelling reasons are to tax, or not tax, charity business income. In reading the background information supplied, it is very clear that there is a very micro lens that is being used to look at this.

However, if you look at the role of charities through a more macro lens, there are good reasons why introducing tax on unrelated business income may have an adverse effect that is not immediately apparent. In the infrastructure of society, charities play an important role often providing opportunities or services that are important to the social fibre of our community, but that Government is simply not able to provide – usually because it does not have the resources (both financial and operational) to do so – nor do they intend to provide them even if they did have the resources.

Additionally, we are in an age where the ability for charities to source funding through external means is becoming harder and harder. Even finding people who are willing to volunteer their time is becoming more difficult. Because of this, charities are often having to look to business models to ensure that they have the financial means to provide both the services and to pay people to carry out these services to our communities. By then taxing these alternative sources of income, while it may increase the funds available to Government, it will decrease the funds that can ultimately be used to strengthen our communities through these important services that charities provide.

Para 2.13 suggests that charitable entities may have an advantage over non-charitable trading entities in that they do not face the compliance costs associated with a tax obligation. However, that is simply not true. Charities also have often onerous accounting compliance requirements that they legally need to meet as do For-Profit entities. And these come at a huge

cost especially when the requirement for audit or review is added onto that. Whereas, the income tax compliance cost is only a portion of the total accounting compliance cost.

If, at any stage, this taxing of non-core business income goes wider and subsequently hits small charitable organizations, then the compliance costs for them will increase hugely due to the more limited skill sets and resources that are often in these types of organizations. In all likelihood, they would need to seek, and pay for, the services of external skills such as specialist tax accountants. That alone, would see compliance costs sky-rocket.

It also needs to be noted that, while the costs to non-charitable organizations can be significant for raising external capital, charities have a far more limited repertoire of options for financing their work which, without the ability to use non-related business ventures, is often limited to a handful of funders and the donations of people who see their work as important.

2.15 suggests that 'tax concessions for unrelated charity businesses reduce government revenue, and therefore shift the tax burden to other taxpayers'. While that may have some element of truth, it also reduces the social burden that the Government cannot afford to cover.

Whilst there might be favour for a taxing of income derived from business interests for top tier organization, there is a big concern that this then opens the door for future changes to then taxing income from business interests for all organisations, which also in turn opens the door for all income to be taxed no matter how it was sourced. And this would have major long-term implications.

Summary

- Charities and not-for-profit organisations are the backbone of New Zealand. New Zealanders rely on these organisations for services that are not provided anywhere else.
- Any loss of these organisations would affect many New Zealanders, with Government being unable to supply the necessary support structures these organisations currently provide.
- While some of these changes appear to be targeting some of the larger charities that have business income that is unrelated to charitable purposes, any change would negatively impact necessary income for the running of not only those charities and not-for-profit organisations but may also potentially have a later flow-on effect on smaller charities and not-for-profit organisations, if the Government and IRD choose to push this concept further.
- Compliance costs between not-for-profit organisations and for-profit organisations are not as substantially different as some may think and there is the potential that these compliance costs for not-for-profits will balloon in excess of what for-profit organizations currently pay.
- Girls' Brigade New Zealand is not in favour of these suggested changes.

IRD is welcome to contact us to discuss the points raised if required.

Submission

Inland Revenue Department
Taxation and the not-for-profit sector (Final Draft)
31 March 2025

MCGUINNESS INSTITUTE
TE HONONGA WAKA

About the McGuinness Institute

The Institute was founded in 2004 as a non-partisan think tank working towards a sustainable future for Aotearoa New Zealand. Project 2058 is the Institute's flagship project focusing on Aotearoa New Zealand's long-term future. Because of our observation that foresight drives strategy, strategy requires reporting, and reporting shapes foresight, the Institute developed three interlinking policy projects: *ForesightNZ, StrategyNZ* and *ReportingNZ*. Each of these tools must align if we want Aotearoa New Zealand to develop durable, robust and forward-looking public policies. The policy projects frame and feed into our research projects, which address a range of significant issues facing Aotearoa New Zealand. The 11 research projects are: *CivicsNZ*, *ClimateChangeNZ*, *EcologicalCorridorsNZ*, *GlobalConflictNZ*, *OneOceanNZ*, *PandemicNZ*, *PublicScienceNZ*, *ScenariosNZ*, *TacklingPovertyNZ*, *TalentNZ* and *WaterFuturesNZ*.

About the cover

This cover features logos and images from a range of not-for-profit New Zealand businesses.

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1.0 Executive Summary

How we treat the not-for-profit sector is a financially, socially and ethically significant issue for New Zealand. Society needs to have faith that charities and not-for-profits are acting ethically, that tax is paid fairly and that the economy is operating on a level playing field. Not-for-profits fulfil an important role in society for the public good; however, it is essential that we have solid checks and balances in place to ensure some are not taking advantage of the system and to ensure any benefits are passed on to those in need.

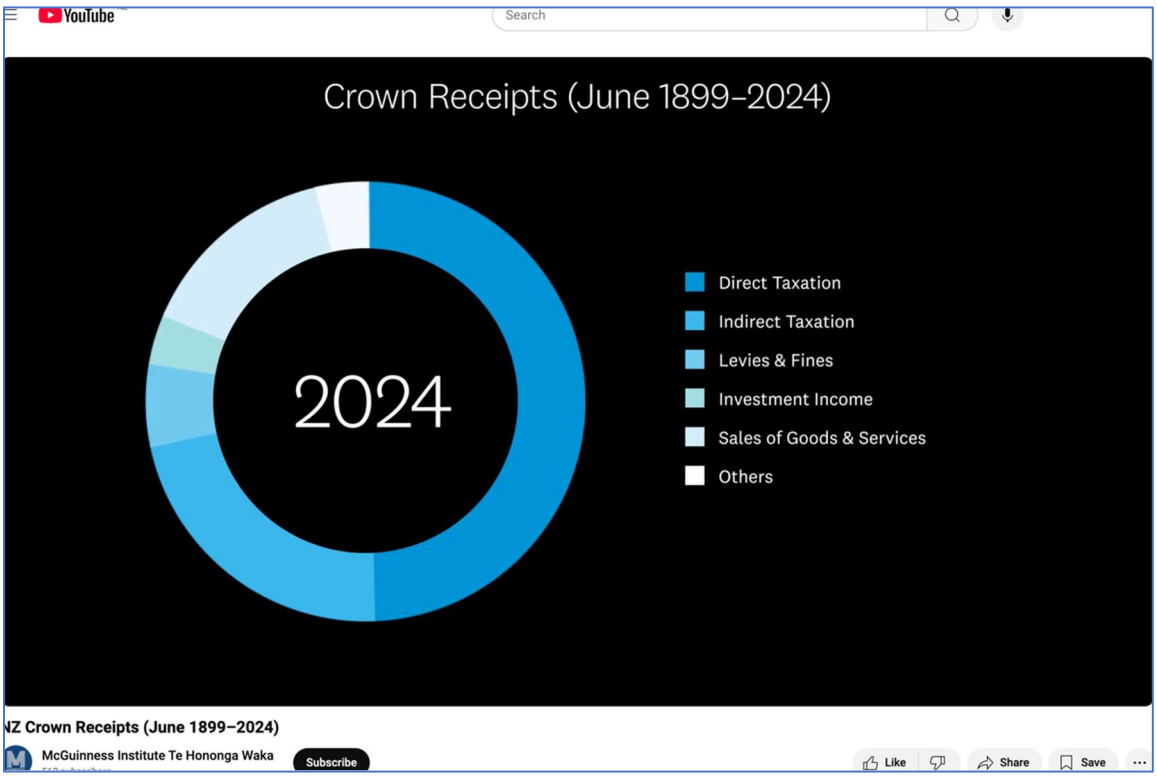
We welcome the opportunity to explore this important topic. We are mindful that society is becoming more untrusting and divisive, and that the Government's financial position is becoming significantly challenged. From a foresight perspective, our tax take and our costs will be significantly impacted by our aging population (e.g. less tax more health costs) and climate adaptation (e.g. more infrastructure, insurance and relocation costs).

We would welcome the opportunity to meet and/or answer any specific questions in response to our submission.

Why our system of tax matters

Figure 1 (below) is a screenshot of a You Tube clip the Institute has produced to show receipts collected over time. It illustrates the move from indirect to direct taxation, and our dependence today on an effective and trusted direct taxation system. (Please note we also have similar clips on Crown Expenses and a series of clips on exports and imports since 1899 – 125 years ago).

Figure 1: The McGuinness Institute You Tube Crown Receipts (June 1899-2024)
Source: McGuinness Institute[1]



Not-for-profits provide significant benefits for our country, with many delivering much-needed services, assisting people who need help, providing resources and supporting our communities. Although they are not financially focused, running a not-for-profit can cost a significant amount of money.

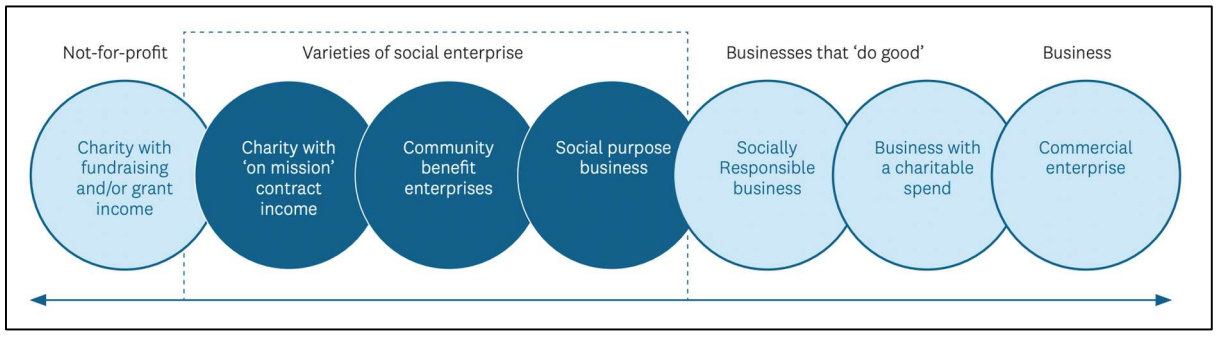
In order to support themselves, approximately 40% of not-for-profits have branched into running some form of business operation to earn income. The *Taxation and the not-for-profit sector* IRD consultation document notes that 11,700 out of 29,000 of New Zealand's not-for-profits reported business income in 2024, although the exact amount is not clearly defined.[2] Any business operations owned by not-for-profits, even if they are completely unrelated to the not-for-profit's purpose, have, since 1940, been exempt from income tax.

Not-for-profits in New Zealand are big business; it is estimated that the income tax exemption misses a potential of $2 billion in taxable profit.[3] The Charities Services *Annual Review 2023/2024* indicates that in the 2023/24 year, not-for-profits had total expenditure of $25.28 billion and a total income of $27.34 billion.[4] To put this into context, Treasury reports that the entire New Zealand Government's total expenditure in the 2023/24 year was $180.1 billion.[5]

One of the most important things charities do is provide a public benefit, however not everything that benefits the public is 'charitable'. To qualify as a charity, an organisation has to provide a benefit to the public, which is very similar to what has been accepted as charitable by the courts. Charities Services assesses applications on a case-by-case basis in light of previous court rulings about charitable public benefit.[6]

However, for-profits also deliver a public benefit. How we see this relationship is defined in an 2020 report, *Report 17 – ReportingNZ: Building a Reporting Framework Fit for Purpose.*[7] The report noted that not only does a social enterprise continuum exists, but that social enterprises and other 'for-purpose' organizations are gaining traction. See Figure 2 below.

Figure 2: The social enterprise continuum
Source: McGuinness Institute (2020)[8]



The Charities Services *Annual Review 2023/2024* also states that although the largest charities in the sector make up only 1% of all registered charities, they account for over half of the sector's annual expenditure (which is approximately $25.3 billion in total, see Figures 3 and 4). The vast majority of New Zealand's charities are small and rely heavily on volunteers, with around one-third of charities reporting an annual income under $10,000.[9]

Religious activities are another example of a not-for-profit sector where society's attitudes have changed significantly since this legislation to exempt not-for-profits from tax was first introduced in 1940.[10] At the time, religion played a significant role in New Zealand society and promoting

religion was seen as beneficial for society. Now, religion plays a much smaller role in how society functions, with fewer people attending religious services and conflict over whether some churches should receive the benefits given to not-for-profits if their purpose is not perceived to benefit society. See, for instance, the controversy around Destiny Church's activities discussed under Recommendation 11 above.

The tax system must be careful not to treat all not-for-profits the same, when they operate on very different scales and for different purposes. Further we question whether not-for-profit is the appropriate context for large charities that run businesses. We suggest that the IRD create a continuum (along the lines in Figure 2), to illustrate that all organisations create public benefits but that some of those do so through creating charitable grants, charitable goods and charitable services – and it is only those grants, goods and services that are not taxed.

Our overall conclusion is that if a charity is using profits to reinvest back into a business, those profits should be taxed using business tax rates. Conversely if a charity is using donating profits from a business enterprise to a third party (in the form of charitable grants, charitable products or charitable services), that profit should be treated as a donation and not taxed. This would require a definition of what makes a charitable grant, a charitable product and a charitable service. It would also require a definition of a third-party (along the lines of a person or organisation who is not a party to a contract or a transaction with the charity, but is a beneficiary).

Summary of Six Key Recommendations:

The six recommendation fit under four sub-groups: External Reporting Board, large charities, small charities and Charities Services. These are further expanded on under Section 4.0 below.

A: External Reporting Board

1. Create a non-GAAP standard for large charities with non-related business profits (with assistance from IRD)

B: Large charities with non-related business profits (often Tier 1 and Tier 2)

2. Tax profit that is not donated but generated from un-related income
3. Put in place annual reporting requirements on staff, board members and other related individuals and organisations to ensure they do not gain tax-free benefits (this could be a statement that must be signed and dated a penalty given if the statement is found to be wrong)

C: Small Charities with no non-related business profits (often Tier 3 and Tier 4)

4. Do not tax un-related income of Tier 3 and 4 charities.

D: Charities Services (the agency established by the Charities Act 2005)

5. Improve the quality of the Charities Annual Report, in particular differentiating between each Tier (e.g. number of charities, number of staff, number of volunteers, revenue, expenditure, assets and liabilities.
6. Create guide that includes a clear set of principles for these two different types of charities.

2.0 Introduction

The McGuinness Institute welcomes the opportunity to offer feedback on taxation and the not-for-profit sector in New Zealand.

We would like to thank the Inland Revenue Department (IRD) for inviting public feedback on this important topic. We would welcome the opportunity to expand on any of our points and would like to speak to our submission if possible.

The Institute would like to acknowledge that McGuinness Institute Limited (registration number CC21440) is an entity controlled by The McGuinness Foundation Trust (registration number CC10457), both registered charities on the Charities Register. As such, we have a direct interest in this area.

Please note we consider a detailed glossary, contained in the consultation document, would have been very useful. Secondly, we felt that more research into how other countries manage the tax status of charities would have been beneficial. There may be other key documents that we are missing, so please excuse any repetition with your existing research.

3.0 Direct Responses to Questions for Submitters

Chapter 2: Charities business income tax exemption

Question 1: What are the most compelling reasons to tax, or not to tax, charity business income? Do the factors described in 2.13 and 2.14 warrant taxing charity business income?

2.13 However, there are various "second-order" imperfections in the income tax system that may need to be taken into account. For example:

- **Charitable trading entities may have an advantage over non-charitable trading entities in that they do not face the compliance costs associated with a tax obligation. This lowers their relative costs of doing business.**
- **The non-refundability of losses for taxable businesses can result in a disadvantage for such businesses relative to tax-exempt businesses, resulting in a higher relative rate of return for non-tax paying businesses over time when there has been a loss in one year.**
- **The costs associated with raising external capital, such as negotiating with investors or banks, can be significant. These costs often make retained earnings the most cost-effective form of financing. Because charities' retained earnings are higher, this may give them lower costs in raising capital. On the other hand, charities generally cannot raise equity capital (as private investors cannot receive a return).**

2.14 Associated with the last bullet point, a charity could more generally have an advantage if it were to accumulate its tax-free profits back into the capital structure of its trading activities, enabling it, through a faster accumulation of funds, to expand more rapidly than its competitors. Arguably, however, such accumulation could potentially arise from any form of income earned by charities.

The issue of unrelated business income (the income a not-for-profit earns from commercial activities not related to its charitable purpose) has raised significant public and political concerns both here and abroad.[11] A paper prepared for the Tax Working Group in 2018 noted that '[i]t is not easy to identify the extent of business activity occurring in the charitable sector. Best estimates from DIA Charities Services and Inland Revenue indicate about 8,500 or 30% of registered charities are likely to have some sort of trading activities.'[12]

The IRD consultation document *Taxation and the not-for-profit sector* reports that by 2024, approximately 11,700 or 40% of New Zealand's not-for-profits reported some form of business income. The document states that '[o]nly a portion of these businesses would be carrying on activities unrelated to charitable purposes, however the exact number of unrelated businesses will be unknown until the term is formally defined'.[13]

As part of understanding this tax exemption, it would be beneficial to have updated, clearer data on how many charities undertake business activities, what kind of activities are being undertaken, their dollar value and how the income is distributed. The Institute believes a careful policy approach needs to be implemented which takes into consideration the following points:

1. The blanket tax exception is no longer appropriate

New Zealanders have been questioning the fairness of some not-for-profits not paying income tax on their unrelated trading or extensive property holdings income for a long time. Since 1940, income tax derived from charity business activities has been tax-exempt in New Zealand.[14] However, it is now 2025 and the law needs to change to reflect that the way not-for-profits operate is very different. Since this law was first implemented New Zealand society and the

purpose and scale of not-for-profits have changed significantly. A small group of not-for-profits have taken on significant trading activities, growing to be million-dollar commercial enterprises that dominate their market segments in price, size and scale. The scale at which some of these unrelated businesses are operating would have been unfathomable when this law was first conceived.

The blanket tax exemption for not-for-profits is no longer fit for purpose, as it fails to consider how differently some not-for-profits are now commercially operating in 2025 and beyond. In the modern world, not-for-profits operate at different scales and work to different purposes. Different rules should apply based on these factors. There are concerns on how this blanket tax exemption is unfair to competition (which have no choice but to pay 28% income tax), as well as ethical questions around the following:

(a) What is a 'charitable purpose' and what constitutes a not-for-profit?
There are questions about whether some institutions receiving tax exemptions are actually providing a benefit to the public, and if the money saved from tax exemptions flows on to those who need it. There have been public petitions for some not-for-profits to be removed from the Charities Register, such as Destiny Church.

Destiny Church qualifies as a charity under the criterion of 'advancement of … religion', which has allowed its trusts and charities to be granted charitable status. Some of the group's controversies include members being charged with breaching the Covid-19 Public Health Order in 2021.[15] This initial controversy around breaching restrictions in the pandemic led to a petition with over 69,000 signatures calling for the church's charitable status to be revoked for its Auckland and Christchurch operations.[16] More recently, another petition to remove Destiny Church from the Charities Register has received over 36,000 signatures.[17] This petition arose in response to Destiny Church members storming Auckland's Te Atatū Community Centre and library to protest a children's science show hosted by a drag king in February 2025. Public figures including the Labour MP for Te Atatū also asked Charities Services to remove Destiny Church from the Charities Register.[18]

The Institute recommends there should be a close evaluation of what should be considered a 'charitable purpose' under the Charities Act 2005 and when the Board should grant Charitable Status. Given the ongoing public interest, additional resources should be dedicated to this evaluation.

(b) Are the profits (and money saved from the tax exemption) used appropriately, within a reasonable time frame and for a charitable purpose?
It is recommended that not-for-profits that earn an unrelated business income over a certain threshold should be required to prove that their profits, and the money saved from their tax exemption, are put towards their charitable purpose within a suitable time frame.

Some have suggested they should have to do this within the financial year; however, more research should be undertaken to understand the implications of each potential time frame. Imposing public reporting on how this money is used will improve transparency and public trust in the taxation system, but it does have complexities. Some not-for-profits, especially those with a long-term focus such as iwi and universities, have long-term purposes. For a more detailed discussion of this, see the s 18(c)(i) case study in Appendix 1.

More analysis is needed to understand the way charities earn income, and how much of the money saved from the tax exemption actually ends up supporting the charitable purpose of the not-for-profit. Changing this tax exemption and removing this loophole for large businesses would improve fairness, competition and transparency in the sector.

2. The tax take from removing this exemption would be significant financially; however, removing the exemption should only impact a small number of charities at the top financial level

The lost tax revenue from this exemption is a significant amount in dollar terms (estimated at $2 billion).[19] However – if this policy change is implemented carefully – it should only impact a small group of not-for-profits that report the highest levels of unrelated business income each year. We suggest that the tax exemption should be removed just for charities that operate substantial commercial activities over certain financial thresholds, in order to avoid increasing compliance costs for small not-for-profits.

The Charities New Zealand *Annual Review 2023/2024* states that 'while the largest charities in the sector make up only 1% of all registered charities, they account for over half of the sector's annual expenditure (approximately $25.3 billion). Most charities are small and rely heavily on volunteers, with around one-third of charities with annual income under $10,000.'[20]

Some potential approaches could be to remove the income tax exemption only for certain thresholds of not-for-profits. Refer to the answer to Q4 below for a more detailed discussion of these options. More detailed analysis is required to understand which option would improve public trust and economic competition while mitigating impacts on the majority of New Zealand's not-for-profits.

3. Removing the blanket tax exemption would make New Zealand compliant and consistent with international rules

It is beneficial for New Zealand to comply with international standards and to learn from policy approaches undertaken in similar countries. According to a 2020 OECD study, the majority of countries either have restricted the commercial activities that a charitable entity can engage in, or tax charity business income if the business income is unrelated to charitable purpose activities.[21] These countries have typically been concerned with:

- a loss of tax revenue from not-for-profits if a broader tax exemption was applied;
- unfair competition claims;
- a desire to separate risk from a charity's assets; and
- a desire to encourage charities to direct profits to their specified charitable purpose.

The Institute believes New Zealand should look at how other countries have approached this and learn from their approaches. Tax exemptions for charities under overseas tax systems provide some examples for New Zealand:

- **UK:** charities cannot undertake commercial trading activities unrelated to their charitable purposes while claiming exemption from income tax. This is to ensure fair competition among commercial activities.[22]
- **USA:** 'unrelated business income' is subject to tax, restricting concessions to ensure the tax regime matches conventional tax policy or social welfare policy.[23]
- **Australia:** charities can carry out unrelated commercial activities without paying tax (similar to New Zealand's status quo), as long as the purpose of the activities is to generate

revenue for the charity's charitable purpose'.[24] Tax on the unrelated business income of not-for-profits was proposed by Australia's Gillard government in 2011, only to be postponed in 2013 and eventually abandoned by the Abbott government in 2014.[25] Scott Morrison, the Social Services Minister at the time, said it was because he was 'focusing on more important issues.'[26]

4. Removing the blanket tax exemption would encourage fairness in business competition

There are concerns that the tax exemption is unfair as there is a significant competitive disadvantage for the businesses that do pay income tax on their goods and services.

Business income tax in New Zealand is 28%, a substantial cost for businesses each year.[27] When this part of a firm's normal cost structure is removed for not-for-profits, it has significant benefits, including:

- higher profits (which the firm can reinvest into the business, allowing it to grow faster than its tax-paying competitors); and
- an ability to charge lower costs for an identical good or service (allowing not-for-profits to dominate their competitors through price cuts).

As a result, it is very difficult for other businesses to compete with not-for-profits, which leads to unfairness. See, for example, the case study of Sanitarium, which does not pay income tax but competes with other food manufacturers that do pay income tax. This case study is discussed in more detail in Appendix 1.

Question 2: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be the most significant practical implications?

There will be a number of practical implications that must be considered, including:

- Higher tax revenue received by the Government (we recommend this is accounted for directly so it is clear how society benefits from any tax changes).
- More Government funds that could be spent on the social and community Sector and areas like health and infrastructure. Charities are not the only entites committed to the public benefit.
- Less money for not-for-profits to spend (as the higher earners will need to pay significant amounts of tax).
- Higher compliance and accounting costs (however, this would only be for the large charities (maybe 200 entities).
- Not-for-profits may be discouraged from starting unrelated business ventures (which may mean they either focus on their not-for-profit purpose or start a for-profit business, rather than merging the two).
- Charitable purposes will need to be reviewed.
- Penalties will need to be put in place and some form of tighter regulation will be required (however this may be no more than currently being adopted)
- Some large charities may need to change their approach to stay competitive (some may not be able to rely on current business models); but see also below.
- More level playing field for businesses competing against charities (which may benefit the consumer, with more choice and more competitive pricing in the long term).

The Institute recommends detailed financial analysis and consultation with the not-for-profit sector so these practical implications are understood in more detail.

Question 3: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what criteria should be used to define an unrelated business?

An unrelated business is a business that is not connected to the charitable purpose. However, the charitable purpose is many cases are both long and broad. That is why we suggest moving towards a charitable grant, a charitable product or a charitable service provided to a third party.

The criteria to define an unrelated business need to be very clear to ensure unrelated business is included and direct charity fundraising is not included. Michael Gousmett, adjunct fellow in the department of accounting and information systems at the University of Canterbury, has raised concerns about iwi organisations, such as Ngāi Tahu's seafood businesses, having tax exemptions for non-primary purpose trading. 'Seafood production is not the same thing as advancing the purposes of iwi therefore that's a non-related trade, a non-primary trade so it should be subject to tax.'[28]

Unrelated business income is when a business is a completely separate commercial operation from the not-for-profit that runs it. The following examples illustrate this difference:

1. **Cancer Society of New Zealand Incorporated (CC30617)**
    - This charity is a member of the group called Cancer Society of New Zealand Incorporated Group.
    - On Daffodil Day (a fundraise for the Cancer Society), people may (or may not) receive flowers, stickers or other small tokens as a thank you for their donation. This money goes towards the Cancer Society of New Zealand Incorporated and their charitable purpose.
    - Charitable Purpose of the group includes:
        - Supporting, funding and promoting outcomes of research within New Zealand into cancer prevention, treatment and cure of cancer.
        - Providing supportive care and information to people affected by cancer, their families/whānau and carers.
        - Promoting education about cancer for health professionals.
        - Delivering health promotion programmes focusing on cancer prevention.
        - Leading advocacy across the cancer continuum.
        - Working with organisations who share similar goals.[29]

2. **Shotover Jet Limited (CC35587)**
    - This charity is a member of the group called Ngāi Tahu Charitable Group.
    - People pay for a jetboat experience on the Shotover Jet, which is based in Queenstown. It is an individual business, which is owned by a registered charity Ngāi Tahu Tourism (all profits go to Ngāi Tahu Tourism). Ngāi Tahu Tourism is part of the Ngāi Tahu Charitable Trust.
    - Charitable purpose: Note the Charities Register says 'refer to the Charitable Trust Deed.'[30] While the Institute was unable to locate the purpose within the Trust Deed, Ngāi Tahu's website shares the group's purpose:
        - 'We invest in the capability and education of people by investing in scholarships and industry-based training programmes; we provide cadetships and internships, we provide comprehensive incentives for our people to learn te reo Māori, and we fund cultural and community-based initiatives that help our people, and their communities, grow.

- We also provide grants to charitable entities that have been set up by our Papatipu Rūnanga (and to Papatipu Rūnanga themselves if they are charitable entities). These grants are steadily increasing and enable charitable activities to be carried out at a local level throughout the Ngai Tahu takiwā."[31]

Question 4: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be an appropriate threshold to continue to provide an exemption for small-scale business activities?

2.33 Some countries only exempt a charity's business income if the business profit is distributed towards a charitable purpose within a given time period.

Below are some possible options for thresholds and restrictions that can be imposed on the current tax exemption. More analysis is required on what implications each option would have. For instance, larger charities may just split into smaller ones to avoid paying income tax. Controls therefore must be enforced to account for subsidiary entities created with the purpose of avoiding the threshold but which are substantively the same entity or similar.

These options could either be implemented individually or together.

Option 1: Tax exemption only allowed if unrelated business income is distributed for charitable purposes within the financial year
This option may alleviate some concerns about whether the exemption benefits the charitable purpose, and will mean not-for-profits need to prove the income-tax savings benefit for the charitable purpose they are intended for.

Auckland University of Technology accounting and taxation senior lecturer Ranjana Gupta has suggested revenue from business activities by charities should be used for charitable purposes within the same year it is earned, so it should not be allowed to accumulate. 'I think companies like Sanitarium, even though they are part of Seventh-Day Adventist Church, because they are competing with Hubbards or Kellogg's, are running their business on a totally commercial model.'[32] More detailed analysis of Sanitarium is in Appendix 1.

One issue with Option 1 is that it encourages short-term planning, potentially at the expense of long-term investment and planning for not-for-profits. This will lead to planning issues, particularly for not-for-profits that have a long-term focus spanning multiple generations (for instance, iwi- and university-run not-for-profits).

Option 2: Tax exemption removed only for the highest-earning not-for-profits
This option alleviates concerns about increased compliance costs for the majority of not-for-profits, which earn a relatively small amount of business income. It is recommended any financial tier system used to determine the tax exemption should be consistent with the External Reporting Board (XRB) Standards for Tiers.

The XRB's tiered reporting system for charities uses annual expenses or operating payments to determine the required reporting standards (see tables below). Tier 1 and 2 charities must prepare financial statements in accordance with generally accepted accounting practice (GAAP), while Tiers 3 and 4 have simplified standards. It therefore makes sense that Tiers 3–4 could still

fit under the income tax exemption, with Tiers 1–2 required to pay income tax. This would benefit smaller not-for-profits that are operating on a less commercial scale; however, there is a risk not-for-profits will just break their businesses into smaller entities, creating a new loophole.

Refer to the tables on the following page for more information on the XRB's tier system and the number of not-for-profits in each tier.

Option 3: Tax exemption to be removed for all unrelated business
This option is the simplest; however, a clear definition of what is 'unrelated' is required to ensure not-for-profits do not pay income tax on grants and donations. It will also have negative impacts on the entire not-for-profit sector.

Option 4: Tax exemption removed for not-for-profits with the highest levels of expenses
There is also an option to remove the tax exemption for a certain number of not-for-profits who report the highest level of expenses over the past year. A certain threshold could be set, such as the below two alternatives:

- the top 1,300 not-for-profits that each report expenses of more than $5 million/year; or
- the top 100 not-for-profits that each report expenses of more than $33 million/year. [33]

More analysis and consultation with the sector is required to understand the implications for this option. It could also create possible loopholes which will need to be managed, such as entities splitting into smaller groups to avoid fitting into high level groups.

Figure 3: The four-tier accounting system for not-for-profits
Source: Charities Services (2025).[34]

	TIER 1	TIER 2	TIER 3	TIER 4
Method of Accounting	Accrual	Accrual	Accrual	Cash
Annual Expenditure	Over $33 million	Under $33 million	Under $5 million	Under $140,000
Public Accountability	Yes	No	No	No
Accounting Standard for Reporting	Full Standard	Reduced Disclosure Regime	Public Benefit Entity Simple Format - Accrual (Not for Profit) OR Tier 3 (NFP) Standard	Public Benefit Entity Simple Format - Cash (Not for Profit) OR Tier 4 (NFP) Standard

Financial overview	Tier 1	Tier 2	Tier 3	Tier 4
Total assets $86.98 billion	$37.23 billion	$28.87 billion	$18.04 billion	$2.84 billion
Total expenditure $25.28 billion	$13.64 billion	$7.84 billion	$3.4 billion	$400 million
Total income $27.34 billion	$14.14 billion	$8.44 billion	$4.17 billion	$590 million

Figure 4: Breakdown of 11,700 charities that reported business income in 2024
Source: Inland Revenue New Zealand (2025).[35]

Reporting Tier	Tier 1	Tier 2	Tier 3	Tier 4
Criteria (total expenses)[6]	**Over $33m**	**$33m-$5m**	**$5m-$140,000** (accrual-based accounting)	**Under $140,000** (cash-based accounting)
Proportion and number of charities reporting business income	1% (100)	10% (1,200)	45% (5,300)	43% (5,100)

2.29 A de minimis threshold that continues to provide tax exemption for Tier 3 and Tier 4 charities would, for example, limit the impact of a policy change to less than 1,300 charities that report annual expenses above $5 million per annum.

Question 5: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, do you agree that charity business income distributed for charitable purposes should remain tax exempt? If so, what is the most effective way to achieve this? If not, why not?

Yes, but it needs to be a donation in the form of a charitable grant, a charitable product or a charities service to a third party. If the profit is being reinvested back into the business it must be taxed. More detailed analysis is needed to understand how this would operate in practice; however, it is suggested that 4.0 Recommendations outlined below are taken into consideration. It is particularly important that all relevant terms are very clearly defined to make compliance easy for small not-for-profits, and to minimize loopholes.

4.0 Six Key Recommendations

The six recommendation fit under four sub-groups: External Reporting Board, large charities, small charities and Charities Services.

A: External Reporting Board

1. Create a non-GAAP standard for large charities with non-related business profits (with assistance from IRD)

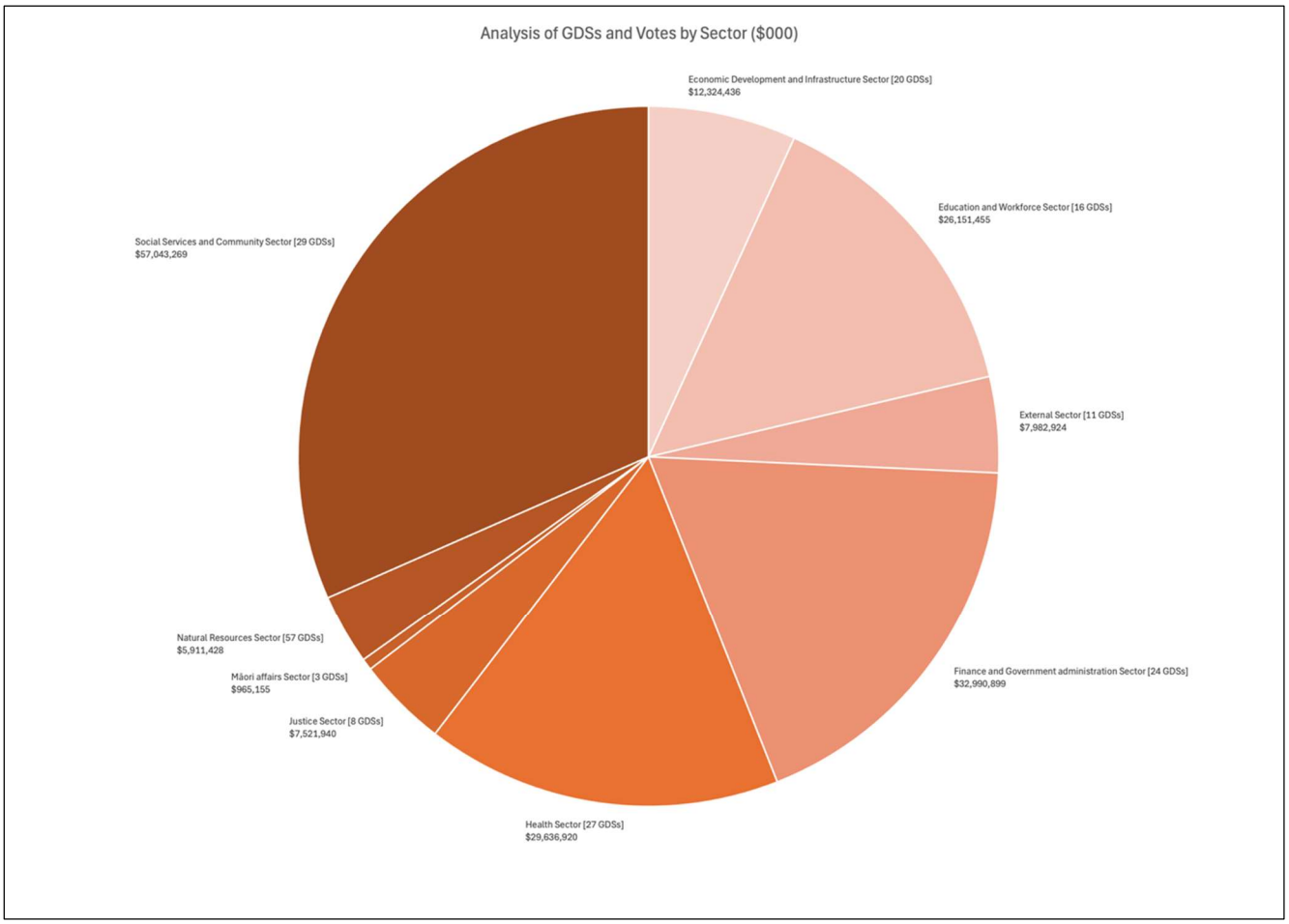
The External Reporting Board could establish a special reporting standard for large charities that run businesses not directly related to their charity purpose. The so-called Large Charities Standards (or Business Charity Standards, or similar), could rely on Section 18 in the Financial Reporting Act 2013 (see Figure 5). These new standards could be developed in a similar way to the Aotearoa New Zealand Climate Standards – creating a threshold based on size/scale, number of staff and/or income/profit earned that is not related to the purpose of the charity. The threshold could be informed by the feedback from this consultation and best practice internationally.

This way the profit could be taxed that is not donated to a third party (in the form of charitable grants, charitable products and charitable services). This will improve transparency, provide additional government funds and build public trust. Arguably much of Government funding is for charitable purposes. See the size of the social and community Sector in Figure 6.

It will improve public trust and ensure greater transparency on who is receiving an exemption if financial statements include clearer reporting on expenses used towards their 'charitable purpose'. It is essential these statements continue to be publicly available and filed on the Charities Register.

Figure 5: Section 18 of the Financial Reporting Act 2013

Figure 6: Analysis of GDSs and Votes by Sector
Source: The Treasury [ref to come]



B: Large charities with non-related business profits (often Tier 1 and Tier 2)

2. **Tax profit that is not donated but generated from un-related income**
3. **Put in place annual reporting requirements on staff, board members and other related individuals and organisations to ensure they do not gain tax-free benefits (this could be a statement that must be signed and dated a penalty given if the statement is found to be wrong)**

This will prevent smaller charities needing to pay income tax and increasing their compliance costs, while ensuring the larger ones pay their fair share of tax (see case studies in Appendix 1 Sanitarium and Ngāi Tahu). Controls should be enforced to account for subsidiary entities created with the purpose of avoiding the threshold but which are substantively the same entity or similar.

This is a difficult one and but we believe it is necessary to ensure charitable trust status is not used as a front to pay excessive benefits tax-free to related parties. This is arguably outside of the ambit of the consultation and maybe more appropriately part of DIA or MBIE's responsibility.

We also suggest that all Tier 1 charities be required to provide an annual statement by employees with a salary over say a salary of $100,000 to provide a statement of benefits received.

This recommendation is also suggested in the 2020 OECD *Taxation and Philanthropy Report,* which 'provides a detailed review of the tax treatment of philanthropic entities and philanthropic giving in 40 OECD member and participating countries'.[36] There is a risk of losing public trust in charities and not-for-profits if the executives receive high salaries. Excessive salaries mean people are less likely to donate, as their money is going to executives rather than to a charitable purpose. Executive salaries should be publicly available on the Charities Register.

The *New Zealand Herald* published analysis into charities' executive pay, examining the Charities Register to find entities with both annual revenues and assets of over $70 million. The 32 charities investigated reported over $8 billion in combined annual revenues, managed more than $25 billion in assets, and employed 51,740 people full- and part-time.[37]

The survey included a broad range of charitable structures, including health and social service providers, Māori and iwi groupings, religious orders, most of the country's universities, and several commercial businesses geared towards charitable ends (such as BestStart Educare, cereal maker Sanitarium [see case study in Appendix 1], Christchurch's Isaac Construction, and kiwifruit grower and dairy grouping Trinity Lands).[38]

The *Herald* found the highest-paid executives were from s 18(c)(i) with an average executive salary of s 18(c)(i) per year. This is especially surprising considering the not-for-profit has one of the smallest staff levels, asset bases and annual revenues of entities surveyed.[39]

In comparison, the *Herald's* research found the s 18(c)(i) was at the bottom of charity executive pay, barely paying its key executives a living wage. Despite the charity turning over s 18(c)(i) annually in donations and social service contracts, and employing nearly 2500 staff, each key manager was reportedly paid an average of only s 18(c)(i) per year.[40]

C: Small Charities with no non-related business profits (often Tier 3 and Tier 4)

4. Do not tax un-related income of Tier 3 and 4 charities.

It may be appropriate to create a small threshold, say $100,000 pa, but the general idea is that these entities are not in the business of operating the entity with the aim of creating a profit.

There is a challenge in ensuring this new legislation will close loopholes and target specific issues without negatively impacting well-functioning not-for-profits. The majority of small not-for-profits are already pressed for resources, and it is in society's interests to encourage not-for-profits to continue their work. Excessive compliance costs, and imposing income tax on all not-for-profit income may put people off operating them. This would be a substantial loss to our society, as not-for-profits provide a public good, filling in gaps that government and private businesses often leave.

Consultation with the not-for-profit sector is essential to ensure any negative impacts are minimized.

D: Charities Services (the agency established by the Charities Act 2005)

5. **Improve the quality of the Charities Annual Report, in particular differentiating between each Tier (e.g. number of charities, number of staff, number of volunteers, revenue, expenditure, assets and liabilities.**
6. **Create guide that includes a clear set of principles for these two different types of charities**.

There are a number of other entities that might help guide this type of reporting and guidance (e.g. NZX, XRB and the FMA). In addition to clearly drawing a distinction between large and small charities, here are a few additional thoughts:

1. **Clearly define charity, public benefit and charitable purpose**
   If we clearly define terms, loopholes can be managed. Any policy change needs to clearly define 'related' vs 'unrelated' income and 'active' vs 'passive' business income. For instance, charities investing in bonds, equities, term deposits, etc also benefit from 'passive' yet 'unrelated' income. Will this be taxed? Clear definitions will avoid loopholes in this area.

   Charity definition: A charitable company is currently defined as a private limited liability company registered under the Corporations Act and meeting the definition of a charitable entity. In New Zealand, a charitable company has been registered as a charity on the Department of Internal Affairs Charities Register, and is eligible to receive a tax exemption.[41]

2. **Uphold fairness, economic competition and equity in the market**
   New Zealand needs to create a fair regulatory environment for the operation of for-profit organisations and businesses. Under the current legislation, New Zealand charities that are registered with Charities Services providing fully charitable activities can access a tax exemption for income from business and trading activities. This has been considered unfair for a number of reasons, particularly as a number of high-profile charities that run large, unrelated trading operations that compete with non-charitable businesses that do not receive the same tax exemptions. Refer to case studies in Appendix 1, including analysis of Sanitarium and Ngāi Tahu-run businesses, which are commonly cited as examples of not-for-profits that take advantage of the tax exemption.

3. **Balance short- and long-term interests of not-for-profits**
   For not-for-profits that plan to grow and benefit the community over the long term, investment for the future may decrease if they must use their income within a certain time period. For instance, iwi organisations are designed to support future generations as well as current members.

4. **Maintain the not-for-profit sector's public trust and social licence**
   As not-for-profits provide a public good, it is essential society places trust in them and their social licence to operate. If even a small number do not comply with public policy and ethics, public trust will be lost and people are less likely to make donations to not-for-profits.

5.0 Conclusion

The Institute supports IRD opening up this complex issue for public discussion. It is necessary to reassess whether the income tax exemption for not-for-profits remains fit-for-purpose and delivers benefits for society. Any new policy changes need to be developed carefully in order to avoid increasing compliance costs for small not-for-profits.

New policy governing this sector needs to be designed to balance the following:

- Support not-for-profits in their work to help the community.
- Ensure public trust in the sector.
- Impose accountability and transparency.
- Close (real and perceived) tax loopholes and maintain fair competition in the market.

The financial numbers we are looking at here are significant – currently $2 billion, and this sector is likely to increase over time – which makes this an immensely important financial, social and ethical issue for New Zealand. Society needs to have faith that charities and not-for-profits are acting ethically, that tax is paid fairly and that the economy is a level playing field. Not-for-profits fulfil an important role in society for the public good, and it is essential we have checks and balances to ensure some are not taking advantage of the benefits they receive.

Appendix 1: Case Studies of Two Charities in New Zealand

Below are two examples of charities registered on the Charities Services Charities Register. These case studies review the 2024 revenue and income tax, and explore the possible income tax each charity might have been required to pay using the standard income rate of 28%.[42] Importantly this work is explorative only and is not intended to be any more than an attempt to explore a few practical examples.

s 18(c)(i)

s 18(c)(i)

Appendix 2: List of Questions not answered

Chapter 3: Donor-controlled charities

Q7. Should New Zealand make a distinction between donor-controlled charities and other charitable organisations for tax purposes? If so, what criteria should define a donor-controlled charity? If not, why not?
N/A

Q8. Should investment restrictions be introduced for donor-controlled charities for tax purposes, to address the risk of tax abuse? If so, what restrictions would be appropriate? If not, why not?
N/A

Q9. Should donor-controlled charities be required to make a minimum distribution each year? If so, what should the minimum distribution rate be and what exceptions, if any, should there be for the annual minimum distribution? If not, why not?
N/A

Chapter 4: Integrity and simplification

Q10. What policy changes, if any, should be considered to reduce the impact of the Commissioner's updated view on NFPs, particularly smaller NFPs?
For example:

- **increasing and/or redesigning the current $1,000 deduction to remove small scale NFPs from the tax system,**
- **modifying the income tax return filing requirements for NFPs, and**
- **modifying the resident withholding tax exemption rules for NFPs.**

N/A

Q11. What are the implications of removing the current tax concessions for friendly societies and credit unions?
N/A

Income tax exemptions

Q12. What are the likely implications if the following exemptions are removed or significantly reduced:

- **local and regional promotional body income tax exemption,**
- **herd improvement bodies income tax exemption,**
- **veterinary service body income tax exemption,**
- **bodies promoting scientific or industrial research income tax exemption, and**
- **non-resident charity tax exemption?**

N/A

FBT exemption

Q13. If the compliance costs are reduced following the current review of FBT settings, what are the likely implications of removing or reducing the exemption for charities?
N/A

Tax simplification

Q14. What are your views on extending the FENZ simplification as an option for all NFPs? Do you have any other suggestions on how to reduce tax compliance costs for volunteers?

N/A

Q15. What are your views on the DTC regulatory stewardship review findings and policy initiatives proposed? Do you have any other suggestions on how to improve the current donation tax concession rules?

N/A

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55 s 18(c)(i) [redacted]

Ryan Donovan

From: Chris Hawkins s 9(2)(a)
Sent: Tuesday, 1 April 2025 12:00 am
To: Policy Webmaster
Subject: Taxation and the not-for-profit sector.

I am a student of charity law.

Q 3 an unrelated business should not include business that furthers the purpose of the charity, for example an Alliance Francaise receiving payment for French lessons.

Q 5 Yes

Warm regards,

Chris Hawkins

Ryan Donovan

From: s 9(2)(a) s 9(2)(a)
Sent: Tuesday, 1 April 2025 12:00 am
To: Policy Webmaster
Subject: Taxation and the not-for-profit sector

Private individual submission.

Dear deputy commissioner, policy

Introduction

I am writing in response to the official issues paper on Taxation and the not-for-profit sector issued on 24th February. This submission is made in a private individual capacity as a chartered accountant that is employed by a firm in public practice. These comments do not represent the views of my employer and should not be confused as the views of my firm, as they are not. The views expressed in this submission are entirely my own.

Question

My feedback focuses on officials consideration relating to the accumulation of income by charitable entities. Particularly in response to question one and the issues raised in 2.13 and 2.14.

A range of concerns are raised around the accumulation of income by charities. This includes for example a time delay between the revenue being earned and the public receiving a benefit from the funds.

The paper also refers to the IS 24/08: Charities – Business Income Exemption that: "A charity might not be carrying on a business … because the activities are not carried on with a profit-making intention. For example, activities carried out on a deliberately loss-making or breakeven basis".

Submission

This submissions focuses on concerns that charities make a profit and accumulate surpluses. The accumulation of surpluses for a charitable cause/purpose is something to be encouraged and celebrated following the destination of funds principals. The official consultation paper appears to completely misunderstand or is silent on this.

The charitable sector provides significant assets and infrastructure for charitable purpose to the community in New Zealand. This is in areas of health, education, sport, region, social services, aged care etc. Examples include community halls, sports arena's & stands, ambulances, rescue helicopters, hospital facilities, hospice beds, retirement care homes, lecture theatres, school buildings (e.g. at state integrated and private schools), pre-school centres, places of worship etc… the list is almost endless.

These assets and community infrastructure are predominantly funded through retained earnings. It can take a charitable entity many years, sometimes generations, to accumulate resources to provide charitable these assets and facilities. (not dissimilar to a household saving up to buy a home). The time horizon for some charitable entities is very long, sometimes the longest lived institutions in our society, such as our religious institutions, iwi, universities etc.

This means there is by definition and necessity a significant time delay between the earning of funds and provision of services to community. This is a positive feature of the system which is strongly focused on stewardship of funds and optimal allocation of resources.

Taxing charities on the accumulation of funds and build up reserves will have a material impact on the supply of capital to the sector. This will have a significant policy and political implications and unintended consequences. For example this will impact on and reduce our communities ability to fund core community assets.

Our best and brightness charities need to operate at a surplus and retain earnings. This is for a range of reasons including ensuring the going concern assumption is meet (e.g. resilience and sustainability of the organisation), funding of multi-year capital projects, and statutory limitations on access to alternative forms of capital (e.g. from private equity or shareholders). Dividends to shareholders and returns on private equity employed are not permitted

Successful and sustainable charitable entities aim to achieve and retain surpluses. These are essential to the sustainability and longevity of these organisations and are used to fund the charitable activity and ensure it can continue and can grow. The retention of earnings is an essential element of good governance. Charities need to be the exact the opposite of loss making or beak-even to survive and prosper.

Taxing of surpluses could create distortion and reduce efficiency in the allocation of resources for charitable entities in the sector. This by encouraging entities to match revenue and expenditure within the reporting period when this might not be the optimal use of funds. For example the practice of spending resources in the year before they are taxed on it and 'lose it', rather than considering if the spending is necessary.

In my view whether the charitable funds arises from a charitable or business activity is irrelevant. There is already policy in place that follows the destination of income principals that if 'individuals' or 'businesses' are donating to a charitable shareholder then they receive a tax credit for the donation. The consultation appears not to the challenge this principals but is proposing to introduce much greater compliance costs? For what purpose or benefit, I don't understand the objective?

The core practical question is the design and implementation of principals to determine what is a charitable activity and what is a business activity. In my experience these activities are so tightly intertwined to be indistinguishable in clients operating in areas of healthcare, education, social services, sports, religion etc.

Examples including tertiary education (Universities, Polytech etc), secondary schools (private school, state integrated proprietors), preschool (e.g. daycares) private hospitals, ambulances (St Johns, Wellington free ambulance), Sports (International sporting events and tournaments), religious institutions (e.g. own rest homes, conference centres, retreats, funds management operations etc) manufacturing of healthy foods.

These activities and funding structures have been painstaking developed over long periods of time to support and sustain these organisations charitable purpose. Almost every charity activity could be argued to be undertaking some sort a business activity in simple terms (e.g. employing staff, earning revenue etc). In current New Zealand law it appears difficult and contentious enough to determine what is an acceptable charitable purpose, let alone introducing further complexity in tax law on what is a unrelated business activity?

Another concern is will tax policy drive entities accounting policy choices that can have a significant impact on reported surpluses or deficits. An example are the choices around the valuation of land and buildings and investment properties e.g. cost vs market valuation. There is variability across the sector in this and the balance sheets and income statement impacts are staggering.

Taxation and the not-for-profit sector

David A Lamborn
31 March 2025

The view that NFPs have an advantage because they don't pay tax does not take into account their contribution to the social fabric and their impact on supporting the poor and vulnerable. If NFPs were not able to continue their work because of the increased financial burden, due to returns from trading activities being lessened, then poverty levels would increase and there would be a greater burden on the state to provide support. This, in can then be argued, will require all rates to be increased.

The ideology of taxing trading activities of the NFPs because these are deemed as being is unrelated to the charitable purposes of the NFP should also be applied to capital gains of any organisation that are not related to the purposes of the organisation (other than to make a profit).

In the charities I'm familiar with the assumption that the returns from trading activities provide an unfair advantage is not correct. For example, the trading activities of many Churches amounts to the hiring out buildings to individuals and groups for quite nominal amounts. Many of these groups that rent the buildings are themselves NFPs or start-up organisations with very little funds. Increasing the rental prices to cover tax requirement would only create a spiral of doom for many community organisations.

There is also an erroneous assumption that NFPs have large pools of retained earnings. In my experience NFPs use their trading activities to directly fund property maintenance which it is incorrect to assume is not core to the mission of the NFP. In effect the trading activities are used to purchase goods and services and therefore support directly other businesses which do pay tax.

In reality the large pool of funds retained as investments by NFPs have been acquired through the capital gains on the sale of surplus property.

Interestingly capital gains are not being looked at here as a potential source of tax revenue, just trading activity. What this proposal means is that a tax on a NFP's trading activities, for example the profits on the operation of an Op Shop run by voluntary labour, is effectively a tax on the voluntary labour used to generate the profit.

Questions and Responses

Q1. What are the most compelling reasons to tax, or not to tax, charity business income? Do the factors described in 2.13 and 2.14 warrant taxing charity business income?

Any factor relating to 2.13 and 2.14 that could be seen as advantageous for a NFP would only ever apply to a very small percentage of NFPs. Generally NFPs are expanding rapidly, and are not in any position to be raising capital. Most charitable organisations barely survive and the fact they have engage in 'trading activities' is seen as a cost itself because it takes time and energy and a diversion of focus for the core mission of the charity.

Q2. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be the most significant practical implications?

For many charities the removal of the tax exemption would mean the charity is no longer able to function. The implications for this are those that rely of the benefits of the charities would in many cases become more desperate.

Q3. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what criteria should be used to define an unrelated business?

For most charities all income is related to core purposes. 2.24 seems to indicate not that the business activity is 'unrelated business income', but that the income is acquired by voluntary labour and/or donated goods.

Q4. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be an appropriate threshold to continue to provide an exemption for small-scale business activities?

As mentioned in 2.24 if the income is achieved predominately by voluntary labour and/or donated goods, then this would be exempt. If charitable business income is taxed there should also be a capital gains tax for other tax payers.

Q5. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, do you agree that charity business income distributed for charitable purposes should remain tax exempt? If so, what is the most effective way to achieve this? If not, why not?

From my experience, 'business income distributed for [the] charitable purposes' of the charity is distributed in the form of goods and services that the charity provides or purchases for supply. There seems to be an assumption that charities distribute cash payments. This surely must only apply to a very small number of charities.

Q6. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what policy settings or issues not already mentioned in this paper do you think should be considered?

A capital gains tax also needs to be introduced.

Q7. Should New Zealand make a distinction between donor-controlled charities and other charitable organisations for tax purposes? If so, what criteria should define a donor-controlled charity? If not, why not?

It would depend on what benefits does the 'donor' receives. I don't feel qualified to respond to this.

Q8. Should investment restrictions be introduced for donor-controlled charities for tax purposes, to address the risk of tax abuse? If so, what restrictions would be appropriate? If not, why not?

As above, I don't have the experience of donor-controlled charities to respond to this.

Q9. Should donor-controlled charities be required to make a minimum distribution each year? If so, what should the minimum distribution rate be and what exceptions, if any, should there be for the annual minimum distribution? If not, why not?

I should think that it would depend on the value of the retained earnings and what is the purpose of having a large amount. Again, I don't have the experience of donor-controlled charities to respond to this.

Q10. What policy changes, if any, should be considered to reduce the impact of the Commissioner's updated view on NFPs, particularly smaller NFPs? For example:
• increasing and/or redesigning the current $1,000 deduction to remove small scale NFPs from the tax system,
• modifying the income tax return filing requirements for NFPs, and
• modifying the resident withholding tax exemption rules for NFPs.

The net income level ($1k) needs to be raised and instituted so that some NFPs are not caught on the fringes and in some years are exempt but in other years are not. The aim should be to reduce compliance costs rather than chase the last tax dollar.

Q11. What are the implications of removing the current tax concessions for friendly societies and credit unions?

Removing the current tax concessions will increase costs and result in a reduction in the benefits for members. This would reduce the attraction to being a member and could mean that some friendly societies and credit unions would go out of existence. Is this a motive for these changes?

Q12. What are the likely implications if the following exemptions are removed or significantly reduced:
• local and regional promotional body income tax exemption,
• herd improvement bodies income tax exemption,
• veterinary service body income tax exemption,
• bodies promoting scientific or industrial research income tax exemption, and
• non-resident charity tax exemption?

For exemptions:
- On local and regional promotional body income tax exemption, removal would mean rate payers would incur additional costs for which they don't receive in most cases a direct benefit.
- Herd improvement bodies income tax exemptions and veterinary service body income tax exemptions relate to the costs associated with specific commercial interests. Any tax credit, if any, should apply relative to the taxation applying to commercial interests.

- For bodies promoting scientific research, where the benefit is to scientific knowledge per se and the public rather than specific commercial interests then the exemption should remain.
- Non-resident charities operating in NZ should have the same oversight as NZ registered charities and therefore operate under the same tax regime.

Q13. If the compliance costs are reduced following the current review of FBT settings, what are the likely implications of removing or reducing the exemption for charities?

If the rationale for introducing and maintaining this exemption was to support the charitable sector, then this should remain. It is paramount that the charitable sector is supported by the taxation system.

Q14. What are your views on extending the FENZ simplification as an option for all NFPs? Do you have any other suggestions on how to reduce tax compliance costs for volunteers?

FENZ are a special case particularly in terms of ACC because of the risks of injury that they face.

Q15. What are your views on the DTC regulatory stewardship review findings and policy initiatives proposed? Do you have any other suggestions on how to improve the current donation tax concession rules?

There probably needs to be a way for more 'real-time' payments of DTC, which might help more donations to charities. There needs to be a way that casual one-off donations can get the necessary receipt.

If donee organisations send to the IRD information for DTC claims, would they then have to supply the donors IRD number?

s 9(2)(a)

From: Celtic Rose s 9(2)(a)
Sent: Monday, 31 March 2025 10:47 am
To: Policy Webmaster
Subject: Urgent: Taxation and the not-for-profit sector

Follow Up Flag: Follow up
Flag Status: Flagged

Hi

I've just seen this article someone posted today regarding charities. What time does it close today?

Would you please extend the submission time frame on this to the end of April as I'd like to submit but I've got disability and am limited at what I can do in a day. Waiting on OPs, physical injury pain, chronic pain & brain fog make everything difficult.

A lot of people don't know about this.

I will try and answer the questions by the cut off however if all I end up being able to submit is below so be it.

1.Real charities are struggling we need all the tax breaks we can get so please don't take money away from real charities. I'm 100% not talking about 'supposed' charities under the guise of religion. Starting up charities need help with an annual funding amount to pay an independant trustee and accountant to do their books each year.

2.Unadulterated education in the not for profit sectors is what we need, just supplying the services they need not the brainwashing of children. Letting them be themselves not making them into what we want them to be. Not putting or prejudices on them. Not taking advantage of someone's beliefs whatever those believes are. Let children be children first off let children naturally by way of play develop their creativity and imagination naturally without molding it. That is not saying don't teach them guidelines, or that there are no consequences for actions, they have to learn to show respect if they want it in return.

We need to be able to receive government money without the limitation of submitting people's private details for us to be able to assure them of their privacy (not inclusive of illegal activity of course). Women and men avoid seeking government help in fear of losing their family. So if this doesn't happen the system will never catch the ones that need the most help and it's the children that will continue to suffer. There are damaged children having children and then damaging those

children through limited fault of their own. They are not just poverty striken families either. I grew up in low socio-economic South Auckland have seen it and I remember it like it was yesterday.

I have a struggling not for profit NGO charity that I'll be trying to get up and running. It's a really great cause that would be helping abused, neglected and traumatised children get back on track towards a healthy and happy childhood into adulthood. Abuse sexual and otherwise is still rife in New Zealand. Our children our most vulnerable need to be seriously protected and giving them help is absolutely not to do with their culture. They would be referred to the provider of their choice and with the same beliefs.

Regards

Robyn

- How could tax obligations for donors and volunteers be simplified? Make the performance report real real simple with no referring of amounts to anywhere else. Just so we enter what has been paid out and what has come in for small charities.

Inland Revenue is seeking public feedback on matters relating to the charities and not-for-profit sector. The consultation document covers the following topics:

- Should the income tax exemption for charity business income be removed or restricted?
- Should there be specific tax rules for donor-controlled charities such as private foundations?
- Are some of the tax exemptions for not-for-profits still fit for purpose?
-

Dunedin Symphony Orchestra
TE TIRA PŪORO O ŌTEPOTI

31 March 2025

To: Minister Nicola Willis
Re: Subissions – Taxation and the not-for-profit sector
Policy.webmaster@ird.govt.nz

Dear Minister Nicola Willis,

The Dunedin Symphony Orchestra (DSO) is grateful for the opportunity to submit its feedback on the Officials' Issues Paper "Taxation and the not-for-profit sector". The DSO is based in Dunedin and serves as the hub of the orchestral community eco-system across Otago and Southland, being the main provider to the communities in these regions of orchestral experiences for both musicians and audiences. Indeed, in 2025, DSO is the only professional orchestra performing in Dunedin. Orchestral excellence drives every aspect of the DSO's operations and every cent earned by the DSO is channelled to achieving this goal.

Next year (2026) will be the orchestra's 60th anniversary, and for all its lifetime DSO has received annual central government funding. The result is an orchestra of regional and national significance. DSO recognises the constraints on the funding it receives from central and local government. Noting the very real decrease in the present-day value of this funding, the DSO has steadily grown income from other income streams. One of these is donations which now form the second-largest income source for the orchestra (after Creative NZ).

Question 1: What is the most compelling reasons to tax, or not to tax, charity business income?
Question 2: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be the most significant practical implications?
Question 3: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what criteria should be used to define an unrelated business?

- There is a lack of clarity regarding the definition and measurement of 'charity business income unrelated to charitable purposes'.
- If 'charitable purposes' is determined by the purpose of expenditure, then identifying which components of an organisation's income are exclusively used for that "uncharitable" expenditure is likely to result in an excessively large additional administrative burden for charities. This would be on top of other challenges that the already-stretched administrations of charitable organisations face.
- In line with accounting and legislative requirements, the DSO's operations are transparent. The DSO's reports show that its operations are already necessarily extremely efficient, ensuring that there is maximum social benefit from every dollar the orchestra receives. The introduction of taxation on the DSO's limited revenue would therefore add to compliance costs and in turn reduce the funding available to the DSO for its activities.

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Dunedin Symphony Orchestra
TE TIRA PŪORO O ŌTEPOTI

In turn this would adversely affect the DSO's ability to provide social benefit and therefore reduce the DSO's positive impact on its community and the orchestra's contributions to that community.

Question 15: What are your views on the Donation Tax Concessions (DTC) regulatory stewardship review findings and policy initiatives proposed? Do you have any other suggestions on how to improve the current donation tax concession rules?

- It is vital that the DTC scheme is retained so that the DSO's income from donations is maintained and grows. Donations have helped to off-set as much of the decline in present-day values of central and local government grants as possible.
- The issues raised in conjunction with DTC suggest that raising awareness of the donation tax credit scheme could help increase the level of support charitable organisations receive via donations.

Thank you again for the opportunity to make this submission.

Yours sincerely

Philippa Harris
GENERAL MANAGER

PO Box 5571, Dunedin 9054
Hanover Hall, 65 Hanover Street, Dunedin
Telephone (03) 477 5623 | Email office@dso.org.nz

IRD Consultation on Taxation and the Not-For-Profit Sector

Submission by Robyn Holt – Board Chair for Devonport Methodist Childcare Trust, Devonport Methodist Church, Accountant for Girls' Brigade New Zealand, and a Tax Accountant.

Submission

I have not sought to answer all questions, however I have focused on some of the points around Questions 1-6.

I believe, in reading the background information supplied, it is very clear that there is a very micro lens that is being used to look at this.

When you look at the role of charities through a more macro lens, there are good reasons why introducing tax on unrelated business income may have an adverse effect that is not immediately apparent. In the infrastructure of society, charities play an important role often providing opportunities or services that are important to the social fibre of our community, but that Government is simply not able to provide – usually because it does not have the resources (both financial and operational) to do so – nor do they intend to provide them even if they did have the resources.

We are currently in an age where the ability for charities to source funding through external means is becoming harder and harder. Even finding people who are willing to volunteer their time is becoming more difficult. Because of this, charities are often having to look to business models to ensure that they have the financial means to provide both the services and to pay people to carry out these services to our communities. They also need to ensure the ability to be around for the long-haul. By then taxing these alternative sources of income, while it may increase the funds available to Government, it will decrease the funds that can ultimately be used to strengthen our communities through these important services that charities provide. And I know from working with and in a number of charities, that there is constant stress related to having the funds to meet the needs when you are relying on the goodwill of funders and donees. The burnout of people working and supporting this industry is high – take away the ability to self-fund and this will go even higher which then has a direct impact on the social fibre of our country.

Para 2.13 suggests that charitable entities may have an advantage over non-charitable trading entities in that they do not face the compliance costs associated with a tax obligation. As an accountant, I can say, that is simply not true. Charities also have often onerous accounting compliance requirements that they legally need to meet as do For-Profit entities. And these come at a huge cost especially when the requirement for audit or review is added onto that which in many cases is required. From my own time-cost, I know that the income tax compliance cost is only a relatively small portion of the total accounting compliance cost. For one charity I do work for on a voluntary basis, they would have a compliance bill that is about 5-10% of their total annual expenditure – it is not cheap by any means and if you add income tax to that, it would be even higher. Whereas, when I'm billing for-profit entities, their compliance cost, which is usually primarily for income tax purposes, is often usually only 1-2%.

If, at any stage, this taxing of non-core business income goes wider and subsequently hits small charitable organizations, then the compliance costs for them will increase hugely due to the more limited skill sets and resources that are often in these types of organizations. In all likelihood, they would need to seek, and pay for, the services of external skills such as specialist

tax accountants. That alone, would see compliance costs sky-rocket. I charge low, others do not!

It also needs to be noted that, while the costs to non-charitable organizations can be significant for raising external capital, charities have a far more limited repertoire of options for financing their work which, without the ability to use non-related business ventures, is often limited to a handful of funders and the donations of people who see their work as important.

2.15 suggests that 'tax concessions for unrelated charity businesses reduce government revenue, and therefore shift the tax burden to other taxpayers'. While that may have some element of truth, it also reduces the social burden that the Government cannot afford to cover.

Whilst there might be favour for a taxing of income derived from business interests for top tier organization, there is a big concern that this then opens the door for future changes to then taxing income from business interests for all organisations, which also in turn opens the door for all income to be taxed no matter how it was sourced. And this would have major long-term implications.

Summary

- While some of these changes appear to be targeting some of the larger charities that have business income that is unrelated to charitable purposes, any change would negatively impact necessary income for the running of not only those charities and not-for-profit organisations but may also potentially have a later flow-on effect on smaller charities and not-for-profit organisations, if the Government and IRD choose to push this concept further.
- Compliance costs between not-for-profit organisations and for-profit organisations are not as substantially different as some may think and there is the potential that these compliance costs for not-for-profits will balloon in excess of what for-profit organizations currently pay.
- I am not in favour of this and I am concerned at the macro effect on our society as well as the cost blow-out that is likely to occur for these charities.

IRD is welcome to contact us to discuss the points raised if required.

netsafe

Netsafe submission on IRD officials paper on taxation and the not-for-profit sector

About Netsafe

1. Netsafe is New Zealand's independent non-profit online safety charity. Taking a technology-positive approach to the challenges digital technology presents, we work to help people in New Zealand take advantage of the opportunities available through technology by providing practical tools, support, education and advice for managing online challenges.

2. We are an independent charity adjacent to Government and law enforcement, supported by the public and private sector and with a focus on online safety. Netsafe provides free support, advice and education seven days a week through a helpline, our website and face to face service delivery across New Zealand.

3. We do not think a compelling case has been put forward to change the tax treatment of charity business income, whether related or unrelated to the charity's charitable purpose.

4. We think the paper contains two incorrect premises (1) that the tax concession reduces government revenue and therefore shifts the burden to other taxpayers and (2) that charities and for-profit entities operate in competition with each other under the exact same conditions but for their tax treatment.

5. As to (1) we think a proper impact analysis needs to be undertaken. The knock on effects of additional compliance burdens, and lost revenue may for some charities mean they will reduce or stop certain services or may cease to operate at all. Many if not most charities operate for the public benefit. The knock on effects to the tax payer of a loss of services or a requirement for government to pick up the tab should those services be reduced or discontinued does not appear to have been factored in to the proposals. In other words, any short-term fiscal gains for tax revenue are likely to be offset by long-term public costs.

6. As to (2) while some large charities may operate in competition with other businesses this is not the case for most other charities. In fact the opposite may be true in that for-profit entities operating in the same market often do so with many fewer restrictions or conditions a charity may face. The proposals fail to acknowledge the unique operational realities, different motives and public benefits provided by charities. For example, grant or contractual obligations on a charity may mean they have an inability to commercialise their products, yet direct for -profit competitors may have unfettered access to the same market. It is therefore overly simplistic to assume the conditions of competition are the same but for tax treatment. Again a fuller impact assessment ought to be conducted to delve into this.

7. Some charities may use surpluses to shore up their future existence. Taxing accumulated surpluses—even those ultimately destined for charitable purposes—could impair an ability to build critical reserves. These reserves are essential for managing fluctuations in funding and addressing unexpected community needs or unforeseen circumstances. Faced with higher compliance costs, this might require a shift towards more passive investments, reducing engagement in innovative, service-oriented activities.

8. In the same vein, the proposals may discourage charities from exploring innovative business models and social enterprises that can enhance community support. The uncertainty around tax liabilities and increased administrative pressures could drive charities away from risk-taking, potentially stifling new initiatives that would benefit society. In addition, donor confidence could be undermined if it appears that funds are eroded by excessive administrative and tax burdens.

9. In light of the above, before these proposals proceed further we think there should be a thorough, sector-specific impact analysis which assesses the full operational and financial impacts of the proposals on charities, ensuring that any changes are supported by robust evidence and tailored to the unique needs of the not-for-profit sector.

10. The proposals ought also to recognise the distinct roles and motives of charities by implementing measures that are sensitive to the size, capacity, and public service nature of these organisations. In particular any tax changes must not force charities to divert critical resources away from their core missions.

Netsafe
31 March 2025

31 March 2025

Partner Reference
G B Cumberland - Auckland

Writer's Details
s 9(2)(a)

Sent by Email

Taxation and the Not-for-profit Sector
c/- Deputy Commissioner, Policy
Inland Revenue Department
PO Box 2198
Wellington 6140
policy.webmater@ird.govt.nz

Submission on Inland Revenue's Taxation and the Not-for-profit Sector Issues Paper

1. This submission on the Inland Revenue (**IR**) issues paper "Taxation and the not-for-profit sector" dated 24 February 2025 (**Issues Paper**) comprises:

   (a) A summary of our key submission points.

   (b) General comments on the Issues Paper and consultation process.

   (c) Responses to most of the questions for submitters in the Issues Paper.

2. Legislation referred to in the submission includes the Income Tax Act 2007 (**Income Tax Act**) and the Charities Act 2005 (**Charities Act**).

3. The submission refers to charities registered under the Charities Act as **registered charities** and to not-for-profit entities as **NFPs**.

Summary of key submission points

4. The Issues Paper consultation process has been too truncated and rushed to provide a sound basis for any decisions to be made by the government to proceed with any of the significant prospective tax changes signalled in the Issues Paper.

5. The Issues Paper's discussion of charity and NFP tax settings is also deficient because it does not give due recognition or weight to the public benefit delivered by charities and other NFPs' advancement of their charitable and other public benefit purposes. Once that public benefit is properly recognised and given appropriate weight, charity and NFP tax concessions discussed in the Issues Paper may actually be viewed as a fiscal gain, not a fiscal cost, for the government and as a benefit, not a burden, to taxpayers.

6. The current charity business income exemption should not be changed to tax charities' so-called "unrelated" business income, because:

   (a) There is no compelling competitive advantage or other reason to make any such change.

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(b) The public benefit delivered by charities' advancement of their charitable purposes supported by such business income, and avoiding the deadweight costs that would be incurred as a result of introducing rules to tax charities' unrelated business income, are compelling reasons not to make any such change.

7. If a change were made to tax charities' unrelated business income, despite the lack of any compelling reason to do so, the design details any such change should ensure that:

(a) The change only affects charities with large-scale unrelated business activities.

(b) The change does not affect charities' related business income, any of their investment income, or any of their income from charity fundraisers.

(c) There is full exemption or other tax relief in relation to unrelated business income to the extent that such income is distributed or applied for charitable purposes, in the year in which it is derived or subsequently.

(d) All of the above aspects of the change, and also all transitional matters, are very clear and straightforward for charities to understand and implement.

8. Imputation credits should also be made refundable for registered charities, in the same way that Maori authority credits are already refundable.

9. Separate regulation of so-called "donor-controlled charities" is not warranted. The existing legal regime for all registered charities is robust and sufficient, and the types of restrictions and requirements suggested in the Issues Paper are not necessary or appropriate.

10. IR's updated view on mutuality and mutual associations in its unreleased draft operational statement requires further, more detailed consultation with stakeholders.

11. The current $1,000 concessionary deduction for non-exempt NFPs should be substantially increased, eg to $5,000 or $7,500, to simplify tax compliance for small-scale NFPs.

12. Non-charity income tax exemptions identified in the Issues Paper should not be removed without a proper assessment of the public benefit delivered by NFPs eligible for each exemption, because in each case that public benefit may warrant retaining the exemption.

13. The non-resident charity income tax exemption should not be removed. It should be left as is, or relevant charities should be required and able to register under the Charities Act.

14. The current, limited FBT exemption for charitable organisation should be maintained. It provides support for charities that is warranted because of the public benefit delivered by the advancement of their charitable purposes.

15. Measures to simplify compliance costs in relation to volunteers, such as a *de minimis* exemption for honoraria payments, would be appropriate.

16. Measures to enhance the donation tax credit (**DTC**) regime would also be appropriate. Consultation on the DTC regulatory stewardship review should take place separately, as we expect this will not have received due attention from stakeholders because of other matters in the Issues Paper and the limited detail on the DTC review in the Issues Paper.

General comments on the Issues Paper and consultation process

17. The Issues Paper consultation process has been inappropriately truncated and rushed. Amongst other things, the matters covered by the Issues Paper are wide-ranging, the Issues Paper's discussion of many of those matters is superficial and does not sufficiently inform or assist prospective submitters to understand and respond to the matters raised, the matters covered affect a large number of different types of charities and NFPs, and the one month timeframe set for submissions is very short.

18. The Issues Paper consultation process has been too truncated and rushed to provide a sound basis for any decisions to be made by the government to proceed with any of the significant prospective tax changes signalled in the Issues Paper.

19. The Issues Paper's discussion of charity and NFP tax settings is also deficient because it does not give due recognition or weight to the public benefit delivered by charities and other NFPs' advancement of their charitable and other public benefit purposes. Once that public benefit is properly recognised and given appropriate weight, charity and NFP tax concessions discussed in the Issues Paper may actually be viewed as a fiscal gain, not a fiscal cost, for the government and a benefit, not a burden, to taxpayers.

20. That deficiency is particularly evident in the Issues Paper's discussion of the prospective taxation of charities' "unrelated" business income, and also the Issues Paper's suggestion that various other income tax exemptions and the FBT exemption for charitable organisations might be removed or "reduced".

Responses to Issues Paper questions for submitters

Question 1: What are the most compelling reasons to tax, or not to tax, charity business income? Do the factors described in 2.13 and 2.14 warrant taxing charity business income?

21. The Issues Paper does not provide any compelling reason to tax charities' business income, including charities' unrelated business income. In this regard:

(a) The Issues Paper correctly acknowledges that the charity business income exemption does not provide a competitive advantage to tax-exempt charity businesses, whether the business is related or unrelated to a charity's charitable purposes. There is no competitive advantage reason to tax charities' business income.

(b) The factors described in paragraphs 2.13 and 2.14 of the Issues Paper do not warrant taxing charities' business income. Those paragraphs do not take into account of or give sufficient weight to:

(i) the charitable purpose-driven nature of charities' operations, so that any decision on the use of a charity's resources, including reinvestment of funds in any business activities, must always be focused on what is in the best interests of the charity's charitable purposes;

(ii) the additional regulation that applies to charities, and registered charities in particular, including Charities Act registration and compliance requirements and the filing and publication of accounts; and

(iii) the significant constraints that charity businesses face in relation to raising external capital, especially equity investment, given that a charity must not operate for private pecuniary profit.

(c) New Zealand's charity business income exemption is not an "outlier", as suggested in the Issues Paper. Australia in particular has relatively recently reviewed and affirmed the continued tax-exempt treatment of charities' business income, including "unrelated" business income, ultimately because of the importance of the public benefit delivered by charities' advancement of charitable purposes supported by their business income.

(d) The Issues Paper does not present or refer to any evidence of any widespread, inappropriate accumulation of tax-exempt unrelated business income. Charities Services has only recently started to gather information regarding registered charities' accumulation of funds and their reasons for doing this, and there are good reasons for charities to accumulate and reinvest funds with a view to sustainably delivering their charitable services.

22. The compelling reason for not taxing charities' business income is that any so-called "fiscal cost" of exempting such income from income tax is outweighed by the public benefit delivered by charities' advancement of their charitable purposes supported by such income. In other words, the exemption is a fiscal gain, not a fiscal cost, for the government, and a benefit, not a burden, to other taxpayers, once the public benefit of charities' advancement of their charitable purposes is taken into account.

23. On that basis, introducing rules to tax charities that are operating unrelated businesses ultimately to support the advancement of their publicly beneficial charitable purposes would be to the net detriment of New Zealand and New Zealanders.

24. In addition, and without derogating from the points set out above, introducing rules to tax charities' unrelated business income would involve considerable complexity, uncertainty, transitional issues, and compliance costs, resulting in significant deadweight loss, and there is also no clarity or certainty that any material additional tax revenue would be raised.

25. Issues that would arise include:

(a) Distinguishing charities' "non-business" and "business" income, a distinction which currently does not matter for many charities (if their purposes are limited to New Zealand and conflicts of interest are properly managed).

(b) Defining "business" income in this context so that it clearly *excludes*:

(i) charities' investment income, which should not be taxed as unrelated business income (even if the nature and scale of the investment activities might otherwise cause the activities to be characterised as a "business"); and

(ii) charity fundraising activities, such a charity dinners, auctions, lotteries and raffles, and activities that involve on-selling donated goods and/or services (even if such activities are business-like and might be described as a "business").

(c) Distinguishing "related" and "unrelated" business activities, which will not be clear-cut for many charities with "mixed purpose" social enterprises.

(d) Defining and determining the application of a "small scale" (or "not large scale") unrelated business exclusion from the taxation of charities' unrelated business income, which would be an essential aspect of any changes, and potentially other exclusions as well.

(e) Potential restructuring/bifurcation of charities' existing operations in order to distinguish between operations that would be taxed differently, to ensure that non-business income and related business income is not "tainted" by any unrelated business activities, and to shift taxable operations out of charitable trust structures taxed at 39% in relation to any taxable trustee income.

(f) Dealing with the transition from being exempt to taxable in relation to unrelated business activities and bringing assets relating to those activities, which currently might have mixed uses (non-business/business, related/unrelated business), into the income tax base, and having to prepare and file income tax returns.

(g) Defining and determining the application of rules to identify the extent to which unrelated business income is accumulated, and therefore taxable, or distributed or applied for charitable purposes, and therefore eligible for exemption or other tax relief.

26. While some of those issues might be addressed or mitigated in part by the design details of any change, introducing rules to tax charities' unrelated business income would inevitably involve significant complexity, uncertainty, transitional issues and compliance costs.

27. Such issues and costs would also be likely to have a chilling effect on charities' inclination to explore and pursue social enterprise and other ideas and opportunities that involve, or might involve, "unrelated" business activity to generate sustainable revenue to support the advancement of their publicly beneficial charitable purposes.

28. All of the remaining questions for submitters in Chapter 2, Questions 2 to 6, are premised on the current charity business income tax exemption being changed to tax charities' "unrelated" business income, even though there is no compelling reason to make any such a change. Our answers to those remaining questions should not be taken as derogating from our answer to Question 1.

Question 2: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be the most significant practical implications?

29. If the current charity business income exemption were to be changed to tax charities' unrelated business income, despite no compelling reason to do so, the change would give rise to considerable complexity, uncertainty, transitional issues and compliance costs.

30. An overview of the types of issues that would arise is set out at paragraph 25 above. As noted, the extent of those issues is itself a forceful reason for not introducing rules to tax charities' unrelated business income.

31. The resulting transitional and compliance costs, together with any actual tax costs incurred in relation to accumulated unrelated business income, would reduce the amount of funds ultimately available to affected charities to advance their charitable purposes.

32. As noted, charities might instead be disinclined to become involved in business activities that would, or might be, treated as unrelated business activities, and this may also reduce the amount of funds ultimately available to charities to advance their charitable purposes.

33. A further practical implication of the taxation of charities' unrelated business income reducing the amount of funds ultimately available to charities to advance their charitable purposes would be the potential requirement for additional government expenditure to meet needs that are currently met by affected charities and/or the adverse effect of those needs no longer being met (or no longer being met to the same level).

Question 3: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what criteria should be used to define an unrelated business?

34. If the current charity business income exemption were to be changed to tax charities' unrelated business income, despite no compelling reason to do so, then:

(a) The first key definitional issue would be what counts as "business" income in this context. As noted earlier, such income should not include:

(i) Charities' investment income, regardless of whether the nature and scale of a charity's investment activities might cause those activities to be viewed as a "business" in other contexts. Charities' investment activities do not involve carrying on business in competition with taxpayers in the market.

(ii) Charities' income from fundraising activities such as charity dinners, auctions, lotteries and raffles, and activities involving the on-sale of donated goods and/or services. Such activities may be business-like but not a business, and even if viewed as a "business" they do not involve carrying on business in competition with taxpayers in the market.

(b) The second key definitional issue in relation to relevant "business" activities would be the distinction between business activities that are "related" or "unrelated" to a charity's charitable purposes. In this regard:

(i) A "related" business should include any business activity that advances, on account of its nature and/or the manner in which it is carried on, any one or more of a charity's charitable purposes.

(ii) An "unrelated" business would be any business that does not fall within that "related" business definition, and would essentially be limited to business activities undertaken solely to generate profit to be distributed or applied to a charity's charitable purposes.

35. Those definitional issues, and especially the "related" vs. "unrelated" business distinction, are likely to be complex, given that there are numerous ways in which charities' social enterprise or other activities that may be viewed as "business" activities can advance charities' charitable purposes. A "principally" or "mainly" test and/or apportionment

provisions might also be required, adding another layer of complexity and potential uncertainty.

Question 4: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be an appropriate threshold to continue to provide an exemption for small-scale business activities?

36. If the current charity business income exemption were to be changed to tax charities' unrelated business income, despite no compelling reason to do so, then:

(a) In light of the complexity, uncertainty, transitional issues and compliance costs that introducing rules to tax charities' unrelated business income would entail, it would be appropriate for an exclusion for "small scale" business activities to exclude all but very large-scale businesses, ie the exclusion should be a "not large scale" exclusion.

(b) In addition, such an exclusion should relate to the scale of a charity's unrelated business activities, not the scale of the charity's overall operations, or a combination of both, rather than just the scale of the charity's overall operations.

(c) Such an exclusion should also be simple to apply, to minimise complexity and cost, and to the extent possible should make use of information that registered charities are already required to collate or prepare in order to comply with their financial reporting and assurance obligations under the Charities Act.

(d) For example, a possible approach would be an exclusion that covers both:

(i) all Tier 3 and Tier 4 registered charities/groups; and

(ii) all registered charities/groups with unrelated business income or profit in excess of a specified threshold.

Question 5: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, do you agree that charity business income distributed for charitable purposes should remain tax exempt? If so, what is the most effective way to achieve this? If not, why not?

37. If the current charity business income exemption were to be changed to tax charities' unrelated business income, despite no compelling reason to do so, then:

(a) Charities' unrelated business income should be exempt, or effectively exempt (by way of tax deductibility and/or refundable credits for tax previously paid) to the full extent that such income is distributed (from the entity deriving the income to another entity) or applied (within or by the entity deriving the income) to advance charitable purposes.

(b) For example, for charities deriving unrelated business income that falls outside the exclusion for "not large scale" business activities, this could include a combination of:

(i) unlimited tax deductibility for any current year distribution or application of unrelated business income to advance charitable purposes; and

(ii) memorandum account credits for any tax paid on accumulated unrelated business income that would be refundable upon the distribution or application of unrelated business funds to advance charitable purposes.

(c) It should also be made clear in this context that distribution or application of unrelated business income to advance charitable purposes includes setting aside or earmarking funds to be used for charitable purposes, either generally or for a particular charitable use.

38. The need for these measures, and the additional complexity and uncertainty they would entail, is another reason why there should be no change to current settings.

Question 6: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what policy settings or issues not already mentioned in this paper do you think should be considered?

39. If the current business income exemption were to be changed to tax charities' unrelated business income, despite no compelling reason to do so, imputation credits attached to company dividends paid to registered charities, especially those which carry out their charitable purposes in New Zealand, should be made refundable.

40. In relation to imputation credit refundability:

(a) The current non-refundability of imputation credits for registered charities means that their investments in domestic equity (in taxable companies) are effectively taxed, at the 28% company tax rate. This impacts on charities' investment decisions, disincentivising domestic equity investments.

(b) There is already established New Zealand precedent for this type of credit to be refundable, namely the refundability of Maori authority credits attached to distributions made by Maori authorities to tax-exempt charities. There is no principled basis for Maori authority credits and imputation credits to be treated differently.

(c) There is also precedent in Australia, where franking credits attached to dividends received by qualifying tax-exempt charities and other organisations are refundable.

(d) Inland Revenue officials have previously acknowledged that the non-refundability of imputation credits for registered charities is inconsistent with the key principle of the imputation credit system that shareholders should, so far as possible, be treated as if the income earned by the company were earned by the shareholders directly.

41. If imputation credits were refundable for registered charities, taxable companies would then more likely be considered as an option for charities' involvement in "unrelated" businesses to generate funds to support the advancement of their charitable purposes.

Question 7: Should New Zealand make a distinction between donor-controlled charities and other charitable organisations for tax purposes? If so, what criteria should define a donor-controlled charity? If not, why not?

42. Separate regulation of so-called "donor-controlled charities" is not warranted, principally because the existing legal regime for all registered charities, including "donor-controlled charities", is robust and sufficient.

43. There is no apparent basis or need to introduce additional complexity, uncertainty, and compliance costs by attempting to define so-called "donor-controlled charities" (which would itself be problematic) and then separately regulate such charities by imposing unnecessary and flawed restrictions and requirements. Separate regulation of "donor-controlled charities" also risks discouraging and hindering genuine philanthropy.

44. Relevant aspects of the existing legal regime for registered charities include:

(a) A charity, including its board and officers, is bound by the charity's rules (which will have been reviewed and approved for Charities Act registration purposes) and by applicable provisions of trust, company or society legislation, as applicable. This will invariably include fiduciary duties to act in the best interests of the charity's charitable purposes and not for private profit, and conflict of interest disclosure and non-participation requirements.

(b) To benefit from income tax exemption and donation tax incentives, a charity must be approved and registered under the Charities Act and under the Charities Act registration, reporting and monitoring regime:

(i) a charity's rules, officer details, accounts and other details must be filed and updated, and those details are all available to Charities Services, the Charities Registration Board, other authorities and the general public;

(ii) annual return obligations, including financial reporting and assurance requirements (which would include any applicable related party disclosure requirements), must be met;

(iii) each charity and its officers (including board members and others) are subject to further duties prescribed under the Charities Act;

(iv) Charities Services and the Charities Registration Board can monitor and inquire into the affairs of a charity and can take action against a charity and/or its officers, including deregistration which can have significant "deregistration tax" and loss of tax concession consequences for the deregistered entity; and

(v) charity information can be collected and shared/exchanged with Inland Revenue.

(c) To benefit from exemption from income tax in relation to any business income, a charity must also comply with detailed "control restrictions" under the current charity business income tax exemption in the Income Tax Act. Essentially, those restrictions require that persons treated as having some control over the business

(eg, a settlor or trustee for a trust, a shareholder or director for a company, and their associates) must not be able to direct or divert any amount from the business to their own, or any associate's, benefit of advantage. If the restrictions are breached, none of a charity's business income will qualify for the exemption.

(d) Under the Income Tax Act and Tax Administration Act 1994, IR can also monitor and inquire into a charity's affairs and has various legislative tools, including general and specific anti-avoidance provisions and tax administration powers, to take action against a charity and/or its officers, and can share/exchange information with Charities Services and the Charities Registration Board.

(e) Under the Charitable Trusts Act 1957 and general charity and trust law, the Attorney-General, as "protector" of charities, can also inquire into a charity's affairs and the Attorney-General, and others, can apply for court directions or orders in relation to charities.

45. That legal regime enables Charities Services and the Charities Registration Board, IR and also the Attorney-General to monitor, inquire into, and take substantive action if required in relation to registered charities, their officers, and their transactions and other arrangements, including any related party transactions and other arrangements.

46. Under the existing legal regime, investigations and substantive action could already be taken in relation to all of the circumstances involving potential inappropriate related party transactions and misapplication or non-application of funds that are set out in paragraph 3.6 of the Issues Paper. In addition, those examples are not exclusive or particular to so-called "donor controlled charities".

47. At most, some enhanced or additional related party disclosure requirements might be warranted for smaller charities, of all types not just so-called "donor-controlled charities". Larger charities, of all types, are already subject to extensive reporting and disclosure requirements.

48. Overseas jurisdictions' imposition of specific restrictions and requirements for "private foundations" does not detract from the points set out above, especially given our understanding overseas restrictions and requirements have been imposed in the context of legal regimes for charities that are not as robust as the existing New Zealand legal regime for registered charities.

Question 8: Should investment restrictions be introduced for donor-controlled charities for tax purposes, to address the risk of tax abuse? If so, what restrictions would be appropriate? If not, why not?

49. There is no apparent basis or need to prohibit or impose restrictions on investments and other transactions, for so-called "donor controlled charities" or for any other type of registered charity, in light of the existing New Zealand legal regime for registered charities.

50. Prohibiting or restricting charities' investments and other transactions, including transactions between a charity and those who have established and/or contributed to the charity, would introduce arbitrariness and complexity, it would inappropriately constrain charities' autonomy and flexibility to determine how best to sustainably advance their charitable purposes, and it may also preclude or affect transactions that would be non-

market transactions *in favour of* the charity, eg favourable financing arrangements for a charity, or the provision of goods and/or services to a charity at less than market value.

51. If any additional requirements were to be introduced at all, they should be limited to additional disclosure requirements that enable enforcement of existing legal duties (eg, ensuring registered charities are subject to related party disclosure requirements), not substantive prohibitions or restrictions on charities' investments and other transactions.

Question 9: Should donor-controlled charities be required to make a minimum distribution each year? If so, what should the minimum distribution rate be and what exceptions, if any, should there be for the annual minimum distribution? If not, why not?

52. There is no apparent basis or need to introduce prescriptive minimum distribution requirements, for so-called "donor controlled charities" or for any other type of registered charity, in light of the existing New Zealand legal regime for registered charities.

53. Introducing any form of minimum distribution requirement to deal with unquantified concerns about accumulation of funds by donor-controlled charities, or by any other type of charity, is unwarranted and would be problematic. Any such distribution requirement would inevitably be arbitrary, create complexity, and involve a significant risk of:

(a) becoming an inappropriate lowest common denominator or target for charities' distributions, if the requirement is set too low; or

(b) an unreasonable constraint and burden on affected charities, forcing them to make distributions that are not in the best interests of sustainably advancing their charitable purposes, if the requirement is set too high.

54. Again, the exiting legal regime already provides the tools for investigating, and if appropriate taking action in relation to, registered charities' accumulation of funds.

Question 10: What policy changes, if any, should be considered to reduce the impact of the Commissioner's updated view on NFPs, particularly smaller NFPs? For example, increasing and/or redesigning the current $1,000 deduction to remove small scale NFPs from the tax system.

55. IR's updated view on mutuality and mutual associations in its unreleased draft operational statement should be the subject of further, more detailed consultation with stakeholders. This is because IR's updated view appears to be contestable and arguably incorrect, it has the potential to impact on a very large number and range of non-exempt NFPs, and legislative clarification may well be warranted.

56. The exemption for friendly societies (including credit unions) should be considered as part of that further consultation on mutuality and mutual associations.

57. The current $1,000 concessionary deduction for non-exempt NFPs should be substantially increased, eg to $5,000 or $7,500. We understand that the amount of the deduction has not been updated since 1979, and such an increase would reflect inflation since that time. Substantially increasing the deduction would reduce tax compliance and administration costs in respect of many small-scale NFPs that have minimal net income each year.

Question 12: What are the likely implications if the following exemptions are removed or significantly reduced: local or regional promotional body income tax exemption; herd improvement bodies income tax exemption; veterinary service body income tax exemption; bodies promoting scientific or industrial research income tax exemption; and non-resident charity tax exemption?

58. In relation to the local or regional promotion body, herd improvement body, veterinary service body, and scientific or industrial research body income tax exemptions:

(a) These longstanding non-charity income tax exemptions should not be removed without a proper, detailed assessment of the public benefit delivered by NFPs that are eligible for each exemption, because in each case that public benefit may warrant retaining the exemption.

(b) We expect that such an assessment may show that although such NFPs are not charitable in a strict charity law sense or for Charities Act registration purposes (at least according to Charity Services and the Charities Registration Board), like charities such NFPs advance, in accordance with the relevant exemption's terms and on a not-for-private-profit basis, purposes that deliver significant public benefit which justifies the exemption.

(c) The position that such NFPs are not required to register under the Charities Act or any equivalent regime in order to be eligible for the exemptions does not mean that the exemptions are not warranted.

(d) The same position applies to other tax-exempt NFPs that need not be charitable and are not required to register under the Charities Act in order to be eligible for exemptions but deliver significant public benefit which justifies the exemptions, eg amateur sport promoters and community housing entities.

(e) If any of the longstanding non-charity exemptions were to be removed or "reduced", practical implications would arise for entities that currently apply the relevant exemption. Such entities may be faced with significant transitional and ongoing costs if they become taxable, or may consider restructuring and associated costs to address or mitigate the effect of removal of the exemption.

(f) If such entities have been structured as NFPs with purposes and restrictions on the use of their funds that are locked into their rules in order to be eligible for the relevant exemption, then transitioning from exempt to taxable or restructuring may also be problematic, putting such entities at a disadvantage moving forward.

59. In relation to the non-resident charity income tax exemption:

(a) Non-resident charities are required to seek "tax charity" approval from IR for their non-business income sourced from New Zealand to be tax-exempt under the current charity non-business income exemption in the Income Tax Act because of a narrow interpretation of the current Charities Act registration regime.

(b) There are non-resident charities deriving non-business income from New Zealand that is not relieved or fully relieved from New Zealand tax under a tax treaty which should be able to qualify for the charity non-business income exemption – either by continuing to provide for IR approval of "tax charity" status for such charities

or by enabling such charities to register under the Charities Act (as in the case of other legislation that provides for New Zealand registration of non-residents).

(c) Examples of such non-resident charities would include a non-resident 'parent' charity receiving payments from a New Zealand registered charity towards the cost of services/programmes provided by the parent to support the New Zealand charity, or a non-resident charity receiving non-business investment income from New Zealand to support a worthy emergency or ongoing overseas cause.

(d) Based on IR's current published interpretation of section CO 1 of the Income Tax Act, which suggests that gifts to charities may be income under that section, such non-resident charities could also include an overseas charity receiving donations from New Zealand. We consider, however, that that aspect of IR's interpretation of section CO 1 is incorrect.

Question 13: If compliance costs are reduced following the current review of FBT settings, what are the likely implications of removing or reducing the exemption for charities?

60. The current FBT exemption for charitable organisations enables charities and other donee organisations to include benefits covered by the FBT rules in employees' remuneration, without having to deal with FBT compliance and payment. Existing limitations on the exemption:

(a) exclude use of the exemption by government/statutory entities (local authorities, public authorities, universities);

(b) exclude use of the exemption in relation to employees mainly employed in business activities outside the charitable organisation's charitable or other public benefit purposes (ie, "unrelated" business activities); and

(c) cap the value of any FBT-exempt "short-term charge facility" benefits (eg, use of an organisation's credit/debit card or supplier account) using the exemption.

61. The exemption effectively lowers charitable organisations' costs in relation to offering remuneration with fringe benefits that can help to attract and retain staff. Fringe benefits may also be delivered a charitable organisation without significantly cutting into its financial resources (eg, providing access to the organisation's own services or benefits sponsored by third parties).

62. If the exemption were to be removed or "reduced", the implications for charitable organisations that use the exemption to help attract and retain staff would include:

(a) Having to identify relevant benefits and work out whether or not such benefits would continue to be FBT-exempt on any other basis.

(b) If FBT would become applicable to any benefits because of the change, either dealing with FBT compliance and payment or discontinuing or restructuring the inclusion of such benefits in employees' remuneration.

(c) In the case of discontinuing or restructuring the inclusion of benefits in employees' remuneration, employee consultation/engagement, changes to remuneration details, and other transitional issues.

63. The overall result would be the reduction of a charitable organisation's resources available for other aspects of delivering its charitable services (because of the effective increase in the cost of maintaining the value of employees' remuneration), or the organisation offering remuneration of less value to employees (affecting the organisation's ability to attract and retain good staff), or a combination of both of those adverse effects.

64. The current, limited FBT exemption for charitable organisations should be maintained, not removed or "reduced". In this regard:

(a) The FBT exemption is an important, albeit limited, form of support for charitable organisations, simplifying tax compliance and also effectively lowering the cost of employee remuneration that includes some fringe benefits, enabling charities to offer such remuneration to attract and retain staff.

(b) Such support for charitable organisations is warranted because of the public benefit delivered by the advancement of their charitable purposes, which would outweigh any "fiscal cost" of the exemption.

(c) Any fiscal cost of the exemption is also already contained by the existing limitations on the exemption, ie the exclusion of government/statutory entities, the exclusion for "unrelated" business employees, and low cap that applies to any FBT-exempt "short term charge facility" benefits.

65. The Issues Paper also refers to a current review of FBT settings which has, as one of its aims, reducing compliance costs, and seems to suggest the review may be relevant to submitters' positions on the FBT exemption. However, the minimal detail in the Issues Paper regarding that review provides no reason or basis for removing or "reducing" the FBT exemption.

Question 15: What are your views on the DTC regulatory stewardship review findings and policy initiatives proposed? Do you have any other suggestions on how to improve the current donation tax concession rules?

66. The DTC regulatory stewardship review findings and recommendations (albeit partially redacted) go beyond the proposals briefly referred to in the Issues Paper, and we expect that the DTC section of the Issues Paper and the DTC review findings and recommendations will not have received due attention from stakeholders because of other more pressing matters raised by the Issues Paper, the very limited detail included in the DTC section of the Issues Paper, and time constraints in relation to considering and preparing submissions on the Issues Paper.

67. Measures to enhance the DTC regime to incentivise donations to charities and other donee organisations would be welcome and appropriate, and we suggest that more detailed consultation on the DTC regulatory stewardship review finding and recommendations should take place separately, outside of the Issues Paper consultation process.

Next steps/further consultation

68. We look forward to Inland Revenue's confirmation of receipt of this submission. We also confirm that we would be happy to discuss any aspect of this submission with Inland Revenue officials.

69. We also reiterate that further consultation should be undertaken with the charitable sector and other stakeholders regarding any prospective changes to charity and NFP tax settings – before any decisions are made to proceed with any such changes.

70. There is otherwise a very real risk that the truncated and rushed Issues Paper consultation process will result in unwarranted and misdirected changes to charity and NFP tax settings, to the net detriment of New Zealand and New Zealanders.

Yours faithfully
SIMPSON GRIERSON

s 9(2)(a)

Nicholas Bland | Senior Associate

s 9(2)(a)

From: Daniel Mitchell s 9(2)(a)
Sent: Tuesday, 1 April 2025 12:02 am
To: Policy Webmaster
Subject: Submission: Taxation and the not-for-profit sector

In response to the public consultation document "Taxation and the not-for-profit sector" I would like to make the following personal submission.

I am a co-chairperson of a local charity that provides essential primary healthcare services to youth aged 10-24. I am also a Trustee of local charity that provides palliative care services to anyone in need.

I do not support any change to the status quo.

The charities I am involved with exist to deliver essential services in the absence of the New Zealand Government fully funding and providing universal access to these and other essential services. The New Zealand Government have historically recognised this by providing registered charities with tax advantages that enable them to further their charitable causes in a way that maintains accountability (i.e., only applies when registration is maintained) and minimises compliance (i.e., no additional requirements beyond those required for remaining registered).

From this consultation, it appears that Hon Nicola Willis and Inland Revenue are concerned that there are some actors that are exploiting the status of a registered charity and the subsequent tax advantages that provides. If this is the problem, I suggest that the solution is to firstly consider whether the Charities Act and regulations are being applied appropriately. For example, considering whether Charities Services has:
- been effectively monitoring compliance and addressing non-compliance;
- the tools required to identify such exploitation;
- the tools required to address such exploitation, if identified;
- the capacity and capability required to use the available tools of monitoring compliance and addressing non-compliance.

These questions must be asked before considering significant changes to the system. Additionally, the problem and scale of the problem must be clearly articulated before considering such significant changes to the system.

My view is that the Charities Act provides all of the tools necessary to identify and address exploitation and non-compliance.

A change in the current system, as proposed, will fundamentally change the funding structures of charities for the worse. Charities that currently provide essential services that the Government has historically decided that it does not want to provide, and with greater efficacy than the Government could provide, would reduce and/or cease their operations. This comes at a time when the necessity if these essential services provided by these charities is increasing

In summary, I do not support any change to the status quo.

Additionally, I support in full the submission made by the Chartered Governance Institute of New Zealand:
https://www.linkedin.com/posts/cginz_submission-on-ir-paper-on-taxation-and-the-activity-7312220833173684224-HZ0Y?utm_medium=ios_app&rcm=ACoAADAYJykBxfzLqICzoVXU0hV-a3nEyiqhp3w&utm_source=social_share_send&utm_campaign=copy_link

Daniel Mitchell

s 9(2)(a)

Ryan Donovan

From: Ruth Davison s 9(2)(a)
Sent: Tuesday, 1 April 2025 7:46 am
To: Policy Webmaster
Subject: Taxation and not for profit sector

Good morning,
I would like to ask a few questions and make a few comments on this submission.

A. What checks and balances are/ will be put in place to ensure charities like Destiny Church are using their funds for appropriate activities? Aggressive behaviour and negative preachings against a legal sector of our society, (LGBTQIA) is not an acceptable use of their funding.

B. Why is a company like Sanortirium not taxed when they are clearly in the commercial sector of creating food? i realise they are a church organisation but if they are making profits, these should be taxed.

C) Will charity shops be exempt from being taxed in any new legislation? I feel that as they do such good work and are more transparent than other organisations, this should be the case. Their vital work will be in jeopardy and the government would need to pick up the slack. In the present financial climate, this is unlikely to happen so more people would be left in a very difficult position.

I will be following the news on this matter with interest.

With kind regards,
Ruth Davison.

Ryan Donovan

From: Steve and Bernadette Joyce s 9(2)(a)
Sent: Tuesday, 1 April 2025 8:01 am
To: Policy Webmaster
Cc: Catholic Hurunui; Thomas Peacock; padrepio1428@gmail.com
Subject: Taxation on the not for profit sector- submission

Providing this is not too late as it is a day past the recommended deadline we make the following comments to assist you in your preparation of tax legislation.

- We are the parish of the Good Shepherd in Hurunui North Canterbury
- Our parish boundary is from north of the Waimakariri river to Cheviot and Hanmer Springs and is one of the largest in the Christchurch Catholic Diocese. We have 5 churches where Masses are said each Saturday evening and Sunday by one parish priest who travels to the different communities each week end. We are a collective or mainly rural communities. The church provides for the spiritual needs for Catholics in the area, as well as assists to build community and social support on a local level. We are run basically by volunteers.
- The church supports firstly its members, but also anyone who knocks at the door in need will generally get help either directly or by referral to Catholic charities.
- We are a Church (a charitable organisation in the taxation sense)- here for God's mission to extend his message throughout our neighbourhoods; so we are concerned primarily for peoples' souls and their bodies too- but are not driven by profit or any of the usual metrics you may find in big business. Money is important, but as a means to an end to sustain us to do the mission work of the church. As such it should be treated differently to a business which in-essence is profit driven. To loose charitable status would impact on our ability to serve God and the communities where we live.
- To sustain the work of the church it is sometimes necessary to use funds donated to it wisely for investment to pay for the ever increasing costs to run the churches such as insurance and power and maintenance.

Recommendations:
Retain the charitable donation status as it currently operates.

On behalf of the Parish Council

Subject : Taxation and the Not for profit sector

Dear sir /Madam

This a submission on the Taxation and Not for Profit, questions 1-9.

Q1. What are the most compelling reasons to tax, or not to tax, charity business income? Do the factors described in 2.13 and 2.14 warrant taxing charity business income?

Primarily additional administrative functions for the charity, more compliance.

With self-assessment system there would be a greater demand on volunteers of the charity to take on additional tasks, potentially losing volunteers who would be uncomfortable or unable to complete tax returns for the charity.

Also potentially changes to how the charity accounts for the income and the assessment of what is and is not business income when the objectives of the charity are doing work for the benefit of or has a philanthropic purpose

Charity having to focus of accounting and taxation matters when previously working on primary activities of the charity

Having to engage accounting and tax specialists rather than spending the resources on the primary activities of the charity.

What the charity does face is the compliance cost with the Charities Register requirements which businesses do not. Many charities struggle to retain staff or volunteers with the necessary skills to meet their current obligations.

The work that the charities are doing potentially would stop and the government would have to step in to fill the demand for the contributions to social housing, to aged care, to protection of children, for the advancement of children

Q2. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be the most significant practical implications?

Providing consistent treatment, definitions and classification for what is unrelated to charity purposes , together with the management of the self-assessment

Q3. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what criteria should be used to define an unrelated business?

Criteria should be what is the purpose of the activity, it’s objective in undertaking the activity.

Q4. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be an appropriate threshold to continue to provide an exemption for small-scale business activities?

Tier 3 and tier 4

Q5. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, do you agree that charity business income distributed for charitable purposes should remain tax exempt? If so, what is the most effective way to achieve this? If not, why not?

Yes to remain tax exempt. As part of the Charities reporting requirements, details of distributions, explanation of projects and spending programs going over multiple financial years.

Q6. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what policy settings or issues not already mentioned in this paper do you think should be considered?

Is a change to the tax exemption going to achieve an overall benefit for the people of New Zealand.

No quantification has been made for the loss of the work funded by the charities .

Chapter 3: Donor-controlled charities

Q7. Should New Zealand make a distinction between donor-controlled charities and other charitable organisations for tax purposes? If so, what criteria should define a donor-controlled charity? If not, why not?

Does the number of organisation in New Zealand in this classification warrant distinction. Review by the Charities Register can classify and manage them accordingly.

Q8. Should investment restrictions be introduced for donor-controlled charities for tax purposes, to address the risk of tax abuse? If so, what restrictions would be appropriate? If not, why not?

Dependant on projects and overall mission of the Charity as many projects extend over multiple financial years.

Q9. Should donor-controlled charities be required to make a minimum distribution each year? If so, what should the minimum distribution rate be and what exceptions, if any, should there be for the annual minimum distribution? If not, why not?

Dependant on Charities objective, achievements, what they are working towards.

thank you. And I look forward to the outcome as it means so much to so many.

creative nz
ARTS COUNCIL OF NEW ZEALAND TOI AOTEAROA

0800 CREATIVE
info@creativenz.govt.nz
www.creativenz.govt.nz

L2 2-12 Allen Street
Te Aro, Wellington
6011

1 April 2025

Inland Revenue
Taxation and the not-for-profit sector

By email: policy.webmaster@ird.govt.nz

Tēnā koutou katoa

Submission to:	**Inland Revenue**
Subject:	**Taxation and the not-for-profit sector**
From:	**Arts Council of New Zealand Toi Aotearoa (Creative New Zealand)**

Introduction

1. Creative New Zealand welcomes the opportunity to comment on the Officials' Issues Paper *Taxation and the not-for-profit sector* (24 February 2025).

2. This submission relates to Chapter 2, *Charity business income tax exemption*, of the Issues Paper.

3. The key contact person for matters relating to this submission is:

Name: Elizabeth Beale
Position: Co-Manager, Policy & Performance
Email: s 9(2)(a)

Key points

4. Creative New Zealand understands that Inland Revenue is considering whether the tax exemption for business income received by a charity, where this income is *'unrelated to the entity's charitable purpose'*, should be removed or the current settings changed.

5. Creative New Zealand submits that:

   (i) There would be a material impact on arts organisations should charities become subject to tax on their "business income". Many arts organisations undertake commercial or business activities to support their operations, including retail, food and beverage and venue hire, which could be considered "unrelated" to their charitable purposes. Business activities operated by arts organisations supports the charitable purposes of these entities.

   (ii) For the arts sector, the impacts could be largely mitigated through appropriate definitions and thresholds, including maintaining the tax exemption for Tier 3 and Tier 4 charities and/or continuing a tax exemption for unrelated commercial activities that operate to raise money for the benefit of the charity or their charitable purposes.

(iii) Should the tax-exemption be removed entirely or the threshold set below Tier 3, the impacts on the arts sector could include:

- a reduction in the viability of arts organisations and the services they provide potentially leading to the failure of organisations and a loss of services
- increased pressure on government agencies such as Creative New Zealand to fill any revenue or funding gap
- increased compliance costs on already under resourced organisations.

(iv) If the thresholds are set low, the additional compliance costs on arts organisations and the agencies enforcing the new rules would likely outweigh the benefits in terms of additional revenue generated for the Government.

(v) The Issues Paper characterises tax concessions as a "cost to the taxpayer". Our view would be that concessions such as tax exemptions on charity business income could also be described as a benefit to the taxpayer, through investment in services that deliver social and cultural value such as arts activities.

6. We understand that Inland Revenue officials have met with representatives of the museums and galleries sector, and we would recommend that officials also meet with representatives of arts organisations (such as theatres, orchestras, dance companies and festivals) to understand the specific impacts on their operations. Many arts organisations will lack the capacity to engage with this consultation process. We would be happy to facilitate any meetings to enable a better understanding of the issues and potential impacts on these organisations.

Further detail

7. Creative New Zealand notes, in relation to the proposals in Chapter 2, that:

- arts organisations in New Zealand rely on a diverse range of revenue sources, including central government through agencies such as Creative New Zealand, local government, trusts and foundations, private philanthropy, earned revenue such as ticket sales, and revenue from commercial or business activities (including retail, food and beverage services, and venue hire)
- limiting arts organisations' income from business activities would have a detrimental impact on the financial viability of a sector that struggles to operate sustainably under current settings
- arts organisations provide valuable and valued services to the public, they operate to provide public benefit, which is recognised through support for these organisations by central and local government as well as through their charitable status
- any reduction in revenue from business activities would be expected to increase the pressure for funding through public sources – including central government.

Question 1: Reason for review

8. Creative New Zealand submits that any changes to tax settings for unrelated charity businesses should support the continued ability of arts organisations to maintain a diversified revenue base, including maximising their income from business activities to support their operations.

Question 2: Implications of change

9. Should the tax exemption be removed or the thresholds set low, there could be a reduction in the viability of many of New Zealand's major arts organisations. As a rough rule of thumb, arts organisations supported by Creative New Zealand often receive about one-third of their revenue from central government, one-third from local government, and the one-third from earned revenue, including ticket sales and commercial or business activities.

10. Any reduction in organisations' income from business activities would either risk the loss of organisations and the services they provide and/or increased pressure on government agencies such as Creative New Zealand to meet the shortfall.

11. As an example, we understand the Arts Centre in Christchurch has set out the potential impact of changes on its operation, recognising its reliance on commercial income to maintain its assets including culturally significant heritage buildings as well as the arts services it provides.

12. If the tax exemption is removed from unrelated business activity income it would require the charity to establish costly systems and processes to accurately allocate specific expenditure with the unrelated business activity income.

Question 3: Definition of unrelated business activity

13. Creative New Zealand submits that the unrelated business activities run by arts organisations should remain tax exempt where those activities are undertaken to raise money for the benefit of the charity or to assist the charity to deliver its services.

14. This appears to be the intent of the example given under the first bullet point of section 2.24. Creative New Zealand would support the continuation of a tax exemption for unrelated commercial activities that operate to raise money for the benefit of the charity.

Question 4: De minimis for small scale trading activities

15. Creative New Zealand supports the commentary in the Issues Paper that acknowledges the compliance cost of changes to tax settings particularly for smaller organisations, which make up the majority of charities in New Zealand, and would include most arts organisations.

16. Creative New Zealand submits that if the tax exemption is removed for charity business income that is unrelated to charitable purposes, continued exemption for small-scale business activities should be provided for Tier 3 and Tier 4 charities. This would be expected to cover the vast majority of arts organisations.

Who we are

17. Creative New Zealand is the national arts development agency of New Zealand, responsible for delivering government support for the arts. We're an autonomous Crown entity operating under the Arts Council of New Zealand Toi Aotearoa Act 2014. Our purpose is: *to encourage, promote, and support the arts in New Zealand for the benefit of all New Zealanders*.

18. Creative New Zealand receives funding through the New Zealand Lottery Grants Board Te Puna Tahua and Vote: Arts, Culture and Heritage. In 2023/24, Creative New Zealand invested $70 million in the arts, supporting the sector through funding, capability building, advocacy, leadership and partnering initiatives.

19. Creative New Zealand allocates approximately 70 percent of what it invests in the arts sector to support arts organisations and groups. This includes 80 major arts organisations that receive three- or six-year funding and rely on Creative New Zealand support as a core component of their revenue. These organisations rely on multiple income sources, including commercial or business activities to deliver their services.

Please feel free to contact us if you have any questions or if you wish to meet to discuss this submission further.

Ngā mihi nui ki a koutou katoa, nā

David Pannett
Senior Manager, Strategy & Engagement
Pou Whakahaere Matua, Rautaki me te Tūhono

Submission to Inland Revenue — Taxation and the Not-for-Profit Sector Consultation

From: Stephanie Brown, CEO, Play It Strange Trust
Date: 31 March 2025

About Play it Strange Trust

Play It Strange was established in 2003. Our purpose is to provide creative outlets for secondary school-aged rangatahi in Aotearoa through songwriting. We support and encourage young New Zealanders to write, record, and perform their own original songs.

Our national songwriting competitions offer not just recognition but real opportunity: over 160 finalists each year records their song in a professional studio, which we then release on digital albums. We also offer mentorship, performance opportunities, and pastoral care: opening doors into the music industry, creative arts, and wider wellbeing.

Our alumni include Kimbra, Georgia Nott (Broods), Liz Stokes (The Beths), Annah Mac, Louis Baker, and CHAII. Many others go on to become music teachers, therapists, community leaders, and creative professionals.

Independent research by ImpactLab has quantified our work's value: for every participant, Play It Strange generates $1.80 in economic returns for every $1 invested. total, we deliver over $600,000 in social value annually. ImpactLab states that Play It Strange increases specialised skills, improves mental health, increases creativity, and increases confidence in youth.

Response to Question 3: ***Should the income tax exemption for charities be limited to income earned in the course of carrying out their charitable purposes?***

We strongly advise against narrowing this exemption. Like many small charities, Play It Strange currently operates entirely on grants and individual donations. But as competition for funding intensifies and available resources shrink, we are actively exploring opportunities to generate our own income - through social enterprise and mission-aligned initiatives.

Reducing or removing tax exemptions on this kind of income would directly disincentivise innovation and self-sufficiency for all not-for-profits. It would punish organisations trying to reduce their reliance on grants and instead take responsibility for building sustainable futures.

Any revenue-generating activity we would pursue (whether it be music services, merchandise, or songwriting workshops) would exist solely to support our mission. Any surplus would be reinvested directly into our charitable work. These would not be profit-driven ventures, but survival-driven strategies, a way to continue serving young people in the face of declining external funding.

Taxing such activity would make it harder, not easier, for charities to survive. It could lead to risk aversion, stagnation, or even closure - especially in creative and community-based sectors already under pressure.

Response to Question 5: ***Should a charity be able to claim a tax exemption if it carries out both charitable and non-charitable purposes?***

Yes, as long as the primary purpose remains charitable, and any non-charitable activity demonstrably supports or enables that purpose.

At Play It Strange, our core kaupapa has not changed since our inception 21 years ago: empowering young songwriters in Aotearoa.

Any future income-generating activities would be designed to strengthen that mission, not divert from it. For example, hosting paid songwriting workshops or community events could fund free recording sessions or support pastoral care for our participants.

Rigidly separating charitable from non-charitable purposes ignores the reality of modern impact work. Charities must be adaptive, resilient, and creative - especially as the number of funding applicants for all granting bodies rise and the available funding pool shrinks. Penalising this adaptability would be counterproductive.

Conclusion

Charities like Play It Strange are working at the intersection of creativity, education, and positive youth development. We fill a gap that would otherwise go unaddressed: providing access, mentorship, and care through music.

We exist not to turn a profit, but to change lives. But the ability to do so increasingly depends on being nimble and sustainable, especially as traditional funding sources become harder to access.

We urge Inland Revenue to protect and enable sustainable charitable models that blend innovation with social purpose. These are not loopholes. They are lifelines.

Aotearoa needs charities that are bold, adaptable, and future-focused. Removing key tax protections would not only hinder this but would put already-stretched organisations at greater risk, especially those serving young people and the arts.

Now is the time for supportive, enabling policy. One that encourages resilience, reduces barriers, and values the critical role charities play in shaping a vibrant, creative, and caring society. We welcome the opportunity to provide further detail or be involved in future consultation.

I will leave you with a quote from a three time Play It Strange finalist, Melinda Xu:

“Through Play it Strange I felt something I never had before: true recognition. My talents, my hard work and pain was validated, and my truest self was confirmed. This was confirmation that I created something of value. I will always remember this moment of pride. It has inspired me to take on countless more challenges and competitions, and ultimately taught one big lesson. Turn pain into power.”

Ngā mihi nui,

s 9(2)(a)

Stephanie Brown
CEO
Play It Strange Trust

Ryan Donovan

From: s 9(2)(a)
Sent: Tuesday, 1 April 2025 10:17 am
To: Policy Webmaster
Subject: Taxation and the not-for-profit sector

External Email CAUTION: Please take CARE when opening any links or attachments.

I am requesting that my personal details will not be disclosed publicly or on any documents accessible to the public and other government agencies for privacy purposes.

MAJOR POINTS OF MY SUBMISSION:
OUR TITHES AND OFFERING FROM OUR INCOME HAS BEEN TAXED FROM WHAT HAS BEEN DEDUCTED FROM OUR WEEKLY WAGES.
AS A CHARITABLE ORGANISATION, WE ARE HELPING THE GOVERNMENT TO PRODUCE: LAW ABIDING CITIZENS BY FURTHERING THE FAITH THAT TEACHES RIGHTEOUSNESS, SUPPORTING LAW AND ORDER OF EVERY COMMUNITIES.
THE CHILDREN ARE BEING TRAINED TO DO THE SAME TO BE A GOOD EXAMPLE OF GOOD BEHAVIOUR AT SCHOOL, AT HOME, COMMUNITIES.
CHARITABLE ORGANISATIONS (CHURCHES) DISCOURAGES USE OF DRUGS, ALCOHOL, GAMBLING, CHURCH TEACHES MEMBERS NOT TO BE A BURDEN TO THE GOVERNMENT BY RELYING ON BENEFITS.
THE CHURCH TEACHES TO BE PRODUCTIVE LIKE WHAT THE BIBLE TEACHES ON: 1 THESSALONIANS 4:11And that ye study to be quiet, and to do your own business, and to work with your own hands, as we commanded you; That ye may walk honestly toward them that are without, and that ye may have lack of nothing.

RECOMMENDATION:
IRD TO CATEGORISE THE CHARITABLE ORGANISATIONS THAT ARE NOT CONTRIBUTING TO ANY IMPROVEMENT OF THE PEOPLE IN THE SOCIETY, REMOVE THEM OR TAX THEM.
IF THOSE CHARITABLE ORGANISATIONS ARE NOT HELPING THE COMMUNITY, TOWN OR THE NATION TO PRODUCE GOOD ABIDING CITIZEN THEN, CHANGE THEIR CATEGORY.
RE-EVALUATE THE POLICY AND REVIEW THE CATEGORIES OF THE REGISTERED CHARITABLE ORGANISATION.
TAX THOSE WHO ARE EARNING HUGE AMOUNT LIKE A BUSINESS AND USING THE CHARITABLE ORGANISATION FOR THEIR OWN PURPOSE AND NOT RETURNING ANYTHING TO THE COMMUNITY, CITY OR NATION.
Sent from my iPhone

Te Aroha Family Budgeting Services Inc.
BUILDING FINANCIAL CAPABILITY

31st March 2025

Submitted via: policy.webmaster@ird.govt.nz

Inland Revenue
Wellington

Re: Taxation and the not-for-profit sector; Official's Issues Paper
Te Aroha Family Budgeting Services Inc support the Community Networks Aotearoa submission.

As a registered charity who recently missed out on securing an MSD Contract, we are now facing a perpetual round of applying for funding to continue providing a FREE service to anyone in our district.

Introducing our organisation and community
Te Aroha Family Budgeting Services have been providing free services to the people in our district for 35 years now. We are getting busier and busier in a time when we are struggling for income more than ever after losing out on MSD funding. We help clients with things such as savings, debt, Kiwisaver Hardship Withdrawls, IRD debt, Work and Income debt and entitlements, loans and lending etc.

Going forward, the only way for us to survive and stay open is to apply for funding and grants, and find other income streams to keep our doors open. We provide one on one sessions with clients, but also provide group sessions called Money Mates and have been able to secure a contract to provide this to a local business. I have also been paid to consult with a company around Communities of Practice meetings in the Budgeting sector. We are going to have to look outside the box for income as there are now more and more applications for funding with Government funding reducing to not only ours, but other sectors.

Our community is a rural, remote one with no government services, no banks, and no public transport. We are often the link between clients and those services that they are unable to go and visit due to these restrictions.

If we were taxed on non related items, it would significantly reduce our ability to stay open. The service we provide is often due to the Government not being available in our town and our clients being unable to afford to travel to see them (the nearest office is 30 minutes away). We end up acting as an agent for the client, therefore saving Government departments and the taxpayers money e.g. rather than paying the client fuel money, we can help them at our office. Another example would be food parcels that we help clients with, rather than the client approaching Work and Income and again, using Taxpayers money.

Not only has one Government department (MSD) taken away any funding that helps us stay open and help people, but now another Government department (IRD) want to penalise us for trying to generate income to make up for the funding lost from the other Government department.

The proposal that IRD has made is full of flaws and inconsistencies, and our service for one cannot support it.

Conclusion
Thank you for considering our submission.

Please contact Sarah Matafeo-Ross on s 9(2)(a) or at manager@tabudget.org.nz to discuss any aspect of this submission further.

Ngā mihi,

Sarah Matafeo-Ross

Te Ātiawa Manawhenua Ki Te Tau Ihu Trust
Waikawa Marina, Beach Road
Waikawa, Picton
PO Box 340, Picton 7250
Ph : (03) 573 5170 / 0800 284 292
Email : office@teatiawatrust.co.nz
Website : www.teatiawatrust.co.nz

31 March 2025

Deputy Commissioner Policy
Inland Revenue
PO Box 2198
Wellington 6140

Tena koe,

ISSUES PAPER: TAXATION AND THE NOT-FOR-PROFIT SECTOR

Introduction – Te Ātiawa o Te Waka-a-Māui Trust Group

Te Ātiawa o Te Waka-a-Māui Trust Group is grouped for accounting purposes only. Each entity, apart from Te Ātiawa Manawhenua Ki Te Tau Ihu Trust, is required to file an income tax return and is liable for their individual income tax payable/(refundable).

Te Ātiawa o Te Waka-a-Māui Trust

This Trust holds and administers the settlement assets on behalf of all members of Te Ātiawa (Te Tau Ihu). The purpose of the Trust is to receive, hold, manage and administer the Trust Fund on behalf of and for the benefit of present and future Members irrespective of a Members place of residence and shall without limitation include:

(a) the promotion amongst the Iwi of health, educational, spiritual, economic, social and cultural advancement and well-being of the Iwi;
(b) the promotion and advancement of the social and economic development of the Iwi including, without limiting the generality of this purpose, by the promotion of business, commercial or vocational training or the enhancement of community facilities in a manner appropriate to the particular needs of the Iwi;
(c) the maintenance and establishment of places of cultural or spiritual significance to the Iwi;
(d) the promotion of a tribal forum to hear and determine matters affecting the Iwi and to advocate on their behalf;
(e) acting as the Mandated Iwi Organisation and Iwi Aquaculture Organisation for the Iwi for Māori fisheries and aquaculture settlement purposes;
(f) the distribution of benefits to Members;

This entity is a PSGE (Post Settlement Governance Entity). Our PSGE is a taxpayer and complies with the various obligations under the Revenue Acts (including the Income Tax Act 2007, Goods and Services Tax Act 1985, and the Tax Administration Act 1994).

Te Ātiawa Manawhenua Ki Te Tau Ihu Trust

This is our charitable Trust. The purposes for which the Trust is established are to receive, hold, manage and administer the Trust Fund for every Charitable Purpose benefiting Te Ātiawa (Te Tau Ihu) whether it relates to the relief of poverty, the advancement of education or religion or any other matter beneficial to the community of Te Ātiawa (Te Tau Ihu) and all the members of Te Ātiawa (Te Tau Ihu) irrespective of where those Members reside.

The aim of our work is to improve the wellbeing of our whānau by way of improved health outcomes, opportunity to increase earning capacity, cultural identity, ensuring our manawhenua rights are protected and protection of the health of our whenua.

The Trust's ultimate aims are to achieve a sustainable transformative change in the life of our whānau. We also aim to protect the mana of our Iwi and our environment by way of ensuring we have a voice at the table, as well as continued support of kaitiakitanga outcomes.

We work alongside our four marae, local and central Government, Government departments, other iwi groups, educational institutions, and other charities. We establish and maintain formal and informal links with many other organisations including Māori social services and Māori housing providers. The Trust provides a range of benefits to whānau members and the wider community. The types of benefits we provide include social housing, tangihanga koha, wānanga engagement opportunities, kaitiakitanga, educational grant support, arts, sports, culture and technical grants, and marae grants. We aid and direct whānau to where support is available to whānau, whether that be for health, educational, cost of living, lack of sustenance or wellness issues.

Te Ātiawa Asset Holding Company Limited

This company is our Asset Holding and ACE Trading Company, registered under the Companies Act 1993, and was incorporated on 18 January 2007.

Our Position and Response to the Issues Paper : Te Ātiawa Manawhenua Ki Te Tau Ihu Trust – Submission on Taxing Charities' Unrelated Business Income

Te Ātiawa Manawhenua Ki Te Tau Ihu Trust is firmly against the idea of taxing charities on income that's not directly tied to their charitable work. This kind of policy would seriously affect the ability of Māori charities, including ours, to support our people, and it doesn't reflect the Crown's responsibilities under Te Tiriti o Waitangi.

What We Are Concerned About:

- **Te Tiriti Obligations Have Been Overlooked**
  The Issues Paper barely mentions Māori, and doesn't explore how this would impact Māori charities. The Crown has not sufficiently engaged with us, nor taken steps to avoid negative impacts to iwi and hapū groups.
- **Māori Charities Are Different**
  Our charitable work is tied closely to our Treaty settlement, our long-term vision, and our tikanga. Taxing income from our settlement assets goes against the purpose of those settlements and penalises Māori for succeeding.
- **Charities Already Have Strong Rules**
  We're already held to high standards – we can't make private profit, we have to use funds for charitable purposes, and we report regularly. These rules are already working to keep charities on track.
- **Less Funding Means Less Impact**
  Taxing our income means less money for housing, education, wellbeing, and responding to emergencies in our rohe. There's no guarantee that the Crown could use that tax money to deliver the same outcomes for our people.
- **Extra Costs and Complications**
  The proposal would make things more complex and expensive, especially when it comes to figuring out what income is "related" or "unrelated." The paper doesn't reflect the extra legal and reporting rules Māori charities already deal with.
- **Poor Process So Far**
  The timeline for feedback has been too short, and Māori haven't been properly brought into the process. These kinds of changes should have been raised during the recent Charities Act review. We expect to see a full select committee process from here.

What We Would Like To Happen:

- Withdraw the proposal to tax unrelated business income for charities.
- If this proposal proceeds (which we do not support), then:
    - Māori must be properly engaged.
    - Income that connects in any way to charitable work should be considered "related."
    - Treaty settlement and fisheries assets must be exempt.
    - Marae, urupā, and smaller charities (Tier 2–4) must be excluded.
    - Māori Treaty settlement obligations must be recognised in any tax rules.

Our Position Summarised:
This proposal would impact Māori charities hard, reduce what we can do for our people, and ignore Treaty settlement obligations. Te Ātiawa Manawhenua Ki Te Tau Ihu Trust calls on the Government to reconsider its approach and engage more thoroughly with Māori charities such as Te Ātiawa Manawhenua ki Te Tau Ihu Trust on more appropriate solutions.

Our Position In Detail:

We strongly oppose the imposition of income tax on unrelated business income for charities. The Crown has an obligation under Te Tiriti o Waitangi / the Treaty of Waitangi to understand the impact of any proposed policy changes for Māori and to consider how any negative or unintended effects might be mitigated. It is apparent that this obligation has not been discharged. The Issues Paper mentions the word 'Māori' once. Specific impacts on Māori charities need to be well understood before any proposal or consultation paper is put forward for public consultation.

Māori comprise a sizeable proportion of the charities sector and have unique drivers and features, that require specialist engagement. The IRD must rectify its omission and undertake targeted engagement with Māori in an appropriate manner before proceeding with further policy development. Recently, on 5 July 2023, the Charities Act 2005 was amended following a comprehensive review of the Act. The Issues Paper proposes significant changes to the charities regime that should have been raised during the review.

Further to this, the timeframes for response have been very short (just over a month) and have not been widely consulted on. Charities should have been engaged appropriately on such significant amendments. We expect that there will be a select committee process, in which we can participate in.

Question One: What are the most compelling reasons to tax, or not to tax, charity business income?

Response: We strongly oppose the imposition of income tax on unrelated business income for charities.

The existing settings within the charities regime provide sufficient safeguards, such as:

a) the prohibition of private profit;
b) the requirement to only distribute funds for charitable purposes; and
c) the requirement for charities to maintain charitable registration

mean that the taxing of profits reduces funds available to Te Ātiawa Manawhenua Ki Te Tau Ihu Trust to carry out its charitable purposes. In effect it will mean that Te Ātiawa Manawhenua Ki Te Tau Ihu Trust will have less money to advance education and wellbeing and relieve poverty for our whānau. We strive to achieve a transformative change in the life of our whānau, as well as protect our cultural identity, and the mana of our Iwi and environment.

Further, and connected to the point above, Te Ātiawa Manawhenua Ki Te Tau Ihu Trust is best placed to carry out the charitable purposes, for the benefit of Te Ātiawa whānau, as opposed to those funds being transferred to the Crown in the form of income tax. This is because:

a) We are in close contact with our whānau and are aware of their needs.
b) There is no guarantee that the funds transferred to the Crown as income tax will directly benefit Te Ātiawa whānau.
c) Taxing unrelated business income is not only inefficient, but it also disincentivises Māori charities developing their own solutions to address current inequities that affect Māori in housing, health and education, because:

i. Māori charities often use their charitable funds to undertake activities that the Crown often have a duty to provide support towards, or practically provide relief for example support offered by Māori charities during the Covid pandemic, or our four marae supporting communities during the Covid pandemic, Tasman Fires, Tasman Bay red weather event and the Wairau Awa floods. There's no guarantee the additional revenue generated by government will deliver the same outcomes and have the same targeted impact on Māori communities;

ii. Taxing unrelated business income will reduce overall funds Te Ātiawa Manawhenua Ki Te Tau Ihu Trust has at our disposal in any given financial year, which will impact on what we can deliver each year for Māori in our communities, and will have a chilling effect on us undertaking charitable activities generally;

"To impose income tax on unrelated business income would discourage Te Ātiawa Manawhenua Ki Te Tau Ihu Trust from undertaking business activity or delivering on its charitable purposes, thereby reducing income earned by the charity altogether. This will result in less funds being available, rather than providing for a transfer of the funds to the Crown, in the form of tax, and ultimately disadvantage Te Ātiawa whanau.

The imposition of income tax would be manifestly unjust given the nature and character of the assets held by Te Ātiawa o Te Waka-a-Maui Group. Assets held by our parent, Te Ātiawa o Te Waka-a-Maui Trust, and our asset holding company Te Ātiawa Asset Holding Company Limited are from our Treaty settlement, which was provided as recognition of the Crown's Treaty breaches. These two entities donate funds to our charity Te Ātiawa Manawhenua Ki Te Tau Ihu Trust. Furthermore, the assets are held on an intergenerational basis as pointed out by the Tax Working Group in their Interim Report on page 121. The Issues Paper fails to recognise this point of difference for iwi and hapū charities who exist for the benefit of current and future uri / descendants.

Further, settlement assets were received to remedy historical breaches by the Crown of the Treaty of Waitangi. To tax Māori when they generate income from those assets, penalises iwi and hapū who are successful, discourages development, and is counter intuitive to the way the assets were transferred." Key objectives for management of Treaty settlement assets include intergenerational sustainability and restoration of their capital base. Iwi/hapū settlement entities typically have a large number of members, and the distribution of dividends for individual gain is not common practice among the majority of iwi and hapū organisations. Retaining the existing tax exemption for charities within a PSGE structure is appropriate to support restoration of the iwi and hapū economic base.

The imposition of income tax appears to be based on the underlying assumption that charities have a competitive advantage by not being subject to income tax and therefore having less compliance costs. In our view, this is not accurate, for the following reasons:

There are significant compliance costs for charities given the robust reporting requirements that apply to registered charities under the financial reporting rules:

a) Charities are still subject to other tax compliance costs, including PAYE and GST.

b) Māori charities are unique in that they have a range of compliance costs that a non-Māori entity, or charity, does not have. For example: strategic planning requires whānau engagement, AGMs, frequent governance Board elections, legal requirement to retain certain assets. In short, any business activity Te Ātiawa Manawhenua Ki Te Tau Ihu Trust practically undertakes is subject to iwi/hapū scrutiny. This analysis is missing from the 'competitive advantage' analysis set out in the Issues Paper. From our Groups' perspective, the administrative and legislative constraints on many mandated iwi organisations and / or asset holding companies are already extensive. There are mandatory legislative restrictions, we are bound by the Māori Fisheries Act 2004 in addition to ordinary charity law, for example restrictions on the sale of settlement quota and income shares, the requirement to account to beneficiaries for performance to all members of an iwi (on a regular basis etc).

c) Introduction of taxation of unrelated business income will substantially increase the already-onerous burden for operating Māori charities. Specifically, apportioning unrelated business income and expenses is administratively onerous and exacerbate compliance costs without any corollary benefit.

The legal system in Aotearoa, does not provide for a settlement vehicle that is bespoke for Māori. Rather, iwi and hapū have been required to establish post-settlement structures with limited options, i.e. limited legal vehicles, and limited tax elections. In short, iwi and hapū have been forced into the charities regime, rather than the regime being fit for purpose, for Māori. To now significantly amend the regime, by imposing tax, will detrimentally affect iwi and hapū in a manner that fails to recognise the relevant Crown-acknowledged settlement history and context.

For charities, the generation of business income (related or unrelated) is not directed toward private profit or gain. Rather, business income provides them with more funds to further their charitable purposes. This is a key and important distinction from for-profit businesses. The proposal to tax 'unrelated business income' will prevent charities from flourishing by discouraging business and innovation. The negative effect on the charities sector will far outweigh the benefit of any revenue generated.
Furthermore, imposing a tax on unrelated business income while at the same time keeping the existing restrictions on charities (i.e., not to exist for pecuniary profit) would create a perpetual inequity between not-for-profits and private companies.

Question Two: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be the most significant practical implications?

Response:
The issues paper does not clarify how legislation will be amended, so it is difficult to comment definitively on practical implications. Notwithstanding this, the following are examples of the significant practical implications should income tax be imposed on the unrelated business income of charities.

If the Crown developed a tax-credit regime (for example, so that tax was only paid on accumulated surpluses rather than all business income), and required charities to maintain a special memorandum account, like a Māori Authority account as alluded to the Issues Paper. This would impose a significant additional accounting burden.

Taxing unrelated business income is not practical, is likely to be expensive, and increase compliance costs for IRD and charities. The Issues Paper lacks any analysis on revenue generation if unrelated business income is to be taxed.

Our PSGE already maintains a Māori Authority credit account, and our charity Te Ātiawa Manawhenua Ki Te Tau Ihu Trust must also do so.

An assessment of business income, and whether it is unrelated or related, would be difficult to apply, and would likely require specialist taxation advice, each year. Presumably an assessment of expenditure would also need to be undertaken. This would result in an increase in costs, resulting in less funds available for Te Ātiawa Manawhenua Ki Te Tau Ihu Trust to fulfill its charitable purposes.

Our charitable purposes are broad and are not mutually exclusive. It would be difficult, from a practical perspective, to dissect business income, as part of the income may be related, and part may be unrelated. To do so creates significant complexity and a subjective assessment that would be difficult to implement practically.

Question Three: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what criteria should be used to define an unrelated business?

Response: Te Ātiawa Manawhenua Ki Te Tau Ihu Trust applies for, and if successful, receives external funding.

In the first instance, it should be noted how difficult it will be to assess whether income is related or unrelated to a charity's purposes. According to the Organisation for Economic Co-operation and Development's Tax and Policy Studies 2020 Taxation and Philanthropy report (OECD report), referenced in the Issues Paper. Itwas noted that:
… countries should reassess the merits of providing tax exemptions for the commercial income of philanthropic entities, at least insofar as this income is unrelated to the entity's worthy purpose. In undertaking such a reassessment, countries will need to consider the added complexities associated with distinguishing between taxable (i.e, unrelated commercial income) and exempt income and weigh the additional compliance and administrative costs against the pursuit of competitive neutrality.

As an "in the alternative" argument, we recommend you advocate that, if the imposition of income tax is to occur, a "broad" approach should be applied, together with necessary exemptions.

You may want to set out some proposed specific criteria such as:

a) A broad approach should be allowable. Anything that touches on our purposes should be considered related. For example: if we purchase a cultural watercraft, the fact that there are employment and training opportunities should mean the income is related.

b) Investment income derived from Treaty settlement assets should be exempt. This is because:

i. The receipt of Treaty settlement assets as recognition of the Crown's breaches of Te Tiriti o Waitangi is a different class of assets because they are primarily for long-term gain and restoration of whānau, hapū and iwi.

ii. Māori are intergenerational investors and manage their asset base accordingly. We often put our assets into safe / stable equity investments and reinvest our earnings for future descendants according to our own hapū and iwi priorities.

iii. Income received pursuant to the Māori Fisheries Act 2004 should be excluded as they are Treaty settlement assets. The Māori Fisheries Settlement was signed on behalf of "all Māori" and we hold our quota for the benefit of our iwi members and future descendants. It would be inappropriate to tax income earned off Treaty settlement assets by a side wind without any benefit, particularly when we are not private companies, and are already constrained by existing charity law.

Our mandated iwi organisations already are burdened by existing, inherent restrictions in legislation. We are required to be established to ensure accountability and transparency to our iwi members, which for profit companies and private entities are not.

Te Ātiawa Asset Holding Company Limited income derives from the sale of annual catch entitlement and passive investments. We are unlike other fishing quota owners or fishers trading in ACE, who operate without any restrictions based on asset class. Our compliance costs are very substantial (mandatory reporting to MIO's (Mandated Iwi Organisations) who must undertake elections of officers every three years, restrictions on composition of board members etc). Furthermore, we already operate with substantially less freedom about managing our settlement assets than other fishing quota owners (for example, in granting security interests over settlement assets etc.). To impose a tax while otherwise keeping the status quo creates inequities.

Question Four: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be an appropriate threshold to continue to provide an exemption for small-scale business activities?

Response: The Issues Paper states that "A starting point for a de minimis exemption threshold in New Zealand could be based on a charity's financial reporting tier. In New Zealand, charities must report their financial information based on a tier system, which is determined by their annual expenses or operating payments and whether they have public accountability."

If there is to be an imposition of income tax for unrelated business income, we consider that all Tier 2, 3 and 4 charities are excluded. The Tier 2 category captures a significant range (between $5m and $33m) and will impact the smaller Tier 2 charities in a significant way.

Further, we consider that marae and urupā committees must be exempt, regardless of the tier.

Question Five: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, do you agree that charity business income distributed for charitable purposes should remain tax exempt? If so, what is the most effective way to achieve this? If not, why not?

Response: We strongly advocate for an exemption, based on the uniqueness of Māori charities, in that they have an obligation to hold and manage assets on an intergenerational basis.

Te Ātiawa Manawhenua Ki Te Tau Ihu Trust has a unique obligation and must take an intergenerational approach when deciding on the distribution of income. Te Ātiawa o Te Waka-a-Maui Group are required to carefully and intentionally balance the needs and aspirations

of generations today with the needs and aspirations of the next generation, and every generation thereafter.

Accordingly, income tax should not be imposed on retained income for Te Ātiawa Manawhenua Ki Te Tau Ihu Trust. As noted under our deed, para 3.1 –

> *The purposes for which the Trust is established are to receive, hold, manage and administer the Trust Fund for every Charitable Purpose benefiting Te Ātiawa (Te Tau Ihu) whether it relates to the relief of poverty, the advancement of education or religion or any other matter beneficial to the community of Te Ātiawa (Te Tau Ihu) and all the members of Te Ātiawa (Te Tau Ihu) irrespective of where those Members reside.*

Question Six: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what policy settings or issues not already mentioned in this paper do you think should be considered?

Response: We would like these additional points to be considered -

a) The unique drivers and features of Māori charities, particularly those that are in receipt of settlement assets, i.e. Treaty settlement assets, or fisheries assets.

b) The social good that charities contribute to Aotearoa, and in particular the work that is undertaken by Māori charities in Aotearoa.

c) Analysis of the underlying drivers for the proposals. The Issues Paper assumes that charities have a competitive advantage without testing that driver. It fails to acknowledge the strict rules around distribution and reporting that do not apply to for-profit entities.

d) Thought around if a business income tax was imposed, whether a charity could then be relieved from its charitable obligations in relation to that portion of income. It appears the proposal is seeking to tax charities, but at the same time maintain the same strict rules around distribution and reporting.

Conclusion:
This proposal would significantly harm Māori charities, limit our ability to support our whānau, and undermine obligations under Te Tiriti o Waitangi. Te Ātiawa Manawhenua Ki Te Tau Ihu Trust urges the Government to reconsider this approach and work with Māori to develop more equitable solutions.

Nga mihi

Te Atiawa Manawhenua Ki Te Tau Ihu Trust

Submission on the Officials' Issues Paper: "*Taxation and the not-for-profit sector*"

Background

I would like to thank officials for the opportunity to submit on the consultation paper.

The focus of the paper is of particular interest to me, as I am involved in the governance of several not-for-profit entities that would be directly affected by the changes proposed in the paper. These entities are a mixture of local and national organisations: they are employers, and each have some commercial aspect where goods and or services are provided to the public as part of the outworking of their respective charitable purposes. In addition to this experience, I have also worked as a tax accountant for several years in public practice with a particular focus on income and employment taxes.

Responses to Discussion Questions

1. ***What are the most compelling reasons to tax, or not to tax, charity business income? Do the factors described in 2.13 and 2.14 warrant taxing charity business income?***

   The assertion at 2.6 that charities may accumulate many years of tax-free income under the current approach for years before the public receives any benefit does not appear to be supported by any evidence. Many charities will, quite rightly, have reserves to ensure that they can continue to operate in the face of changes to funding and donations, or unexpected costs (particularly capital costs) that may arise. In my experience, any funds beyond this are applied to the charitable purposes within a year or two. Similarly, I note that accounting profits do not necessarily mean a charity has excess cash reserves, and so measuring a charity by its public benefit relative to accumulated funds is not necessarily an accurate representation.

   The point at 2.15 that tax concessions for "unrelated charity businesses" reduces government revenue appears to be overly narrow in focus. While it is arguable that changes could result in higher income tax revenue (assuming the taxable income outweighs any tax losses), it overlooks the fact that a tax burden could result in lower funding for some charities if they wish to maintain their existing level of public service.

   Charitable funding through grants and donations can be competitive and subject to changing criteria and the overall economic climate. These sources of income for charities are already stretched as it is, and the sector would likely require government support if it was to avoid shrinking. Given the size of the sector, and the fact that not all "unrelated charity businesses" would be in a tax paying position, this could create an overall net-negative position for the government relative to any increase in revenue. For these reasons, I agree with the conclusion reached in 2.16.

   Lastly, it is important to acknowledge that many charities, and particularly those that operate "unrelated charity businesses", already contribute to tax revenue through GST and employment taxes, both of which make up a reasonable proportion of the government's annual tax take. While it is beyond the scope of the consultation paper, I believe that using tax as a mechanism to address issues (perceived and real) in the not-for-profit sector is too blunt a tool, and far too wide in scope. The desired outcome of ensuring charities use their funds to further their charitable purposes could be achieved in more targeted ways, such as an increase in funding to Charities Services and increased penalties for charities that do not meet the legislative and regulatory requirements.

2. ***If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be the most significant practical implications?***

   Most significant would be the increase in compliance costs (financial and otherwise) in the short and long term.

   In the short-term, many charities would need to engage tax advisors and prepare their accounting systems, particularly where fixed assets are involved and there are differences between the accounting and tax depreciation rates. This would be costly and time-intensive for charities, particularly as most charities will be unaccustomed to the nuances of income tax rules. It will also create additional pressure for accountants, especially given the large number of charities in the sector. In the long-term, charities would need to invest time, energy and finances into preparing annual tax returns, all of which would detract from the charity's ability to provide a benefit to the public.

3. ***If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what criteria should be used to define an unrelated business?***

   If the exemption was to be removed for charitable business income, the definition of "unrelated charity business income" would need to be clearly set out in legislation. Ambiguous wording, or a definition that required an interpretation statement from officials would be unhelpful or too complex. Like the conclusion reached at 2.16, the Government will need to decide exactly what charities it is seeking to tax and the basis on which it wishes to do so.

   Many charities will have a broad charitable purpose, particularly where the work they do is not limited to a specific group or area. Accordingly, seeking to define "unrelated charitable business income" could be fraught with difficultly, and at its worst, require individual charities to seek a determination from Inland Revenue to obtain clarity.

   With respect to officials, similar processes for other aspects of income tax are often time consuming and require expert assistance (at significant cost) to apply for. I believe that a bright-line revenue threshold (e.g. $10-15 million) could be a viable alternative. It would offer clarity, and would also only apply to larger, more well-resourced charities, therefore sparing smaller charities from burdensome compliance costs.

4. ***If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be an appropriate threshold to continue to provide an exemption for small-scale business activities?***

   If there is to be a de minimis threshold for a tax exemption under any proposed changes, as suggested at 2.29, it should apply to Tier 3 and Tier 4 charities. These will be predominantly small and medium sized charities, and for whom the compliance costs of preparing a tax return would be disproportionate by comparison to large, more well-resource charities. An expenditure threshold of $5 million would be reasonable and convenient. It would tie to financial reporting standards which charities are already accustomed to – thereby reducing any potential compliance costs associated with determining whether a charity is eligible for the exemption or not.

5. ***If the tax exemption is removed for charity business income that is unrelated to charitable purposes, do you agree that charity business income distributed for charitable purposes should remain tax exempt? If so, what is the most effective way to achieve this? If not, why not?***

   If the exemption is to be removed, I believe that the charity business income distributed for charitable purposes should remain tax exempt. This would create an incentive for businesses caught by the rules to distribute income in a timely manner that benefits the public.

   A memorandum account approach would be preferable to a requirement limiting any exemption to distributions made during the tax year. This would provide greater flexibility in making distributions and result in a reduced distortionary tax effect on decision making. It would, however, need to be simple and cost-effective to establish and maintain, especially if it is to be filed alongside tax returns.

   To preserve cashflow, it would be preferable to have a system where tax only payable if distributions are not made to the charitable parent within a specified period (e.g. within two income years). A system reliant on tax being paid upfront, with a refund only available in a later income year when a distribution is made, would be unnecessarily difficult. It would tie up funds for a length of time, to the detriment of the business and / or charity.

13. ***If the compliance costs are reduced following the current review of FBT settings, what are the likely implications of removing or reducing the exemption for charities?***

    On 4.27, I agree that the current FBT exemption has a distortionary effect on the labour market, however I do not believe this is a negative. Quite often, charities cannot pay a salary that is competitive with businesses and so charities are unable to hire the talented and skilled individuals needed to sustain the charity and to grow it. While comparatively small, the current FBT exemption allows for benefits that help to attract excellent employees, such as vehicles and health insurance.

    Many charities are unlikely to be able to offer these to all employees, and as such, they will be reserved for senior staff or those in leadership roles who are essential to the continued operation of the charity. In so far as these staff are concerned, they will be responsible for finding grants, donations and other income to support the cost of these benefits. This is yet another way that the Government is assisting charities; without it, increased Government funding may be required to help the sector attract suitably qualified and experienced staff.

    Additionally, as someone who has prepared FBT returns, I am aware they can be complex and unnecessarily complicated even at the best of times and with the most efficient systems. Even applying some of the existing concessions meant to help simplify the process can be costly because multiple calculations are required to determine which methods can be applied. There are also further compliance costs involved in tracking benefits and usage (such as preparing a logbook for vehicle usage), which require time and energy and would therefore detract from charities' ability to provide a benefit to the public.

    I believe it would be more pragmatic to leave the current exemption in place until officials have completed the ongoing review of the FBT system, and the recommendations have been implemented. Because this has the potential to simplify the system, and therefore reduce

compliance costs, it does not make sense that charities would be required to start preparing FBT returns under one system only for it to be replaced by another one not long after.

15. ***What are your views on the DTC regulatory stewardship review findings and policy initiatives proposed? Do you have any other suggestions on how to improve the current donation tax concession rules?***

    I appreciate that taxpayers would prefer to be able to receive DTCs more frequently throughout the year, particularly if they are able to apply on a rolling basis. Collecting the data from donee organisations would likely help to speed up the process for donors, but it would need to be user friendly for donee organisations. It could come with higher compliance costs if regular filings of DTC claims are required, as some donee organisations wait for the end of the financial year to issue receipts.

    I agree with that there should be a three-month grace period for re-registration where donee status is retained. Where charities have, for whatever reason, lost donee status, this would provide a fallback to enable them to continue receiving donations in the interim and therefore continue to operate. While it is preferable that charities would not lose donee status in the first place, such a period would ensure that charities are not disadvantaged where it does occur.

Summary

I am supportive of officials' moves to examine the rules, but I am concerned that any perceived increase in the tax take arising from any changes could come at the cost of higher costs for charities and therefore result in a decreased ability to outwork their charitable purposes. Furthermore, I am concerned that the accompanying compliance costs for many charities would be yet another cost to absorb, particularly for complicated taxes such as FBT, which would detract from the ability to provide a benefit to the public.

I am happy for officials to contact me to discuss the points raised above, if required.

Yours Sincerely

Jonny Reid

s 9(2)(a)

Charities
LAW REFORM
AOTEAROA NEW ZEALAND

SUE BARKER
CHARITIES LAW

Submission to:
Deputy Commissioner, Policy
Inland Revenue Department

On: Taxation and the not-for-profit sector

By email: policy.webmaster@ird.govt.nz

23 March 2025

INTRODUCTION

1. This submission is from **SUE BARKER CHARITIES LAW**, PO Box 3065, Wellington 6140

2. We are happy to be contacted to discuss the points raised in our submission. Our details are:

SUE BARKER – Director

s 9(2)(a)

About SBCL

3. Sue Barker Charities Law ("**SBCL**") is an award-winning boutique law firm founded in 2012 specialising in charities law and public tax law. The firm's director, Sue Barker, is the author of *Taxation of Charities in Aotearoa New Zealand* (LexisNexis, forthcoming) and was a member of the Policy Advice Division of the Inland Revenue Department from 1993-1998.

In 2019, Sue was awarded the New Zealand Law Foundation International Research Fellowship Te Karahipi Rangahau ā Taiao, New Zealand's premier legal research award, to undertake research into the question "What does a world-leading framework of charities law look like?". The report from the fellowship, entitled *Focus on purpose*, was released in April 2022 making 70 recommendations for charities law reform in Aotearoa New Zealand.

As part of the research, Sue drafted a Bill to amend and restate the Charities Act 2005. The draft Bill is the product of 2 years of dedicated research, including consultation with several hundred people, building on more than two decades of specialist legal practice in this area. A copy of the draft Bill is included in chapter 8 of *The Law and Practice of Charities in Aotearoa New Zealand* 2ed (LexisNexis, 2024), together with accompanying commentary.

More information about Sue and the research can be found at www.charitieslaw.co and www.charitieslawreform.nz.

Summary of recommendations

5. We strongly recommend that the proposals in the issues paper do **not** proceed. When the approach taken by other jurisdictions is properly examined, it becomes clear they are a cautionary tale rather than a precedent to be followed. The proposals would act as an unnecessary blanket barrier to much-needed charitable work at a time when the charitable sector is already struggling with increasing costs, increasing demand for services yet diminishing revenue streams. Any issues with specific charities can be more than adequately

addressed using existing tools. There is no compelling basis to impose such unnecessary complexity on the charitable sector. For example:

- The concept of an "unrelated business income tax" has failed all over the world: there is no bright line between a "related" and an "unrelated" business and attempts to draw one are fraught with difficulty that will not be able to be resolved by "guidance". Ultimately, a UBIT only creates work for lawyers and accountants while raising no material revenue whatsoever.
- The concept of a "donor-controlled" charity is an oxymoron and should not be used. The suggestion of creating a new arbitrary category of charity for the purpose of opposing minimum distribution requirements was strongly rejected as unworkable during the review of the Charities Act. It remains unworkable and should not proceed.

We also strongly recommend that the FBT exclusion for charities is **not** removed. No matter the outcome of the current review of FBT settings, requiring charities to file FBT returns would not reduce compliance costs. Section CX 25 is an important support for charities that should remain in place for as long as the FBT regime itself remains.

The arguments for removing the FBT exclusion apply equally to the arguments for making imputation credits refundable to registered charities, an important matter that is not substantively addressed by the issues paper. Allowing for imputation credit refundability would allow more funding to flow to charities where the impact would be multiplied. The question of whether permitting imputation credit refundability to registered charities would have a "material fiscal cost" is a question that requires analysis rather than assumption. When all factors are taken into account, the fiscal impact may in fact be positive.

We strongly oppose the removal of the tax exemptions in sections CW 40, CW 49, CW 50 and CW 51. Charities resort to section CW 40 precisely because the fundamentals of the Charities Act are not sound: if the definition of charitable purpose was interpreted appropriately, charities that meet all the legal requirements for registration would be able to register under the Charities Act, and therefore be subject to the comprehensive transparency and accountability disclosure requirements of that legislation. In our considered view, the Charities Act is not working, and requires a proper first principles review so that issues can be addressed at the level of source rather than symptom. In particular, it is essential to clarify the purpose of the

Charities Act: there appears to be an assumption that the Charities Act is directed at rationing the tax privileges of charity in line with the conception of the public interest to which the government of the day seeks to give effect in its policies. However, such an approach effectively turns charities into instruments of the state, and undermines their independence, which is key to what makes them distinctive and valuable. It is essential to resolve fundamental questions such as the purpose of the Charities Act, and how the definition of charitable purpose should be interpreted, *before* proceeding to make changes to the tax settings. The Charities Amendment Act 2023 failed to address any issue of concern to the charitable sector (even in relation to the financial reporting requirements for small charities as discussed in the body of this submission). Changes to the tax settings for charities should not proceed until there has been an opportunity to address fundamental issues by means of a proper first principles review of the Charities Act, carried out *independently* of the Department of Internal Affairs.

We support increasing the not-for-profit deduction from $1,000 to $5,000.

We also support removal of the territorial restriction in section CW 42. There does not appear to be any reason for its ongoing existence other than the fact that it has been in the legislation since 1916 for reasons that cannot now be identified. Removal of the territorial restriction should not be dependent on introducing new, complicated and unworkable rules: the territorial restriction is not necessary or helpful and should be removed irrespective of whether the proposals in the issues paper are proceeded with.

Assumptions

6. We also take issue with some of the assumptions underlying the issues paper. For example:

(i) the tax treatment of charities is not a "concession";

(ii) New Zealand is not an "international outlier" in exempting the business income of charities but is rather a world-leader in this respect;

(iii) it is not correct to say that the public does not receive "any benefit" from a charity's accumulations;

(iv) charities' ability to accumulate tax-free profits does not allow them to "expand more rapidly than their competitors", but merely provides a degree of offset to the considerable disadvantages charities otherwise face in their ability to access capital;

(v) the tax treatment of charities does not "reduce government revenue and therefore shift the tax burden

to other taxpayers": charities provide important "externalities" that far outweigh any perceived "costs" of their tax treatment (and are, indeed, the very reason tax privileges are given to charities in the first place);

(vi) whether charities' business income should be subject to tax does not depend on "the level of support that the Government wants to provide to charities", but rather the type of society we want to live in;

(vii) the approaches taken in other jurisdictions require comprehensive analysis of the context in which they arose, and whether they are actually working, before being regarded as "precedents to follow";

(viii) New Zealand's rules for private charitable foundations are not "unusually loose": they simply need to be used;

(ix) under the neutrality principle, the tax system should not be used to "encourage a particular economic activity";

(x) a system of replacing tax privileges with direct funding was comprehensively rejected in 1987: charities are in a better position than government to determine where their funds should be directed;

(xi) the FBT exclusion for charities does not "distort the labour market", as evidenced by the difficulties charities face in attracting and retaining staff.

We expand on these points below.

Abbreviations

7. This submission uses the following abbreviations:

Charities Act – the Charities Act 2005

Charities Services – the Department of Internal Affairs – Charities Services | Ngā Ratonga Kaupapa Atawhai

Companies Act – the Companies Act 1993

DIA – the Department of Internal Affairs | Te Tari Taiwhenua

draft Bill – the draft Bill to amend and restate the Charities Act, included as chapter 9 of the *Focus on purpose* report and included with accompanying commentary in chapter 8 of *The Law and Practice of Charities in Aotearoa New Zealand* 2ed (LexisNexis, 2024)

External Reporting Board - External Reporting Board | Te Kāwai Ārahi Pūrongo Mōwaho

Focus on purpose *report* – S Barker *Focus on purpose – what does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3

Income Tax Act – the Income Tax Act 2007

Incorporated Societies Act – the Incorporated Societies Act 2022

IRD – the Inland Revenue Department | Te Tari Taake

issues paper – Inland Revenue | Te Tari Taake *Taxation and the not-for-profit sector* 24 February 2025

Law Commission - Te Aka Matua o te Ture | Law Commission

MBIE – the Ministry of Business, Innovation and Employment | Hīkina Whakatutuki

NFP – not-for-profit entity

Tax Working Group - Tax Working Group | Te Awheawhe Taake

Trusts Act – the Trusts Act 2019

UBIT – unrelated business income tax

8. This submission has been prepared on an entirely pro bono basis: we do not act for, and have not been funded by, any charity or any other third party in the making of this submission. We also make no apologies for the length of this submission. The issues raised by the issues paper are complex and their impact far-reaching. We ask that matters raised by this submission are properly considered before any decisions are made.

9. This submission is organised as follows:

Contents

UNDERLYING ASSUMPTIONS AND FUNDAMENTAL PRINCIPLES

10. The issues paper is based on a number of underlying assumptions. It also appears to overlook a number of fundamental charities law principles.

11. Before changes are made to the tax settings for charities, it is important that underlying assumptions are acknowledged and analysed. It is also important that any changes are consistent with, and do not cut across, fundamental charities law principles, as these principles will continue to apply to charities irrespective of whether any changes to the tax settings are made: it is not reasonable to expect charities and other community organisations to have to try to comply with two inconsistent and conflicting bodies of law. In addition, if existing charities law already provides an answer, why is further change needed?

12. We ask that the following fundamental principles be given due consideration:

Protecting the boundary between charities and government

13. Charities have been described as the "invisible subcontinent" on the social landscape, "poorly understood by policymakers and the public at large, often encumbered by legal limitations, and inadequately utilised as a mechanism for addressing public problems".[1]

14. Yet, the charitable sector is significant, even when evaluated by traditional measures: the New Zealand charitable sector has some $86.98 billion of assets under management, and a total annual income exceeding $27 billion[2] (broadly equivalent to that of Fonterra),[3] representing approximately 6.5% of New Zealand's gross domestic product.[4] More than 100,000 people work in the sector full-time, representing approximately 4% of the New Zealand workforce,[5] with an additional approximately 90,000 people working part-time.[6] Many charities have no paid staff:[7] New Zealand charities are supported by more than 170,000 volunteers who contribute some 1.4 million hours of volunteering every week.[8]

15. However, the charitable sector's contribution is even more significant when the wider benefits it confers, such as social capital, social cohesion, societal trust and

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[1] M Haddock *Salamon Crafted Lenses to Better See Civil Society – Will we Wear Them?* Nonprofit Quarterly 5 October 2021: <nonprofitquarterly.org/salamon-crafted-lenses-to-better-see-civil-society-will-we-wear-them/?mc_cid=8f07978388&mc_eid=7c71b4ef5b> referring to Dr Lester M Salamon, described as "one of the world's most prolific and influential scholars of nonprofit organisations".
[2] Charities Services | Ngā Ratonga Kaupapa Atawhai *Charities Services Annual Review 2023/2024* at 14.
[3] Statista *Sales revenue of Fonterra Co-operative Group Limited from financial year 2015 to 2024*: https://www.statista.com/statistics/1101756/new-zealand-fonterra-sales-revenue/#:~:text=Fonterra%20Co%2Doperative%20Group%20Limited%20sales%20revenue%20FY%202015%2D2021&text=In%20the%20financial%20year%202021,18.8%20billion%20New%20Zealand%20dollars.
[4] Calculated as 27.34/420: https://www.stats.govt.nz/indicators/gross-domestic-product-gdp/.
[5] Charities Services | Ngā Ratonga Kaupapa Atawhai *Charities Services Annual Review 2023/2024* at 12. Note that 100,000 is a drop from the 145,000 reported in 2021: see Charities Services Ngā Ratonga Kaupapa Atawhai 2020/2021 Annual Review at 19.
[6] Te Tari Taiwhenua Internal Affairs *Modernising the Charities Act 2005: Discussion Document* Feb 2019 at 9.
[7] Te Tari Taiwhenua Internal Affairs *Modernising the Charities Act 2005: Discussion Document* Feb 2019 at 9.
[8] Charities Services | Ngā Ratonga Kaupapa Atawhai *Charities Services Annual Review 2023/2024* at 21. Note that 170,000 is a drop from 2021, when 217,000 volunteers were contributing some 1.7 million hours of volunteering every week. See Charities Services Ngā Ratonga Kaupapa Atawhai 2020/2021 Annual Review at 19. This figure is in turn a drop from the 230,000 reported in February 2019: see Te Tari Taiwhenua Internal Affairs *Modernising the Charities Act 2005: Discussion Document* February 2019 at 9.

community wellbeing,[9] are taken into account.[10] As noted by the Australian Productivity Commission, charities and other not-for-profit entities ("**NFPs**") generate important "externalities" or "spillovers":[11]

> NFP activities may generate benefits that go beyond the recipients of services and the direct impacts of their outcomes. For example, involving families and the local community in the delivery of disability services can generate broader community benefits (spillovers), such as greater understanding and acceptance of all people with disabilities thereby enhancing social inclusion. Smaller community-based bodies can play an especially important role in generating community connections and strengthening civil society.

16. These externalities are significant, as IRD has itself noted:[12]

> One of the reasons governments provide subsidies [sic] to the private sector rather than simply increasing state provision is that it can result in a *better targeting of resources*. The donations people make to a charity provide *an effective indicator of the extra goods and services people feel are needed*. Subsidising charities also ensures that those members of society who do not donate to charities but who nevertheless benefit indirectly from charities are contributing through their general tax payments.
>
> … a common feature of charities is that they provide a benefit to society over and above any benefit received by the recipient or supplier of the relevant goods or services. For example, the benefit to society of a charity running a soup kitchen is greater than the value of the meals provided there. This is what economists call a "positive externality". The presence of an externality is one of the few justifications for the use of subsidies through the tax system. A subsidy can be used to give some recognition to the supplier for the extra benefit that those activities provide to society generally.

17. The charitable sector provides vital "glue" that holds society together.[13]

18. Before making changes to the tax settings for charities in an isolated and siloised way, we ask that consideration be given to the "unseen" value that the charitable sector provides, the context in which it sits, and the potential impacts and unintended consequences that will follow if such factors are overlooked.

19. In that context, we would like to draw your attention to important research that conceptualises society as having 3 distinct sectors (with family and friendship

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[9] "Social capital" refers to the "norms and networks that shape the quality and quantity of a society's social interactions. It encompasses institutions, relationships, and customs that shape the quality and quantity of a society's social interactions. Increasing evidence shows that social capital is critical for societies to prosper economically and for development to be sustainable. Social capital, when enhanced in a positive manner, can improve project effectiveness and sustainability by building the community's capacity to work together to address their common needs, fostering greater inclusion and cohesion, and increasing transparency and accountability". See Helmut K Anheier, Stefan Toepler, Regina List (eds) *International Encyclopedia of Civil Society* (Springer, 2010) Vol 1 at 224, referring to the World Bank definition at www.worldbank.org.

[10] See Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010, and Robert Fitzgerald AM, then Principal Commissioner of the Productivity Commission, *The Productivity Commission's Report on the Not-for-Profit Sector 10 years on,* hosted by Queensland University of Technology and the Australian Centre for Philanthropy and Nonprofit Studies on 15 December 2020: <www.youtube.com/watch?v=bi3F-aspQiq>.

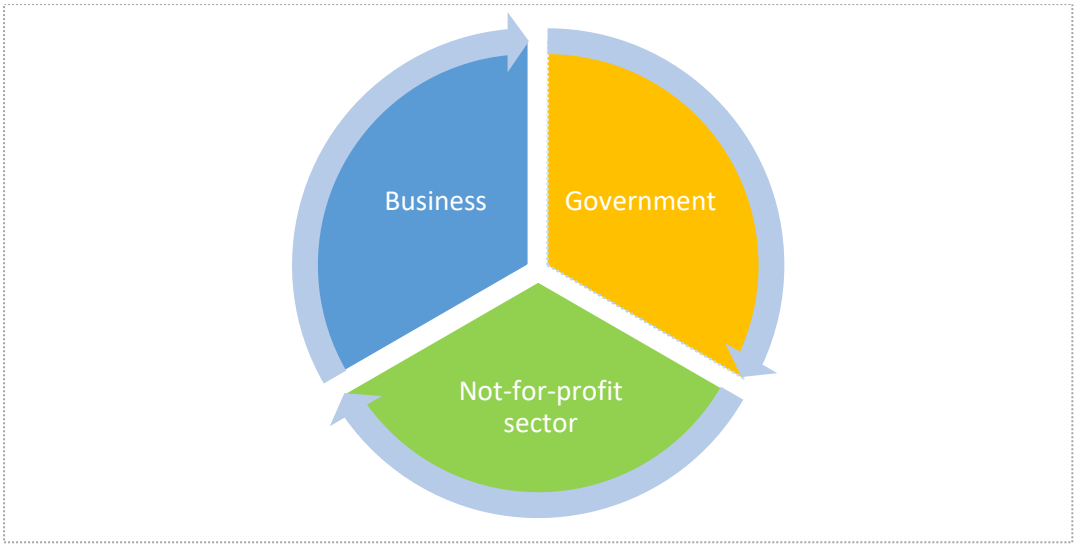
[11] Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010 at 31, xxix.

[12] Inland Revenue Department *Tax and charities, a government discussion document on taxation issues relating to charities and non-profit bodies* June 2001: <taxpolicy.ird.govt.nz/publications/2001/2001-dd-charities> at [2.7] – [2.9] (with emphasis added).

[13] Report of the Community and Voluntary Sector Working Party April 2001 *Communities and Government – Potential for Partnership Whakatōpū Whakaaro* at 6.

networks occupying the space in between):[14] the economy (business), the polity (government), and a "third" or "not-for-profit" sector, as illustrated by diagram 1.0:

Diagram 1.0:



20. It is critical that any policy design proceeds from a proper understanding of the distinction between the 3 sectors, and the need to protect the boundaries between them.

Non-distribution constraint

21. The "third" or not-for-profit sector is comprised of non-state, non-partisan, non-violent (so the mafia does not qualify), self-governing organisations, in which people come together outside of the family to pursue shared needs, interests or ideas. The key distinguishing characteristic of entities in the "third" sector is that they are not-*for*-profit: that is, they are subject to the "non-distribution constraint".

22. The issues paper does not mention the non-distribution constraint or contain any analysis of its impact. However, it is critical to understanding why the business income of charities is exempt from income tax.

23. Briefly, the non-distribution constraint is a term coined by Henry Hansmann in the 1980s:[15] while not-for-profit entities are not precluded from earning a profit, they are precluded from *distributing* that profit to individuals; any net earnings must be retained and devoted in their entirety to furthering the entity's purpose. Entities in the not-for-profit sector are "all about their purposes":[16] it is their commitment to

[14] M McGregor-Lowndes "An Overview of the Not-for-Profit Sector" in M Harding (ed) *Research Handbook on Not-for-Profit Law* (Edward Elgar, 2018) 131 at 131, 151, referring to Lester Salamon "The Rise of the Nonprofit Sector" (1994) 73(4) Foreign Affairs 109; R Atkinson "A primer on the Neo-Classical Republic Theory of the Nonprofit Sector (and the other three sectors too)" in M Harding (ed) *Research Handbook on Not-for-profit law* (Edward Elgar, 2018) 48; M Turnour "Beyond charity: outlines of a jurisprudence for civil society" (Doctoral thesis, Queensland University of Technology, 2009). See also Helmut K Anheier, Stefan Toepler, Regina List (eds) *International Encyclopedia of Civil Society* (Springer, 2010) Vol 1 at 186.
[15] H Hansmann "The Role of Nonprofit Enterprise" (1980) 89(5) Yale LJ 835 - 902 at 838 (footnotes omitted).
[16] Robert Fitzgerald AM, then Principal Commissioner of the Productivity Commission, *The Productivity Commission's Report on the Not-for-Profit Sector 10 years on,* hosted by Queensland University of Technology and the Australian Centre for Philanthropy and Nonprofit Studies on 15 December 2020: <www.youtube.com/watch?v=bi3F-aspQig>.

their stated purposes that underpins support for their activities.[17] Those concerned with a not-for-profit entity can have confidence that its funds will be used only to further the entity's purpose, and not for the private pecuniary profit of any individual, both during the life of the entity and on its winding up.[18]

24. The concept of the non-distribution constraint can be described in other ways, such as the "financial gain prohibition" in the Incorporated Societies Act 2022 (which appears to be simply another way of saying that incorporated societies must, by definition, be not-for-profit entities).[19] However the concept might be described, the non-distribution constraint is what distinguishes the not-for-profit sector from the business sector:[20] because for-profit companies can distribute profits to individuals, they are, by definition, not subject to the non-distribution constraint; as such, they can never be considered part of the not-for-profit sector, even if they have adopted a public benefit purpose, because they will never be able to provide certainty that all of their funds will always be destined for the public benefit purpose, as opposed to the private pecuniary profit of an individual. In other words, comparing a for-profit business with a charitable business is not comparing apples with apples: taxing the business income of charities would not achieve "horizontal equity" unless for-profit businesses were made subject to the non-distribution constraint (and the comprehensive disclosure requirements imposed by the Charities Act). If for-profit businesses are concerned about charities' business income tax exemption, they always have the option of restructuring as charities themselves, but generally they do not do this as it would mean forever forfeiting their ability to draw private profit from the business.

25. We understand that IRD is concerned about other charities following the "Best Start" model (discussed further below) and moving their businesses into the charitable sector. But why would this be A Bad Thing? The government has a stated objective of encouraging philanthropy:[21] while moving a business into the charitable sector would allow that business to access income tax exemption, it would also increase the resources available to the charitable sector. Overall, as discussed in more detail below, the impact may in fact be revenue-positive when all factors are taken into account. In addition, such a change will subject that business to the constraints of registered charitable status, including the non-distribution constraint, the prohibition on private pecuniary profit, the "destination of funds" test, and comprehensive

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[17] See, generally, Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010.
[18] For charities, once funds or other assets are impressed with charitable purpose, they must be forever destined for charitable purposes, including on winding up. See *Trustees of the Auckland Medical Aid Trust v CIR* [1979] 1 NZLR 382 (SC) at 387; *Commissioner of Inland Revenue v Carey's (Petone and Miramar) Ltd* [1963] NZLR 450; *Calder Construction Co Ltd v Commissioner of Inland Revenue* [1963] NZLR 921; and *Commissioner of Inland Revenue v NTN Bearing-Saeco (NZ) Ltd* (1986) 8 NZTC 5,039.
[19] See sections 3(a), 8(1) and 22 of the Incorporated Societies Act 2022 (which provide that societies must be carried on for lawful purposes other than for the financial gain of any of their members); 3(d)(iv) (which provides that societies should not distribute profits or similar financial benefits to their members); 12(1)(b) (which provides that the Registrar must refuse incorporation if a proposed purpose is for the financial gain of any of its members); 23 and 24 (which set out the parameters of what does and does not constitute a prohibited "financial gain"); 26(1)(l) and 216 (which make it clear that surplus assets must be distributed to 1 or more not-for-profit entities on winding up); 143-149 (which empower a Court to order that a financial gain be recovered from a member or former member); and 210(e) (which provides for the High Court to liquidate a society if it carries on any operation that is contrary to the financial gain provisions).
[20] M McGregor-Lowndes "An Overview of the Not-for-Profit Sector" in M Harding (ed) *Research Handbook on Not-for-Profit Law* (Edward Elgar, 2018) 131 at 133; R Atkinson "Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis and Synthesis" (1997) 27 Stetson Law Review 395 at 419 n 74.
[21] https://www.beehive.govt.nz/release/%E2%80%98twelve-days-giving%E2%80%99-encourage-generosity.

transparency and accountability requirements. We recommend that further consideration is given as to whether this factor does in fact give rise to a problem to be "fixed".

Terminology

26. Terminology is often an issue in the context of charities law. For example, the "third" or not-for-profit sector may go by other names, such as the community and voluntary sector, the core sector, or civil society:[22] the lack of agreement on a name is arguably a reflection of the diversity of the sector itself, and something to be celebrated and embraced. However the broader not-for-profit sector might be described, the charitable sector is a subset of it.

27. The charitable sector can be thought of as all "entities" (defined in section 4(1) of the Charities Act to mean any society, institution, or trustees of a trust, whether incorporated or not) that are eligible to be registered under the Charities Act. That is, all not-for-profit entities whose purposes meet the centuries-old definition of being "charitable".[23] In other words, all charities are by definition subject to the non-distribution constraint.

28. The charitable sector touches on all aspects of our society, including health, education, social housing, growing the economy, social investment, poverty reduction, public interest journalism, sport, art, protecting the environment, protecting wildlife, working to combat climate change, and many others. The presences of charities are one of the abiding markers of a healthy society.[24] A key feature of the charitable sector is its diversity: the charitable sector allows for authentic expressions of pluralism, democratisation, and localism,[25] as people come together to address issues *they* see arising in their community (which issues may not yet be on the radar of government). Communities know best what communities need.[26]

29. As noted by the Impact Initiative, many solutions are needed to the complex and connected challenges New Zealand faces: the housing crisis, the mental health crisis, fixing the economy, inequality and poverty are not challenges that Government alone can solve.[27] Charities are a key part of the solution to almost every challenge we face. Research indicates that charities carry out services more effectively and efficiently than government.[28] Tax settings that inhibit charitable work may not raise

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[22] Care should be taken with use of the term "for purpose" to describe the sector, as this term may apply to for-profit companies as well as not-for-profit entities; as such, it does not delineate the not-for-profit sector from the for-profit sector.
[23] In Australia, this requirement has been codified in paragraph (a) of the definition of "charity" in Charities Act 2013 (Cth) s 5. In New Zealand, Charities Act s 13(1)(b)(ii) requires that a society or institution may not be "carried on for the private pecuniary profit of any individual". For charitable trusts, the requirement in Charities Act s 13(1)(a) that income be derived in trust for charitable purposes "itself excludes any element of private pecuniary profit" (*Trustees of the Auckland Medical Aid Trust v CIR* [1979] 1 NZLR 382 (SC) at 398).
[24] Dr O Breen, Rev Dr L Carroll, N Lavery *Independent Review of Charity Regulation Northern Ireland* January 2022 at 22.
[25] M McGregor-Lowndes *Australia: Countering the 'Lady Bountiful' Narrative* 19 May 2021: <carleton.ca/panl/2021/australia-countering-the-lady-bountiful-narrative/>; *Report to the Minister of Finance and the Minister of Social Welfare by the Working Party on Charities and Sporting Bodies* (Treasury, Wellington, November 1989) at 85.
[26] See <www.huie.org.nz/wp-content/uploads/Webinar-Summary-%E2%80%93-Educating-political-parties-to-help-the-community-sector.pdf>.
[27] Impact Initiative *A Roadmap for Impact* April 2021 at 6, 8.
[28] See, for example, R Atkinson "Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis and Synthesis" (1997) 27 Stetson Law Review 395 at 403.

net revenue, and may in fact be revenue *negative* when all factors are taken into account.

Protecting the independence of charities

30. The distinction between the charitable sector and the other two sectors might be summarised as follows:[29]

    (i) business sector: *private* organisations operating for *private* purposes;

    (ii) government sector: *public* organisations operating for *public* purposes; and

    (iii) charitable sector: *private* organisations operating for *public* purposes.

31. The essence of a charitable purpose is that it must operate for the benefit of the public,[30] but that fact does not stop charities from being *private* organisations. As with all not-for-profit entities, charities are, by definition, independent, private bodies that should be self-governing and free from inappropriate government interference.[31] The concept of public benefit is an objective concept, separate from the conception of the public interest to which the government of the day seeks to give effect in its policies. For example, a particular government may have no particular policy regarding people living with a disability; however, that fact does not preclude disability charities from continue to work tirelessly to improve the lives of people living with a disability. Indeed, governments often "pick up" services that have been shown by charities to be effective.

32. It is important to protect the *boundary* between charities and government; the *independence* of the charitable sector from government is what makes charities distinctive and valuable:[32]

> … both Government and charities themselves must guard against allowing charities to inadvertently fall under the influence of the State, or the sector will lose that which makes it distinctive and valuable to begin with …
>
> … the independence of the sector must remain paramount. Although it is part of the existing common law that charities must be, and be seen to be, free from the influence of Government or any other group, no more formal protection of that status exists. The sector must continue to be seen as more than an outlier to local or national government. How independence can best be promoted and safeguarded must be an important feature of any debate on the future of the sector.

33. Charities enable people to come together in furtherance of a shared purpose, free from the dictates of the median voter or profit-seeking private shareholders. Charities' independence enables them to take risks, experiment, innovate, and reach into communities in ways that governments cannot.[33] Charities are also untethered

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[29] See MD Connelly "The Sea Change in Nonprofit Governance: A New Universe of Opportunities and Responsibilities" (2004) 41 Inquiry at 6, 8; RT Langford *Purpose and Public Benefit* in *Charity Law: Exploring the Concept of Public Benefit* D Halliday and M Harding (eds) (Routledge, 2022) at 281.
[30] *Latimer v Commissioner of Inland Revenue* [2002] 3 NZLR 195 (CA) at [32].
[31] See Te Aka Matua o te Ture - New Zealand Law Commission Issues Paper 24 *Reforming the Incorporated Societies Act 1908* (NZLC IP 24, 2011) at [1.10] - [1.12], referring to the United Nations' International Classification of Non-profit Organisations. See also Incorporated Societies Act 2022, section 3(d)(iii): "societies are private bodies that should be self-governing in accordance with their constitutions, any bylaws, and their own tikanga, kawa, culture, and practice, and should be free from inappropriate Government interference".
[32] Lord Hodgson of Astley Abbotts *Trusted and Independent: Giving charity back to charities – Review of the Charities Act* July 2012 at [3.15], [4.21].
[33] See *Report to the Minister of Finance and the Minister of Social Welfare by the Working Party on Charities and Sporting Bodies* (Treasury, Wellington, November 1989) at 85: "[a]nother role of the charities sector which

to electoral cycles, potentially enabling them to address issues on a longer-term basis than governments. Philanthropic capital has been described as the "venture capital of social development", generating new activities or stimulating new directions whose impact goes far beyond their original cost, and which are often subsequently picked up by government.[34]

34. Charities' independence underpins their advocacy work, which has been critical in many important societal changes that have been achieved over the centuries, including the abolition of slavery, universal suffrage, anti-smoking laws, and many others.[35] Charities provide critical balance to the ability of the most economically powerful to dominate and shape policy, thereby providing important protection against the skewing of public policy debates in favour of vested monied interests.[36] Charities are the 'eyes, ears and conscience of society', with an important role in holding government to account.[37]

35. The independence of charities is as critical to democracy as free and fair elections, an independent judiciary, and a free press.[38] Just as Inland Revenue does not tell taxpayers how to run their businesses,[39] similarly, the legal and policy settings should not be telling charities how to further their charitable purposes. In a liberal democracy such as New Zealand, policy design must have at the forefront the need to protect the independence of charities, and the *boundary* between charities and government.

The importance of social enterprise

36. The issues paper also does not mention the words "social enterprise", even though charities running businesses, by definition, fall within the term. Social enterprise is recognised internationally as an integral part of a just transition to a more equitable, sustainable economy: social enterprise is experiencing "astonishing growth", a world-wide trend with start-up activity particularly significant;[40] former British Prime Minister, Gordon Brown HonFRSE, argues there is "no route to the future that does not have social enterprise at its centre".[41]

37. From a definitional perspective, "social enterprise" refers to the *process* of using business models or "trade" to create positive social outcomes or impacts. In other words, social enterprise is an *activity* that is agnostic as to legal structure: social enterprise can be carried out by for-profit companies as well as by charities. Used as

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has grown up since the government took on the role of providing many social services is to be the risk takers the public sector cannot be in the provision of basic social services. The strength of the charitable sector is that it is capable of taking on new forms and entering new areas as need is met elsewhere".

[34] See *Report to the Minister of Finance and the Minister of Social Welfare by the Working Party on Charities and Sporting Bodies* (Treasury, Wellington, November 1989) at 87, referring to M Liffman, 1987/88.

[35] See the discussion in S Barker *Focus on purpose - what does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3, chapter 1, and the references cited therein.

[36] See the discussion in S Barker "Advocacy by charities: what is the question**?"** (2020) 6 CJCCL 1 at 55 - 57.

[37] House of Lords Select Committee on Charities *Report of Session 2016–17 - Stronger charities for a stronger society* HL Paper 133: <publications.parliament.uk/pa/ld201617/ldselect/ldchar/133/133.pdf> at 3, 99, 116.

[38] For a fuller discussion, see Rosemary Teele Langford (ed) *Governance and Regulation of Charities: International and Comparative Perspectives* (Edward Elgar, 2023) ch 4 *Designing an Optimal Charities Framework* and the authorities cited therein.

[39] *Grieve v Commissioner of Inland Revenue* [1984] 1 NZLR 101 (CA) at 109-110, referring to *J T Tweddle v Commissioner of Taxation of the Commonwealth of Australia* (1942) 2 AITR 360 at 364.

[40] A Patton "UK State of Social Enterprise Survey reveals mental health is mission no. 1" Pioneers Post 13 October 2021. This trend may explain why "DIA has observed an increase in start-up businesses registering as charities": Tax Working Group *Future of Tax: Interim Report* 20 September 2018 at 120.

[41] L Joffre "Ex-PM Gordon Brown: 'There is no route to the future that does not have social enterprise at its centre'" Pioneers Post 27 November 2020.

a noun, the term "social enterprise" refers to any entity, whether for-profit or not-for-profit, that is carrying out the *activity* of using business models to create positive social outcomes.

38. Any use of business methods by a charity must be carried out in furtherance of its charitable purposes (as discussed in more detail below); a charity's business activity is therefore, by definition, being used to create positive social outcomes.

39. Charities, in fact, have a number of distinct advantages when it comes to carrying out social enterprise:

    (i) **Purpose is "baked into the DNA" of charities**: registered charities exist within an ecosystem that supports their devotion to their charitable purposes, even if they use business means to achieve them. Charities therefore have a reliable "mission lock", as well as a recognised identity: these factors build trust and confidence in those engaging with the charity that funds generated by the social enterprise activity will be devoted to furthering the stated positive social outcomes.

    (ii) **The non-distribution constraint**: the non-distribution constraint (to which all charities are subject, as discussed above) provides further trust and confidence that the funds generated by the social enterprise activity will be devoted to furthering the positive social outcomes. In other words, those engaging with the charity can have confidence that decisions will be based on what is best for the charitable purposes, rather than for the private profit of individuals.

    (iii) **The financial reporting rules**: from 1 April 2015,[42] the annual returns of every registered charity are required to be accompanied by financial statements prepared in accordance with financial reporting standards issued by the External Reporting Board | Te Kāwai Ārahi Pūrongo Mōwaho.[43] These financial statements must be made publicly available on the charities register on an annual basis if the charity wishes to remain registered.[44] Research indicates that, as a result of this change, New Zealand charities are subject to the most comprehensive set of transparency and accountability disclosure requirements for charities in the world.[45] When a social enterprise is structured as a for-profit company, such requirements are generally not imposed, which can leave the for-profit social enterprise vulnerable to claims of "green-washing". By contrast, registered charities are subject to built-in accountability mechanisms to ensure the funds generated by the social enterprise activity are indeed being used to further the stated positive social outcomes. These mechanisms protect against "green-washing", and further provide trust and

[42] Charities Act 2005, sections 41(2) and 42A, as inserted by section 19 the Financial Reporting (Amendments to Other Enactments) Act 2013 (2013 No 102), with effect from 1 April 2015 (see clause 3(2) of the Financial Reporting Legislation Commencement Order 2014 (LI 2014/52)).
[43] See Charities Act sections 41(2)(a) and 42A, inserted on 1 April 2015 by the Financial Reporting (Amendments to Other Enactments) Act 2013 (2013 No 102).
[44] The High Court has recently confirmed that a failure to file 2 consecutive annual returns can constitute a "significant or persistent failure" justifying deregistration under section 32(1)(b) of the Charities Act (*Grounds for removal from register*). See *World Gospel Bible College Charitable Trust v Commissioner of Inland Revenue* [2024] NZHC 1232 (17 May 2024) at [32].
[45] See S Barker *Focus on purpose - what does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3, Appendix A.

confidence when a charity is used to carry out social enterprise activity.

40. Government recognises that "complex social and environmental challenges cannot be solved by Government alone": it is now "even more vital to increase social enterprise activity".[46] Far from indicating a "problem" to be "resolved", an increase in social enterprises seeking charitable registration is something to be *encouraged*.

41. When it comes to important businesses such as childcare and food manufacture, one might rationally prefer such businesses to be carried out by charities, who are required by law to be devoted to their charitable purposes and are not at the mercy of profit-seeking private shareholders: "when profit takes a front seat in those particular endeavors, they actively violate the public good and rob public pocketbooks all at the same time".[47] In other words, businesses moving into the charitable sector is not inherently A Bad Thing.

42. Sustainability and financial viability are key challenges for the charitable sector, as costs increase, demands for service increase, regulatory burdens and their associated compliance costs increase, all while revenue streams diminish leading to increasing competition for limited funds. The legal and tax settings should in fact be *encouraging* charities to carry out social enterprise activity, including by running businesses to raise funds for their charitable purposes, to help them diversify their income streams, reduce their dependency on government funding and donations, and encourage self-sustainability.

43. Placing restrictions on charities' ability to run businesses would not only make it more difficult for social enterprises structured as charities to operate, but it would cut across the flexibility charities need to make their own decisions, particularly in areas which may experience volatile profitability.[48] We ask that IRD please consult with the Ākina Foundation and MBIE in this area, to ensure the left and right hands of government are not pulling in opposite directions.

44. We are also concerned that the Māori voice appears to be almost entirely absent from the issues paper.

The impact of the financial reporting rules

45. The issues paper also does not analyse the impact of the financial reporting rules for charities.

46. A key feature of the New Zealand charities law framework is that the obligation to provide comprehensive financial and non-financial information applies to all registered charities, without exception.[49] As a result, New Zealand now has the benefit of consistent and comparable transparency and accountability information for all registered charities, providing comprehensive visibility. Unlike some jurisdictions, New Zealand registered charities are also required to include their constituting

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[46] Impact Initiative *A Roadmap for Impact* April 2021 at 6.
[47] https://nonprofitquarterly.org/profit-as-primary-driver-the-daily-disaster-of-u-s-healthcare/?mc_cid=b92024642a&mc_eid=%5b7c71b4ef5b.
[48] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 29-30.
[49] Sections 42AB and 42AC of the Charities Act, inserted by the Charities Amendment Act 2023, allow regulations to be made permitting a small subset of very small charities to be exempted from the requirement to comply with External Reporting Board standards and instead require only minimum financial information. However, as at the date of writing, no such regulations have been made and appear unlikely ever to be made. For a fuller discussion, see Barker et al *The law and practice of charities in New Zealand* 2ed (LexisNexis, 2024).

document, and any amendments, on the charities register.[50]

47. These requirements answer for New Zealand many if not all of the questions that other jurisdictions were grappling with when they installed their complicated rules regarding minimum distribution requirements and business activity. The Charities Act is "Al Capone" legislation:[51] with the benefit of these rules, New Zealand has the opportunity to do things better and smarter, underscoring the imperative to ensure issues are properly analysed, and consulted on, before decisions are made.

48. It does not appear to be widely appreciated that the comprehensive information now made publicly available by means of the charities register is not only available to Charities Services and IRD, but also to charities' many other stakeholders, including donors, philanthropic funders, government funders, volunteers, employees, members, clients, suppliers, other supporters, the media, and the public generally: the charities register provides a forum for accountability, enabling the "scrutiny of 1,000 eyes", and an informed basis for asking questions by any stakeholder. An effective legal framework for charities (which includes the tax settings for charities) should create an environment that enhances the inherent high levels of compliance by most registered entities. As noted by the recent review of charities law in Northern Ireland,[52] developing a legal framework that recognises the goodwill and willingness of most charities to comply is key to success; while the framework must provide protection from the minority who wish to exploit others, perpetrate harm, or otherwise abuse the system, focusing on enforcement, or second-guessing the day to day operational activities of charities through command and control "regulation" rather than on building strengths, risks destroying the goodwill and cooperation on which the success of the system relies. A charities law framework will work best when it creates a simple, enabling regime that both encourages and supports charities to *focus on their charitable purposes*, and creates an informed arena in which the government agencies, the public, the media and others become allies in scrutinising the actions of registered charities and holding them to account.[53] As Richard Fries, Chief Commissioner of the Charity Commission for England and Wales from 1992 - 1999, points out, a Charities Act regime is not about "regulation" in the form of central planning or "interfering with the soul" of charity;[54] the balance of a charities law framework should lean towards "accountability, not regulation".[55]

49. Sunlight is the best disinfectant, and there are many examples of how effectively an

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[50] Charities Act, section 40(1)(e). In this respect, New Zealand differs from England and Wales. See Lord Hodgson of Astley Abbotts *Trusted and Independent: Giving Charity Back to Charities* (Report, July 2012) at 142.
[51] The reference to "Al Capone" legislation is a reference to the infamous gangster, Al Capone, who was ultimately convicted of tax evasion rather his more notorious crimes such as the illegal sale of liquor ("bootlegging") and murder. Capone's conviction highlighted the effectiveness of tackling complex criminal enterprises by focusing on financial irregularities and tax violations. See Federal Bureau of Investigation *Solving Scarface – How the law finally caught up with Al Capone* 28 March 2005: https://archives.fbi.gov/archives/news/stories/2005/march/capone_032805. The term "Al Capone legislation" in a charities context was coined by Professor Myles McGregor-Lowndes in a webinar presentation for the Charity Law Association of Australia and New Zealand, 9 March 2021.
[52] Dr O Breen, Rev Dr L Carroll, N Lavery *Independent Review of Charity Regulation Northern Ireland* January 2022 at 22, 45 - 47, 63 - 66, 152 – 154.
[53] Dr O Breen, Rev Dr L Carroll, N Lavery *Independent Review of Charity Regulation Northern Ireland* January 2022 at 45 - 47, 63 - 66, 152 – 154.
[54] Paper prepared by R Fries entitled *New Zealand Charity Law Framework: Notes,* December 2020. See also M McGregor-Lowndes and B Wyatt (eds) *Regulating Charities: the Inside Story* (Routledge, 2017) at 271.
[55] See also the discussion in S Barker *Focus on purpose - what does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3 chapter 2, and Rosemary Teele Langford (ed) *Governance and Regulation of Charities: international and Comparative Perspectives* (Edward Elgar, 2023) chapter 4.

approach of using the comprehensive information now available to simply ask questions works in practice.[56] Yet, many people remain unaware of the charities register and the wealth of information available on it. Before reaching to create complicated new rules, an infinitely more efficient and cost-effective option should be comprehensively explored: alternative options, such as increasing public (and government) awareness of fundamental principles like the non-distribution constraint, the destination of funds test, the important fiduciary duties of loyalty and obedience to which every registered charity is subject, the existence and utility of the charities register,[57] and the important role of the public, the media and other stakeholders in providing a "triumvirate of security",[58] are consistently overlooked.

50. We understand IRD is concerned that information can be "lost" on consolidation. This issue was also raised as part of the review of the Charities Act.[59] In response, clause 69(2)(c) of the draft Bill proposes adopting the approach taken in subdivision 60-E of the Australian Charities and Not-for-profits Commission Act 2012: clause 69(2)(c) would enable the Charities Registrar (currently Charities Services) to require a particular registered charity to prepare a report, in addition to reports already required to be provided under the financial reporting rules.[60] However, DIA rejected this approach: we understand that such a targeted "please explain" approach was not considered necessary as Charities Services is already able to request information under sections 50 to 52 of the Charities Act. IRD also has wide powers to request information under tax legislation. We ask that existing tools are used before reaching to create new, complex rules.

The tax expenditure analysis

51. The issues paper describes the tax privileges for charities as "concessions", using the word "concession" no less than 22 times over 21 pages. However, the paper does not analyse whether the tax privileges for charities are *appropriately* so described; instead, having assumed that such terminology is appropriate, the paper then makes a number of second-order assertions that are similarly assumed rather than analysed, such as the following (with emphasis added):

> 1.4 Every tax concession has a "cost", that is, it *reduces government revenue and therefore shifts the tax burden to other taxpayers*.
>
> 2.15 The fiscal cost of not taxing charity business income unrelated to charitable purposes, particularly income that is accumulated, *is significant and is likely to increase*. Tax concessions for unrelated charity businesses *reduce government revenue, and*

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[56] See, for example, M Sharpe *Low-profile charity criticised for low donation rate despite $111 million fund* Stuff 9 December 2022: https://www.stuff.co.nz/national/300753515/lowprofile-charity-criticised-for-low-donation-rate-despite-111m-fund and M Sharpe *Trustees gone from $131m charitable trust after 'modernisation process'* Stuff 17 October 2023: https://www.stuff.co.nz/national/300989923/trustees-gone-from-131m-charitable-trust-after-modernisation-process.

[57] See S Barker *Focus on purpose - what does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3, recommendations 5.2, 5.3 and 8.13.

[58] A term used by Dr Oonagh Breen Professor of Law at the Sutherland School of Law, University College Dublin, in an interview with the writer on 3 December 2020.

[59] See Te Tari Taiwhenua Internal Affairs *Modernising the Charities Act 2005: Discussion Document* February 2019 at 44: "In some cases, consolidation can reduce transparency. Consolidated financial statements may not contain all the information needed to fully assess the financial wellbeing of business subsidiaries of a charitable group. Consolidation may also obscure transactions between the charitable arm and business arm of a charitable group. It may not be clear if transactions between the charitable and the business arms are furthering a charitable purpose".

[60] For a fuller discussion, see Barker et al *The law and practice of charities in Aotearoa New Zealand* 2ed (LexisNexis, 2024) at 727-732.

> *therefore shift the tax burden to other taxpayers*.
>
> 4.10 Specific tax concessions are generally inconsistent with New Zealand's broad-base, low-rate tax framework. If the Government wishes to *encourage a particular economic activity*, it is preferable this is done in a transparent way by *direct funding* rather than through the tax system.

52. The issues paper does not provide any evidence to support these controversial assertions, which derive from a controversial economic theory known as a "tax expenditure analysis" that tacitly underlies the issues paper's proposals.

53. Broadly, a tax expenditure analysis conceptualises some (albeit not all) of the tax privileges for charities as a "subsidy", and then recasts the revenue said to be "foregone" from such "subsidy" as a *direct tax expenditure* by government;[61] this amount is then used as a means of estimating the "cost" of such tax privileges, so that they can be assessed against alternative policy options, such as a system of direct grants.

54. An underlying "tax expenditure analysis" led to the approach taken by the former Minister of Finance, Hon Roger Douglas in 1987 when he announced an intention to impose a "flat tax" of 15%, including on the income of charities, and support charities instead through a system of *direct funding* by Government.[62] The proposal was very controversial: then Prime Minister, Rt Hon David Lange, wrote that it was an "unaccustomed addition to the burdens of office to have the finance minister take leave of his senses".[63] Charities perceived the proposal as a threat to their independence, and argued that charities were in a better position than government to determine where their funds should be directed.[64] The proposal to tax the income of charities did not proceed; instead, in 1988, the Government appointed a working party tasked with reviewing the appropriate taxation regime for charitable organisations and sports bodies,[65] a process which ultimately culminated in the registering, reporting and monitoring regime established by the Charities Act 2005. We query why IRD is proposing measures that have already been considered and rejected.

55. The tax expenditure analysis can be traced back to the 1960s, and the work of Harvard Law Professor, Stanley Surrey.[66] Following its genesis in the United States,

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[61] A tax expenditure analysis also underlies the comments of the Tax Working Group that charities are "using what would otherwise be tax revenue" and that government therefore has a role in verifying that "intended social outcomes are actually being achieved". See *Future of Tax: Final Report* 21 February 2019 at 21 (recommendation 78), 103 - 104, [40], [42] - [44].

[62] New Zealand Government *Economic Statement* 17 December 1987: <natlib.govt.nz/records/20527942?search%5Bi%5D%5Bcollection%5D=General+Lending+Collection&search%5Bi%5D%5Bcreator%5D=New+Zealand.&search%5Bpath%5D=items>. See also *Report to the Minister of Finance and the Minister of Social Welfare by the Working Party on Charities and Sporting Bodies* (Treasury, Wellington, November 1989) at 14 - 15; Michael Cullen *Labour Saving – A memoir,* (Allen & Unwin, 2021) at 109 - 116; Charities Bill 1R (30 March 2004) 616 NZPD 12,117 - 12,118; Charities Bill 2R (12 April 2005) 625 NZPD 19,950, per Gordon Copeland (United Future).

[63] See Rt Hon *David Lange ONZ CH My Life (Auckland: Viking, 2005)* ISBN 0-670-04556-X at 236-238.

[64] *Report to the Minister of Finance and the Minister of Social Welfare by the Working Party on Charities and Sporting Bodies* (Treasury, Wellington, November 1989) at [1.2.2(d)], 16.

[65] *Report to the Minister of Finance and the Minister of Social Welfare by the Working Party on Charities and Sporting Bodies* (Treasury, Wellington, November 1989) at 2, 14. The Working Party concluded (at 7, 28, 30, 49, 52) that direct grants do not provide an incentive for individuals to give; demoralise organisations and make them accountable to Government rather than their supporters; and overly centralise the source of the charitable sector's financial support.

[66] See SS Surrey *Pathways to Tax Reform: the Concept of Tax Expenditures* (Cambridge, Mass: Harvard University Press, 1973); "The Tax Expenditure Concept and the Budget Reform of 1974" (1976) 17 Boston College Law Review 679 - 736. The concept had also been raised earlier: "[i]n 1863, Gladstone, as Chancellor

the tax expenditure analysis spread around the Anglosphere, like neoliberalism: Treasuries in Australia,[67] Canada[68] and Aotearoa New Zealand,[69] for example, now annually issue "tax expenditure statements" with tax privileges for charities specifically listed.

56. However, even Stanley Surrey himself acknowledged that a tax expenditure analysis has its limitations.[70] For example, a tax expenditure analysis does not capture all the nuances of tax policy and its effects on different groups.[71] In addition, by measuring only the "cost", a tax expenditure analysis *structurally ignores the benefits provided by charities*, such as contributions to social cohesion and democracy. Such "meta-benefits" may be intangible and difficult to measure but they are nevertheless critically important: indeed, they arguably represent the very reason tax privileges are given to charities in the first place.

57. As one commentator put it:[72]

> *A strong charitable sector is itself a public good*. A thriving nonprofit sector acts as a counter to government power in a variety of ways. It minimises the activities undertaken by government, provides an avenue for non-governmental voices to be heard on vital issues, and minimises government growth. The charitable sector also encourages altruism, and fosters a communitarian ethos, both of which reduce the need for taxation. Under this view, *the sector itself is the benefit-producing act, and there is no need to justify funding each specific good or services within the sector*. Instead, the sector should be thought of in the same manner as national defense or a working market. *If, on the whole, the current structure is necessary to sustain the sector, then the fact that individual activities might not be justifiably subsidised when viewed in isolation is tolerable. Overbreadth might be the price we pay for having a sector to act as a counterweight to government.*

58. In other words, rather than a "cost", the tax privileges for charities are more appropriately viewed as an *investment in an overall system* that allows people to manifest important liberal democratic values, such as diversity, pluralism and freedom of association in pursuit of public benefit (as determined objectively rather than in line with the conception of the public interest to which the Government of the day seeks to give effect in its policies).[73] Charities provide authentic expression of the positive values of civil society in a pluralist political environment.[74] Charities' very existence promotes pluralism and diversity, which are either inherently

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of the Exchequer, attacked all tax-exempt status of charities in a speech in Parliament as a concealed and unregulated tax subsidy, in perpetuity, for large well-endowed charities" (Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 327, 246 n 83); in *National Anti-Vivisection Society v Inland Revenue Commissioners* [1948] AC 31 (HL) at 52 Lord Wright described the exemption from income tax as amounting to "receiving a subsidy from the State".

[67] Australian Government | The Treasury *2024-2025 Tax expenditures and insights statement* 17 December 2024: https://treasury.gov.au/publication/p2025-607085.

[68] Government of Canada *Report on Federal Tax Expenditures* 29 February 2024: https://www.canada.ca/en/department-finance/services/publications/federal-tax-expenditures.html.

[69] Te Tai Ōhanga The Treasury *2024 Tax Expenditure Statement* 30 May 2024: https://www.treasury.govt.nz/publications/tax-expenditure/2024-tax-expenditure-statement.

[70] Stanley S Surrey, Paul R McDaniel *Tax Expenditures* Harvard Law Review Vol 99 No 2 (December 1984) at 491-498.

[71] Stanley S Surrey, Paul R McDaniel *Tax Expenditures* Harvard Law Review Vol 99 No 2 (December 1984) at 491-498.

[72] Miranda Perry Fleischer "Subsidising charity liberally" in Matthew Harding (ed) *Research Handbook on Not-for-profit law,* (Edward Elgar 2018) 418 at 433 (emphasis added).

[73] R Fries, Chief Commissioner of the Charity Commission for England and Wales from 1992 - 1999 *The status of the Charity Commission under the 2006 Act* (unpublished paper) March 2012 at 1.

[74] https://carleton.ca/panl/2021/australia-countering-the-lady-bountiful-narrative/,

desirable or intimately related to our liberal democratic values.[75] Rather than seeking to micro-manage the activities of charities, the system works better, and more effectively and efficiently, when it *protects charities' independence*: the fact that some individual activities might not be selected for "subsidisation" in isolation by the government of the day is therefore tolerable, as some overbreadth is merely the price we pay for living in a liberal democracy, and within an overall system that contributes significantly to social cohesion, social capital and wellbeing.[76]

59. As noted by the Ontario Law Reform Commission:[77]

> Charity generally considered (not the specific benefits provided by charitable acts) is a *public good which cannot by definition be provided by government* … There are a number of arguments worth canvassing. These are all mainly based on the fact that *government should not and cannot be the sole agency of the maximisation of social welfare in a liberal democracy* … Governments are constrained by norms of universality and equality to act categorically. In large societies, the delivery of social welfare benefits or subsidies for the arts, education, health care and the like, requires the *bureaucratisation* of decision-making so that all discretionary distributions are in compliance with these fundamental norms. *These constraints mean that governments cannot be creative, flexible or particularistic in the provision of social welfare*. In a society with a heterogeneous population with widely varying values, the government's performance in the provision of social welfare would be *decidedly lacklustre* from the point of view of the *vast majority* of its citizens. The voluntary provision of the goods would permit *more pluralism (less dictatorship)* in the determination of public values, and the ways in which publicly valued things, like education, are provided. Moreover this alternative method of provision would permit *more daring innovations or experimentations* than governments might be willing to engage in, since widespread disagreement about the provision of some things might be based only on whether it is worthwhile subsidising it out of the consolidated revenue fund **a***s opposed to whether the thing itself is of public benefit* …
>
> The political theories offer a better understanding of the [charitable] sector. Their insight as to the overall value of the sector in a liberal-democratic polity is instructive and valid, and, at a very general level, *should serve to inform the sector's public regulation. It suggests a regime of regulation which is non-confrontational and as inobtrusive as possible*.

60. In other words, the constraints of the dictates of the median voter means that government cannot and does not have all the answers. Softening the impact of the "tyranny of the majority" is a key factor underscoring the value and importance of the charitable sector. As noted by former Australian Productivity Commissioner Robert Fitzgerald AM, the great value of the charitable sector lies in things like social cohesion, the restoring of social trust, social engagement and the reduction of social

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[75] Rob Atkinson "Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis and Syntheses" (1997) Stetson Law Review 395, 402-430 at 403.
[76] MP Fleischer "Subsidising Charity Liberally" in M Harding (ed) *Research Handbook on Not-for-Profit Law* (Edward Elgar, 2018) 418 at 433.
[77] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 244. See also R Atkinson "A primer on the Neo-Classical Republic Theory of the Nonprofit Sector (and the other three sectors too)" in M Harding (ed) *Research Handbook on Not-for-profit law* (Edward Elgar, 2018) 48 at 75, referring to J Simon, H Dale and LB Chisholm "The Federal Tax Treatment of Charitable Organisations" in Walter Powell and Richard Steinberg (eds) *The Nonprofit Sector* (Yale University Press 2006) 267 at 279: a robust, independent and pluralistic charitable sector allows some judgments about what constitutes the public interest to be made without "committing all such determinations to the majoritarian processes of government".

isolation.[78] These and other less tangible metabenefits, such as the benefits said to flow from volunteerism, the increase in supply of public goods, pluralism, and social capital, are notoriously difficult to measure but must nevertheless be taken into account.

61. The fact that a tax expenditure analysis structurally ignores such benefits perversely leads to charities being perceived and regulated as if they are some kind of "tax loophole" or "fiscal cost",[79] and therefore something to be reduced rather than enabled. Such misperceptions mischaracterise charities and undermine their status in society, in direct contradiction to the statutory purpose of the Charities Act regime (namely, to *promote* public trust and confidence in the charitable sector).[80]

62. More perniciously, a tax expenditure analysis encourages a perception that the decision to award tax privileges to charities should be based on government perceptions as to what is worth "subsidising" out of public funds, rather than "whether the thing itself is of public benefit".[81] As such, charitable funds come to be seen as government funds, and charities come to be "perceived and regulated" as though they are merely (underfunded) service delivery arms of the state,[82] spending *government* dollars rather than charitable dollars,[83] such that the government should be able to exercise operational control over what charities can do, what they can say, and when they can spend their own money charities. Such an approach is fundamentally misconceived: by undermining the independence of charities, such an approach causes people to turn away from charities at a time when they are never more needed.[84]

63. It is important to note that a tax expenditure analysis is only a theory: it is not an immutable truth. It stems from another assumption that taxing charities is a normal part of the "benchmark" structure for tax calculation purposes, and that charities' tax privileges are a *departure* from that benchmark and therefore a "concession".[85]

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[78] https://probonoaustralia.com.au/news/2021/05/the-potential-for-transformative-change-and-the-role-nfps-can-play/?utm_source=Pro+Bono+Australia+-+email+updates&utm_campaign=b1ba91e34e-News+20_May_21&utm_medium=email&utm_term=0_5ee68172fb-b1ba91e34e-146780953&mc_cid=b1ba91e34e&mc_eid=f6f3595123.

[79] JE Tyler III Book Review: Myles McGregor-Lowndes and Bob Wyatt (eds), Regulating Charities: the Inside Story, New York: Routledge (2017) 9(1) Nonprofit Policy Forum 5. <papers.ssrn.com/sol3/papers.cfm?abstract_id=3142335> at 3.

[80] Charities Act, section 3(a).

[81] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) 244.

[82] John E Tyler III, 'Book Review: Myles McGregor-Lowndes and Bob Wyatt (eds), *Regulating Charities: the Inside Story*' (2017) 9(1) *Nonprofit Policy Forum* 1, 3; Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010 at 76, 307, 310.

[83] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 271-272.

[84] For a fuller discussion, see Rosemary Teele Langford (ed) *Governance and Regulation of Charities: international and Comparative Perspectives* (Edward Elgar, 2023) chapter 4.

[85] For a fuller discussion, see, for example, E Brody "Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption" (1998) 23 Journal of Corporation Law 585; M McGregor-Lowndes, M Turnour, E Turnour "Not for profit income tax exemption: is there a hole in the bucket, dear Henry? (2011) 26 Australian Tax Forum 601-631; R Colinvaux "Rationale and Changing the Charitable Deduction" (2013) 138 Tax Notes 1453; N Brooks "The Role of the Voluntary Sector in a Modern Welfare State" in J Phillips, B Chapman and D Stevens (eds) *Between State and Market: Essays on Charities Law and Policy in Canada* (Montreal & Kingston: McGill-Queen's University Press, 2001) 166 at 171; DG Duff "Tax Treatment of Charitable Contributions in a Personal Income Tax: Lessons from Theory and Canadian Experience" in M Harding, A O'Connell & M Stewart (eds) *Not-for-Profit Law: Theoretical and Comparative Perspectives* (Cambridge University Press, 2014) 199; R Atkinson "Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis and Synthesis" (1997) 27 Stetson Law Review 395 at 402 - 426; Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010 at E5 - E7; BI Bittker and GK Rahdert *The exemption of Nonprofit Organisations from the Federal Income Taxation* 85 Yale LJ (1976) 299.

64. Such an approach first requires that the appropriate tax benchmark is defined, so that the value of tax "expenditures" might be measured against that benchmark. However, there is no generally accepted ideal tax base: most tax systems are hybrid systems that have been built up over time, often as a result of a series of political compromises. Because each tax system will contain a number of non-neutralities and distortions, there will always be differing views about the standard or benchmark needed for tax expenditure analysis, meaning that what might seem like a "concession" from the point of view of one benchmark system might not be a concession at all when examined from another benchmark.[86]

65. In that context, it is important to note that tax systems are generally designed to tax individuals and businesses on their *personal gain*, resulting in a misfit for entities such as charities *where personal gain is prohibited*.[87] While there is no universal agreement on the ideal tax benchmark, there is remarkable consistency around the world in providing tax privileges for charities.[88] On this basis, charities are *outside* the normal tax base, and their tax privileges are not a "concession".[89]

66. The analogy of for-profit companies might illustrate the point: for-profit companies are subject to tax on their business income, but the tax system allows them to deduct expenses incurred in deriving that income in calculating the amount on which tax is imposed.[90] Such deductions reduce the amount of tax payable, but they are not conceptualised as "concessions", and companies are not considered to be "using what would otherwise be tax revenue":[91] for-profit companies are not expected to cede operational control over their day to day activities as a result of receiving these tax privileges. Instead, their independence is respected and day to day operational decisions about how to run the business, including whether to accumulate or pay dividends, are entrusted to those in charge of the company. The deductions are simply considered a proper measure of the tax base (a proper adjustment in arriving at the "benchmark").

67. Whether the tax privileges for charities are correctly characterised as a "concession" or a proper measure of the tax base was considered by the Australian Industry Commission, which made the following comments:[92]

> The Commonwealth Treasury view is that the revenue forgone from tax concessions to

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[86] *Charitable organisations in Australia,* Industry Commission, Report No 45, 16 June 1995, Australian Government Publishing Service, Melbourne, p 267.
[87] By virtue of the non-distribution constraint, as discussed above.
[88] See, for example, Industry Commission *Charitable organisations in Australia - Report No 45* 16 June 1995 at 292.
[89] See R Atkinson "Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis and Synthesis" (1997) 27 Stetson Law Review 395 at 431 n 110, 432: "It is a useful, but dangerous, shorthand to describe the tax exemption as a subsidy. It is … more properly understood, and defended, as an exclusion from the tax base … Congress is not 'giving' such organisations any 'benefits'; the exemption (or deduction) is not a 'loophole', a 'preference' or a 'subsidy' – it certainly is not an 'indirect appropriation'. Rather, the various Internal Revenue Code provisions comprising the tax exemption system exist basically as a reflection of the affirmative policy of American government to not inhibit by taxation the beneficial activities of qualified exempt organisations acting in community and other public interests … the charitable exemption reflects not only a desire to promote the helping of others, but also a healthy agnosticism about how that help can best be given, a willingness on the part of the majority to promote minority conceptions of the good of others … helping others our way will cost … But whether we assume those costs will depend, ultimately, on what kind of society we want to live in".
[90] Income Tax Act 2007 flowchart B2.
[91] See Tax Working Group *Future of Tax: Final Report* 21 February 2019 at 21 (recommendation 78), 103 - 104, [40], [42] - [44].
[92] *Charitable organisations in Australia,* Industry Commission, Report No 45, 16 June 1995, Australian Government Publishing Service, Melbourne, at 267 (emphasis added).

> [charities] is the *equivalent of government expenditure* and should be considered in relation to other forms of assistance to determine the most cost efficient use of government funds. *The alternative view* … is that the various deductions and exemptions available to donors and [charities] represent an *appropriate adjustment of the tax base and should not, therefore, be considered a concession.*
>
> While this may seem a sterile discussion, for most people in the sector the debate has *important implications for policy:*
>
> > If the deduction is seen as an absolutely necessary adjustment to income, it becomes 'a matter of principle' … and there remains little to discuss concerning the proper tax treatment of charitable giving. If it is an incentive, however, alternative subsidies are fair game for consideration. The tax policy debate over the last two decades suggests that the first view is *by no means universally accepted*.

68. We strongly submit that the tax privileges for charities are not appropriately characterised as either a "concession" or a "subsidy": they are merely a proper measure of the tax base. In addition, when the benefits provided by charities are taken into account, the tax privileges for charities do not amount to a net "fiscal cost".[93]

69. Another difficulty with a tax expenditure analysis is that it is not possible to know how charities would behave in the absence of the tax exemption: some charities earning business income may simply close down their businesses, thereby precluding any additional tax revenue for the government while also reducing funds available for the charities to devote to their charitable purposes. To the extent that services provided by charities are reduced or not carried out as a result, government may have to make up the shortfall; however, research indicates that charities carry out services more effectively and efficiently than government.[94] In other words, the removal of a tax privilege may in fact *increase* government's costs, potentially well beyond the amount that would otherwise have been "spent" on the exemption. The experience of other jurisdictions also indicates that attempts to tax the business income of charities *fail to raise any material revenue*.[95] The assertions that the tax privileges for charities "reduce government revenue and therefore shift the burden to other taxpayers" require critical analysis and an evidential footing: the reality is that the very opposite is more likely to be the case.

70. A tax expenditure analysis also inexorably leads to a mindset that charities should be merely instrumental to other more central objectives of the state:[96] it conceptualises tax exemption as an inducement to undertake specific activities or to engage in behaviour in a certain way. Under the classic conception of the quid pro quo approach, the state bestows tax exemption in recognition of charities "lessening the burdens of government".[97] This factor is reflected in the following comment in the issues paper:[98]

> If the Government wishes to encourage a particular economic activity, it is preferable

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[93] See A O'Connell *Taxation and the not-for-profit sector globally* in M Harding (ed) Research Handbook on Not-for-Profit Law (Edward Elgar, 2018) 388 at 397.
[94] See, for example, R Atkinson "Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis and Synthesis" (1997) 27 Stetson Law Review 395 at 403.
[95] See the discussion in *Focus on purpose,* chapter 5.
[96] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 14.
[97] Evelyn Brody, "Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption" (1998) 23 Journal of Corporation Law 585 at 590.
[98] Issues paper at [4.10].

> this is done in a transparent way by direct funding rather than through the tax system.

71. Again, no authority is cited in support of this controversial statement. It is short-sighted to view the tax privileges for charities as "encourage[ment for] a particular economic activity". With respect, this was the mistake Hon Roger Douglas made in 1987. The tax privileges for charities are not a proxy for direct grants: they are an investment in the type of society we want to live in.[99]

72. The importance of doing justice to the diversity of the charitable sector was noted by the Ontario Law Reform Commission in the following terms:[100]

> The federal regime of regulation [of charities] should not be based exclusively or even largely on the general premise that charities are doing the work of government and therefore that the exemption, deduction, credit are in some sense state subsidies and/or state incentives. The tax expenditure analysis in our view does not do justice to the diversity of the sector; it does not apply to a very substantial number of charities and even with respect to the ones for which it seems plausible, it often serves merely to undermine the sector's own self-understanding. Few people in the sector think or feel that they are doing the government's work, and many would be mildly offended if the government insisted they were.

73. A tax expenditure analysis is fundamentally at odds with the *independence* of the charitable sector which, as discussed above, is key to what makes them distinctive and valuable. Charities are private organisations, albeit for public purposes.[101] Reflecting the principle of *settlor autonomy*, the law makes it clear that people involved with charities have a legal duty to comply with the rules that *they have signed up to*.[102] Once an entity's purposes, as expressed in their constituting document, are accepted as charitable, it is for the charity to determine how best to further *those charitable purposes*, including in respect of decisions to accumulate or distribute funds. The tax privileges support charities' furthering their charitable purposes: they do not convert charitable dollars into government dollars. As noted by the National Council of Voluntary Organisations:[103]

> … perhaps part of the basic value of legal charity lies in the fact that it is not at the mercy of the dominant political agenda or the whim of fashion in public policy. This means charities can challenge the dominant orthodoxy, pilot and show the value of different approaches, and seek to educate or even sometimes change public opinion. This is not to argue that charities do not have a great deal to contribute to the Government's policy agenda, they obviously do. Around a quarter of charities seek, for example, to address poverty. Some support self-help groups. Others run extensive volunteering programmes. Most trustees are unpaid. *However, the fact that they contribute to achieving government policy objectives is incidental*.

74. The quid pro quo for the privileges of registered charitable status is the requirement for charities to provide comprehensive transparency and accountability information under the Charities Act: this quid pro quo should not be recast as a requirement for charities to cede day to day operational control to government simply because they

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[99] See R Atkinson "Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis and Synthesis" (1997) 27 Stetson Law Review 395 at 432.
[100] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 333.
[101] Matthew Harding "Independence and Accountability in the Charity Sector" in John Picton and Jennifer Sigaloos (eds) *Debates in Charity Law* (Hart, Oxford, 2020) 13, at 13-14.
[102] Trusts Act, sections 24 and 26; Companies Act, section 134; Incorporated Societies Act 2022, section 56.
[103] National Council of Voluntary Organisations *For the public benefit? A consultation document on charity law reform* 2001 at [4.1.4] (with emphasis added).

receive tax privileges. As with for-profit entities (which also receive tax privileges), charities are independent, self-governing entities: charities are bound by legal duties to further their stated charitable purposes, and best positioned to determine for themselves (within the parameters of their constituting document and the general law) how best to spend their own charitable funds in furtherance of their own charitable purposes (which must, by definition, operate for the public benefit). If a charity's specific charitable purposes happen to align with government objectives, all well and good, but charities must legally further *their own* charitable purposes. It is critical from the perspective of both tax and charities law policy that charities are not incorrectly conceptualised as merely an extension of the state. In Australia, this principle has been codified in section 5(d) of the Charities Act 2013 (Cth), which makes it clear that a charity may not be a government entity.

75. The tax privileges for charities should not be seen as a "fiscal cost" or as expenditure on charities individually, but rather as an investment in an overall *system*, and in the social capital and wellbeing of New Zealanders generally. Proposals in the issues paper that are based on a tax expenditure analysis and its accompanying assumptions have the potential to cause considerable harm to the charitable sector, and require critical examination before being progressed further.

The underlying clash of paradigms

76. The current hegemony of a tax expenditure analysis reflects one side of an "underlying clash of paradigms" that permeates the area of charities law. Broadly (and at the risk of oversimplification), one paradigm seeks to *restrict* charities and the other seeks to *enable* their work.[104]

77. In enacting the Charities Act 2005, Parliament made a decision to use the definition of charitable purpose as the gateway to certain privileges, including certain tax privileges.[105] The concept of charitable purpose is a creature of trust law: from their inception, charities were an adaptation of the private law institution of the trust.[106] Trust law is fundamentally a principles-based equitable area of law;[107] one might conceptualise it as *alkali*. Tax law, company law, and the "command and control" regulatory approach currently taken to the Charities Act are all rules-based, black-letter areas of law, which might be conceptualised as *acid*. If New Zealand creates a legal environment for charities that is too "acidic", it risks killing off the very things it is wanting to grow: instead, it will encourage that which thrives in an acidic environment, such as weeds, pests, and dis-eases.

78. In that context, it is important to bear in mind that the fundamentals of the Charities Act are not sound. The original Charities Bill that was introduced into Parliament in

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[104] For a fuller discussion, see Barker et al *The law and practice of Charities in Aotearoa New Zealand* 2ed (LexisNexis, 2024) at 497-505.
[105] The income tax exemption for charities currently contained in Income Tax Act 2007 s CW 41 (*Charities: non-business income*) (formerly Income Tax Act 2004 s CW 34, Income Tax Act 1994 s CB 4(1)(c), and Income Tax Act 1976 s 61(25)) turns on the definition of charitable purpose contained in s YA 1 (and its predecessors including Income Tax Act 1976 s 2): "charitable purpose 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 …". From 1 July 2008, charities had to be registered under the Charities Act in order to qualify for the exemption (s CW 41(2), (5)).
[106] As noted by the Supreme Court of Canada in *Vancouver Society of Immigrant and Visible Minority Women v Minister of National Revenue* [1999] 1 SCR 10 at [144].
[107] K Chan *The public-private nature of charity law* (Bloomsbury, 2016) at 1; H Brandts-Giesen *Need for genuine trust expertise has never been greater* 943 LawTalk 16 September 2020.

2004 was widely regarded as fundamentally flawed,[108] and was almost completely rewritten at Select Committee stage in response to hundreds of submissions, with further substantial changes made by Supplementary Order Paper, before being passed, under urgency, through all final stages on one day (12 April 2005). Concerns about "fast law" not making good law were assuaged at the time by then Finance Minister, the late Hon Sir Dr Michael Cullen, indicating that the Charities Act would be subject to a full first principles post-implementation review. Almost 2 decades later, no such review has been undertaken: instead, the Charities Act has been subjected to a series of piecemeal amendments that have similarly been rushed through, often against the strong opposition of the charitable sector.[109]

79. The Charities Amendment Act 2023 is an example of this. DIA itself acknowledges that its review of the Charities Act, which culminated in the Charities Amendment Act 2023, suffered from inadequate consultation, inadequate problem definition, and a lack of evidence to support the proposals.[110] Although it was Labour Party policy for the 2017 general election to prioritise the "long-promised review of the Charities Act … beginning with a first principles review of the legislation, including examining, updating and widening rather than narrowing, the definition of charitable purpose", as well as examining whether the disestablishment of the Charities Commission has improved things for the sector, and ensuring that charities can advocate for their charitable purposes without fear of losing their registered charitable status,[111] a succession of junior Labour Ministers reneged on this manifesto commitment (despite the Labour party ultimately having an absolute majority in Parliament) and instead permitted the review process to be overtaken by DIA officials. During the passage of the Charities Amendment Bill 169-1 through Parliament, reference was made to the very large *disconnect* between how DIA views the Charities Act, and how the vast bulk of the charitable sector views it.[112] This disconnect is apparent in the explanatory note to the Bill, which states that the fundamentals of the Charities Act were considered "sound and fit for purpose" (including the definition of charitable purpose), and a first principles review of the Charities Act was therefore "not needed".[113] However, throughout the review process, submitters made it very clear that the fundamentals of the Act are not sound, the definition of charitable purpose is not working well, and a first principles review of the Charities Act is very much needed if the charitable sector genuinely is to thrive and continue its vital contribution to community wellbeing.[114] The majority of submitters in fact called for

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[108] For a fuller discussion of the gestation and passage through Parliament of the original Charities Bill, see *Reflections on Regulatory Accountability* in Myles McGregor-Lowndes and Bob Wyatt (eds) *Regulating Charities: the Inside Story* (Routledge, 2017) ch 10.
[109] See the Statutes Amendment Bill (No 2) 2011 271-1 which became the Charities Amendment Act 2012; the Crown Entities Reform Bill 2011 332-1, part 3 of which became the Charities Amendment Bill (No 2) 2012 332-3C and then the Charities Amendment Act (No 2) 2012; the Statutes Amendment Bill 2015 71-1, part 3 of which became the Charities Amendment Bill 71-2B and Charities Amendment Act 2017; and the Charities Amendment Bill 169-1 which became the Charities Amendment Act 2023.
[110] See Te Tari Taiwhenua | Internal Affairs *Regulatory Impact Statement: Modernising the Charities Act* (Report, 19 October 2021) at 3, 6, 9, 10, 45, 53, 120.
[111] New Zealand Labour Party *Community and Voluntary Sector Manifesto 2017* at 1, 4, 5.
[112] See for example Charities Amendment Bill 169-3 In Committee (20 June 2023) NZPD per Hon Louise Upston (National — Taupō, then in opposition but since then appointed the new Minister for the Community and Voluntary Sector).
[113] charitiesact frequently asked questions - dia.govt.nz
[114] For a summary of submissions during the review process, see Te Tari Taiwhenua Internal Affairs *Modernising the Charities Act 2005 - Summary of submissions* December 2019, for example at 10: "Calls for a comprehensive first principles review: Nearly all submitters asked for the scope of the review to be widened". See also S Barker *What does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3.

the Bill to be *withdrawn*, and for Labour to honour its manifesto commitment to carry out a proper, first principles, post-implementation review of the Act, one carried out *independently* of DIA. Significantly, the Charities Amendment Bill was opposed by every MP in Parliament outside of Labour (that is, by National, ACT, the Green Party of Aotearoa New Zealand, Te Pāti Māori, Dr Elizabeth Kerekere and Hon Meka Whaitiri).

80. The series of piecemeal changes to which the Charities Act has been subjected over the past 2 decades, including in particular the Charities Amendment Act 2023, have slowly eroded the gains made by charities in 2004, and slowly changed the underlying paradigm of the legislation from an enabling framework to one of ever-increasing restriction. Combined with a depleted media, the net result is that Charities Services is now effectively able to operate as a law unto itself, able to make its own rules behind closed doors with no meaningful transparency or accountability whatsoever: New Zealand has effectively devolved to a business unit of a government department the power to determine, with almost complete subjectivity, the nature and scope of its civil society.

81. Add to this a "hunger games" funding environment,[115] that pits charities against each other in a struggle for survival,[116] and the cohesiveness of the charitable sector, and charities' natural inclinations to collaborate and build cooperative networks in furtherance of shared purposes and social justice,[117] are undermined.[118]

82. As a small, unicameral, non-federal nation, with a "do-it-yourself" mindset forged by geographical isolation, and a proud history of sticking up for itself on the world stage, often described as the "social laboratory of the world", you would think that New Zealand would be steadfastly on the side of liberal democracy, and therefore on the *enabling* side of clash of paradigms. However, as it turns out, New Zealand now has *the most restrictive* charities law framework of all comparable jurisdictions, in application if not in legislation. New Zealand appears to be unthinkingly following the model of China: the charities law framework is being used to privilege charities that have a contract with government, while at the same time being used as a tool for suppression of not-for-profit advocacy.[119] Combined with the most comprehensive framework of transparency and accountability requirements for charities, discussed above, New Zealand effectively now has the worst of both paradigms. As New Zealand increasingly creates an "acidic" environment, it is no surprise that the charitable sector is struggling; New Zealand is creating the very environment that

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Submissions on the Charities Amendment Bill can be accessed on the Parliament website at https://bills.parliament.nz/v/6/3550d34e-8dd7-4f7b-b87c-59059878dad0?Tab=sub.

[115] Vu Le *What are we willing to give up to end the nonprofit hunger games?* Nonprofit AF 27 April 2020: https://nonprofitaf.com/2020/04/what-are-we-willing-to-give-up-to-end-the-nonprofit-hunger-games/.

[116] 'A lingering survival of the fittest culture pits non-profits against one another in the endless hunt for funding': <www.theglobeandmail.com/business/careers/leadership/article-do-you-work-in-a-non-profit-nows-the-time-to-convince-your-directors/>, April 2021.

[117] LN Tink and BC Kingsley *Transforming the Non-Profit Community in Edmonton: Phase 1 — identifying myths, trends and areas for change* (Edmonton Chamber of Voluntary Organisations: Edmonton AB, 2021) at 10, 21; Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010 at J4, J5.

[118] LN Tink and BC Kingsley *Transforming the Non-Profit Community in Edmonton: Phase 1 — identifying myths, trends and areas for change* (Edmonton Chamber of Voluntary Organisations: Edmonton AB, 2021) at 22. See also Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010 at J3, quoting from the Sydney Morning Herald: 'having non-profit groups engaging in cutthroat competition has produced some poor — not to mention perverse — results'.

[119] For a fuller discussion, see Barker et al *The Law and Practice of Charities in Aotearoa New Zealand* 2ed (LexisNexis, 2024), chapter 8.

prevents the charitable sector from thriving.

83. The proposals in the issues paper will only make this issue worse. It is important to resist the impulse to "create more rules": attempts to impose "command and control regulation" on the charitable sector is a fraught exercise. For example, attempting to establish in advance the parameters of desirable conduct sits uneasily with a principles-based area of law that requires flexibility to cater for a wide diversity of situations.[120] In short, a quest for "regulatory certainty" risks damaging or distorting the very concept on which the regime is based, an incongruity that the President of the Court of Appeal (as he was then) might describe as the common law "making a hash of equity".[121]

84. Charities law issues are complex and their impact far-reaching: the legal framework needs to work for charities and society more broadly and must be about more than the administrative convenience of DIA. Before we make any more kneejerk, piecemeal, siloised changes, it is critical to ensure that the fundamentals of the charities law framework as a whole are sound. They are not. To make any changes to the tax settings for charities now would therefore not only be premature but would risk making the situation for charities worse: any tax changes should be deferred until a proper review of the Charities Act (one carried out *independently* of the Department of Internal Affairs) has taken place.

Purpose-based governance

85. Another factor that appears to have been overlooked in the issues paper is the restrictions to which charities are already subject.

86. For example, in order to register as a charity, an entity must have a set of rules.[122] Those rules must meet a number of requirements in order for the entity to be eligible to gain or maintain charitable registration.[123]

87. In the first instance, a charity's rules must make it clear that it is a "not-for-profit" entity:[124] that is, that it is subject to the "non-distribution constraint".

88. A charity's rules must also articulate purposes that meet the legal test of being exclusively charitable. Having done so, the rules must also limit the entity to furthering charitable purposes, rather than the private pecuniary profit of any individual,[125] even if the rules are amended, and even on winding up.[126] This principle

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[120] See C Decker and M Harding "Three challenges in charity regulation: the case of England and Wales" in M Harding, A O'Connell & M Stewart (eds) *Not-for-Profit Law: Theoretical and Comparative Perspectives* (Cambridge University Press, 2014) 314 at 315 - 316, 319.
[121] Kós P, opening address to the Charity Law Association of Australia and New Zealand Conference "Murky Waters, Muddled Thinking: Charities and Politics" 4 November 2020 at [33] - [35].
[122] See Charities Act, sections 17(1)(c), 24(1)(e), and 40(1)(e).
[123] See, for example, Charities Services | Ngā Ratonga Kaupapa Atawhai *Charitable purpose and your rules*: https://www.charities.govt.nz/ready-to-register/need-to-know-to-register/charitable-purpose-and-your-rules/.
[124] Note that section 4(1) of the Charities Act defines an "entity" to mean a "any society, institution, or trustees of a trust".
[125] M McGregor-Lowndes "An Overview of the Not-for-Profit Sector" in M Harding (ed) *Research Handbook on Not-for-Profit Law* (Edward Elgar, 2018) 131 at 132 - 133, referring to H Hansmann "The Role of Nonprofit Enterprise" (1980) 89 Yale LJ 835, among others.
[126] See Charities Services *Charitable purpose and your rules*: <www.charities.govt.nz/ready-to-register/need-to-know-to-register/charitable-purpose-and-your-rules/>. If a registered charity's constituting document allows the charity to be wound up, the winding up clause must require all surplus assets, after payment of liabilities and the expenses of winding up, to be distributed to charitable purposes in order to be eligible for registration. This requirement is buttressed by the "deregistration tax" contained in s HR 12 of the Income Tax Act 2007, which is designed to ensure assets of a charity that is deregistered can only be used for charitable purposes.

is known as the "destination of funds test": in principle, charities law is agnostic as to how a charity raises its funds (subject to the general law), provided all activities of the charity are carried out in furtherance of its stated charitable purposes (and otherwise in accordance with its constituting document) and all funds, however raised, are ultimately destined for charitable purposes.[127] Once funds are impressed with charitable purpose, they must be forever destined for charitable purposes.

89. The issues paper refers to the destination of funds test as a "destination of income" approach.[128] However, this characterisation is not correct: *all* funds of a charity must be destined for its charitable purposes.[129]

90. The rules of a charity must also make it clear that none of its funds may be applied to the private pecuniary profit of any individual (the "prohibition on private pecuniary profit"): although fair value may be paid for goods and services actually rendered,[130] owners or stewards of a not-for-profit entity are prevented from personally enjoying any profits.

91. These three principles (the non-distribution constraint, the prohibition on private pecuniary profit, and the destination of funds test) are arguably all different ways of saying the same thing: those concerned with a charity can have confidence that its funds will be used only to further its charitable purposes, both during the life of the entity and on its winding up.

92. The effect of these requirements is that, if a charity is complying with its rules, it must be furthering its stated charitable purposes, and cannot, by definition, be providing unacceptable private benefit to anyone. The following statements in the issues paper appear to overlook this factor:

> 2.6 [The destination of funds] approach allows income to be accumulated tax free for many years within a registered charity, or within its registered business subsidiaries, *before the public receives any benefit*.
>
> 3.6 In donor-controlled charities [sic] there can be a significant lag between the time of tax concessions [sic] for the donor and the charity, and the time of the ultimate public benefit. This occurs when the donor-controlled charity accumulates most or all its funds and makes no or very minimal charitable distributions.
>
> 3.17 To mitigate concerns about unrestricted [sic] accumulation *and a significant timing mismatch between the tax benefit and the ultimate public benefit being achieved*, donor controlled charities could be required to make a minimum distribution each year for charitable purposes.

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[127] For charities, once funds or other assets are impressed with charitable purpose, they must be forever destined for charitable purposes, including on winding up. See *Trustees of the Auckland Medical Aid Trust v CIR* [1979] 1 NZLR 382 (SC) at 387; *Commissioner of Inland Revenue v Carey's (Petone and Miramar) Ltd* [1963] NZLR 450; *Calder Construction Co Ltd v Commissioner of Inland Revenue* [1963] NZLR 921; and *Commissioner of Inland Revenue v NTN Bearing-Saeco (NZ) Ltd* (1986) 8 NZTC 5,039.

[128] Issues paper at [2.5].

[129] See, for example, Advisory Committee on the Charitable Sector *Report #3 – Towards a federal regulatory environment that enables and strengthens the charitable and non-profit sector* July 2021: <www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/corporate-reports-information/advisory-committee-charitable-sector/report-advisory-committee-charitable-sector-july-2021.html>: "There is wide-spread interest from many charities in an approach that focuses on the uses and not the sources of funds for charitable purpose. The solution suggested by some in the sector is to apply a "destination of funds" test (in other words an approach that enables charities to earn revenues from business-type activities as long as those revenues are dedicated to charitable purposes)".

[130] It is important to note that incidental private benefits do not prevent a purpose from being charitable: *Latimer v Commissioner of Inland Revenue* [2004] 3 NZLR 157 (PC) at [35] - [36].

93. With respect, these statements reflect a fundamental misconception of charities law: it is simply not correct to say that charities do not benefit charitable purposes until they distribute funding. All activities carried out by a charity must be undertaken in furtherance of its stated charitable purposes. Every decision made by every charity, including a decision to accumulate rather than spend, must be made in the best interests of those charitable purposes.

94. As noted by the National Council of Voluntary Organisations ("**NCVO**"):[131]

> … the charitable status of an organisation, and hence its entitlement to charitable tax reliefs, does not directly depend on how much it achieves. It depends on what it sets out to do, its charitable objects. It is easy, however, to exaggerate this contrast. As soon as an organisation is established as a charity, the law requires that it actually does that and only that which it was set up to do. If the organisation's activities do not in fact further its purposes then, in time, its activities must change to conform to the law. So while the law does not specify exactly what the activities in question must be, or exactly which outcomes they must have, it does specify that they must in general be worthwhile activities with worthwhile outcomes, with their worth being judged by their contribution to the objects that the law judges charitable.

95. The NCVO continued as follows:[132]

> Would it be better, the Government might ask, for the law to decide which activities are worth subsidising according to what they actually achieve? To this, there are at least four responses. *One is that charitable tax reliefs are not subsidies. Since there is no distributed profit, but only reinvestment in the worthwhile objectives, there is nothing there to tax*. The second is that the monitoring and enforcement costs involved in tracking the usefulness of charitable activities, together with the costs of *lost goodwill and enthusiasm from the monitored organisations and their workers, will eat dramatically into any savings which may be made by withdrawal of tax reliefs from underachieving organisations*. Thirdly, we may anyway doubt *whether the law, or the Government, is always best placed to decide which activities are useful or which outcomes are desirable*. And fourth, it is in any case a mistake to think that all the worth in charitable activities can be understood in terms of the outcomes of those activities as opposed to their intrinsic value as expressions of public moral concern …
>
> When the 1992 Charities Act was discussed in the Lords it was mooted that an activities test was needed. The argument made against this was that such a test would be too difficult both to define and to apply in practice. It is easy to understand why this argument might have been made – imagine the difficulty of defining a beneficial activities test that could encompass the diversity of the charitable sector's work. It was suggested by some of those submitting evidence that a more obvious concern with what organisations do and achieve would promote public confidence in charities. However, as the term "more obvious concern" indicates, the law already allows an emphasis on activities and outcomes. Consideration is given to whether the pursuit of the particular purposes of the organisation will benefit the public. Organisations are not granted charitable status if it is believed either that their objects will do harm or that they will not achieve benefit. The proposed activities of the organisation are assessed on application to ensure that they are in accord with the organisation's objects. Further, if charities act outside their objects or fail to pursue them with proper care they are acting in breach of trust and trustees are personally liable for any funds that have been lost or

[131] National Council of Voluntary Organisations *For the public benefit? A consultation document on charity law reform* January 2001 at [2.5.7].
[132] National Council of Voluntary Organisations *For the public benefit? A consultation document on charity law reform* January 2001 at [2.5.8], [3.2.2] (with emphasis added).

misapplied.

96. These arguments apply equally in a New Zealand context. As Parachin and Murray have noted,[133] a focus on activities in a purpose-based area of law creates a "square peg, round hole" problem: it leads to a regulatory focus on quantitative measures of activities (such as "how much" accumulation or business activity a charity can undertake) that are "confusing, costly to quantify and track, and do not address the substantive issue of ensuring charities are operating for recognised charitable purposes".[134] An activities-based approach also assumes that government knows better than charities how to further their charitable purposes, which can stifle or demoralise voluntary effort. Fundamentally, the proposals in the issues paper reflect the wrong paradigm. As Laird Hunter QC has noted, "doing good shouldn't be so hard".[135]

97. Changes based on misconceptions should not be made: in the absence of clear empirical evidence as to whether a perceived problem actually exists, and clear analysis as to whether any such perceived problem could not be more than adequately dealt by using tools that already exist, changes to the tax settings for charities should not be made.

Enforce the fiduciary duties

98. The issues paper also does not analyse the impact of the fiduciary duties to which every registered charity is subject. In our view, this is a critical omission.

99. Having required every registered charity to have a set of rules, the law then imposes important fiduciary duties on those involved with the charity to *comply* with those rules.

100. For charities that are structured as companies, section 134 of the Companies Act 1993 provides that the directors must act in accordance with the company's constitution. This duty was then imported into section 56 of the Incorporated Societies Act 2022, which requires officers of incorporated societies to act in accordance with the society's constitution. The Trusts Act 2019 similarly provides that trustees must know and act in accordance with the terms of the trust.[136] These duties can collectively be thought of as the "duty of obedience".

101. For charities that are structured as companies, section 131 of the Companies Act also provides that directors have a duty to act in good faith and in what the director believes to be the best interests of the company. This duty was then imported into section 54 the Incorporated Societies Act, which requires officers of incorporated societies to act in good faith in the best interests of the society.

102. However, while incorporated societies do have some things in common with companies, they are by definition not-for-profit entities, which means they are "all about their purposes", as discussed above. There is considerable support for the

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[133] A Parachin "Regulating Charitable Activities through the Requirement for Charitable Purposes: Square Peg Meets Round Hole" in J Picton and J Sigafoos (eds) *Debates in Charity Law* (Hart, 2020) 129 at 129; I Murray "How Do We Regulate Activities within a Charity Law Framework Focussed on Purposes?" (2020) 26(2) Third Sector Review 65.

[134] *Report of the Consultation Panel on the Political Activities of Charities* 31 March 2017: <www.canada.ca/en/revenue-agency/services/charities-giving/charities/about-charities-directorate/political-activities-consultation/consultation-panel-report-2016-2017.html> at 17.

[135] Interview with Laird Hunter QC, Edmonton, Canada (4 February 2021).

[136] Trusts Act 2019, sections 23 and 24.

proposition that the "best interests" of an entity that exists to pursue purposes are *what would best further those purposes*. In other words, the "interests" of a purpose-based entity are synonymous with its purposes.[137] The distinction is important because what might further the purposes of a charity, and what might be in the best interests of the charity as an *entity*, might conflict. For example, where the purposes of a charity been satisfied, it may no longer be necessary or useful for the charity to continue to exist. Acting in the best interests of the *entity* would encourage the charity to continue even though the purpose has been satisfied; however, fidelity to *purpose* would make it clear that purpose is the overarching paradigm, and the charity should close, even if closure would not necessarily be in the best interests of the charity as an entity in itself. It may be for this reason that the Trusts Act articulates the duty as being one to further the charitable purposes in accordance with the terms of the trust.[138] It is charities' commitment to their purposes that underpins support for their activities, protects against mission drift and builds the trust that enables them to provide their unique value to society.

103. Collectively, these duties can be thought of as the "duty of loyalty".

104. For charities that are structured as charitable trusts, incorporated societies or charitable companies, these duties of loyalty and obedience clearly apply to them by statute. Importantly, however, these statutory duties merely codify the underlying common law: in its review of trust law, the Law Commission noted that the statutory list of duties in the Trusts Act was a summary only, intended to restate well-accepted principles of case law in simplified form;[139] similarly, the Incorporated Societies Act sought to codify the duties of officers of incorporated societies "as they might be described if a court were to comprehensively list them";[140] a similar process of codifying directors' common law duties was undertaken when the Companies Act was enacted in 1993.

105. In other words, whether a charity is incorporated under one of these Acts or not, a court would be expected to find that those who have signed up to the charity's rules have fiduciary duties to comply with them, including the stated charitable purposes:[141] the focus of the underlying law is on holding people involved with charities to the charitable purposes that *they have signed up to.*

106. Acting in breach of the fiduciary duty is "unlawful" and therefore already constitutes serious wrongdoing as that term is defined in section 4 of the Charities Act (which in turn is grounds for Charities Services to take action, including deregistration under section 32(1)(e)).

107. In other words, rather than trying to "regulate" charities' legitimate activities by distorting the definition of charitable purpose, or slicing and dicing the charitable sector into arbitrary categories for the purpose of devising arbitrary bright line rules

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[137] See, for example, Rosemary Teele Langford *Purpose-based governance: a new paradigm* UNSW LJ 954; and Ian Murray and Rosemary Langford "The Best Interests Duty and Corporate Charities - The Pursuit of Purpose" (2021) 15 *Journal of Equity* 92.
[138] Trusts Act 2019, sections 25 and 26.
[139] Te Aka Matua o te Ture - Law Commission *Issues Paper 31 – Law of Trusts: Preferred Approach Paper* 13 November 2012 at [3.8] – [3.10].
[140] MBIE Hīkina Whakatutuki *Exposure Draft: Incorporated Societies Bill Request for Submissions* November 2015 ISBN 978-0-908335-76-3 at [75].
[141] See also S Barker *Focus on purpose – what does a world-leading framework of charities law look like?* [2022] NZLFRR 3 (the "*Focus on purpose*" report), recommendation 2.1.

regarding accumulations or other activities in a fundamentally purposes-based area of law, an infinitely better approach would be to *enforce the fiduciary duties*.

108. In the first instance, this should be done by simply asking questions: any registered charity should be aware that, as a condition of its registration, it may be called upon to demonstrate how any decision, for example to accumulate rather than spend, has been made in good faith in the best interests of its stated charitable purposes and otherwise in accordance with its rules and the general law. IRD has itself acknowledged that removing the business income tax exemption "might not be necessary if accumulations were monitored":[142] in other words, if there was an instance of a particular charity unduly hoarding funds, the issue could be more than adequately dealt with by "questions from the monitoring authority".[143] Such questions are informed by the comprehensive information now made available by means of the charities register. Provided the charity can demonstrate that any particular accumulation has been indeed made in good faith in the best interests of its stated charitable purposes, in principle, there is no difficulty,[144] no reason for the state to intervene, and no need for additional rules. Instead, if this minimum threshold can be satisfied, the onus would fall to those who allege otherwise to demonstrate that the charity's decision was or could not have been so made, if they wanted to take further action.

109. Such an approach respects the independence and diversity of charities, and works *with* the underlying law, rather than cutting across it. Charities law contains built in protections against unacceptable private pecuniary profit, while also allowing flexibility for the wide variety of ways in which public benefit might be furthered. Working with the underlying law in this way provides clarity of mandate for Charities Services and Inland Revenue, a clear basis for oversight of charities' activities and clear limits for regulatory intervention, without requiring blanket granular assessments of charities' activities that risk excessive regulation and stifling of voluntary effort.

110. As discussed in more detail chapter 8 of *The Law and Practice of Charities in Aotearoa New Zealand* 2ed (LexisNexis, 2024), the focus of a charities law framework should be on enforcing the fiduciary duties (that is, "purpose-based governance") supported by "explanatory accountability" (now readily made possible by means of the financial reporting rules), rather than on ever-increasing "command and control" regulation.[145] If there is doubt that the fiduciary duties already apply, a better approach would be to *clarify* their application rather than introducing new, complex rules that will cut across the underlying law and be expensive to comply with and administer.

111. Against that backdrop, our specific comments on the proposals in the issues paper follow.

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[142] Inland Revenue Department *Tax and charities, a government discussion document on taxation issues relating to charities and non-profit bodies* June 2001 at [9.8].
[143] Inland Revenue Department *Tax and charities, a government discussion document on taxation issues relating to charities and non-profit bodies* June 2001 at [9.8].
[144] *Re The Foundation for Anti-Aging Research and The Foundation for Reversal of Solid State Hypothermia* (2016) 23 PRNZ 726 at [88].
[145] For a fuller discussion, see Rosemary Teele Langford (ed) *Governance and Regulation of Charities: international and Comparative Perspectives* (Edward Elgar, 2023) chapter 4.

CHAPTER 2 – BUSINESS INCOME TAX EXEMPTION

112. The government's stated objectives in reviewing the tax settings for charities include "simplifying tax rules and reducing compliance costs".[146] Despite this, chapter 2 of the issues paper proposes the following cocktail of measures for charities:

    (i) taxing the "unrelated" business income of tier 1 and 2 charities;

    (ii) making exceptions, for example when the business is "*substantially* run by unpaid volunteers" or "*primarily* engaged in selling donated goods or services" or for "certain fundraising activities that are promoted primarily to raise money for the benefit of a charity" (which would arguably described every "unrelated" business of a charity);

    (iii) allowing deductions for distributions (donations or dividends) paid by a charity business to its parent charity (with no such deduction apparently available where the charity carries out the business itself);

    (iv) adding a new anti-avoidance rule to ensure that amounts distributed by the business are not immediately reinvested by the charity back into the business;

    (v) creating a "special memorandum account", similar to an imputation credit account or Māori authority credit account, allowing credits for tax paid to be refundable when they are attached to dividends paid to their charitable parent in later years (again, with no similar provision apparently available where the charity carries out the business itself);[147] and

    (vi) creating new rules to ensure that unrelated business income earned by a charity through a limited partnership is taxable.

113. These proposals are based on three fundamental assumptions:

    (i) that the business income tax exemption for charities gives charities a competitive advantage in terms of an ability to grow a business faster through an ability to accumulate funds tax-free (this perceived advantage is referred to below as a "**competitive advantage in relation to expansion**");[148]

    (ii) that a charity accumulating funds is not applying them for the benefit of charitable purposes;[149] and

    (iii) that the business income tax exemption for charities results in a loss of tax revenue, that "shifts the tax burden to other taxpayers".[150]

114. Not one of these assumptions bears critical examination, as discussed further below.

115. The issues paper also raises three other justifications (referred to as "second-order imperfections") for removing the business income tax exemption for charities:[151]

    (i) The issues paper suggests that charitable trading entities may have an "advantage" over non-charitable trading entities "in that they do not face the

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[146] Issues paper at [1.6].
[147] It is not clear to us how such an approach would be preferable to a charity simply claiming a deduction for a distribution made to a "donee organisation" under section DB 41 (assuming the charity was structured as a company).
[148] Issues paper at [2.14].
[149] Issues paper at [2.6].
[150] Issues paper at [2.4], [2.15], [1.4].
[151] Issues paper at [2.13].

compliance costs associated with a tax obligation", arguing that this "lowers their relative costs of doing business".[152] However, this suggestion overlooks the fact that registered charities are required to incur significant compliance costs in preparing the comprehensive transparency and accountability information required under the financial reporting rules, which information must be made publicly available on the charities register. Taxpaying businesses are not generally subject to the significant compliance costs associated with these comprehensive disclosure obligations. Charities are also subject to the compliance costs of tax obligations such as PAYE and GST. In addition, if a charity breaches the territorial restriction or the control restriction of section CW 42, its business income will be subject to tax. There is no evidence to suggest that charities have lower relative costs of doing business. To the contrary, given their financial reporting obligations, the relative costs for charities are likely to be higher than their for-profit counterparts. We submit that the first bullet point in paragraph [2.13] does not raise a "second-order imperfection" justifying removal of charities' exemption from income tax and should instead be put to one side.

(ii) The issues paper also suggests that non-refundability of losses for taxable businesses "can result in a disadvantage for such business relative to tax-exempt businesses, resulting in a higher relative rate of return for non-tax paying businesses over time when there has been a loss in one year".[153] With respect, this argument appears to be clutching at straws. Far from being a disadvantage, taxpaying businesses have an *advantage* in that they are able to carry forward losses to be offset against future income (as the issues paper itself notes, inconsistently with its own argument, at [2.11]). In addition, taxpaying businesses also have the advantage of being able to utilise imputation credits: the fact that imputation credits are non-refundable means that charities effectively *are* subject to income tax on their investments in New Zealand companies, an important point that is not analysed in the issues paper.[154] It is not clear that non-refundability of losses is indeed a "second-order imperfection", or how it in any way adds to the debate as to whether the business income of charities should be taxed. We submit that the second bullet point in paragraph [2.13] should also be put to one side.

(iii) The issues paper then goes on to suggest that charities' ability to accumulate funds tax-free "may give them lower costs in raising capital":[155]

> The costs associated with raising external capital, such as negotiating with investors or banks, can be significant. These costs often make retained earnings the most cost-effective form of financing.

The issues paper does not cite any evidence in support of this statement, which overlooks the significant advantage for-profit businesses have in simply being able to *access* these forms of capital. Although the paper acknowledges that charities "generally cannot raise equity capital (as private investors cannot receive a return)",[156] the paper does not acknowledge that charities' ability to

[152] Issues paper at [2.13].
[153] Issues paper at [2.13].
[154] Beyond minor passing reference: Issues paper at [2.9], footnote 3.
[155] Issues paper at [2.13].
[156] Issues paper at [2.13].

access debt capital is also limited. For example, governments tend not to lend to charities, as priorities have shifted towards delivery of services, thereby restricting charities' ability to access government funding for capital development; the use of philanthropic capital on a loan basis to charities is similarly not widespread. Access to debt capital in the form of conventional loan finance is also limited, as charities often fail conventional lending criteria: income (for example from donations or government contracts) may be inherently uncertain, depriving charities of a stable revenue stream to service the debt; charities with government contracts may also have contract periods shorter than the debt service period which may cause particular uncertainty over ability to pay. Charities also have no "owner" to put their personal assets at risk, depriving many charities of suitable assets for collateral, creating further potential difficulties for accessing conventional loan finance. There are currently significant issues with charities being "de-banked", often due to the considerable additional due diligence requirements charities may be subjected to under anti-money laundering requirements.[157] In other words, far from providing charities with a competitive "advantage" or the ability to "grow a business faster", the ability to accumulate pre-tax funds merely *offsets* significant disadvantages that charities face in their ability to access sufficient capital to expand to an optimal size.[158]

116. These points are significant: the "second-order imperfections" listed in paragraph [2.13] of the issues paper do not raise any rationale, let alone a compelling one, for removing charities' exemption for business income.

117. The absence of a compelling rationale is underscored by the three fundamental assumptions on which the proposal to remove charities' exemption for business income is based. These three assumptions do not bear critical scrutiny, for the reasons discussed next.

Assumption 1: that the business income tax exemption provides charities with a competitive advantage in relation to expansion

118. The issues paper acknowledges that the business income tax exemption does not provide charities with a competitive advantage in relation to pricing;[159] however, it argues instead that a charity "could" have an "advantage" if it were to "accumulate its tax-free profits back into the capital structure of its trading activities, enabling it, through a faster accumulation of funds, to expand more rapidly than its competitors".[160] The issues paper appears reluctant to use the words "competitive advantage" in this context, describing its concern as one of merely an "advantage" or "unfair competition".[161] However, an alleged "advantage" to "competitors" is clearly a "competitive advantage" by any other name: in other words, the issues paper's underlying concern appears to be that the business income tax exemption gives charities a "competitive advantage in relation to expansion". In this regard,

[157] See the discussion in Community Networks Aotearoa | Te Hapori Tuhononga o Aotearoa *Better Banking for All* 2023: https://www.communitynetworksaotearoa.org.nz/banking-issues-in-the-community-sector8b737fea.
[158] See also the discussion in Austaxpolicy: Tax and Transfer Policy Blog *Do Businesses Run by Charities Have a Competitive Advantage?* 17 November 2021.
[159] Issues paper at [2.7] to [2.23].
[160] Issues paper at [2.14].
[161] Issues paper at [2.4], [2.14].

the issues paper makes the following comments:[162]

> The current tax policy setting makes New Zealand an **international outlier**. According to a 2020 OECD study, most countries have either restricted the commercial activities that a charitable entity can engage in, or they tax charity business income if the business income is unrelated to charitable purpose activities. These countries have typically been concerned with a loss of tax revenue from businesses if a broader tax exemption was applied, **unfair competition** claims, a desire to separate risk from a charity's assets, and a desire to encourage charities to direct profits to their specified charitable purpose.

119. It is misleading to state that the current tax policy settings make New Zealand an "international outlier": many countries do not tax the business income of charities, including, most notably, Australia. Australia has looked closely at its business income tax exemption for charities no less than 4 times, and consistently found that it should remain in place. Far from being international outliers, countries that do not tax the business income of charities are actually world-leaders:[163] other jurisdictions are looking to countries such as New Zealand and Australia as "leading the way" with respect to their tax treatment of the business income of charities. For example, in Canada, the Special Senate Committee on the Charitable Sector recently recommended a return to a clear destination of funds test, along the lines adopted in Australia:[164]

> Charities [in Canada] are restricted as to the forms of business-like activities they may undertake to generate revenue for use in charitable activities. The rules surrounding permissible activities are *complex* and have evolved over the years. Legal interpretation of the current case law and CRA policy holds that, to be permissible, "*business activity must … play a clearly minor role, in terms of both resources and attention, in comparison to the charity's charitable purpose*".
>
> These provisions are widely held to be *outdated*:
>
> > When the current provisions of the Income Tax Act were written more than a half-century ago, charities operated primarily on the basis of receiving donations from individuals and corporations. According to some of those who were involved in drafting the existing rules related to business activities by charities, those provisions were meant to cover things like hospital auxiliaries running gift shops. They certainly did not foresee situations where charities would be landlords or even developers, when they would operate state-of-the-art fitness facilities or provide endorsements for a fee.
>
> Witnesses, including Brian Emmett (Imagine Canada), argued that reform is sorely needed, particularly in light of the context in which charities operate. By his estimate, Canada's social deficit gap will stand at approximately $26 billion in 2026, placing increasing pressure on charities. In order to meet growing demand, witnesses, including Mr Emmett, told the committee that charities will need to explore every funding opportunity available to them. In Mr Emmett's view, a declining donor base,

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[162] Issues paper at [2.4] (with bolding added)
[163] See, for example, Emily Harle *Donor-reliant funding has 'reached its limits', researchers warn* ThirdSector 20 March 2025: "The funding sources civil society groups have long relied on are increasingly unreliable, politically constrained or inadequate for today's needs … funding often reproduces economic and political power imbalances and can lead to a project-driven civil society unable to confront power … Out of necessity, many civil society groups, particularly in the global south, are already pioneering [other approaches, such as social enterprise], distributing financial risk, increasing independence and making themselves accountable to the communities they serve rather than external funders. Civil society as a whole can learn from these examples".
[164] Report of the Special Senate Committee on the Charitable Sector *Catalyst for Change: A Roadmap to a Stronger Charitable Sector* June 2019 at 88 - 92 (emphasis added).

> coupled with challenges in accessing government funding, means that earned income is the only option that offers "any prospect of long-term growth"
>
> Proposed solutions
>
> *Many witnesses argued that adopting a "destination of funds" test is key to helping charities raise much needed revenue*. As one witness observed:
>
> > It's time to permit a charity to carry on any type of revenue-generating activity so long as the proceeds are used to further its charitable purpose. This would mean the focus would be on the use to which the funds are put, not on how it raises the money.
>
> Witnesses … noted that the destination of funds test had been successfully adopted in Australia, following a High Court decision in the *Word Investments* case. For his part, Gordon Floyd argued that *Canada should follow the example of other common law jurisdictions and allow charities to earn revenue "that can help fund their vital core costs"* …
>
> *Venture failure*
>
> Witnesses recognised the risk inherent in business, acknowledging that some charities' business ventures would fail. However, while recognising not all charities would have the expertise to undertake revenue generating activities, witnesses maintained that charities, in consultation with their professional advisers, should be free to make this decision for themselves …
>
> Overall, although recognising that difficulties could arise with the implementation of a destination of funds test, witnesses believed that these challenges are not insurmountable. In terms of strategies to mitigate any negative effects, the Muttart Foundation suggested that the CRA should develop "additional guidance" in consultation with charities … Ms Manwaring noted that … technological change has delivered opportunities for revenue generation that have not yet been contemplated by the current administrative guidance on permissible related business.
>
> The committee is acutely sensitive to the need to explore innovative means of ensuring adequate funding for the sector, while simultaneously protecting against undue risk. The committee also understands the need for clear guidance to help charities confidently navigate the rules with which they must comply.

120. On the basis of the above, the Special Senate Committee made the following specific recommendations in the context of charities running businesses:[165]

> Recommendation 28 – that the Government of Canada direct the Canada Revenue Agency to develop and implement a pilot project to assess the viability of granting registered charities greater latitude in undertaking revenue-generating activities (provided the proceeds are used to further charitable purposes) through the implementation of a "destination of funds" test.
>
> Recommendation 29 – that the Government of Canada direct the Canada Revenue Agency to update policy statement CPS-019 (what is a related business) to provide greater clarity on permissible revenue generation activities for registered charities, particularly with regard to revenue generating opportunities arising from new technologies.

[165] Report of the Special Senate Committee on the Charitable Sector *Catalyst for Change: A Roadmap to a Stronger Charitable Sector* June 2019 at 92.

121. Reflecting how difficult it can be in practice to move away from unhelpful measures once enshrined in legislation, the Government of Canada responded supporting recommendation 29, but not recommendation 28:[166]

> Under the ITA [Income Tax Act], charities have the ability to carry on a wide variety of revenue-generating activities. In terms of occasional and periodic fundraising activities and events (ie, activities which do not rise to the level of a business) there are few restrictions placed on these types of activities. In terms of business activities (generally meaning activities that are regular, continuous and designed to earn a profit), the ITA allows charities to carry on businesses that relate to the furtherance of their charitable purposes. *In this respect, related businesses include a range of activities involving the charities charging for, or being paid, to deliver goods or services that fulfil their charitable mandate. This includes charities that charge admissions to museums and theatres or that operate heath, wellness and athletics centres, as well as those that provide training courses or run tuition based schools*. In addition, the concept of related business encompasses a range of complementary business activities that, while not involving the direct delivery of services, are nonetheless necessary for the fulfilment of the purpose (eg parking lots and cafeterias at hospitals) or which naturally flow from a particular activity (eg where the charity sells property created in a sheltered workshop). When a charity runs a related business, any revenue received from such activities is completely exempted from income tax.
>
> In practice, it is largely only businesses that have little or no connection to a charity's purposes that do not qualify as a related business, and even then, only when these are run by paid staff: as volunteer-run businesses are deemed to be related businesses under the ITA. Where a charity seeks to operate an unrelated business, it can establish a separate, taxable corporation to carry on the business and donate the profits back to the charity (and paying a very low rate of tax as a result of the Charitable Donation Tax Deduction)
>
> That said, the Government supports Recommendation 29 which calls on the Government to update policy statement CPS-019 (What is a related business) to provide greater clarity on permissible revenue generation activities for registered charities. The CRA is reviewing its policy statement CPS-019, What is a related business, to provide greater clarity on permissible revenue generation activities for registered charities, particularly with regard to revenue generating opportunities arising from new technologies. In this regard, the CRA will work with sector representatives and consider any recommendations brought forward.

122. The underlying assumption, that charities running businesses have a competitive advantage over their for-profit counterparts, was challenged by the Advisory Committee on the Charitable Sector ("**ACCS**"):[167]

> The ACCS believes [the words italicised in the above extract] to be an inaccurate statement about the current state of the law. A suggestion that fees from charitable programs (such as tuition fees) are related business income only increases the *confusion and concern of the sector*. Charging a fee for a charitable programme has

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[166] Hon D Lebouthillier, Minister for National Revenue *Government Response to the Report of the Special Senate Committee on the Charitable Sector* 30 March 2021 at 16 - 17 (emphasis added): <www.ratnaomidvar.ca/government-response-to-the-report-of-the-special-senate-committee-on-the-charitable-sector/>.

[167] Advisory Committee on the Charitable Sector *Report #3 – Towards a federal regulatory environment that enables and strengthens the charitable and non-profit sector* July 2021 "Purposes and Activities Working Group – Earned Income by Charities" (emphasis added).

been a long-standing acceptable practice. Improved guidance products would highlight the fact that such revenue streams are not related business income …

There is widespread interest from many charities in an approach that focuses on the uses and not the sources of funds for charitable purpose. The solution suggested by some in the sector is to apply a "*destination of funds*" test (in other words, an approach that enables charities to earn revenues from business-type activities as long as those revenues are dedicated to charitable purposes). However, in its response to the Special Senate Committee's report recommendation to pilot a "destination of funds" test, the Government indicated that it does not intend to "develop and implement a pilot project to assess the viability of granting registered charities greater latitude in undertaking revenue-generating activities (provided the proceeds are used to further charitable purposes)". We understand that the Government's hesitation rests on 3 factors:

(i) the requirement that the ITA is administered as written (eg a pilot project would require temporary or partial suspension of the Act and that is not legally possible);

(ii) the assertion that charities already have sufficient flexibility within the ITA to earn income to support their activities; and

(iii) a concern that a destination of funds test would allow tax-exempt charities to *unfairly compete* with tax paying businesses.

While we acknowledge that this approach may indicate a significant policy shift, we argue that major societal shifts that are underway, and exacerbated by the pandemic, call for thinking outside the traditional framework. We know that regulatory sandbox pilots have happened in other areas of the government. We also know from our consultations that charities do not believe there is flexibility within the current framework. Finally, *framing earned income by charities as synonymous with the work of the private sector sets up a false and incomplete narrative.* For-profit entities do not have a charitable purpose. Organisations in our sector are defined by a public/charitable purpose and their ability to meet their purpose should be fully supported. The [Purposes and Activities Working Group] suggests that we continue consultations to better understand the implications of this fundamental change to the income-earning regime governing charities, and to provide further recommendations to the Minister of National Revenue.

123. The ACCS strongly recommended a more supportive environment for charities conducting business activities:[168]

The charitable sector continues to experience stress around the growing gap between demand for their services and the resources available to meet their purpose. Many charities are afraid that the gap will not be met through more fundraising and government grants. As a result, more and more charities are looking at ways to earn income through commercial activities to help them raise the resources needed. While the pandemic is exacerbating the funding gap faced by many charities, interest in earned income as a possible solution *is not a new phenomenon. As the second largest source of funding for the sector, it is already well established*. The spike in interest on this topic among charities is noteworthy, and one we've seen before (eg Imagine Canada published an extensive survey of earned income activities of charities following the *2008/09 financial crisis*, which also brought the subject to the fore) …

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[168] Advisory Committee on the Charitable Sector *Report #3 – Towards a federal regulatory environment that enables and strengthens the charitable and non-profit sector* July 2021 "Purposes and Activities Working Group – Earned Income by Charities" (emphasis added).

> Given the importance of earned income to the charitable sector, and *how other parts of the federal Government are encouraging social enterprise via charities and non-profits* (eg Employment and Social Development Canada (ESDC) and its $755 million Social Finance Fund), the CRA *should acknowledge that this is a legitimate and even encouraged activity*, and clarify that [its] guidance is intended to help charities successfully navigate the regulatory regime …
>
> Charities have embraced earned income as a strategy to generate resources to use in addressing their purpose, and the ITA recognises and supports this reality. However, there is a broadly held view that the current regulatory and legislative regime *more effectively inhibits this work than enables it*. Our consultations and deliberations focused on the need *for a more supportive environment for* earned income activities of charities …
>
> It is recommended that the CRA work to create a more supportive environment for earned income of charities by:
>
> 6. Revising and clarifying guidance on the various ways charities can earn income, *including eliminating the current "linked and subordinate" test for related business*.
>
> 7. Coordinating with other federal departments (notably ESDC, GAC and Heritage Canada) … to develop a *shared vision of how an enabling environment for earned income by charities can further the purposes of the sector*.

124. As the Senate Committee noted:[169]

> … the culture of giving and volunteerism is a core value in Canada. This shared value is a thread of fixity running through the fabric of our nation, knitting communities together. While strong, this thread is not unbreakable. Demographic change, financial constraints, red tape, outdated rules and a lack of recognition combine to stifle the sector and jeopardise the spirit of giving and volunteerism that we hold so dear. The sector stands ready to weave a brighter future for our nation; it behoves the federal government to ensure that it receives the support it needs to do so.

125. In other words, the rules regarding charities' business activities in Canada are seen as not working, with considerable work underway seeking to restore Canada to the destination of funds test *already used* by New Zealand and Australia. In other words, the approach taken in Canada is not an "international precedent" for New Zealand to follow, but rather a cautionary tale. New Zealand's current approach is world-leading: New Zealand should exercise considerable caution before seeking to remove it.

126. In that context, careful consideration should be taken to the approach taken by Australia.

Industry Commission of Australia - 1995

127. In 1995, the Industry Commission of Australia concluded that the income tax exemption for the business activities of "Community Social Welfare Organisations" ("**CSWOs**") had few adverse consequences, and did not give rise to a competitive advantage in terms of either pricing or expansion:[170]

> *Income tax exemption does not compromise competitive neutrality* between organisations. All organisations which, regardless of their taxation status, aim to

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[169] Report of the Special Senate Committee on the Charitable Sector *Catalyst for Change: A Roadmap to a Stronger Charitable Sector* June 2019 at 127.
[170] Industry Commission *Charitable organisations in Australia - Report no 45* 16 June 1995 at K5 - K6 (emphasis added, footnotes omitted).

> maximise their surplus (profit) are *unaffected* in their business decisions by their tax or tax-exempt status.
>
> CSWO commercial activities do have certain advantages over for-profit firms, such as better cash flows. However, *for-profits also have certain advantages over CSWO commercial organisations. These include easier access to capital – both equity and debt, and the ability to personally benefit from profits*. The overall situation is unclear.

128. In reaching this conclusion, the Australian Industry Commission noted that the "competitive advantage" argument had two aspects, one related to pricing and one related to expansion:[171]

> Inquiry participants made considerable comment on the effect of tax exemptions and concessions on the business activities of CSWOs.
>
> It was put to the Commission that favourable tax treatment may give CSWOs an advantage over tax paying competitors. It was said that these advantages are relevant for all commercial activities of CSWOs – both where they are engaging in *unrelated* business (for example, sales of furniture or Christmas cards) in order to raise funds for their core welfare services, or where the activity is the *core* objective (for example, nursing home care). Some participants argued that the advantage is a hindrance to for-profit competitors for a number of reasons including:
>
> - CSWOs are able to cut prices to consumers below those which for-profit firms can sustain; and
> - CSWOs are able to *expand their operations more rapidly than their for-profit counterparts because they can use their tax free surplus to fund such expansion*.

129. The Commission considered that making a distinction between "related" and "unrelated" businesses was difficult and most likely not sensible:[172]

> CSWOs compete against for-profit firms in business activities unrelated to the main purpose of the CSWO, as well as core activities such as nursing homes.
>
> The *unrelated* activities attempt to raise funds to support the core activity of the organisation. CSWOs are involved in a wide range of activities that are not directly related to their core objectives. Examples include general insurance, financial services, worm farms, recycled clothing, packaging, sheet metal products and sales of Christmas puddings. CSWOs compete against other tax paying firms but are exempt from paying tax on any profits made.
>
> *Core* activities include nursing homes, hostels, medical aids and appliances and services in the health care industry. Tax paying firms are increasingly competing in these markets, many of which were previously the sole domain of CSWOs.
>
> *Even though any competitive advantage and resulting resource effects are relevant to both core and unrelated activities,* many of the suggested solutions to the perceived problems have tended to focus *only on the unrelated activities* …
>
> In order to treat unrelated activities differently, it would be necessary to *distinguish* them from the core activities of a CSWO. This poses a number of difficulties. For example, is a workshop employing disabled or unemployed staff providing valuable training or selling furniture? Similarly, is an opportunity shop selling second hand clothes for funds or providing affordable clothing to those in need? *It is often difficult to judge whether those activities are directly meeting the principal objective of the*

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[171] Industry Commission *Charitable organisations in Australia - Report no 45* 16 June 1995 at 309 (emphasis added).
[172] Industry Commission *Charitable organisations in Australia - Report no 45* 16 June 1995 at 309 - 310 (emphasis added).

> *CSWO or whether they are attempting to raise funds to support other charitable purposes*.
>
> Even if it were always possible to separate out the core and unrelated activities of CSWOs, *it is unclear whether there would be any benefits from doing so*. The competitive advantage given to CSWOs may be *less of a problem in unrelated activities than in core activities*. Some unrelated activities are not tax favoured activities. For example, goods purchased for re-sale are excluded from sales tax exemptions. This reduces the ability of that organisation to take resources away from other commercial retailers. Similarly, land tax, in some States, is also payable if the land is used for commercial purposes. These taxes minimise the commercial advantage of unrelated activities of CSWOs.
>
> There is *limited information* about the extent to which CSWOs engage in unrelated business activities, and hence, little information on the problems and inefficiencies that result. It is clear that, if inefficiencies do arise because of some of the tax exemptions, *they are just as likely to arise in core areas as they are in the unrelated areas*.
>
> The general conclusion that can be drawn is that it is *not sensible to look only at unrelated business income activities*. The problem is a wider one that should be analysed, not by looking at whether the CSWO's activity is related or not, but at whether the activity is competing with other firms.

130. With respect to income tax exemption, the Australian Industry Commission concluded that the competitive advantage argument did not stand up to scrutiny in relation to either related or unrelated businesses:[173]

> CSWOs do enjoy some benefits from the income tax exemption, namely *better cash flows* (see Appendix K). However, there are *some important, potentially offsetting, differences* between income tax-exempt firms and for-profit firms. For-profits have a number of *offsetting advantages including the capacity to borrow, the ability to benefit personally from profits, and the ability to expand using market-based instruments such as share issues*. Overall, the income tax exemption does not appear to represent a critical advantage to CSWOs over for-profit competitors.

131. The Commission expanded on these points in Appendix K of its report, highlighting that any potential competitive advantage may in fact be more likely to arise in *related* businesses than *unrelated* ones, but that any such advantage is not affected by the income tax exemption:[174]

> *It is the behaviour of CSWOs which may represent "unfair competition" not the taxation advantage itself. For example, some CSWOs may indeed give away all, or part of their potential surplus to consumers by selling at discounted prices. Examples include second hand clothing shops or some fitness centres. Giving away their surplus may be part of the purpose of the organisation and the imposition of an income tax would not change their behaviour …*
>
> It has also been argued that tax exempt firms will use their exemption to grow more quickly than their for-profit counterparts because their tax-free earnings can be ploughed back into the business. Rose-Ackerman (1982) argued against this argument, claiming that it *presupposes an inefficient capital market*:

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[173] Industry Commission *Charitable organisations in Australia - Report no 45* 16 June 1995 at 311 - 313 (emphasis added).
[174] Industry Commission *Charitable organisations in Australia - Report no 45* 16 June 1995 at K1 - K4 (emphasis added, footnotes omitted).

> *The more efficiently the capital market operates, the less important are retained earnings.* If, however, lenders have difficulty evaluating a firm's investments, the firm may prefer to exploit internal sources of funds, and firms with high levels of retained earnings have an advantage.

132. In the result, the Australian Industry Commission considered that charities did not have a competitive advantage over their for-profit counterparts, in terms of *either* pricing or expansion.

133. The Commission also noted that non-refundability of imputation credits has a distorting effect on the investment decisions of CSWOs, and is therefore relevant to the "competitive advantage" analysis.[175] This point is discussed further below.

Australian Productivity Commission - 2010

134. Over a decade later, in 2009, the Australian Productivity Commission was asked to examine "the extent to which tax exemptions accessed by the commercial operations of not-for-profit organisations may affect the competitive neutrality of the market".[176] Submissions received by the Commission on the issue were split between those (generally not-for-profit entities) arguing for retention of the existing tax privileges and those (generally for-profit organisations) arguing for the tax privileges to be removed.[177]

135. Reporting in 2010, the Commission concluded that income tax exemptions for the business income of charities are "not significantly distortionary".[178] In reaching this conclusion, the Commission noted the importance of competition and competitive neutrality:[179]

> It has been well established that exposing firms to greater competition and increased openness has sharpened incentives to reduce costs and innovate … Competitive neutrality is a key aspect in promoting strong competition by removing distortions that inhibit the flow of resources to their most efficient use.
>
> The competitive neutrality principle is that sellers of goods and services should compete on a level playing field; that is, one provider should not receive an advantage over another due to government regulation, subsidies or tax concessions.
>
> Competitive neutrality removes artificial advantages and allows businesses to compete on a basis that offers the best cost and quality combinations to customers. This is likely to result in more effective competition and more efficient outcomes.
>
> Concerns about competitive neutrality are most likely to arise in an environment where one or more competitors receive significant government benefits – direct or indirect – not available to other competitors.
>
> *Governments provide direct and indirect assistance to many businesses, for example tax concessions for research and development, industry adjustment grants, and restrictions on the number of taxi plate licences*. Some of these advantages are well justified in terms of public confidence, or enhanced activity that also benefits others (externalities). Indeed, when the Government purchases goods and services from the

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[175] Industry Commission *Charitable organisations in Australia - Report no 45* 16 June 1995 at 318.
[176] Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010 at v, terms of reference, xxxv.
[177] Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010 at 200.
[178] Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010 at 197.
[179] Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010 at 198 (references omitted).

> private sector, it could be seen to favour one provider over another – this is why the Commonwealth's core principle for Government procurement is value for money …
>
> In addition to concerns about the effect on competition, non-neutral tax treatment can compromise three key principles of optimal tax systems: efficiency, equity and simplicity:
>
> - Efficiency can be compromised whenever decisions about resource allocation are driven by tax considerations … rather than market signals of opportunity cost.
> - Equity can be compromised whenever providers of similar or identical goods and services are treated differently by the tax system.
> - Simplicity can be compromised whenever the tax system mandates special treatment of selected taxpayers.

136. Importantly, the Commission also noted that a *range* of potential competitive neutrality scenarios exist:[180]

> The great majority of NFPs operate outside the market. These NFPs provide services – some community-wide, some member-based – that are not normally provided by businesses. This includes the provision of charitable services which are not funded by government or the private sector except through donations. There are few competitive neutrality concerns for these parts of the NFP sector except in relation to differential access to concessions …
>
> Some NFPs conduct commercial activities in direct competition with for-profit providers of goods and services. The remainder operate in areas in between; that is, providing services in areas that are currently of little interest to for-profit business and/or services to members that differ from those that for-profit businesses might provide. Thus there is a range of potential competitive neutrality scenarios: from clear areas where tax concessions and other government subsidies [sic] do not have competitive neutrality implications to those where the subsidies have a potentially significant effect on competition. This latter category may include organisations competing for government services.

137. The Commission summarised the justifications for providing tax privileges to NFPs as follows:[181]

> Stakeholders have posited two justifications for providing advantage to NFPs:
>
> - NFPs may face *disadvantages* relative to for-profit businesses, and concessions assist to offset these disadvantages. The main disadvantages cited are *difficulties accessing capital* and lack of size and scale, where economies of scale and scope may not be fully exploited. *While there is some merit in the first point* … , many NFPs do not take advantage of opportunities to grow, preferring small scale, local connections and control … In any case, many of these perceived disadvantages are not exclusive to NFPs and are shared by small businesses.
> - *The policy motivation for providing concessions [sic] is the additional public benefit (spillovers) provided by an NFP's activities* – such concessions vary according to the status of the NFP … Where NFPs compete with for-profit businesses, such concessions are only justified if they deliver spillovers commensurate with the effective subsidy provided less any costs imposed by

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[180] Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010 at 201-202.
[181] Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010 at 202 (emphasis added).

> the loss of competition. In addition, the government should have decided that the spillovers constitute a valid area for a subsidy.
>
> Once government has decided to provide subsidies to NFPs, the form of the subsidy – whether tax concession, direct grant or something else – will affect the cost to the taxpayer and the distortions it introduces. The provision of input tax concessions … is likely to be an ad hoc, arbitrary, non-transparent, and imprecise method of providing subsidies.

138. The Australian Productivity Commission concluded that income tax exemption does not result in a competitive advantage for charities, a conclusion which is particularly significant because it was reached *despite* analysing the question from the perspective of a tax expenditure analysis (where the tax privileges for charities are conceptualised as "concessions" or "subsidies"):[182]

> *Income tax exemptions are unlikely to violate competitive neutrality*
>
> Most NFPs are exempt from income tax. The [1995] Industry Commission … concluded that such exemptions were unlikely to provide an unfair advantage to NFPs. Whether or not there is an income tax exemption, the output and pricing decisions to maximise a surplus (or profit) are the same. Thus the income tax exemption does not distort decisions such as how many people to employ, what price to charge and so forth, as long as tax is a fixed share of profit.
>
> Put another way, the objective of a for-profit business is to maximise profit by either (or both) increasing revenue or cutting expenditure. For a given profit, the tax on the profit – income tax – does not affect the decision to maximise profit (although a sufficiently high income tax could make the business unviable). This applies similarly to income tax exempt NFPs, which seek to maximise their output for a given cost.
>
> There is one potential hitch to this analysis, however: there is a different treatment in tax law of accounting profit (and profit as assessed by the Tax Office) to economic surplus. To the extent that for-profit organisations seek to minimise their accounting profit – that is, pay less tax – for a given level of economic surplus, there could potentially be a different allocation of resources by an NFP compared with a for-profit for an identical activity. The 1995 report posited that such effects would be insignificant. In view of more recent changes to accounting standards (including the adoption of International Financial Reporting Standards), which have as their aim to more closely align accounting and economic measures of surplus, *it is likely that the differences have narrowed further* …
>
> Overall, income tax exemptions for NFPs are *unlikely* to significantly distort resource allocation …

139. The Commission also acknowledged that tax privileges are important to NFPs, and that concerns regarding their removal were valid.[183]

140. As part of its review, the Australian Productivity Commission undertook a specific case study on community housing organisations ("**CHOs**"). The following observations made in Appendix I of its report are particularly relevant to the matters raised in the issues paper, as many community housing providers in New Zealand

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[182] Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010 at 203 - 205 (emphasis added, references omitted).
[183] Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010 at 209.

run businesses and are structured as charities:[184]

> While a regulatory framework has the potential to deliver many benefits, *poorly designed regulation has the potential to impose costs on CHOs which offset the benefits of the regulation* … A stated reason for the government's preference for community housing is the sector's *flexibility* in their ability to deliver specialised services to tenants and flexibility in financing arrangements. A regulatory framework which forces standardisation on organisations may therefore *undermine the very feature which the government seeks to utilise* …
>
> *Consistency of government funding and policy is seen as essential* for long-term planning by the sector, and to help attract private investment … While the focus in government policy is on risk management as it relates to CHOs, the private sector has expressed the view that policy risks are equally important in assessing risk in the sector. Private sector partners seek *certainty with respect to the continuing availability of tax benefits*, the adequacy of rent and continuing support for the growth and stability of the industry since they need to be able to accurately assess risk and discount premiums … For example, *CHOs are concerned that they may risk losing the tax concessions afforded to NFPs when they engage in entrepreneurial activities.* This is despite the community benefit from activities such as developing mixed private-community properties where some dwellings are sold to the private market for profits which are then used to subsidise the tenants of the community dwellings … This issue was raised in the survey conducted by Gilmour and Bourke (2008), where growth providers saw their ability to borrow from banks impeded by the uncertainty over the consistency of government policies and funding …
>
> In terms of factors external to CHOs, and notwithstanding strategic planning in some jurisdictions …, there remain concerns in the sector about what it sees as a *lack of a clear and consistent government vision for the sector* and accompanying regulatory framework, and funding uncertainty. In particular, there does not appear to be a consistent view of the roles of the public and community housing sectors, and the relationship between them. Whether the community housing sector plays a complementary or alternative role to social housing has implications for how the sector is funded (should social housing and community housing compete for funds?), and how tenants are allocated to housing (should CHOs have choice of tenants, even where public and community housing waiting lists are combined?). Different jurisdictions have different visions for the role that community housing will play in relation to social housing.
>
> The rescoping of a regulatory framework … and the decision by the Australian Government to remove $750 million in funding for the Social Housing Initiative in September 2009, which CHOs perceived as 'punishment' for being efficient, demonstrate the *regulatory and funding uncertainty* faced by CHOs. This uncertainty is seen by some as impeding their ability to access private finance.
>
> In terms of factors internal to CHOs, the rapid movement to a more entrepreneurial business model has created *tensions between the social and commercial goals of CHOs*, and concern about skill deficiencies and mismatches. The above assessment points to the *value in clear policy objectives about the role and value of CHO provision;* careful assessment of risk and the risk management options; transparency about all sources of funding; and robust evaluation.

141. These factors apply equally in New Zealand: there is significant risk that taxing the business income of charities will further exacerbate the ability of the charitable sector

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[184] Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010 at I31 - I32, I38 - I39, I44 (emphasis added, references omitted).

to provide much-needed housing.

The Word Investments *case*

142. Australia considered the issue of charities running businesses again in 2008, when the High Court of Australia (Australia's highest Court) delivered its decision in *Commissioner of Taxation of Australia v Word Investments Ltd* ("***Word Investments***").[185]

143. Briefly, *Word Investments* concerned a Christian charity ("**Wycliffe**") that ran a funeral business (Word Investments Ltd ("**Word**")) to raise funds for its Christian activities. Although Word's stated purposes were clearly charitable as for the advancement of religion, the Commissioner of Taxation rejected Word's application for exemption from income tax on the basis that it was "commercial" and therefore not a "charitable institution":[186]

> The Commissioner submitted that the main object of Word was not religious but was "to engage in investment and trading activities for the purpose of raising funds for Wycliffe and other similar organisations". The Commissioner submitted that the "basic function" of Word was to conduct businesses, and the making of profits and the distribution of them to charitable institutions like Wycliffe were merely incidental to the conducting of businesses.

144. The High Court of Australia disagreed with the Commissioner's analysis:[187]

> It is therefore necessary to reject the Commissioner's arguments so far as they submitted that Word had a "commercial *object* of profit from the conduct of its business" which was "*an end in itself*" and was not merely incidental or ancillary to Word's religious purposes. Word endeavoured to make a profit, *but only in aid of its charitable purposes*. To point to the goal of profit and isolate it as the relevant purpose is to create a *false dichotomy* between characterisation of an institution as commercial and characterisation of it as charitable.

145. Accordingly, the fact that Word focused on business activities was not an impediment to its characterisation as "charitable".[188] In this respect, the decision of the High Court of Australia is a reasonably straight-forward application of the "destination of funds" test: charities law is agnostic as to how charities raise their funds, as all funds of a charity must ultimately be destined for charitable purposes.[189] There is nothing inherently nefarious about business activity.

The Henry Review - 2010

146. Contemporaneously with the 2010 Australian Productivity Commission review, a review of Australia's tax system commenced in 2009 ("**the Henry Review**").[190] One of the principles underlying the Henry Review was that tax privileges for NFP organisations should not undermine competitive neutrality where NFP organisations

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[185] *Commissioner of Taxation of Australia v Word Investments Ltd* [2008] HCA 55.
[186] *Commissioner of Taxation of Australia v Word Investments Ltd* [2008] HCA 55 at [13].
[187] *Commissioner of Taxation of Australia v Word Investments Ltd* [2008] HCA 55 at [24] (emphasis added).
[188] *Commissioner of Taxation of Australia v Word Investments Ltd* [2008] HCA 55 at [43] - [44].
[189] See, for example, *Auckland Medical Aid Trust v Commissioner of Inland Revenue* [1979] 1 NZLR 382 at 387; *Commissioner of Inland Revenue v Carey's (Petone and Miramar) Ltd* [1963] NZLR 450; *Calder Construction Co Ltd v Commissioner of Inland Revenue* [1963] NZLR 921; *Commissioner of Inland Revenue* v *NTN Bearing-Saeco (NZ) Ltd* (1986) 8 NZTC 5,039.
[190] DR K Henry AC, G Smith, Dr J Harmer, H Ridout, Professor J Piggott *Australia's Future Tax System Final Report* 2 May 2020: <treasury.gov.au/review/the-australias-future-tax-system-review/final-report>.

operate in commercial markets.[191]

147. In its May 2010 report, the Henry review concluded that NFP tax privileges do not generally violate the principle of competitive neutrality:[192]

> Categories of NFP organisations that currently receive income tax or GST concessions should retain these concessions. NFP organisations should be permitted to apply their income tax concessions to their commercial activities.

148. The Henry Review also noted that permitting NFP organisations to undertake commercial activities freely reflects the principles of the *Word Investments* decision and would "reduce costs associated with education, assistance, advice, disputes and litigation".[193]

149. Following the Henry Review, the Australian Government announced in 2011 that it would tax the retained income of NFP trading operations; however, this policy was withdrawn in 2014 without having been implemented.[194]

Australian Productivity Commission - 2024

150. In May 2024, the issue of charities running businesses arose again, with the Australian Productivity Commission making the following comments:[195]

> The Commission sees no case to change the income tax exemption for charities provided by the Australian Government. *An income tax exemption for charities is appropriate as they produce no taxable income*. Even when a charity generates income through commercial activities which are not intrinsically charitable, any funds raised in this manner *must be directed towards furthering charitable purposes and cannot be distributed to the owners or members of a charity* (ATO, TR 2011/4). The Commission (2010, pp. 203–205) and the Henry Tax Review (2010, p. 209) have also found that charities still have an incentive to maximise outputs and minimise costs (the equivalent of profit maximising), so there are no competitive advantages created by the income tax exemption

151. In other words, when the issue is analysed, rather than merely assumed, the business income tax exemption for charities is found *not* to create a competitive advantage, in relation to *either* pricing or expansion. The issues paper makes no mention of the Australian approach to the business activities of charities; yet, Australia has comprehensively looked at this issue and consistently found that the business income tax exemption for charities should remain. Far from being international outliers, New Zealand and Australia are world leaders in their treatment of charities' business income.

OECD Report

152. The issues paper refers to the Organisation for Economic Co-operation and Development's Tax and Policy Studies 2020 *Taxation and Philanthropy* report ("the **OECD report**"), which considered that income tax exemptions for the commercial

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[191] DR K Henry AC, G Smith, Dr J Harmer, H Ridout, Professor J Piggott *Australia's future tax system – Report to the Treasury: Part 2 – Detailed analysis* December 2009, Pt 2 vol 1 at 206.
[192] DR K Henry AC, G Smith, Dr J Harmer, H Ridout, Professor J Piggott *Australia's future tax system – Report to the Treasurer: Part 2 – Detailed analysis* December 2009, Pt 2 vol 1 at 209, 210 and recommendation 42.
[193] DR K Henry AC, G Smith, Dr J Harmer, H Ridout, Professor J Piggott *Australia's future tax system – Report to the Treasurer: Part 2 – Detailed analysis* December 2009 at 212.
[194] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 19.
[195] See Australian Productivity Commission *Future foundations for giving – report no 104* 10 May 2024: https://www.pc.gov.au/inquiries/completed/philanthropy/report#media-release at 174.

income of philanthropic entities give rise to "competitive neutrality concerns" that require the "attention of policy makers":[196]

> … countries should *reassess the merits* of providing tax exemptions for the commercial income of philanthropic entities, at least insofar as this income is *unrelated* to the entity's worthy purpose. In undertaking such a reassessment, countries will need to consider the added *complexities* associated with distinguishing between taxable (ie unrelated commercial income) and exempt income and weigh the additional compliance and administrative costs *against the pursuit of competitive neutrality*.

153. However, the existence of a competitive advantage was assumed, rather than analysed:[197]

> A concern regarding exemption of commercial income of philanthropy entities is that this may [sic] create an unfair competitive advantage for philanthropic entities over for-profit businesses …
>
> A competitive advantage may [sic] result from tax concessions [sic] that apply to the income, inputs, or outputs of philanthropic entities, including when they operate businesses. In this context, it is argued that philanthropic entities can undercut the competition …
>
> If there are no restrictions on the commercial activities a philanthropic entity can engage in and the income from those activities is fully tax exempt, it may [sic] give rise to competitive neutrality and revenue loss concerns. To avoid such concerns, the report identifies a number of policy options … The competitive neutrality concerns associated with exempting the commercial income of philanthropic entities gives rise to an important issue that requires the attention of policy makers.

154. In addition, the OECD's conceptualisation of competitive advantage relates only to pricing, a form of competitive advantage that the issues paper itself rejects.[198] The OECD report does not raise any issues with competitive advantage in relation to expansion, the only form of competitive advantage that the issues paper considers relevant.[199] In other words, the OECD report's recommendations are directed towards addressing a problem that the issues paper itself considers does not exist.

155. Nevertheless, in recommending that countries tax the unrelated business income of charities, the OECD report pointed out that, of 40 countries studied, only New Zealand, Australia and Malta currently exempt *all* commercial income of charities from tax.[200]

156. Of the remaining 37 countries, the OECD report noted a number of different approaches:[201] some countries, such as Canada, restrict the commercial activities an entity can engage in; others treat all income as taxable but allow a deduction for distributions towards the worthy purpose; others, such as the United States, treat "unrelated" business income as taxable, often above a certain threshold.[202] These approaches can be contrasted with the very straightforward and uncomplicated "destination of funds" approach adopted by Australia and New Zealand (and also by

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[196] OECD Tax Policy Studies *Taxation and Philanthropy* (2020) 27 (OECD Publishing, Paris): <www.oecd-ilibrary.org/taxation/taxation-and-philanthropy_df434a77-en> at 3, 9, 19, 134 and ch 6 (emphasis added).
[197] OECD Tax Policy Studies *Taxation and Philanthropy* (2020) 27 (OECD Publishing, Paris) at 23, 128, 31, 134.
[198] Issues paper at [2.7]-[2.12].
[199] Issues paper at [2.14].
[200] OECD Tax Policy Studies *Taxation and Philanthropy* (2020) 27 (OECD Publishing, Paris) at 58.
[201] OECD Tax Policy Studies *Taxation and Philanthropy* (2020) 27 (OECD Publishing, Paris) at 42, 58, 129; see also 3, 9, 19, ch 6.
[202] OECD Tax Policy Studies *Taxation and Philanthropy* (2020) 27 (OECD Publishing, Paris) at 58 - 62.

the United States until the introduction of the unrelated business income tax ("**UBIT**") in 1950, as discussed further below).[203]

157. Importantly, the OECD report noted the difficulty of trying to draw a distinction between related and unrelated business income:[204]

> … the definitions of related and unrelated commercial income *vary widely* across countries and such tax rules often result in *significant complexity*.
>
> Other approaches are less complex, but may not fully exclude unrelated income from the preferential tax treatment. One approach is to only exempt income generated from commercial activities where it is *reinvested* towards the entity's worthy purpose in a timely fashion. To facilitate some *flexibility* on behalf of the entities, such a policy could potentially be subject to an *exception or allowance for the creation of small reserves* that may be necessary to support the ongoing pursuit or expansion of the philanthropic entity's activities that are directly connected to its worthy purpose. Another approach may be to limit the size of the expansion through a *threshold* beyond which income from commercial activities is taxed.

158. In addition to failing to analyse whether the business income tax exemption for charities in fact gives rise to a competitive advantage, the OECD report also suffers from a number of other flaws. For example, as with the work of the Tax Working Group and the issues paper itself, at no point does the OECD report mention the term "social enterprise": it does not address the importance of enabling social enterprise, or the additional barriers to social enterprise that would be created by imposing unnecessary restrictions on the business activities of charities. The OECD report also does not analyse the conditions that existed at the time various countries introduced their complex rules to tax the business income of charities, or the fact that such conditions may not apply in New Zealand. As with the Tax Working Group and, the OECD report also does not analyse the impact of the comprehensive transparency and accountability requirements for charities that were introduced in New Zealand from 2015, providing New Zealand with comprehensive visibility and accountability in a manner that simply was not available in other jurisdictions when their complicated rules were introduced. Instead, the OECD report recommends that New Zealand simply follow the approach taken in other jurisdictions for no apparent reason other than the fact that other jurisdictions are doing so.

159. It is noteworthy that the OECD has also recommended that New Zealand introduce a capital gains tax,[205] a recommendation dismissed by the government on the basis that it would be a "wrecking ball for the economy".[206] The issues paper's proposals to tax the business income of charities would be a wrecking ball for the charitable sector as well as for the economy. The OECD report does not provide a compelling basis for New Zealand to depart from the destination of funds approach.

No compelling rationale

160. To summarise, when the issue is actually analysed rather than merely assumed, the business income tax exemption is found not to give charities a competitive advantage

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[203] OECD Tax Policy Studies *Taxation and Philanthropy* (2020) 27 (OECD Publishing, Paris) at 31.
[204] OECD Tax Policy Studies *Taxation and Philanthropy* (2020) 27 (OECD Publishing, Paris) at 42, 129, 134 (emphasis added).
[205] https://www.rnz.co.nz/news/business/529042/inland-revenue-raises-capital-gains-tax-questions.
[206] https://www.rnz.co.nz/news/political/529074/you-can-t-tax-yourself-to-prosperity-nicola-willis-on-capital-gains-tax.

in relation to either pricing or expansion, but instead merely provides a degree of offset to the considerable disadvantages charities otherwise have in their ability to access the level of capital needed to grow to an optimum size. The "unfair advantage" argument raised in the issues paper does not bear scrutiny, and does not provide a rationale, let alone a compelling one, for removing charities' exemption for business income.

Assumption 2: that accumulations are somehow inconsistent with charitable purpose

161. The second fundamental assumption underlying the issues paper's proposals is that a charity accumulating funds is somehow not applying them for the benefit of charitable purposes:[207]

> [The destination of funds] approach allows income to be accumulated tax free for many years within a registered charity, or within its registered business subsidiaries, *before the public receives any benefit*.

162. This assumption is misconceived.

163. The essence of charitable purpose is public benefit, a test which applies to *purposes*, not activities:[208] there is nothing inherent in the charitable purposes test that obliges a charity to pursue its charitable purposes in a particular way or to show immediate public benefit from every activity. Accumulating funds for, say, a long-term capital project or to generate income for future charitable expenditure can be just as valid ways of pursuing charitable purposes as spending the funds upon receipt. Public benefit can take time to achieve: one of the key advantages of the charitable sector is that charities are not constrained by the median voter and can therefore address issues on a longer-term basis than governments. Imposing short-term thinking on the charitable sector by forcing charities to spend even when it may not be in the best interests of the charity's charitable purposes to do so is more likely to be *counterproductive* to the public benefit. For example, a certain degree of accumulation is essential for charities, as we saw acutely during the COVID-19 pandemic, when many charities had to rely on their reserves in order to survive. Ultimately, whether any particular item of funding should be "spent or saved" is a decision for the governing body of a charity to make, taking into account all relevant circumstances, including the important fiduciary duties discussed above.

164. The fallacy of assumption 2 might be illustrated by analogy with the family: extrapolating the proposals in the issues paper to a family setting would mean that families would be encouraged to spend everything they earn, and punished for any attempts to save on the basis that doing so was inherently contrary to the family's interests. However, clearly, the interests of the family may sometimes be best served by taking a longer-term approach, such as saving for important benefits like housing or education. Exactly the same principle applies to charities: forcing charities to spend on an indiscriminate basis to satisfy an arbitrary objective rather than on how best to further their charitable purposes would cut across the underlying law and cause considerable complexity and confusion. Public benefit is more likely to be maximised through a *judicious* use of funds. It is not appropriate for government to

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[207] Issues paper at [2.5] - [2.6] (emphasis added).
[208] For a fuller discussion, see Barker et al *The Law and Practice of Charities in Aotearoa New Zealand* 2ed (LexisNexis, 2024) and S Barker *Focus on purpose – what does a world-leading framework of charities law look like?* [2022] NZLFRR 3, chapter 8, and the references therein cited.

seek to interpose itself into the day to day operational decisions of charities, effectively dictating to charities when they can spend their own money. As discussed above, the fact that charities receive tax privileges does not cause charitable funds to somehow morph into government funds: charities are private, independent, self-governing organisations, best placed to determine for themselves how best to further their charitable purposes.

165. If there was a genuine instance of a charity unduly "hoarding" funds, it can be more than adequately dealt with using existing tools, in particular by enforcing the fiduciary duties as discussed above. Such an approach would be infinitely preferable to removing agency from charities on a blanket basis, forcing hasty and indiscriminate spending irrespective of the circumstances to satisfy a misconceived assumption that somehow public benefit cannot be achieved by accumulating funds.

Tax Working Group

166. The issues paper's assumption that accumulations are somehow inconsistent with public benefit appears to derive from the work of the Tax Working Group | Te Awheawhe Taake. However, the Tax Working Group's consideration of issues related to charities was cursory at best.

167. The terms of reference for the Tax Working Group were *entirely silent* on the topic of charities,[209] perhaps reflecting the fact that it had been specifically tasked with considering whether New Zealand should introduce a capital gains tax.[210] Nevertheless, issues relating to charities were considered at *one* Tax Working Group meeting. For the 6 July 2018 meeting, officials prepared a background paper ("**the background paper**") that focused on what officials described as the two "most important tax policy matters for not-for-profits": private foundations and business income, concluding that "accumulations" were an "underlying issue for both".[211]

168. There does not appear to have been *any consultation* with the charitable sector in the preparation of this background paper, or in the selection of these two issues as "key": had the charitable sector been asked, it is highly unlikely that these 2 issues would have been chosen as most pressing, or even considered to be issues at all.

169. Nevertheless, in relation to charities' exemption for business income, the background paper made the following comments:[212]

> Concerns are often expressed that the exemption provides an *unfair competitive advantage* to charitable businesses *at the expense* of taxpaying for-profit businesses. The impact of the perceived unfairness as reported in the media and by constituents is claimed to outweigh the wider public good that charitable businesses provide through funding charitable purposes.

170. Officials noted that recent reviews, such as IRD's 2001 *Tax and charities* discussion

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[209] Minister of Finance *Terms of Reference: Tax Working Group* 23 November 2017.
[210] Minister of Finance *Terms of Reference: Tax Working Group* 23 November 2017.
[211] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 2.
[212] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 5 (emphasis added) (see also [53] at 16).

document,[213] and the Henry Review,[214] have not supported this perceived unfairness in relation to pricing.[215]

171. Officials also noted that the principle of competitive neutrality would support active and passive income being taxed at the same rate for any particular taxpayer: in other words, if charities' passive income is exempt, their business income should be exempt also.[216]

172. Nevertheless, the question of whether charities' business income should continue to be tax-exempt was described in the background paper as one of the "most important tax policy matters for not-for-profits" and "the most common charity-related theme addressed by submitters" to the Tax Working Group.[217]

173. According to the background paper, only 11 submissions were made to the Tax Working Group on the topic (perhaps reflecting a perception that its work was focused on a capital gains tax rather than on the tax treatment of charities).[218] Of these 11 submissions, only 7 were in favour of removing the business income tax exemption for charities, most of whom broadly aligned with the proposal put forward by IRD in its 2001 *Tax and charities* discussion document that charitable businesses should claim a deduction under section DB 41 of the Income Tax Act for amounts distributed to a "donee organisation", instead of having a tax exemption themselves.[219] One submitter provided a detailed alternative proposal for taxing charities' business income, involving the implementation of a "charity credit account", as a precursor to removing tax exemptions for charities altogether.[220]

174. The balance of the 11 submitters argued that charities' business income tax exemption should remain, pointing to matters such as:[221]

    (i) the lack of evidence of competitive advantage;

    (ii) the flow-on benefits to society from charities running businesses, such as the provision of employment opportunities and payment of taxes such as PAYE and GST;[222]

    (iii) the fact that business operations provide greater cashflow certainty, reducing charities' reliance on annual funding rounds, donations, and government funding;

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[213] Inland Revenue Department *Tax and charities, a government discussion document on taxation issues relating to charities and non-profit bodies* June 2001.
[214] DR K Henry AC, G Smith, Dr J Harmer, H Ridout, Professor J Piggott *Australia's Future Tax System Final Report* 2 May 2010: <treasury.gov.au/review/the-australias-future-tax-system-review/final-report>.
[215] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 5, 17 - 18.
[216] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 2 (coversheet).
[217] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 16, 19.
[218] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018, Annex C.
[219] It should be noted that s DB 41 only provides a deduction for entities structured as companies. Section DV 12 provides a similar deduction for Māori authorities. However, this deduction may not assist where a charity has a different legal structure, and/or has not separated its business into a separate entity.
[220] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 30.
[221] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 29 - 30.
[222] PAYE and GST are discussed further below.

(iv) the fact that income tax exemption offsets the considerable disadvantages that charities otherwise face in accessing the level of capital needed to grow to an optimum size (as discussed above); and

(v) the need for flexibility for charities to make their own decisions about the prudent retention of capital, particularly if the business is in a sector which experiences years of volatile profitability. Charities function best in an environment that allows them to raise funds in a flexible way: they cannot have the impact necessary to make real change if they are required to maintain a subsistence existence each year.

175. Officials' background paper did not discuss the findings of the 1995 Australian Industry Commission report, discussed above, that the income tax exemption does not provide charities with a competitive advantage in terms of either pricing or expansion.[223] The impact of the new financial reporting rules for charities also does not appear to have been considered. In addition, as with the OECD report, the concept of "social enterprise" is not mentioned.[224]

176. Instead, as with the OECD report, the background paper appears to have simply *assumed* that charities have a competitive advantage (albeit in terms of expansion rather than pricing), and that accumulating surpluses was somehow inconsistent with charitable purpose. These assumptions then flowed through to the Tax Working Group's finding that the "real question" in relation to perceived competitive advantage was whether charities are distributing funds for charitable purpose (that is, whether there is "excess accumulation")".[225]

176. This finding appears to have been reached based on very little deliberation;[226] according to the minutes of the 6 July 2018 meeting, most of the Tax Working Group's discussion regarding charities centred around private foundations,[227] following which the Tax Working Group made 4 decisions relating to charities:[228]

> The charities section in the interim report should be framed as follows:
>
> o *Accumulations and that the default setting should be distribution.* Need to factor in the need for some charities to make large calls on crises. Also potentially different approach when capital did not receive a tax benefit going into the charity – e.g. Treaty settlements (note: Hinerangi to think about accumulation by Māori authorities);
>
> o Deregistration – need to make the rules more robust;
>
> o *Private foundations – need to require distributions* particularly when the capital has received a tax benefit going in; and
>
> o GST – should charities be getting GST back? (note: Hinerangi to think about impacts for marae).

177. We note in passing that the issues paper does not pick up on the "need to factor in

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[223] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 5.
[224] Even though it was raised in TWG submissions. See Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 29.
[225] Secretariat for the Tax Working Group *Minutes* 6 July 2018 at 4 - 5.
[226] Secretariat for the Tax Working Group *Minutes* 6 July 2018 at 4 - 5.
[227] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 15, 5 - 6 (emphasis added).
[228] Secretariat for the Tax Working Group *Minutes* 6 July 2018 at 5 (emphasis added).

the need for some charities to make large calls on crises" or the need for a "potentially different approach when capital did not receive a tax benefit going into the charity – eg Treaty settlements". Indeed, the Māori voice appears to be almost entirely absent from the issues paper the Maori.

178. The 4 conclusions made at the 6 July 2018 meeting then flowed directly into the Tax Working Group's interim report, issued in September 2018,[229] its final report, issued in February 2019,[230] and the August 2019 tax policy work programme,[231] apparently without any further deliberation.

179. In its final report, the Tax Working Group concluded as follows in relation to the business income of charities:[232]

> The Group received many [sic] submissions regarding the treatment of business income for charities and whether the tax exemption for charitable business income confers an unfair advantage on the trading operations of charities.
>
> The Group considers that the underlying issue is more about the extent to which charities are distributing or applying the surpluses from their activities for the benefit of the charitable purpose. If a charitable business regularly distributes its funds to its head charity, or provides services connected with its charitable purposes, it will not accumulate capital faster than a taxpaying business.
>
> The question, then, is whether the broader policy settings for charities are *encouraging appropriate levels of distribution*. The Group recommends the Government periodically review the charitable sector's *use of what would otherwise be tax revenue, to verify that the intended social outcomes are actually being achieved*
>
> In this regard, the Group notes that other countries, *such as Canada*, have introduced regimes where all registered charities are *required to spend a minimum amount each year on their own charitable activities or on gifts to qualified donees* (for example, other charities).

180. As with the OECD report and the background paper, these conclusions are based on a number of assumptions. For example, the conclusion that charities are using "what would otherwise be tax revenue" reflects an underlying tax expenditure analysis, use of which is adopted without critical analysis or even acknowledgement. In addition, no evidence is provided to support the assertion that business income tax exemption gives charities an "unfair advantage" in terms of their ability to accumulate income tax free (that is, a competitive advantage in relation to expansion) and that charities should therefore be "encouraged" to distribute. As discussed above, research indicates that that is not the case. Further, exploration of alternative options, such as raising awareness of and enforcing the fiduciary duties, is also entirely absent from the Tax Working Group material.

181. The Tax Working Group continued as follows:[233]

> Private charitable foundations and trusts
>
> The Group is concerned about the treatment of private charitable foundations and trusts. These foundations and trusts benefit from the donor tax concessions [sic] but are not required to have arm's-length governance boards or distribution policies. The

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[229] Tax Working Group *Future of Tax: Interim Report* 20 September 2018 at 23.
[230] Tax Working Group *Future of Tax: Final Report* 21 February 2019 at 103 - 104.
[231] Inland Revenue Department *Government tax policy work programme 2019-20* 8 August 2019.
[232] Tax Working Group *Future of Tax: Final Report* 21 February 2019 at 102 - 103.
[233] Tax Working Group *Future of Tax: Final Report* 21 February 2019 at 103-104.

> rules around these foundations and trusts appear to be unusually loose.
>
> The Group recommends that the Government consider whether to apply a distinction between privately controlled foundations and other charitable organisations and removing concessions for privately controlled foundations or trusts that do not have arm's-length governance or distribution policies.

182. These points are contested, as discussed further below.

183. In the result, and perhaps reflecting the fact that issues relating to charities had received little more than *1 hour's* deliberation during the *entire tenure of the Group*,[234] issues relating to charities were identified as "matters requiring further work",[235] and "kicked for touch" to the review of the Charities Act.[236]

The review of the Charities Act

184. The review of the Charities Act has a tortured history, as touched on above, ultimately (and controversially) culminating in a set of 21 changes announced by the former Minister for the Community and Voluntary Sector in June 2022.[237] One of these changes was a proposal to update the annual return forms to require larger charities to report the reasons for their accumulated funds in their annual returns.

185. The rationale for this proposal was described by DIA in the following terms:[238]

> *Charities have many good and valid reasons for accumulating funds.* However, these reasons are not always clear to the public in the annual return, financial statements, and statement of service performance. This is based on a desktop review of the suite of financial and performance reporting of 23 registered charities (single entities, and groups). This sample illustrated that *while charities are transparent in their reporting on what or how much is accumulated*, the user of the report needs a certain level of knowledge or understanding about charities, investments, business and accounting to understand why the charities have accumulated funds.
>
> For example, as part of targeted engagement, some philanthropic organisations shared that their accumulated funds are to ensure the charity exists in perpetuity, in accordance with the trust's deed, and they can only distribute income generated from investing those funds. However, this is not clear in an annual return, financial statement, or performance report. To conclude that the accumulated funds are valid, a person looking into this would need to:
>
> • know that trusts can be established in perpetuity;
>
> • know that trustees have a duty to act in accordance with the perpetuity rule [sic];

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[234] The agenda for the July 2018 meeting reveals that reveals that 1¼ hours were to be allocated to a discussion about charities (including consideration of a proposal from a scholarship winner to implement a "charity credit account" prior to removing the income tax exemptions for charities altogether). See Secretariat for the Tax Working Group, 6 July 2018 *Agenda* at 1.

[235] Tax Working Group *Future of Tax: Interim Report* 20 September 2018 at 23; Tax Working Group *Future of Tax: Final Report* 21 February 2019 at 12 - 13, 103 - 104.

[236] In February 2020, business activities and accumulation of funds were elevated to two of three issues to be fast-tracked as part of the review of the Charities Act. In April 2021, the issues addressed were extended to five issues: reporting requirements for small charities; charities' business and accumulation activities; investigating potential improvements to the appeals mechanism; matters relating to the government agency; and duties of officers of charities. See Te Tari Taiwhenua *Modernising the Charities Act* 26 October 2021: <www.dia.govt.nz/charitiesact>. See also the discussion in S Barker "Charity regulation in New Zealand: history and where to now?" (2020) 26(2) Third Sector Review 28.

[237] Minister for the Community and Voluntary Sector press release *Charities Act changes to benefit NZ communities* 2 June 2022: https://www.beehive.govt.nz/release/charities-act-changes-benefit-nz-communities.

[238] Te Tari Taiwhenua | Internal Affairs *Regulatory Impact Statement: Modernising the Charities Act* (Report, 19 October 2021) at 34 - 36 and 38 (with emphasis added).

> and
>
> • refer to the suite of information provided by the charity on their purpose, income sources and expenditure.
>
> *We cannot expect the public to have this level of knowledge*. There is a problem with the accessibility of information on accumulated funds, in terms of understandability and simplicity. This *can* undermine public trust and confidence in the charitable sector, because informing the public on how charitable funds are used, using funds wisely and effectively, and ensuring funds go to the end cause are key characteristics of public trust and confidence. Public trust and confidence is critical as it encourages support of the charitable sector, in the form of donations and volunteering.

186. In other words, based on a "desktop review" of only 23 charities, which review did not indicate any issue with transparency of charities' reporting on accumulated funds, DIA imputed to the public an inability to ascertain from the comprehensive information already provided by means of the charities register whether any particular accumulation was valid.

187. A side-effect of constant suggestions of a problem with charities' business and accumulation activities[239] is to mislead the public into thinking there is indeed a problem that requires "fixing" when there is in fact no evidence of any issues that could not be adequately addressed on a case by case basis within the current framework. The net effect is to unfairly undermine public trust and confidence in the charitable sector as a whole, contrary to the very purpose of the Charities Act itself.

188. DIA continued as follows:[240]

> The objective for this topic is to improve accessibility of information on why charities have accumulated funds, *while charities maintain independence to govern and manage funds in ways that service their communities*. This aims to support our overall objective that the Charities Act supports charities to continue their vital contribution, while ensuring that contribution is transparent.
>
> Media interest and public queries over the last several years have highlighted an interest in charities accumulating funds, including concerns that charities are accumulating for non-charitable reasons, and that it is unclear why some have significant accumulated funds. However, *we do not have direct information on the public's view of the accessibility of accumulated funds information.*
>
> Stakeholder views of the problem
>
> *Most stakeholders during targeted engagement in 2021 (and in the 2019 consultation) said that charities report enough financial information to provide transparency about accumulated funds, and that further reporting is not required.* Some thought that [service] performance report requirements taking effect from 1 January 2022 … would be useful in better understanding how accumulated funds are charitable [sic] and said that we should wait and see the full impact of this reporting before making changes.
>
> However, other stakeholders (large charities with business activities, fundraising charities, and academics) agreed that increased transparency and accountability on accumulation or distribution of funds is needed. *Some of these stakeholders referred to "passive" private foundations that "hoard tax-free funds" and only distribute funding for*

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[239] See, for example, RNZ *Charities' $2 billion in untaxed profits* 4 December 2024: https://www.rnz.co.nz/news/business/535585/charities-2-billion-in-untaxed-profits.
[240] Te Tari Taiwhenua | Internal Affairs *Regulatory Impact Statement: Modernising the Charities Act* (Report, 19 October 2021) at 35 - 36 (with emphasis added).

administrative costs and professional service fees.

189. In other words, while most stakeholders did not agree there was a problem to be fixed, unsubstantiated anecdotal evidence of "some" charities allegedly "hoarding" funds was considered to require a blanket regulatory response, without any consideration of whether any such issue might be more than adequately addressed by using tools already available.[241] The imperative appears to have been to be seen to be doing something to implement the recommendations of the Tax Working Group, rather than carrying out the "further work" required to ascertain whether a regulatory response was even needed.

Annual returns

190. New annual return forms for registered charities were released in April 2024.[242] For reporting periods beginning on or after 1 April 2024,[243] larger charities in tiers 1 – 3 will be asked the following question in their annual returns:[244]

> How do you plan to use your charity's accumulated funds in the future?
>
> *Things to consider:*
>
> • *How accumulating funds will help to achieve your charity's goals of advancing your charitable purpose.*
>
> • *Specific reasons for accumulating funds (i.e., planning for future generations and the sustainability of your charity or upcoming significant projects or planned capital expenditure (e.g., buildings).*

191. DIA states that the information provided by means of this question will be used to gather "sector level data" about the level of accumulations in the charitable sector, which data will be used by Charities Services and Inland Revenue to "inform compliance activities".[245] It is not clear what "compliance activities" are being referred to, as there are no specific compliance requirements in either the Charities Act or the Income Tax legislation regarding accumulated funds (other than compliance with the fiduciary duties, enforcement of which appears to be a blind spot for both IRD and Charities Services). It would be surprising if government departments were proceeding on the basis that the proposals in the issues paper will be implemented given the public assurances that "no decisions have been made".[246] We note that the issues paper's consultation period is very attenuated, extending to little over 4 weeks for an already-stretched charitable sector to respond to "the biggest shake-up in the taxation of charities and not-for-profits in New Zealand since

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[241] See discussions above regarding fundamental charities law principles.
[242] See Charities Services | Ngā Ratonga Kaupapa Atawhai *New forms hub* 4 September 2024: https://www.charities.govt.nz/charities-act-hub/new-forms-hub/.
[243] The new forms are not mandatory until reporting periods beginning on or after 1 April 2024, meaning that for those charities with a standard 31 March balance date, the new forms will not need to be used until September 2025. Early adoption is possible, but there does not appeal to be any particular advantage for a charity in doing so.
[244] Charities Services | Ngā Ratonga Kaupapa Atawhai *Form 3 – Annual Return for a Tier 3 charitable entity* (undated but released in April 2024) at 21, available at Charities Services | Ngā Ratonga Kaupapa Atawhai *Resources | He Rauemi* https://www.charities.govt.nz/resources-page. The updated annual return for tier 1 and 2 charities is completed online, but includes the same question.
[245] Te Tari Taiwhenua | Internal Affairs *Regulatory Impact Statement: Modernising the Charities Act* (Report, 19 October 2021) at 45.
[246] Inland Revenue | Te Tari Taake *Public consultation on taxation and the not-for-profit sector* 24 February 2025: https://www.ird.govt.nz/updates/news-folder/public-consultation-on-taxation-and-the-not-for-profit-sector: "These are only policy proposals at this stage. No decisions have been made. Government will consider feedback and decide whether any changes should be made to current rules and any changes it decides to proceed with would need to be included in a future taxation Bill. Inland Revenue will ensure that affected entities are kept informed".

1940".[247] To make matters worse, the consultation period ends on 31 March, a date that coincides with financial year end for many charities. Sir Peter Gluckman has commented on the current trend of "abbreviated and tokenistic" consultation, even when the matter is crucial.[248] On 23 March 2023, the Minister of Finance is reported as saying that "nothing major" is coming in the Budget "except for charities".[249]

192. If decisions have in fact already been made, such that the current consultation process is intended to be only tokenistic, aimed at giving the appearance of consultation when the outcome is already predetermined, we ask that IRD please be honest with the charitable sector about that fact. The Generic Tax Policy Process ("**GTPP**") emphasises early, informed consultation with the public and stakeholders, to ensure "better, more effective tax policy development through early consideration of all aspects – and likely impacts – of proposals, and increased opportunities for public consultation".[250] The Government consistently states how much it values the charitable sector: the proposals in the issues paper will have far-reaching impact and multiple unintended consequences, not just for the charitable sector but for New Zealand society more broadly. We ask that the GTPP is properly followed *before* any decisions are made.

Generating funds

193. Returning to DIA's review of the Charities Act, it should be noted that the requirement to disclose the reasons for accumulated funds does not apply to tier 4 charities (that is, charities with annual operating payments under $140,000), even though such charities may hold significant accumulated funds.[251] DIA argues that Charities Services can use existing tools to require information from these charities if needed,[252] raising the question of why the same approach could not be applied for larger charities as well.

194. The new annual returns for charities also ask the following question:[253]

> Is generating funds for, or making grants or donations to, other charities or

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[247] Liam Sutherland *Potential tax changes for the not-for-profit sector not exactly charitable* MinterEllisonRuddWatts 11 March 2025: https://www.minterellison.co.nz/insights/potential-tax-changes-for-the-not-for-profit-sector-not-exactly-charitable#:~:text=Since%201940%2C%20income%20derived%20from,carried%20out%20in%20New%20Zealand.

[248] Peter Gluckman *'Deepening Our Democracy'. Insights & Opinion* Koi Tū: The Centre for Informed Futures (blog) 6 November 2022: https://informedfutures.org/deepening-our-democracy/.

[249] https://www.nzherald.co.nz/nz/government-budget-cuts-nicola-willis-is-prepping-for-a-bonfire-of-the-vanity-projects-ryan-bridge/JYC2BVMKGVDXHIHPTEAVGL2KP4/.

[250] See Inland Revenue Department *How we develop tax policy* 15 November 2023: <www.taxpolicy.ird.govt.nz/about-us/how-we-develop-tax-policy>.

[251] Unlike most comparable jurisdictions, New Zealand measures size, for the purposes of the financial reporting rules for registered charities, as a function of expenditure, rather than income or assets. See Te Kāwai Ārahi Pūrongo Mōwaho | External Reporting Board *External Reporting Board Standard A1: Application of the Accounting Standards Framework* December 2015, incorporating amendments to 31 March 2024. Expenditure was considered 'more reflective of underlying activity than revenue', and an expenditure approach also protects charities from fluctuations in tier due to, for example, one-off large bequests. For a fuller discussion, see the Charities Volume chapter 7 (*Reporting*).

[252] Te Tari Taiwhenua | Internal Affairs *Regulatory Impact Statement: Modernising the Charities Act* (Report, 19 October 2021) at 46.

[253] Charities Services | Ngā Ratonga Kaupapa Atawhai *Form 4A – Combined Performance Report and Annual Return for a Tier 4 charitable entity* (undated but released in April 2024) at 14 and *Form 4B – Annual Return for a Tier 4 charitable entity* (undated but released in April 2024) at 14, *Form 3 – Annual Return for a Tier 3 charitable entity* (undated but released in April 2024) at 13, available at Charities Services | Ngā Ratonga Kaupapa Atawhai *Resources* | *He Rauemi* https://www.charities.govt.nz/resources-page. The updated annual return for tier 1 and 2 charities is completed online, but includes a similar question. For a fuller discussion, see the Charities Volume, chapter 7 (*Reporting*).

organisations the main way your organisation/charity carries out its charitable purposes?*

□ No

□ Yes

195. Unlike the accumulated funds question, this question is not limited to the annual return: it also appears in the new application for registration form,[254] and the new "update details" form.[255] It is also not limited to larger charities: all registered charities will be expected to answer this question.

196. This question was not included in the package of announcements made in June 2022; it appears instead to have been included in the forms by administrative fiat. It also does not appear to relate to the Charities Act and appears instead to derive directly from the Tax Working Group focus on private foundations (being those that make "grants or donations") and business income (being those "generating funds"), which focus was kicked for touch to the review of the Charities Act, as discussed above.

197. As part of that review, DIA issued a policy paper in May 2021 entitled *Charities accumulating funds*.[256] In this paper, DIA proposed to make a distinction between "charities that generate funds to support their own or others [sic] charity" (which it proposed to define as "fundraising charities") and charities that "further charitable purpose directly through their activities". DIA then argued that "fundraising charities" (as so defined) "do not further charitable purpose until they distributed [sic] funding", and that more transparency was needed as to why "fundraising charities" were accumulating funds, and "how and when the funding will be distributed to charitable purpose".[257] Otherwise, DIA argued, public trust and confidence in the charitable sector would be undermined.[258]

198. It should be noted that these comments do not make sense as a matter of charities law. There is no distinction in charities law between charities that "do" and charities that "fund": "funding" is a form of "doing". All activities carried out by a charity must be undertaken in furtherance of the charitable purposes set out in the charity's rules; every decision made by every charity, including a decision to accumulate rather than spend, must be made in good faith in the best interests of those charitable purposes.[259] DIA provided no evidence to support its assertion that the comprehensive information already provided by registered charities under the financial reporting rules was in any way undermining public trust and confidence in the charitable sector.[260] DIA has itself acknowledged in its own regulatory impact statement that its review of the Charities Act suffered from inadequate consultation,

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[254] Charities Services | Ngā Ratonga Kaupapa Atawhai *Form 1 – Application for registration as a charitable entity* (undated, but released in April 2024) at 16.
[255] Charities Services | Ngā Ratonga Kaupapa Atawhai *Form 2 – Update details form for a charitable entity* (undated, but released in April 2024) at 10.
[256] Te Tari Taiwhenua | Internal Affairs *Charities accumulating funds* (initial policy paper) May 2021 at 1: https://www.dia.govt.nz/Targeted-engagement-and-stakeholder-feedback.
[257] Te Tari Taiwhenua | Internal Affairs *Charities accumulating funds* (initial policy paper) May 2021 at 1.
[258] Te Tari Taiwhenua | Internal Affairs *Charities accumulating funds* (initial policy paper) May 2021 at 1.
[259] See, for example, Trusts Act 2019, sections 24 – 26; Incorporated Societies Act 2022, sections 54 – 56, and the discussion in chapters 7 and 8 of the Charities volume.
[260] See Te Tari Taiwhenua | Internal Affairs *Regulatory Impact Statement: Modernising the Charities Act* (Report, 19 October 2021) at 32, 33.

inadequate problem definition, and a lack of evidence to support its proposals.[261]

199. Nevertheless, to address its perceived problem regarding its perceived category of "fundraising charities", DIA put forward 5 options, one of which was to impose a "mandatory distribution requirement" requiring fundraising charities (as defined) to distribute a minimum of 5% of their net assets every year.[262]

200. DIA's suggestion of making a distinction between "fundraising charities" and other charities was strongly opposed by submitters,[263] as was the proposal to find some way of taxing their accumulations.[264] There are many legitimate reasons why it may be in the best interests of a charity's charitable purposes to accumulate funds, particularly for charities that take a long-term or inter-generational perspective (noting the ability of charities to exist into perpetuity).[265] For example, it is good governance to have at least 6 months of operational funding in reserves (as was acutely demonstrated during the COVID-19 pandemic); grant-making foundations require significant permanent reserves in order to generate sufficient income from which to make grants;[266] for charities that run businesses (which are, by definition, social enterprises, as discussed above),[267] the fact that meeting investor needs is not their main priority, and that they aim to reinvest profits into the social mission of the enterprise, is in fact a highly valued feature, rather than something to be curtailed. There is no principled reason for isolating the activity of accumulations for special treatment, or for "slicing and dicing" the charitable sector into arbitrary categories aimed at restricting the ability of private foundations and charitable businesses to accumulate funds.

201. By October 2021, DIA itself appeared to acknowledge this fact, making the following comments in its regulatory impact statement:[268]

> An alternative problem that we considered and *ruled out*
>
> We considered whether there was a problem with distribution of accumulated funds by "*fundraising charities*". Charitable status can be granted to organisations that exist for certain purposes and that meet certain requirements. Our initial view was that organisations include those that "do" charitable purpose (i.e. directly further charitable purpose through their activities e.g. education providers, religious organisations, budget service providers etc.), and those that generate funds to support their own or others charitable purpose (e.g. *private foundations, and "unrelated" businesses such as opportunity shops, food retailers, transport companies and tourism operators*). We identified that in *some* cases, "fundraising charities" distribute very limited funds to charitable purpose [sic] per annum. Our initial problem definition was that it is *unclear* how or when fundraising charities plan to distribute their funds to benefit charitable purpose, which *could* undermine public trust and confidence in the charitable sector.

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[261] Te Tari Taiwhenua | Internal Affairs *Regulatory Impact Statement: Modernising the Charities Act* (Report, 19 October 2021) at 3, 6, 9, 10, 45, 53, 120.
[262] Te Tari Taiwhenua | Internal Affairs *Charities accumulating funds* (initial policy paper) May 2021 at 2-3.
[263] Te Tari Taiwhenua | Internal Affairs *Regulatory Impact Statement: Modernising the Charities Act* (Report, 19 October 2021) at 36.
[264] Te Tari Taiwhenua | Internal Affairs *Charities accumulating funds* (initial policy paper) May 2021 at 3.
[265] See Trusts Act 2019 s 16(6)(a).
[266] Ann O'Connell 'Taxation and the Not for profit Sector globally: common issues, different solutions' in Matthew Harding (ed) *Research Handbook on Not-for-profit law* (Edward Elgar, 2018) 388 at 410.
[267] See the discussion in S Barker *Focus on purpose – what does a world-leading framework of charities law look like?* [2022] NZLFRR 3, chapter 5.
[268] Te Tari Taiwhenua | Internal Affairs *Regulatory Impact Statement: Modernising the Charities Act* (Report, 19 October 2021) at 34 - 36 and 38 (with emphasis added).

> *We consulted with targeted stakeholders on this problem definition. Most stakeholders (large and small charities including what we referred to as "fundraising charities", iwi, umbrella groups, and lawyers) did not agree with the problem. They considered that it lacks recognition that charitable purposes can be furthered by accumulating funds, by any type of charity, and an approach to focus on a newly defined class of charities was arbitrary, too simplistic, and would be very difficult to implement.* It was also reinforced that any entity must be established for charitable purposes – there is no test of what level of distributed funds is "charitable enough"; the funds must simply be for [the charity's stated charitable purposes]
>
> Fundamental matters concerning charitable purpose are out of the scope of this work. *There is also a lack of evidence that the lack of distribution by some charities is invalid or non-charitable, as there have not been investigations into this*. On that basis, and because of the feedback that it would *not be practical to define and target "fundraising charities", we discarded this problem definition and focused on the matter of transparency.*

202. In other words, on the basis of feedback received, DIA stated that it would not be practical to define and target "fundraising charities", and as a result they discarded this problem and focused instead on the matter of transparency (hence the "accumulated funds" question discussed above).

203. A significant question therefore arises as to why the question regarding "generating funds" is being asked in *all* of Charities Services' new forms? DIA argues that the information provided by means of this question will "make it easier for researchers who have an interest in philanthropy to identify 'giving charities' (eg private funders or community trusts) as opposed to 'doing charities' on the charities register".[269] DIA also argues this information will be useful for "charities looking for funding, to help them more easily identify grant funders on the register".[270]

204. However, all charities "give" and all charities are "giving charities". "Giving charities" appears to be merely another way of referring to "fundraising charities", the category that DIA had specifically rejected during the consultation process. Identifying grant funders on the charities register could easily have been achieved by simply *asking* charities to indicate whether they wish to be identified on the charities register as one that can be approached by those seeking funding (in a similar manner to that already adopted for kaupapa Māori charities, Pasifika charities and charities supporting ethnic communities).[271]

205. The *real reason* for asking this question appears to be to dovetail in with the accumulating funds question in order to identify which charities with accumulated funds fall within the Tax Working Group's categories of "private foundations and charities running businesses". As the former Minister noted:[272]

> We considered some other options, for example looking at whether we require a distribution plan, or set a minimum percentage that larger charities need to distribute. *But I feel that would be putting the cart before the horse, I want to know why first*

206. The new forms were finalised in April 2024, almost a year before the issues paper

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[269] Charities Services | Nga Ratonga Kaupapa Atawhai *He Rourou Atawhai - Forms Consultation* August 2023.
[270] Charities Services | Nga Ratonga Kaupapa Atawhai *He Rourou Atawhai - Forms Consultation* August 2023.
[271] See, for example, the new tier 3 form on page 3.
[272] G Cann *Charities sitting on millions more in cash than a year ago* Stuff 15 April 2023: https://www.stuff.co.nz/business/131757175/charities-sitting-on-millions-more-in-cash-than-a-year-ago (with emphasis added).

was released. The presence of the "generating funds" question in the new forms gives the impression that the issues raised in the issues paper have already been decided, and the attenuated consultation of little more than 4 weeks for what has been described as "the biggest shake up in the taxation of charities and not-for-profits in New Zealand since 1940" is intended to be tokenistic only.

207. This concern is exacerbated by the apparent absence of a legal basis for Charities Services to ask this question in its Charities Act forms.

Section 72A

208. The power to prescribe forms is governed by section 72A of the Charities Act, which gives Charities Services the power to prescribe forms simply by posting on its website (provided it has first consulted with persons it considers to be "representative of the interests" of registered charities).[273]

209. As discussed above, the Charities Act has been subjected to a number of piecemeal changes over the years, of which section 72A is an example. Section 72A was inserted into the legislation by Statutes Amendment Bill in February 2012,[274] just 4 months before the Charities Commission was controversially disestablished in July 2012.[275] In the Charities Act as originally enacted in 2005, forms were required to be prescribed by regulation.[276] There was no consultation with the charitable sector, or any publicly-available commentary, explaining why the protection of a regulation-making power was being removed: the explanatory note to the Statutes Amendment Bill simply states that the new provision allows the Charities Commission to prescribe a form "only for certain purposes" and provided it has first satisfied certain publication and consultation requirements.[277]

210. The Charities Commission was, of course, an autonomous Crown entity;[278] as such, it was subject to the comprehensive accountability requirements of the Crown Entities Act 2004. When the Charities Commission was disestablished, this new power to prescribe forms was simply transferred across to Charities Services;[279] however, the question of whether such a broad, sweeping power was appropriately conferred on a business unit of a government department, that is subject to almost no meaningful accountability beyond minimal passing reference in a 350-page DIA annual report covering DIA's comprehensive work across a wide range of areas (including gambling, censorship, countering violent extremism, government recordkeeping, unsolicited electronic messages, anti-money laundering, private security personnel and private investigators),[280] does not appear to have been considered.

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[273] Charities Act 2005, section 72A(6).
[274] Statutes Amendment Bill (No 2) 271-1, clause 16, which became section 14 of the Charities Amendment Act 2012 (2012 No 4).
[275] Charities Amendment Act (No 2) 2012 (2012 No 43), sections 9 and 2.
[276] Charities Act 2005 (as originally enacted), sections 42 (*Regulations concerning content of annual returns*) and 73(1)(a) and (b) (*Regulations*) and Charities (Fees, Forms, and Other Matters) Regulations 2006 (SR 2006/301), as originally promulgated on 29 September 2006.
[277] Statutes Amendment Bill (No 2) 271-1 (22 February 2011) (explanatory note) at 2-3.
[278] Charities Act 2005 (as originally enacted), section 9.
[279] See Charities Amendment Act (No 2) 2012 (2012 No 43), section 16 and schedule 2, which provided as follows with respect to section 72A: "Omit "Commission" in each place where it appears and substitute in each case "chief executive"."
[280] Te Tari Taiwhenua Department of Internal Affairs *Annual Report 2023 Pūrongo ā-Tau*: <www.dia.govt.nz/Resource-material-Corporate-Publications-Annual-Reports#Earlier> at 11, 157, 240, 300–301.

211. Section 72A makes it clear that Charities Services may prescribe a form only for purposes relating to its functions and duties *under the Charities Act*:[281] Charities Services is not permitted to design forms to collect information for tax purposes outside of very limited parameters: specifically, section 72A(3) and (4) allows Charities Services to use forms to collect information "for the purpose of … subpart LD of the Income Tax Act". Subpart LD relates to *donee status*.

212. The questions in the new forms relating to accumulated funds and generating funds do not relate to donee status, or to Charities Services' functions and duties under the Charities Act. They relate, instead, to the Tax Working Group recommendations to tax the accumulations of charities, through imposing mandatory distribution requirements and removing the exemption for charities' business income. A serious question arises as to whether the questions in the new forms regarding accumulated funds and generating funds can lawfully be asked.

213. It would not be appropriate for Charities Services to use its statutory powers to collect information for IRD in a manner contrary to the clear statutory parameters within which such powers are required to be exercised. The Charities Act is not tax legislation: it is not included in the list of "Revenue Acts" set out in schedule 1 of the Tax Administration Act 1994; indeed, the function of determining charitable status was specifically *removed* from IRD when the Charities Act was passed in 2005. Nowhere does the Charities Act state that its purpose is to ration the tax privileges of charity in line with the bureaucracy's conception of what is worth "subsidising" out of public funds. In a liberal democracy such as New Zealand, it is important to protect the independence of charities: it is critical to protect charities' independence or we will lose that which makes them distinctive and valuable.[282] Undermining charities' independence will in turn undermine their ability to attract the donations and volunteer support on which so many depend: people do not join or support charities to be part of government, or to have their contributions sequestered by government. As noted by Hon John Rae MP on the introduction of "donee status" in 1962:[283]

> I believe if people are given a little incentive ***great things will be done privately***, and fewer demands will fall on the Government's plate.

214. Research indicates that charities carry out services more effectively and efficiently than government.[284] If charities are forced to close or reduce their services as a result of the proposals in the issues paper, more will fall on the government's plate, which would likely *increase* government's costs, in direct contradiction to the statutory duty of Inland Revenue to "collect over time the highest net revenue that is practicable within the law".[285] Such an outcome would also be contrary to the very purpose of providing tax privileges to charities in the first place, and a serious "own goal" for the government.

215. The Charities Act should not be used as a tool for turning charities into instruments

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[281] Charities Act 2005, section 72A(2).
[282] Lord Hodgson of Astley Abbotts *Trusted and Independent: Giving charity back to charities – Review of the Charities Act* July 2012 at [3.15], [4.21].
[283] Dr Michael Gousmett *The history of the charitable purpose tax concessions in New Zealand: Part 1* New Zealand Journal of Taxation Law and Policy Vol 19 (June 2013): 139, referring to NZPD Vol 330 (11 July 1962) at 840 per Hon John Rae MP (with emphasis added).
[284] See, for example, R Atkinson "Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis and Synthesis" (1997) 27 Stetson Law Review 395 at 403.
[285] Tax Administration Act 1994, section 6A(2).

of the state. At a purely practical level, it would not make sense for charities' ability to register under the Charities Act to change every 3 years depending on which political party was in power: charities are designed to exist into perpetuity;[286] the sheer logistics of charities regularly falling on and off the register would be administratively unworkable, particularly given the impact of the deregistration tax in section HR 12.

Double jeopardy

216. It is also concerning that scarce taxpayer and charitable resources are being expended in relation to proposals to tax the business income of charities and impose minimum distribution requirements when such proposals were so comprehensively rejected during the review of the Charities Act.

217. We accept that the Charities Act is not working:[287] the fundamentals of the Charities Act are not sound, and a first principles review of the Charities Act is very much needed if we genuinely wish to support charities' "massive role in our communities".[288] Despite this, DIA has consistently resisted a "first principles review", despite it being Labour party policy to conduct one. It appears that IRD now seeks to "take matters into its own hands", by seeking to make changes to the tax settings for charities instead. However, such a siloised approach would be short-sighted: if the Charities Act is not working, the proper place to address issues is in the Charities Act (preferably by enforcing existing rules). Rushing to create complicated tax rules seeking to address issues at the level of symptom rather than cause will have myriad unintended consequences that will ultimately only make it more difficult for charities to carry out their work, and put the reform that genuinely is needed even further out of reach.

218. There is no question that New Zealand is in a time of considerable fiscal constraint; however, going after charities and other community organisations is not the answer. It is important that other alternatives, such as enforcing the fiduciary duties, are properly considered before rushing to make further kneejerk piecemeal reform.

Conflating the distinction between purposes and activities

219. Another factor that appears to have been overlooked in the analysis to date is that "business" and "accumulations" are inherently *activities*, when charities law is a fundamentally *purposes*-based area of law.

220. Charities are a unique legal construct in that they are defined by their *purposes* rather than by their activities or their underlying legal structure. As the Supreme Court of Canada has noted, charities law derives from trust law, where the focus is

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[286] Trusts Act 2019 s 16(1), 16(6)(a); *New Zealand Society of Accountants v Commissioner of Inland Revenue* [1986] 1 NZLR 147 (CA) at 157; *Tasmanian Electronic Commerce Centre Pty Ltd v Commissioner of Taxation* [2005] FCA 439 at 36. See also I Murray *Charity law and accumulation: maintaining an intergenerational balance* (Cambridge University Press, 2021).

[287] For a fuller discussion, see Barker et al *The Law and Practice of Charities in Aotearoa New Zealand* 2ed (LexisNexis, 2024); Seed the Change | He Kākano Hāpai *Changes to the Charities Act – what you should know*: https://www.seedthechange.nz/charities-reform; S Barker "Charity regulation in New Zealand: history and where to now?" (2020) 26(2) Third Sector Review 28; M McGregor-Lowndes and B Wyatt (eds) *Regulating Charities: the Inside Story* (Routledge, 2017) chapters 9 and 10; and S Barker *Focus on purpose - what does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3.

[288] https://www.rnz.co.nz/news/political/535535/tax-changes-for-charities-to-be-announced-in-next-budget.

on charitable purposes rather than "charitable activities":[289]

> … the character of an activity is at best ambiguous; for example, writing a letter to solicit donations for a dance school might well be considered charitable, but the very same activity might lose its charitable character if the donations were to go to a group disseminating hate literature. In other words, it is really the purpose in furtherance of which an activity is carried out, and not the character of the activity itself, that determines whether or not it is of a charitable nature. … Unfortunately, this distinction has often been blurred by judicial opinions which have used the terms 'purposes' and 'activities' almost interchangeably. Such inadvertent confusion inevitably trickles down to the taxpayer organisation, which is left to wonder how best to represent its intentions .. in order to qualify ….

221. There is, in fact, no such thing as a "charitable activity" in isolation:[290] once an entity's purposes are determined to be "exclusively" charitable, the focus of the underlying common law is on ensuring the entity's activities further *those charitable purposes*. The common law of charities otherwise says very little about charities' activities,[291] beyond a generally-accepted prohibition on partisan political activity.[292]

222. The purpose-based focus of charities law is reflected in the essential requirements for registration in section 13(1) of the Charities Act, and income tax exemption in section CW 41(1) of the Income Tax Act, both of which turn on whether an entity's *purposes* are charitable.[293]

223. The assumption that accumulations are somehow inconsistent with public benefit is therefore an oxymoron: it does not make sense to say that a charity accumulating funds is not applying them for the benefit of its charitable purposes; every activity carried out by every charity must, by definition, be carried out in furtherance of its charitable purposes. Issues relating to activities are best dealt with by *enforcing the fiduciary duties*. A charity accumulating funds must be able to demonstrate that doing so is in the best interests of its charitable purposes or it is in breach of fiduciary duty.

224. Charities need flexibility to determine how best to run their operations, including regarding whether to accumulate or "spend".[294] Such decisions are best made by charities, not government. Reinforcing the fiduciary duties and the destination of funds test would allow charities to focus their energy and resources on furthering their charitable purposes in good faith in the best way possible without being distracted by the need to fall within blunt, arbitrary, unnecessary and ultimately ineffective rules (and without the need to create complex alternative legal structures, such as "community interest companies" to work around them, as discussed further below).

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[289] See *Vancouver Society of Immigrant and Visible Minority Women v Minister of National Revenue* [1999] 1 SCR 10 at [152], [144].
[290] See, for example, the discussion in S Barker "The myth of charitable activities" [2014] NZLJ 304.
[291] As noted in Report of the Special Senate Committee on the Charitable Sector *Catalyst for Change: A Roadmap to a Stronger Charitable Sector* June 2019 at 82.
[292] The prohibition on partisan political activity has been codified in Canada (Income Tax Act (RSC 1985 c1 (5th Supp)) s 149.1(6.2)), Australia (Charities Act 2013 (Cth) s 11(b)) and Scotland (Charities and Trustee Investment (Scotland) Act 2005 s 7(4)(c)). In other jurisdictions, such as England and Wales, Northern Ireland and New Zealand, a partisan prohibition applies by means of the common law.
[293] See also section 5(3) and (4) of the Charities Act, which similarly makes it clear that the ancillary purpose rule applies to purposes, rather than activities.
[294] Submission of Royal New Zealand Coastguard Incorporated.

No compelling rationale

225. If chapter 2 of the issues paper is aimed at a specific religious charity engaged in cereal manufacture,[295] it should be noted that the proposals in chapter 2 will likely have no impact whatsoever on that charity. For a religion focused on healthy eating, manufacturing healthy cereals is likely to be a business "related" to its charitable purposes. Even if its cereal manufacturing business were "unrelated", we understand that particular charity already distributes its net income to its head charity. On that basis, the proposals in chapter 2 will have no impact on the targeted charity, and would instead simply impose blanket deadweight costs and unnecessary restrictions on good charities trying to raise funds for their charitable purposes.

226. The underlying assumption that charities do not further charitable purpose until they distribute funding is misconceived, and represents a fundamental lack of understanding of the fiduciary duties to which all registered charities are subject. It does not justify removal of the business income tax exemption: as the issues paper itself notes,[296] accumulation could arise from any form of income earned by charities.

227. The "allergy to accumulations" assumption does not bear scrutiny, and does not provide a rationale, let alone a compelling one, for removing charities' exemption for business income.

Assumption 3: that charities' business income tax exemption results in a loss of tax revenue that "shifts the burden to other taxpayers"

228. The third assumption underlying the issues paper is that the income tax exemption for the business income of charities results in a "loss of tax revenue" that "shifts the burden to other taxpayers":[297]

> The fiscal cost of not taxing charity business income unrelated to charitable purposes, particularly income that is accumulated, *is significant and is likely to increase*. Tax concessions for unrelated charity businesses *reduce government revenue, and therefore shift the tax burden to other taxpayers*.

229. No evidence whatsoever is provided to support these controversial assertions.

230. Assumption 3 is reflected in comments made by the Tax Working Group that charities are "using what would otherwise be tax revenue", and that government therefore has a role in verifying that the "intended social outcomes are … being achieved".[298]

231. These comments reflect an underlying tax expenditure analysis, an outdated economic analysis that inherently leads to misconceptions about charities and government over-reach, as discussed above. When the tax expenditure analysis is critically examined, rather than merely assumed, it becomes clear that charities are not "using what would otherwise be tax revenue": their tax privileges do not result in a "loss of tax revenue" and are in fact more likely to *reduce* the burden on other taxpayers.

232. Because charities are subject to the non-distribution constraint, there is no private profit to tax, even when they use business means to raise funds for their charitable

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[295] As noted by the Minister of Finance in: https://www.rnz.co.nz/news/political/535535/tax-changes-for-charities-to-be-announced-in-next-budget.
[296] Issues paper at [2.14].
[297] Issues paper at [2.15], [2.4] and [1.4]
[298] Tax Working Group *Future of Tax: Final Report* 21 February 2019 at 13.

purposes: the tax privileges for charities are therefore not a "concession" but merely a proper measure of the tax base.

233. In addition, removing the exemption for the business income of charities is likely to raise no revenue. As IRD has itself noted,[299] it would not be rational for a charity continue to engage in an activity that becomes subject to tax when it could put its resources into alternative activities where no tax would be imposed; a tax change focusing on only one type of income is likely to be distortionary, in creating a "preference for … charities to invest in passive (non-business income) investments if income from these investments remains untaxed".[300]

234. If the newly-taxed activity ceases, it follows that there will be no income to tax. More fundamentally, if charities are forced to close or reduce their services as a result, government may have to "pick up the slack". The experience of other jurisdictions indicates that attempts to tax the business income of charities *fail to raise any material revenue*.[301]

235. In other words, seeking to tax the business income of charities is not only likely to raise no revenue, but it is in fact more likely to *increase* government's costs.

236. The issues paper argues that whether charities should be taxed on their business income "depends on the level of support that the Government wants to provide to charities".[302] With respect, the more appropriate question is, what type of society do we want to live in? Protecting the independence of charities is critical to protecting their important role in a liberal democracy. New Zealand has traditionally had a strong culture of volunteering, high levels of social cohesion, and low levels of corruption. It is important that the link between these concerning trends and the ever-increasing levels of unnecessary regulation being imposed on charities is made.

237. The assumption that charities' business income tax exemption results in a loss of tax revenue does not bear scrutiny, and does not provide a rationale, let alone a compelling one, for removing the exemption.

Complexity

238. In summary, the issues paper does not provide *any* compelling reason to tax the business income of charities. However, there are compelling reasons *not* to do so. For example, seeking to impose an unrelated business income tax would result in a significant increase in complexity, and a corresponding significant increase in compliance and administration costs (for no material revenue).

239. The issues paper acknowledges that distinguishing between related and unrelated businesses would increase the compliance costs for affected charity businesses, and "could be difficult in practice unless the legislation and associated guidance is clear".[303] However, to suggest that legislation and associated guidance might be able to provide "clarity" in relation to such a distinction is quixotic and promises

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[299] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 2 (coversheet).
[300] Issues paper at [2.18].
[301] See the discussion in S Barker *Focus on purpose – what does a world-leading framework of charities law look like?* [2022] NZLFRR 3, chapter 5.
[302] Issues paper at [2.16].
[303] Issues paper at [2.21] and [2.19].

significantly more than could ever be delivered.

240. The experience of other jurisdictions indicates that there is no "bright line" indicating when charitable businesses are "related" and when they are not, and attempts to draw one are fraught with difficulty.[304] The difficulty arises because business is inherently an activity: attempts to draw prescriptive, blanket, black-letter lines regarding activities in a fundamentally purposes-based area of law simply do not work.[305] Any such line would necessarily be arbitrary, and will require constant adjustment with further arbitrary rules to fill gaps and address unintended consequences. The net result will be ever-increasing complexity that will inexorably lead to ever-increasing unnecessary administrative and compliance cost. It would also risk enlivening a "culture of regulatory gaming",[306] and creating a climate whereby:[307]

> [t]hose that would do harm [become] increasingly adept at finding new ways to inflict it, which means government must continually amend the rules to fight new risks. And so it continues in a never-ending loop with the rules becoming ever more complex and the regulation of charities ever more removed from the day to day good works that charities perform.

241. To make matters worse, a prescriptive "regulatory" approach can also lead to undesirable behavioural changes, by distracting charities from their charitable purposes as they expend scarce resources endeavouring to satisfy the dictates of ill-fitting rules that cut across the destination of funds principle and are expensive to comply with and administer.[308] The complexity of the rules also increases administration costs, most likely well beyond any revenue raised. There is nothing to indicate that the rules have any practical impact on the circumstances of competing for-profit businesses; instead, their net impact is to place significant unnecessary barriers in the way of much-needed social enterprise activity.

242. New Zealand has the opportunity to do things better, and smarter. Harmful regulation risks stifling innovation and demoralising voluntary effort: changes must not come at the expense of the goodwill and community heart that lies behind most if not all charitable work.

243. There is no compelling reason to subject charities to such complexity and cost, particularly when the much better alternative of simply enforcing the fiduciary duties is available, as discussed above.

Does the approach of other jurisdictions provide a model for New Zealand to follow or a cautionary tale?

244. The issues paper argues there are "many international precedents to follow" in terms

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[304] See S Barker *Focus on purpose - what does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3, chapter 5.
[305] See also Report to the Treasurer *Australia's future tax system: Part 2 – Detailed analysis,* December 2009, Pt 2 vol 1: <treasury.gov.au/review/the-australias-future-tax-system-review/final-report at 212.
[306] C Decker and M Harding 'Three challenges in charity regulation: the case of England and Wales' in M Harding, A O'Connell and M Stewart (eds) *Not-for-Profit Law: Theoretical and Comparative Perspectives* (Cambridge University Press, 2014) 314 at 329, 325.
[307] T de March, former director-general of the Charities Directorate in Canada, in M McGregor-Lowndes and B Wyatt (eds) *Regulating Charities: the Inside Story* (Routledge, New York, 2017) at 273.
[308] C Decker and M Harding "Three challenges in charity regulation: the case of England and Wales" in M Harding, A O'Connell & M Stewart (eds) *Not-for-Profit Law: Theoretical and Comparative Perspectives* (Cambridge University Press, 2014) 314 at 321, 325, 326, 329.

of taxing the unrelated business income of charities.[309] However, the issues paper does not appear to have analysed whether the approaches taken in other jurisdictions are actually working. The experience of other jurisdictions demonstrates that attempts to tax the unrelated business income of charities are fraught with difficulty: attempts to impose an unrelated business income tax have, in fact, "failed all over the world".[310]

245. The approach taken in other jurisdictions must be properly understood if informed decisions are to be made as to whether to adopt it.

United States

246. In the United States, the unrelated business income of tax-exempt organisations has been subject to a separate tax since 1950.[311] The principal justification for introducing a UBIT was fear of "unfair competition" from not-for-profit entities carrying on businesses unrelated to their purposes.[312] A key example given was the operation of a business called "Mueller Macaroni" by New York University Law School.[313]

247. The UBIT in the United States is a creature of statute and must be understood in its context. Briefly, section 501(c)(3) of the United States internal revenue code provides an exemption from income tax for (emphasis added):

> Corporations, and any community chest, fund, or foundation, *organized and operated exclusively* for religious, *charitable*, scientific, testing for public safety, literary, or educational *purposes* … no part of the net earnings of which inures to the benefit of any private shareholder or individual …

248. This provision is interpreted as permitting exempt organisations to undertake commercial activities provided the primary purpose of the organisation remains its exempt purpose (on its face, a "destination of funds" test).[314] However, in a modification of the destination of funds test, and in what the High Court of Australia might describe as a "false dichotomy",[315] if the unrelated business activities and income constitute a large proportion of total non-profit activity (such as Mueller Macaroni), or become a "primary purpose" of the organisation, the organisation's exempt status may be withdrawn.[316]

249. In addition, section 511 of the United States internal revenue code imposes tax on the "unrelated business taxable income" of exempt organisations at ordinary

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[309] Issues Paper at [2.21].
[310] Discussion with Professor Myles McGregor-Lowndes, Queensland University of Technology: "Australia carefully looked at the idea of imposing an "unrelated business income tax" but rejected it. In fact, an unrelated business income tax has failed all over the world."
[311] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 313, 321.
[312] M McGregor-Lowndes, M Turnour, E Turnour *Not for profit income tax exemption: is there a hole in the bucket, dear Henry?* 26 Australian Tax Forum 601 at 624, referring to JG Simon, H Dale and L Chisolm, 'The Federal Tax Treatment of Charitable Organizations' in WW Powell and R Steinberg (eds) *The Nonprofit Sector: A Research Handbook* (Yale University Press, 2ed, 2006) 267. See also Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 321; OECD Tax Policy Studies *Taxation and Philanthropy* (2020) 27 (OECD Publishing, Paris) at 31.
[313] M McGregor-Lowndes, M Turnour, E Turnour *Not for profit income tax exemption: is there a hole in the bucket, dear Henry?* 26 Australian Tax Forum 601 at 624 n 101; OECD Tax Policy Studies *Taxation and Philanthropy* (2020) 27 (OECD Publishing, Paris) at 31 referring to Brody and Cordes, 2001.
[314] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 318.
[315] *Commissioner of Taxation of Australia v Word Investments Ltd* [2008] HCA 55 at [24].
[316] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 321; Industry Commission *Charitable organisations in Australia - Report no 45* 16 June 1995, Box K1 at K4 - K5.

corporate (or trust) tax rates. Section 511 is extremely long and complex: it is set out in Appendix D of the *Focus on purpose* report for reference, not so much for its content, but rather as an indication of what New Zealand might expect if it were to follow a similar line.

250. The UBIT is imposed on "unrelated business taxable income" which is in turn defined in section 512 of the United States internal revenue code. Passive income (such as dividends, interest payments, royalties and rents) is specifically excluded from the definition.[317]

251. The UBIT applies to commercial activities "unrelated" to the organisation's charitable purpose. The approach taken is to define an "unrelated trade or business" very broadly in section 513, and then carve out certain activities from the definition, such as: business activities performed without compensation; business activities carried on primarily for the convenience of members, students, patients, officers or employees; business activities related to the sale of donated merchandise; the conduct of certain kinds of public entertainment; bingo games; and certain hospital services.[318]

252. Sections 512 and 513 are also set out in Appendix D of the *Focus on purpose* report, again not so much for their content but for an indication of the UBIT's inherent complexity.

253. Section 514 of the US internal revenue code deals with "unrelated debt-financed income", and sets out complex rules requiring the inclusion, in the income on which UBIT is imposed, of rent received from certain "debt-financed property": this provision is intended to prevent the use of sale and leaseback arrangements involving exempt organisations to "launder" otherwise taxable income as deductible rental expenses paid to the purchasing tax exempt organisation.[319]

254. There is also specific provision for "feeder" organisations: section 502 provides that an organisation operated for the "primary purpose of carrying on a trade or business for profit" is not exempt merely on the ground that all of its profits are payable to an exempt organisation. However, there are exceptions to this rule provided by section 502(b), which defines the term "trade or business" to exclude (emphasis added):

    (1) the deriving of rents which would be excluded under section 512(b)(3), if section 512 applied to the organisation

    (2) any trade or business in which *substantially all* the work in carrying on such trade or business is performed for the organisation *without compensation*, or

    (3) any trade or business which is the selling or merchandise, *substantially all* of which has been received by the organisation as *gifts or contributions*.

255. The short point is that the UBIT rules in the United States are very complex. In principle, their intention is not to prevent charities from running unrelated businesses, but to remove the tax exemption, and therefore the perceived

[317] See Appendix D: s 512(b).
[318] See Appendix D: s 513(a)(1), (a)(2), (a)(3), (d), (f), and (e) respectively.
[319] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 322.

competitive advantage, from doing so.[320]

256. However, the rules act as a significant barrier to charities running businesses to raise funds for their charitable purposes, which may explain why social enterprise did not originate in charities in the United States.[321] It may also explain the proliferation of alternative legal structures for social enterprise in the United States, including the low profit limited liability company (or "L3C"), the benefit corporation, the social purpose corporation and the benefit limited liability company.[322] Such alternative legal structures have been described as "first generation" solutions to the "trust deficit" problem that inhibits the flow of capital to social enterprises structured as for-profit companies:[323] social enterprises structured as companies generally cannot access the grant and philanthropic types of funding that are available to charities. In other words, such alternative legal structures are a workaround, but they have not proved successful.[324] Bearing in mind the significant advantages that charities have over for-profit entities as a vehicle for social enterprise, as discussed above, a much better approach would be to simply *not* tax charities' business income in the first place: such an approach would mean that complicated (and ultimately unsuccessful) workarounds become unnecessary.

257. The United States UBIT rules also generate some anomalous results, as illustrated by the "art museum shop" example:[325]

> A NFP art museum with a shop would have to ensure '[e]ach line of merchandise must be considered separately to determine if sales are related to the exempt purpose', so a shirt with a print of an art work held by the museum (related) would be taxed differently from a shirt with a print of an art work held outside the museum (unrelated). *Where facilities and staff are used for both related and unrelated purposes, both income and expenses must be allocated, which can be difficult to determine, verify and regulate*. One United States commentator, Thomas Kelley, believes that this confusion is because what 'appears simple in the regulation has become muddled in the execution' by the IRS. The implication of his argument, is that if the IRS had followed simple processes, similar to that adopted by the High Court of Australia [in *Word Investments*], the law would not have deteriorated to an 'unprincipled, unpredictable test that amounts to an examination of whether the organisation 'smell[s] like' a charity to whomever is inquiring'.

258. In addition to issues of complexity and anomalous results, the United States UBIT rules are also understood to be ineffective in generating revenue:[326] most UBIT

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[320] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 226.
[321] Interview with Lloyd Hitoshi Mayer, Professor of Law, University of Notre Dame Law School (15 January 2021): "Charities know there is a line, so they take 3 steps back from it. Sophisticated charities can walk closer to the line but most don't want to deal with it".
[322] See New York University Grunin Centre for Law and Social Entrepreneurship *Mapping the State of Social Enterprise and the Law 2018–2019*: <socentlawtracker.org/wp-content/uploads/2019/05/Grunin-Tepper-Report_5_30_B.pdf> at 4.
[323] See D Brakman Reiser and SA Dean *Social Enterprise Law – Trust, public benefit and capital markets* (Oxford University Press, 2017).
[324] See the discussion in S Barker *Focus on purpose - what does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3, chapter 5.
[325] M McGregor-Lowndes, M Turnour, E Turnour *Not for profit income tax exemption: is there a hole in the bucket, dear Henry?* 26 Australian Tax Forum 601 at 626, referring to Internal Revenue Service Guidance *Tax on Unrelated Business Income of Exempt Organizations* (Publication 598 (03/2010), United States Department of the Treasury, March 2010) and T Kelley *Rediscovering Vulgar Charity: A Historical Analysis of America's Tangled Nonprofit Law* (2005) 73 Fordham Law Review 2437, 2475 and the citations therein (emphasis added).
[326] OECD Tax Policy Studies *Taxation and Philanthropy* (2020) 27 (OECD Publishing, Paris) at 31.

returns in fact report net losses.[327] In other words, considerable complexity bearing significant compliance and administration costs are imposed for *no additional revenue.*

259. Despite these difficulties, the rules appear to have influenced the approach taken in Canada.[328]

Canada

260. Like the United States, but unlike Australia, Ireland, the United Kingdom and New Zealand, Canada's system of charities law is administered through tax law: federal tax legislation governing charitable organisations has been in place in Canada since 1917.

261. It is important to understand the context of Canada's rules regarding business income and minimum distribution requirements before making decisions as to whether to follow them.

262. The principal objective of Canada's first income tax Act, the War Charities Act 1917, was to encourage the efficient operation of legitimate war charities.[329] At this time, Canadian charities law was focused on encouraging private philanthropy to assist the Government in responding to two world wars and the Great Depression: in other words, the underlying paradigm was an enabling one focused on preserving and promoting the charitable sector for its own sake, rather than a restrictive one focused on policing the tax privileges available to charitable organisations.[330]

263. However, some decades later, in 1950, the Canadian income tax legislation was amended to make a distinction between charities that "fund" and charities that "do": on the basis of anecdotal evidence (mostly American) that foundations were subject to abuse, the legislation was amended to distinguish foundations from "charitable organisations".[331] A "charitable organisation" was conceived as an "active" or "operational" charity, and was eligible for tax-exempt status if "all" its resources were "devoted to charitable activities carried on by the organisation itself".[332]

264. The 1950 insertion of a statutory reference to "charitable activities" has been described as "ill-conceived".[333] As discussed above, the common law of charities law

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[327] OB Breen *Holding the line: regulatory challenges in Ireland and England when business and charity collide* in M McGregor-Lowndes and K O'Halloran (eds) "Modernising Charity Law – Recent Developments and Future Directions" (Edward Elgar, Cheltenham, UK, 2010) 136 at 155.
[328] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 326: "Although the statutory and regulatory regime under the United States tax law is considerably more detailed than the analogous Canadian regime, the systems are surprisingly similar in basic design and policy. In part, this is because the 1976 reforms in Canada were inspired by the *Tax Reform Act of 1969*". See also 54: "the debate on the sector in the United States has always been polarised between those suspicious of the philanthropic motives of wealthy private benefactors and those who regard the sector as a vitally important part of democratic society. This polarisation has surfaced frequently in the Canadian debate on the sector to an extent, we would suggest, not justified by the facts nor grounded in our indigenous political culture. This is because we have tended to accept, without sufficient critical distance, many of the presuppositions of the vast American literature that has arisen out of these two reports [of the 1969 Peterson Commission and the 1975 Filer Commission]".
[329] The Income War Tax Act 1917 7-8 Geo 5 c 28 (Can): Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 34, 251, 258.
[330] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 254, 261, 262.
[331] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996 at 261, 262, 272.
[332] An Act to amend the Income Tax Act, SC 1950 cl 40: Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 259 - 260.
[333] Report of the Special Senate Committee on the Charitable Sector *Catalyst for Change: A Roadmap to a Stronger Charitable Sector* June 2019 at 95, referring to the evidence of Professor A Parachin; and Advisory Committee on the Charitable Sector *Report #1 – Towards a federal regulatory environment that enables and*

focuses on purposes, rather than activities. Importing a statutory reference to "charitable activities" in a fundamentally purposes-based area of law has been described as the source of "considerable difficulty",[334] a "major problem",[335] a "mistake",[336] and as creating "considerable uncertainty";[337] it has also been described as perpetuating "unnecessary confusion" about the distinction between purposes and activities that "plagues much of the discourse" surrounding charities in Canada,[338] with "more than a few instances where a court has been led astray".[339]

265. In practice, it has led to a "sustained emphasis on activities at the expense of purposes".[340]

266. Despite these difficulties, the "ill-conceived" reference to "charitable activities" remains in the Canadian legislation to this day.[341]

267. In 1950, a much more stringent regime was put in place for "funding" charities (charitable trusts and charitable corporations). For example, neither was permitted to "carry on any business":[342] the basis for this restriction is understood to be that some foundations had been operating businesses and accumulating business income *with the intention of distributing the income to their "proprietors" on dissolution*.[343] It is important to note that such an outcome would not be legally possible in New Zealand: distributing charitable funds to proprietors on dissolution is clearly inconsistent with registered charitable status (in particular the non-distribution constraint and the prohibition on private pecuniary profit), and most likely also the "control" provisions of the business income tax exemption in section CW 42. It would also not be possible under the "deregistration tax" of section HR 12 of the Income Tax Act 2007.

268. However, the preferable option of enforcing the fiduciary duties on a case-by-case basis may not have been considered available in Canada at the time. As discussed above, charities law is a creature of equity, which is a system of law based on principles,[344] in contrast to the common law which is largely based on rules. Tax law in particular is a rules-based creature of statute.[345] Where charities law is administered through the tax system, as in the United States and Canada, by a

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strengthens the charitable and nonprofit sector January 2021 "Examining the regulatory approach to charitable purposes and activities".

[334] P Broder "Report of the Senate Special Committee on the Charitable Sector – A response" (2020) The Philanthropist Journal.

[335] *Report of the Consultation Panel on the Political Activities of Charities* 31 March 2017, section A – Background and History.

[336] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 336.

[337] Report of the Special Senate Committee on the Charitable Sector *Catalyst for Change: A Roadmap to a Stronger Charitable Sector* June 2019 at 88.

[338] Report of the Special Senate Committee on the Charitable Sector *Catalyst for Change: A Roadmap to a Stronger Charitable Sector* June 2019 at 88.

[339] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 336.

[340] Report of the Special Senate Committee on the Charitable Sector *Catalyst for Change: A Roadmap to a Stronger Charitable Sector* June 2019 at 82.

[341] Section 149.1(1) Income Tax Act (RSC 1985 c1 (5th Supp)), definition of "charitable organisation" at [(a.1)]; report of the Special Senate Committee on the Charitable Sector *Catalyst for Change: A Roadmap to a Stronger Charitable Sector* June 2019 at 95, referring to the evidence of Professor A Parachin.

[342] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 259 - 261, referring to s 57(1)(eb)(i) and (ec)(i) of the Income Tax Act SC 1947-48.

[343] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 261.

[344] H Brandts-Giesen *Need for genuine trust expertise has never been greater* 943 LawTalk 16 September 2020.

[345] Interview with Laird Hunter QC (4 February 2021); interview with Dr Kathryn Chan, Assistant Professor of Law, University of Victoria (4 February 2021).

federal tax authority tasked with maximising revenue,[346] equitable principles may be "crowded out" by black letter rules.[347] In using an equitable concept, such as charitable purpose, as the cornerstone of a regulatory regime, care must be taken to ensure the legal framework does not damage or distort the very concept on which it is based. New Zealand does have the option of enforcing the fiduciary duties, as discussed above, and therefore does not need to resort to black letter rules.

269. In addition, tax secrecy provisions meant there was a general lack of information about charities in Canada at the time. Again, this factor falls in sharp contrast to the position in New Zealand, where every registered charity is subject to comprehensive transparency and accountability requirements, which must be made publicly available on the charities register.

270. In the result, in 1950, Canada imposed a blanket statutory restriction on foundations running businesses, and a rudimentary "disbursement quota" regime to encourage distribution rather than accumulation, both of which form the basis for the current rules in Canada.[348]

271. A subsequent recommendation to tax the business income of charitable *organisations* was not implemented: in 1967, some years after the UBIT had been introduced in the United States, the Royal Commission on Taxation in Canada ("**the Carter Commission**") recommended reform of the Canadian federal income tax laws;[349] with respect to the business income of charitable organisations, the Carter Commission concluded that income tax exemption "could well be regarded" as a competitive advantage, and recommended it be removed (with an exclusion for "a certain minimum amount of income from occasional sales, for example bazaars and rummage sales, and from small sales operations such as gift shops" on the basis of administrative convenience).[350] However, the discussion of the tax treatment of charitable organisations in the Carter Commission report was criticised as falling "well below the standard of analysis set in the Report as a whole",[351] and the recommendation to tax the business income of charitable organisations was not implemented.[352] Instead, a centralised registration and reporting system was put in place.[353] However, even to this day, tax secrecy provisions mean that considerably less information is available about registered charities in Canada compared to the position in New Zealand, as discussed further below.

272. In 1975, further developments in Canada catalysed a change in underlying paradigm.

The 1975 Green Paper

273. In 1975, the Canadian Department of Finance published a Green Paper ("**the 1975**

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[346] M McGregor-Lowndes and B Wyatt (eds) *Regulating Charities: the Inside Story* (Routledge, New York, 2017) at 83, per Marcus Owens.
[347] Interview with Dr Kathryn Chan, Assistant Professor of Law, University of Victoria (4 February 2021).
[348] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 261.
[349] Canada *Report of the Royal Commission on Taxation* (Ottawa, 1966) Commissioner K le M Carter.
[350] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 266, referring to Canada *Report of the Royal Commission on Taxation* (Ottawa, 1966) Commissioner K le M Carter at 129 - 134.
[351] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 265, referring to RM Bird and MW Bucovetsky *Canadian Tax Reform and Private Philanthropy* (Toronto: Canadian Tax Foundation, 1976) at 20.
[352] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 267.
[353] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 34.

Green Paper")[354] looking into a number of issues concerning the tax treatment of charities.[355] While acknowledging the Government's appreciation for the contribution of the charitable sector, the 1975 Green Paper argued that, with over 35,000 charities receiving over $500 million in donations, and with the 15 largest charities having assets in excess of $700 million, the tax privileges for charities were a "major public expense":[356]

> *Every dollar of tax relief represents a cost to the Canadian taxpayer*. The government therefore believes that it is appropriate that the rules of taxation ensure that the people of Canada obtain maximum benefit from the charities.

274. This claim did not pass without dissent; from a paradigm perspective, the Ontario Law Reform Commission noted this was the first time that federal tax policy had been explicitly formulated in the rhetoric of the tax expenditure theorists:[357]

> … the government's ultimate objective was to *deploy* the tax *subsidy* to the *maximum benefit* of Canadians. In the logic of this view, if perhaps not entirely in the conviction of the government, *charitable dollars were considered government dollars*.

275. The reform proposals contained in the 1975 Green Paper were a response to perceived abuses of family foundations, based on vigorous arguments that had been expressed by American writers and politicians in the late 1960s:[358]

> It has become evident in recent years that a few taxpayers have been abusing the opportunity to establish private charities. The most common abuse has been in arranging investments and expenses to ensure that the charity has little income and pays out a relatively small sum annually in comparison to its capital. This may be done by having the charity invest in low-yield debt or equity of the donor's business, by renting premises from the donor at high rent, by paying family members high salaries for relatively little work, or by lending money to family members at low rates of interest.

276. It should be noted that non-arm's length transactions with related parties such as these would not be possible under New Zealand law, as they would breach the fiduciary duties owed by the relevant trustees or directors.[359]

277. Another perceived abuse was the use of family foundations to retain control of a family business while avoiding the tax consequences of intergenerational wealth transfers.[360] Although charitable trusts and charitable corporations were prohibited from carrying on a business, the rules did not necessarily prohibit their ownership of a controlling interest in a corporation through which the business was carried out:[361]

> A trust could be established, with the family members as trustees, and the controlling interest in the business corporation gifted to the trust over time. Dividends could be declared on the non-voting preferred shares owned only by family members and very little or no income would accrue to the charitable trust. As a result, very little would have to be spent on charitable activities to comply with the ninety percent disbursement

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[354] Canada, Department of Finance, *The Tax Treatment of Charities* (Discussion Paper) Ottawa: June 1975 (the Green Paper).
[355] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 271.
[356] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 271, referring to the Green Paper at 5.
[357] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 271 n 119, 272 (emphasis added).
[358] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 273, referring to the Green Paper at 9.
[359] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 272, n 127.
[360] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 273.
[361] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 274.

> rule. Control of the family business corporation would, however, remain in the members of the family through their position as trustees of the foundation. Also, there would be no capital gains tax on the equity interest owned by the charitable trust.

278. However, such concerns would not arise in New Zealand where there is no capital gains tax, no intergenerational wealth transfer tax, and very high requirements for transparency and accountability, providing ample information through which to enforce the fiduciary duties.

279. Again, as in 1950, there was only anecdotal evidence, mostly American, to support these claims of abuse. Commentary in Canada in the early 1970s referred to concerns being expressed in the United States regarding "secret" operations of large family-controlled foundations and their suspected abuses of the tax privileges:[362]

> The "tax expenditure" rhetoric of the American tax economists was deployed in Canada to explain that these organisations, in particular, owed much more in the way of public accountability than they were currently inclined or required to give. *The anxiety caused by these apparent deficiencies in the regulatory regime was heightened by the lack of statistical data on the sector in Canada*.

280. American reforms of 1969 had severely curtailed the activities of "private foundations" in the United States. Using these reforms as a model, the 1975 Green Paper proposed a number of measures designed to "remedy" such perceived abuses in Canada:[363]

> … nearly all the specific recommendations for reform were, at least in part, motivated by a fear that wealthy families were manipulating the charity tax laws for their *private advantage*. On this issue, the Green Paper's arguments were a reflection of nearly identical arguments expressed much more vigorously by American writers and politicians in the late 1960s. The American effort had led to the enactment of the *Tax Reform Act of 1969,* which severely curtailed the activities of "private foundations" in the United States. Those reforms served as a model for the 1975-76 reforms in Canada.

281. Foundations were perceived to be abusing the tax privileges of charities in a number of ways: for example, family members acting as officers of the foundation might be overcompensated, or the foundation might lend money to a family business at non-arm's length concessional rates.[364] However, again, such non-arm's length transactions with related parties could not lawfully occur in New Zealand under current settings as they would likely constitute a breach of fiduciary duty.

282. At the time, and in sharp contrast to the current position in New Zealand, there was a lack of public accountability of registered charities in Canada: the annual information returns and annual tax returns of registered charities, if indeed filed, were confidential (due to tax secrecy provisions). The 1975 Green Paper argued the "tax concessions" granted to charities were "so large they entitle the public to know with some precision about the activities of the charity" and recommended every registered charity be required to file an annual public information return containing

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[362] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 270, referring to JH Myers *United States Federal Tax Treatment of Charities and Contributions and Bequests to them,* in Report of Proceedings of the 27 Tax Conference (Toronto: Canadian Tax Foundation, 1975) 385, and V Peters and F Zaid *The Present and Proposed Taxation of Non-Profit Organisations* (1971) 9 Osgoode Hall LJ 359.
[363] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 273 (footnotes omitted) and 271, referring to Canada, Department of Finance, *The Tax Treatment of Charities* (Discussion Paper) Ottawa: June 1975 ("**the Green Paper**").
[364] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 274.

information on income and expenses.[365]

283. Nevertheless, the 1975 Green Paper contained a number of proposals to remedy these perceived abuses, including a proposal for a new tripartite classification of charities: charitable organisations, public foundations, and private foundations. Private foundations were subject to an even stricter regulatory regime including a very high "disbursement quota" (up to 90% of income); they were also prohibited from carrying on a business of any sort, related or unrelated (although ownership of equity in a corporation did not count as carrying on a "business").[366]

284. With respect to charitable organisations, it had become obvious that many needed to carry out business activities and accumulate funds in order to survive and fulfil their charitable purposes. The 1975 Green Paper proposed to clarify that charitable organisations and public foundations were able to carry on "related" businesses (considered something of a "housekeeping" measure, since an absolute prohibition had long been recognised as unrealistic and was not enforced), with warranted accumulations permitted at the Minister's discretion.[367] The Green Paper also recommended that every registered charity file an annual public information return, disclosing information about their income and expenditure.[368]

285. Overall, the 1975 Green Paper proposals would have substantially increased the federal government's regulatory control over the charitable sector on the basis of very little solid empirical information.[369] The charitable sector balked at the aggressiveness of the proposals, arguing they were too complex for the vast majority of charities, and "far too onerous to correct minor, infrequent, and often only perceived, abuses".[370]

286. However, the 1975 Green Paper set the tone for what was to follow: as indicated by a number of factors, the Canadian Government's attitude towards the charitable sector was becoming less benign, driven by a "deepening of the tax expenditure bias" that ultimately led to a change in paradigm.[371]

287. The Green Paper's recommendations were broadly enacted in 1976:[372] charitable organisations and public foundations were permitted to operate related businesses (but were prohibited from operating unrelated business), while private foundations were not permitted to run a business of any kind. The Minister was given a power to permit charities to accumulate, and a new public information disclosure regime was

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[365] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 275, referring to the Green Paper.
[366] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 274.
[367] Regularising the previous administrative practice of turning a blind eye to warranted accumulations.
[368] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 275.
[369] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 272.
[370] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 285.
[371] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 277.
[372] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 276 - 277, referring to SC 1976-77 c4.

established.

288. The 1976 changes are reflected in current Canadian income tax legislation:[373]

(i) A "charitable organisation" is defined as an organisation "constituted and operated" exclusively for charitable purposes, all the resources of which are devoted to "charitable activities" carried on by itself.

(ii) A charitable organisation is considered to be devoting its resources to charitable activities carried on by it *to the extent that* it carries on a "related business".

(iii) A "related business" is defined to *include* a business that is unrelated to the purposes of the charity if "substantially all" persons employed by the charity in the carrying on of that business are not remunerated for that employment. This provision enables public foundations and charitable organisations to operate gift shops, run bingos, sell Christmas cards, or carry on any other such enterprises *provided the staff are mostly volunteers*.

(iv) A charitable organisation or public foundation may be deregistered for carrying on a business that is not a "related business". A private foundation may be deregistered if it carries on "any business".[374]

289. In this respect, the Canadian rules differ from the United States rules which impose a tax on unrelated business profits rather than precluding the activity altogether.

The fallacy of "charitable activities"

290. However, the changes were criticised for having been written into the income tax legislation "in accordance with the worst traditions of draughtsmanship that Canadians have come to expect from the Income Tax Act".[375]

291. In addition to the rules relating to businesses, the Canadian income tax legislation also obliges all registered charities to meet certain minimum distribution requirements, the aim of which is to ensure that the resources of registered charities "are in fact devoted to charity, and therefore, that registered charities deserve their tax-exempt status and right to issue tax receipts"; however, as noted by the Ontario Law Reform Commission, there are other ways to accomplish this objective, such as by enforcing the fiduciary duties (as discussed above).[376]

292. In addition, the distinction between related and unrelated business has been criticised as being "poorly defined at the margins" and the source of difficulty in case law:[377] some early cases interpreted the concept of "related business" as coterminous with a destination of funds test (meaning that a business is "related" if all of its funds are ultimately applied to the charitable purposes), but more recent cases have not.[378]

293. The Canada Revenue Agency ("**CRA**") considers a "related business" to be one that

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[373] Income Tax Act (RSC 1985 c1 (5th Supp)) ss 149.1(1), (6), (2)(a), (3)(a), (4)(a), 168. See also Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 293.
[374] Any type of foundation may also face deregistration if it acquires control of a corporation (ss 149.1(3)(c) and (4)(c), the latter referring to a "divestment obligation percentage").
[375] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 277.
[376] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 289.
[377] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 293.
[378] See the discussion in Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 293 - 297.

is either substantially run by volunteers, or one that is both "linked" and "subordinate" to a charity's purpose, arguing that "running a business cannot become a purpose in its own right", and a related business may only receive a "minor amount" of the charity's attention and resources.[379] This approach bears a striking similarity to an extra-statutory approach that has been unilaterally adopted by Charities Services in New Zealand that a business may not become a "focus".[380]

294. However, this approach does not make sense as a matter of charities law: as noted by the High Court of Australia, to make a distinction between what is commercial and what is charitable is to create a "false dichotomy".[381] All activities carried out by charities must be carried out in furtherance of their charitable purposes. The Canadian approach has been muddied by statutory references to "charitable activities",[382] which importantly have no statutory equivalent in New Zealand (raising the question of why the Canadian approach is so often so uncritically followed in New Zealand).[383]

295. In addition, the legislative feature that an "unrelated business" can be deemed a "related business" if it is "substantially run" (interpreted by CRA to mean at least 90%) by volunteers, has been much-criticised:[384]

> … using "volunteer-run" as a measure to deem a business to be a "related business" is often gender-biased, can encourage labour exploitation and possibly mission-drift by the charity … the issue [demonstrates] how out of date the current related business framework has become … we heard from many charities that this framework has become quite outdated, both limiting what charities can do, and also holding entrenched patterns in place that need to change.

296. Before adopting the approaches taken in other jurisdictions, it is very important to consider whether those approaches are actually working in those jurisdictions. The rules regarding charities running businesses in Canada have been described as "unduly strict", as inhibiting self-funding, and as "thwart[ing] innovation".[385] In June 2019, the Special Senate Committee on the Charitable Sector recommended a return to a clear destination of funds test, along the lines adopted in Australia, as discussed above.

297. It would be nonsensical for New Zealand to adopt the approach taken in another jurisdiction, in a different time and a different context, when there are strong and growing calls within that jurisdiction to move to the approach already taken in New

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[379] Canada Revenue Agency *Policy Statement CPS-019 What is a related business?* (effective date, March 2003): <www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/policy-statement-019-what-a-related-business.html>.
[380] Charities Services *Myth busting: when charities can run businesses* 24 February 2021.
[381] *Commissioner of Taxation of Australia v Word Investments Ltd* [2008] HCA 55 at [24] (emphasis added).
[382] Section 149.1. See also P Broder "Report of the Senate Special Committee on the Charitable Sector – A response" (2020) The Philanthropist Journal; Report of the Special Senate Committee on the Charitable Sector *Catalyst for Change: A Roadmap to a Stronger Charitable Sector* June 2019 at 88.
[383] Canadian case law has been applied in New Zealand without any analysis of the different statutory framework on which it is based, as discussed in more detail in Barker *Taxation of Charities in Aotearoa New Zealand* (LexisNexis, 2025) forthcoming.
[384] Advisory Committee on the Charitable Sector *Report #3 – Towards a federal regulatory environment that enables and strengthens the charitable and non-profit sector* July 2021 "Purposes and Activities Working Group – Earned Income by Charities" and cover page.
[385] P Broder "Report of the Senate Special Committee on the Charitable Sector – A response" (2020) The Philanthropist Journal.

Zealand!

England and Wales

298. England and Wales take a different but broadly analogous approach to that taken in the North American tax-based jurisdictions, albeit based on a concept of "trade", rather than "commercial" or "business" activities.

299. "Trading" in England and Wales generally involves the provision of goods or services to customers on a commercial basis;[386] although some sales of goods or services may not be regarded as "trade",[387] guidance from the tax authority, His Majesty's Revenue and Customs ("**HMRC**"), indicates that "[s]imply because a venture is a one-off or occasional does not mean that it will not be trading for tax purposes":[388]

> Whether an activity is, or is not, trading depends on the facts in each case. When it is not clear it will be necessary for HMRC to look at all the circumstances surrounding the activity … When deciding whether an activity amounts to trading it is not relevant that the profits are intended to be used for charitable purposes.

300. The distinction matters, because profits from "trading" by charities are, in principle, subject to tax unless specifically exempted.[389] An intention to use profits for charitable purposes will not prevent those profits from being liable to tax:[390] in other words, there is no "destination of funds" test applicable to exempt the unrelated business income of charitable organisations in England and Wales.[391]

301. The English and Welsh tax legislation divides trading undertaken by charities into two forms: charitable trading and non-charitable trading.[392]

302. Charitable trading exists where the trade is exercised in the course of the actual carrying out of a *primary purpose* of the charity, or the work in connection with the trade is *mainly* carried out by the *beneficiaries* of the charity.[393] Profits of a "charitable trade" are exempt from tax.[394]

303. In other words, while the North American jurisdictions make a distinction between "related" and "unrelated" business activity, the UK makes a broadly analogous

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[386] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* updated 4 May 2021: <www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles> at [2].
[387] The Charity Commission for England and Wales indicates that the following activities are not generally regarded as "trading": the sale or letting of goods donated to a charity for the purpose of sale or letting; the sale of investments; the sale of assets which the charity uses, or has used, for its charitable purposes; the letting of land and buildings where no services are provided to the user (Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016: <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/869136/CC35_PDF_v2.pdf> at [3.1], [3.3], [3.10].
[388] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [2].
[389] Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [3.1].
[390] OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [10.24].
[391] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 329.
[392] This distinction is made for the purposes of direct tax, but not for the purposes of value-added tax (VAT). See HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [1], [4].
[393] For charitable companies, see Corporation Tax Act 2010 (UK) s 479(1); for charitable trusts, see Income Tax Act 2007 (UK) s 525(1).
[394] For charitable companies, see Corporation Tax Act 2010 (UK) s 478; for charitable trusts, see Income Tax Act 2007 (UK) s 524.

distinction between "primary purpose trading" and "non-primary purpose trading".[395]

304. Profits made by a charity from trade that is exercised in the course of the actual carrying out of a "primary purpose" of the charity (such as tuition fees charged by charitable schools or universities, admission fees charged for exhibitions by art galleries or museums with charitable status, a religious charity selling bibles, a charitable clinic charging patients or selling medicines, or the provision of serviced residential accommodation by a charitable residential care home in return for payment) is considered "primary purpose trading" and is *prima facie* exempt from tax.[396]

305. Work carried out by beneficiaries of a charity may constitute primary purpose trading, inherently (that is, whether it relates to a primary purpose of the charity or not):[397] for example, profits from trade such as the sale of goods manufactured by the beneficiaries of a disability charity, a farm operated by students of an agricultural college, a restaurant operated by students as part of a catering course at a further education college, may qualify for exemption as relating to the primary purpose of the charity;[398] however, even for trading that is not related to the charitable purpose (that is, "non-primary purpose" trading), the profit may still qualify for exemption where the work is carried out "mainly" by beneficiaries of the charity.[399]

306. "Charitable trading" comprises primary purpose trading and trading mainly carried out by beneficiaries:[400] profits arising from charitable trading are exempt from tax, provided they are applied solely to the purposes of the charity.[401]

307. HMRC states that it will advise charities whether, in its opinion, a particular activity is within the definition of primary purpose trading.[402] HMRC takes a broad interpretation of what constitutes the primary purpose of a charity in this regard, to include within the tax exemption trading activities that are considered "ancillary" to the carrying out of the primary purpose.[403] Examples of trading that qualifies as primary purpose because it is "ancillary" to the carrying out of a primary purpose

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[395] The concept of "primary purpose" trading is introduced by Corporation Tax Act 2010 (UK) s 479(1)(a); Income Tax Act 2007 (UK) s 525(1)(a).
[396] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [4], [6]. See also OB Breen *Holding the line: regulatory challenges in Ireland and England when business and charity collide* in M McGregor-Lowndes and K O'Halloran (eds) "Modernising Charity Law – Recent Developments and Future Directions" (Edward Elgar, Cheltenham, UK, 2010) 136 at 142.
[397] Corporation Tax Act 2010 (UK) s 479(1)(b); Income Tax Act 2007 (UK) s 525(1)(b).
[398] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [10]; Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [3.6]; OB Breen *Holding the line: regulatory challenges in Ireland and England when business and charity collide* in M McGregor-Lowndes and K O'Halloran (eds) "Modernising Charity Law – Recent Developments and Future Directions" (Edward Elgar, Cheltenham, UK, 2010) 136 at 142 - 143.
[399] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [4(b)], [11]; OB Breen *Holding the line: regulatory challenges in Ireland and England when business and charity collide* in M McGregor-Lowndes and K O'Halloran (eds) "Modernising Charity Law – Recent Developments and Future Directions" (Edward Elgar, Cheltenham, UK, 2010) 136 at 142.
[400] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [4].
[401] Section 478(3) Corporation Tax Act 2010 (UK); Income Tax Act 2007 (UK) s 524(1), (4); HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [4], [5]; Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [3.6].
[402] Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [3.6]: "In the case of any doubt or difficulty, trustees may need to consult their own professional advisers as well".
[403] OB Breen *Holding the line: regulatory challenges in Ireland and England when business and charity collide* in M McGregor-Lowndes and K O'Halloran (eds) "Modernising Charity Law – Recent Developments and Future Directions" (Edward Elgar, Cheltenham, UK, 2010) 136 at 142.

include:[404]

- sale of relevant goods or provision of services, for the benefit of students by a school or college (text books, for example)
- provision of a crèche for the children of students by a school or college in return for payment
- sale of food and drink in a cafeteria to visitors to exhibits by an art gallery or museum (although sale to the general public, as opposed to exhibition visitors, is non-primary purpose trading)
- sale of food and drink in a restaurant or bar to members of the audience by a theatre (although sale to the general public, as opposed to the audience, is non-primary purpose trading)
- sale by able-bodied staff of items produced by the disabled in a disabled workshop
- sale of confectionery, toiletries and flowers to patients and their visitors by a hospital

308. The level of annual turnover may have a bearing on whether the trading is considered "ancillary", but there is no specific level of annual turnover beyond which trading will definitely not be regarded as ancillary.[405] In other words, a mathematical approach is not applied.[406]

309. Any other type of trading that does not fall within the above but is nevertheless undertaken to raise funds for charitable purposes is referred to for tax law purposes as "non-charitable trading".[407] This concept does not equate exactly with the concept of "non-primary purpose trading", as ancillary non-primary purpose trading may be considered charitable trading.[408]

310. Non-charitable trading is broadly equivalent to the North American concept of "unrelated business income", and covers a wide spectrum of activities, from selling promotional goods in a charity gift shop to running side-line businesses like funeral services.[409] The profit from "non-charitable trading" is taxable, regardless of whether it is used for the purposes of the charity, unless it is exempt under the "small-trading exemption".

311. The "small-trading" exemption applies where:[410]

    (i) the non-charitable trading turnover falls below the charity's small scale annual turnover limit (which is £8,000, unless the turnover is greater than £8,000 in which case the limit is 25% of the charity's total incoming

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[404] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [7].
[405] Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [3.7].
[406] OB Breen *Holding the line: regulatory challenges in Ireland and England when business and charity collide* in M McGregor-Lowndes and K O'Halloran (eds) "Modernising Charity Law – Recent Developments and Future Directions" (Edward Elgar, Cheltenham, UK, 2010) 136 at 143.
[407] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [4].
[408] Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [3.8].
[409] OB Breen *Holding the line: regulatory challenges in Ireland and England when business and charity collide* in M McGregor-Lowndes and K O'Halloran (eds) "Modernising Charity Law – Recent Developments and Future Directions" (Edward Elgar, Cheltenham, UK, 2010) 136 at 139; HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [4].
[410] Corporation Tax Act 2010 (UK) ss 480(1), (2), (4), (5), 482; Income Tax Act 2007 (UK) ss 526(1), (2), (4), (5), 528, HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [5], [14] - [16]; Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [3.12].

resources for the tax year (including donations and grants, whether taxable or not, but excluding capital receipts) up to a maximum of £80,000);[411]

(ii) if the charity's total turnover exceeds the annual turnover limit, the charity had a reasonable expectation that it would *not* do so;[412] and

(iii) profits are used solely for the purposes of the charity.[413]

312. Where the trading is all charitable or all non-charitable, the tax treatment is fairly straightforward. However, for some charities, an activity may involve both charitable and non-charitable trading. For example, a charity providing a public art gallery may run a shop selling a range of goods, some connected with furthering the charity's primary purpose (such as books relating to the exhibition, or copies of the charity's paintings) and some not so connected (such as promotional pens, mugs and tea towels).[414] Other examples include:[415]

- the letting of serviced accommodation for students in term-time (primary purpose), and for tourists out of term (non-primary purpose), by a school or college
- the sale of food and drink in a theatre restaurant or bar both to members of the audience (beneficiaries of the charity – ancillary) and the general public (non-beneficiaries – not ancillary)
- the operation of a café by a "relief of the disabled" charity where only 50% of the staff are disabled (beneficiaries) and the other 50% are not charitable beneficiaries

313. Another example is where non-primary purpose work is carried out partly but not *mainly* by beneficiaries only,[416] or where a shop run by a charity whose aim is to enhance the skills of disabled people sells books donated for sale (not trading), toys made by disabled people (primary purpose trading), and bought-in soft toys (non-primary purpose trading whose only purpose is to raise funds).[417]

314. In such cases, the charitable (primary purpose) and non-charitable (non-primary purpose) parts of the trade are deemed by statute to be two entirely separate trades: the profit from the non-charitable trading remains taxable unless exempt under the small-trading exemption. The income and expenditure is apportioned between the taxable and non-taxable trades on a reasonable basis.[418] HMRC advises that charities should "ensure they have accounting systems that permit the identification of charitable and non-charitable trading, and the proper allocation of receipts and expenses to each";[419] this will likely require identifying each individual piece of work done, classifying it as charitable or non-charitable in the accounting system, and

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[411] Corporation Tax Act 2010 (UK) s 480(5); Income Tax Act 2007 (UK) s 528(6); HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [15].
[412] Corporation Tax Act 2010 (UK) s 482(1)(b); Income Tax Act 2007 (UK) s 528(1)(b).
[413] Corporation Tax Act 2010 (UK) s 482(6); Income Tax Act 2007 (UK) s 526(5).
[414] Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [3.9].
[415] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [8].
[416] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [11].
[417] Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [3.10].
[418] Corporation Tax Act 2010 (UK) s 479(2)-(4); Income Tax Act 2007 (UK) s 525(2) - (4); HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [8], [11], [38]; Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [3.9].
[419] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [8], [37].

allocating costs, including indirect costs such as overheads, accordingly.[420]

315. The tax rules for charities running businesses in England and Wales contain some other inherent complexities. For example, there can be adverse tax consequences for a charity if it has transactions with a "substantial donor".[421] In addition, if a charity incurs losses in non-primary purpose trading, the trustees may be liable for breach of trust if the loss was incurred irresponsibly.[422] From a tax perspective, the charity's tax exemptions on other income may be at risk, although a trading loss resulting in "non-charitable expenditure" may be able to be set-off against the amount that would otherwise be chargeable to tax, with a "self-cancelling" effect.[423] In this regard, it is necessary to apply a "commerciality test", to ascertain whether the trading was on a commercial basis, with a reasonable expectation of gain (for corporation tax) or with a view to the realisation of profit (for charitable trusts liable to income tax). Even if the taxable trade was not "commercial", the loss may still be allowable if the trade was part of a larger commercial undertaking. However, whether or not a trading loss is allowable can be difficult to ascertain and will depend on the circumstances of each case:[424] HMRC advises that charities "may wish to obtain professional advice".[425] Losses unable to be set off may be able to be carried forward.[426]

The "significant risk" test

316. Importantly, the issue of charities running business in England and Wales is not solely governed by tax law. Charities law, administered by the Charity Commission for England and Wales ("**CCEW**") also applies.

317. In this regard, CCEW considers that charities may engage in business activities to raise funds for their charitable purposes (that is, non-primary purpose trading), only where no "significant risk" is involved: the "significant risk" to be avoided is that the turnover may be insufficient to meet the costs of carrying on the trade and the difference has to be financed out of the assets of the charity. CCEW considers a number of factors in determining whether a risk is "significant", including: the size of the charity, the nature of the business, the expected outgoings, turnover projections, and the sensitivity of business profitability to the ups and downs of the market. In general, CCEW considers that a lottery or trading qualifying for the small-scale exemption may be considered not to involve significant risk.[427]

318. If charities wish to carry on non-primary purpose trading involving "significant risk", CCEW requires that they do so through a trading subsidiary, even if the profits would be tax exempt if the trading were carried on by the charity itself.[428] A trading

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[420] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [37] - [38].
[421] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [39].
[422] Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [3.14].
[423] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [41].
[424] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [42] - [44].
[425] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [44].
[426] HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [44].
[427] Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [3.8], [3.11], [3.12].
[428] Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [3.8], [4.1]; HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [34].

subsidiary is a company, owned and controlled by one or more charities, set up in order to trade, and usually having a purpose to generate income for its parent charity.[429] The profits from a trade carried on by a trading subsidiary do not qualify for tax exemption and are liable to corporation tax in the usual way, but trading subsidiaries may be able to reduce or eliminate their tax liability by making donations to their parent charity as "Gift Aid".[430] This mechanism provides an incentive for a trading subsidiary not to meet its funding needs out of retained profits, as those retained profits will be liable for corporation tax. A trading subsidiary's needs for funding will therefore normally be met out of share capital and/or loan capital normally provided by the parent charity. In this regard, CCEW makes the following comments:[431]

> This provision has to be justifiable as an investment of the charity's assets … Parent charities must not provide support to trading subsidiaries on terms which involve a greater or lesser element of gift. For example:
>
> - a parent charity must not make donations to the trading subsidiary, in cash or in kind, whether by purchasing stock for the subsidiary, and donating that stock to the trading subsidiary, or otherwise;
> - a parent charity must not settle the debts of a trading subsidiary;
> - a charity must, if allowing the use of its staff, buildings or equipment by a trading subsidiary, make fair charges for those uses.

319. In the context of financial viability, CCEW makes the following comments:[432]

> A trading subsidiary should become financially viable as soon as possible. It is therefore important to have a business plan in place that clearly identifies the point at which trading is expected to be profitable and to assess progress against the business plan. Where financial viability is not anticipated within 2 years of operation, careful consideration should be given to the appropriateness of undertaking the planned trading activity.

320. In all decisions relating to the subsidiary, the interests of the charity are paramount: if a charity's trustees keep a failing trading subsidiary going at the charity's expense, they may be personally liable for consequential losses to the charity.[433]

321. As noted by Breen, trading subsidiaries can be costly to set up and maintain for charities. They require separate administrative structures, and when charity trustees sit on their boards, conflict of interest issues may arise.[434]

322. As part of the review of the Charities Act, DIA specifically consulted on whether New

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[429] Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [4.1].
[430] Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [4.1], [4.3] - [4.7]; HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [45].
[431] Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [4.6].
[432] Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [4.1].
[433] Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [4.16]; OB Breen *Holding the line: regulatory challenges in Ireland and England when business and charity collide* in M McGregor-Lowndes and K O'Halloran (eds) "Modernising Charity Law – Recent Developments and Future Directions" (Edward Elgar, Cheltenham, UK, 2010) 136 at 150; Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [2], [4.8].
[434] OB Breen *Holding the line: regulatory challenges in Ireland and England when business and charity collide* in M McGregor-Lowndes and K O'Halloran (eds) "Modernising Charity Law – Recent Developments and Future Directions" (Edward Elgar, Cheltenham, UK, 2010) 136 at 150.

Zealand should introduce a similar "significant risk" test:[435]

> Providing support to a business may be a good use of charitable funds, if the business has the potential to provide sustainable income for the charity. However, if the business is not successful, it may deflect the charity's funds away from its charitable purpose. If the business closes, the charity may not get back the funds it used to support the business, particularly if the business has borrowed money or has other creditors (see example C). Members of the public who donate to charities expect donations to go to charitable purposes. If too many charities take on too much business risk, this could ultimately start to erode public trust and confidence in the charities sector.
>
> Example C: Charitable funds lost through business activities
>
> The Southern Cross Charitable Trust was deregistered as a charity for gross mismanagement and advancing a noncharitable purpose to provide private benefit to related parties.
>
> The Trust was formed in 1993 with purposes to provide education and support youth-at-risk and was registered under the Act in 2008. Previously, the Trust had set up and provided substantial funds for the Kiwi Can programme.
>
> The Trust raised funds by charging interest on loans to building projects. For each project, the Trust established a trust and a company, each run by one of the trustees. The Trust established a total of 45 trusts and companies in this manner.
>
> Huge amounts of money went through the Trust, with very little applied to charitable purposes. Between 2005 and 2010, the Trust received an estimated $30 million from the building projects. Around $25 million of this was loaned back to related entities.
>
> During the time it was registered, the Trust provided $11,392 in donations to registered charities.
>
> Approximately $34.5 million remained outstanding in loans and unpaid interest at the time of deregistration.
>
> In England and Wales, charities are not permitted to run businesses where there is significant risk to charitable assets. However, *introducing a significant risk test in New Zealand could make it more difficult for some charities to raise funds*.
>
> As discussed above, *most charity officers will already be bound by other duties under the law depending on the charity's legal structure*. However, governance standards, discussed in the chapter on the Obligations of charities, are another way to mitigate the potential risk to charitable funds. Standards could include guidance for charities when making decisions on business activities.
>
> This guidance could also respond to wider concerns of charities and investment. In particular, concerns about charities that wish to invest in social enterprises that provide lower rates of return than other investment options.

323. In response to a specific consultation question as to what, if any, restrictions (such as the "significant risk" test in England and Wales) should exist on the level of risk for charities undertaking business activities, many submitters responded that it is not Charities Services' role to manage the business risk of charities.[436] Further, Charities Services is not well-placed to do so in any event. It is regulatory over-reach

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[435] Te Tari Taiwhenua Internal Affairs *Modernising the Charities Act 2005: Discussion Document* February 2019 at 44 - 45 (emphasis added).
[436] See, for example, the submissions of New Zealand Red Cross Incorporated; EY Law; Methodist Church of New Zealand Te Haahi Weteriana O Aotearoa; Royal New Zealand Plunket Trust; Council for International Development; Scott Moran; SPCA; and Auckland North Community and Development.

to substitute charities' decision-making in this way.

324. The rules regarding charities running businesses in England and Wales are clearly very prescriptive and complex. As with the United States and Canada, the rules in England and Wales appear to have been based on a perception that charities running businesses have a competitive advantage over their for-profit counterparts:[437]

> Compared to ordinary commercial companies, charities enjoy *considerable advantages in the tax treatment they receive* in relation to trading and trading profits. For example, in terms of VAT, certain sales and purchases are exempt or zero-rated. In terms of direct tax, there are a number of benefits – for example:
>
> - a charity's trading profits are, in certain circumstances, exempt from tax; this includes profits from primary purpose trading, and profits made from lotteries and from certain types of fund raising event – exemption is subject to conditions relating to the application of the profits received by the charity
> - income received by a charity from the sale of goods that have been donated to it is not generally regarded as trading profits and is not taxable.

325. However, again, the proposition that the tax privileges for charities provide a competitive advantage is asserted rather than analysed. Once the underlying assumptions are actually acknowledged and interrogated, the issue of competitive advantage is found not to exist: as discussed above, businesses run by charities do not have a competitive advantage over their for-profit counterparts in terms of either pricing or expansion. Tax exemption for charities' business income has no practical effects on the competitiveness of for-profit businesses, and instead merely provides a degree of offset to the significant disadvantages charities otherwise face in accessing capital.[438] In other words, the complex rules in place in England and Wales were designed to address a problem that New Zealand has acknowledged does not in fact exist.

326. As with the US, the complexity of the rules in England and Wales have led to the creation of an alternative legal structure in the form of a "Community Interest Company" or "CIC" in 2004.[439] A CIC might be considered a halfway house between a fully commercial enterprise and a charity: although it does not enjoy charitable tax exemption, it does not suffer from the constraints imposed on charities relating to commercial activities;[440] however, it does have a number of statutory constraints, such as an asset lock and a dividend cap, which appear to have resulted in a lower take-up than expected.[441] In other words, as with the L3C and other structures in the US, the CIC is a workaround. Bearing in mind the significant advantages that charities have over for-profit entities as a vehicle for social enterprise, as discussed above, a much better approach would be to simply *not* tax charities' business income

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[437] Charity Commission for England and Wales *CC35 – Trustees, trading and tax: how charities may lawfully trade* February 2016 at [2] (emphasis added).
[438] Australia Industry Commission; Australian Productivity Commission *Contribution of the Not-for-Profit Sector* 11 February 2010; DR K Henry AC, G Smith, Dr J Harmer, H Ridout, Professor J Piggott *Australia's Future Tax System – Final Report* 2 May 2010 (Henry Review). See also Ann O'Connell *Taxation and the not-for-profit sector globally: common issues, different solutions* in M Harding (ed) Research Handbook on Not-for-profit law (Edward Elgar, UK, 2018) 388 at 397.
[439] Companies (Audit, Investigations and Community Enterprise) Act 2004 (UK) Pt 2.
[440] OB Breen *Holding the line: regulatory challenges in Ireland and England when business and charity collide* in M McGregor-Lowndes and K O'Halloran (eds) "Modernising Charity Law – Recent Developments and Future Directions" (Edward Elgar, Cheltenham, UK, 2010) 136 at 151.
[441] OB Breen *Holding the line: regulatory challenges in Ireland and England when business and charity collide* in M McGregor-Lowndes and K O'Halloran (eds) "Modernising Charity Law – Recent Developments and Future Directions" (Edward Elgar, Cheltenham, UK, 2010) 136 at 151 - 152.

in the first place: such an approach would mean that complicated (and ultimately unsuccessful) workarounds become unnecessary.

Ireland

327. Ireland follows a similar approach to that taken in England and Wales in basing its approach on the concept of "trade", rather than "commercial" or "business" activities, with "trade" defined to *include*:[442]

> … every trade, manufacture, adventure or concern in the nature of trade

328. This definition is considered less clear than the HMRC approach of considering "trading" to generally involve the provision of goods or services to customers on a commercial basis.[443] Again, the distinction matters, because charities' profits from "trading" are, in principle, subject to tax unless specifically exempted.[444] An intention to use profits for charitable purposes will not prevent those profits from being liable to tax:[445] as with England and Wales, there is no "destination of funds" test applicable to exempt the unrelated business income of charitable organisations in Ireland.

329. Ireland does not formally make a distinction between "charitable trading" and "non-charitable trading", relying instead solely on an underlying distinction between "primary purpose trading" and "non-primary purpose trading".

330. The "profits of a trade carried on by any charity" are exempt from tax in Ireland if the trade is exercised in the course of the actual carrying out of a *primary purpose* of the charity, or the work in connection with the trade is *mainly* carried out by the *beneficiaries* of the charity (and the profits are applied solely to the purposes of the charity).[446]

331. What constitutes profit made by a charity from trade that is "exercised in the course of the actual carrying out of a primary purpose of the charity" in Ireland is interpreted in a similar manner to the concept of primary purpose trading in England and Wales.[447] Profit from primary purpose trading is *prima facie* exempt from tax in Ireland, provided the profits are applied solely to the purposes of the charity;[448] however, an exception is made for the profits of a trade of farming carried on by a charity, which are not required to be applied solely for charitable purposes.[449]

332. In addition, as in England and Wales, work carried out by beneficiaries of a charity may constitute primary purpose trading in itself; profit from trading that is unrelated to the charitable purpose (that is, "non-primary purpose" trading) may still qualify for exemption where the work is carried out "mainly" by beneficiaries of the charity.[450] There is limited guidance in Ireland as to what might be required to satisfy the "mainly" criterion, and in practice it is assessed by the Irish tax authority, the

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[442] Taxes Consolidation Act 1997 (Ireland) s 3.
[443] OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [10.24]. Compare HM Revenue and Customs *Annex iv: trading and business activities – basic principles* 4 May 2021 at [2].
[444] OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [10.21].
[445] OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [10.24].
[446] Taxes Consolidation Act 1997 (Ireland) s 208(2)(b).
[447] OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [10.25].
[448] Taxes Consolidation Act 1997 (Ireland) s 208(2)(b)(ii); OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [10.28] - [10.30].
[449] Taxes Consolidation Act 1997 (Ireland) s 208(3).
[450] OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [10.31].

Revenue Commissioners ("**Revenue**"), on a case by case basis.[451]

333. There is no official public guidance as to when a particular activity might qualify as "ancillary" and therefore within the concept of primary purpose trading in Ireland.[452] The approach taken in practice appears to be one of scale, with insignificant trading ventures tending to be overlooked as "ancillary", but larger-scale trading likely to be more problematic.[453] This approach can be contrasted with the "non-mathematical" approach taken in England and Wales.[454]

334. If Revenue finds that the trading activities of a charity are not ancillary to its charitable purpose, but rather constitute non-primary purpose trading, tax will be due on all the trading activities of the charity (even if all the profits ultimately are used for charitable purposes): unlike England and Wales, there is no clear power to apportion charitable and non-charitable trading and to assess them separately for tax purposes.[455] There is also no clear "small-trading exemption", although Revenue has in the past granted a concession from tax liability in respect of small scale non-primary purpose trading.[456]

335. If a charity incurs a trading loss, and the charity trustees are found not to have taken sufficient care, the Charities Regulatory Authority may bring an action against the charity trustees:[457] if the High Court is satisfied that any property of the charity was misapplied, or dealt with in a manner that endangers the property, or there has been any other misconduct or mismanagement on the part of any charity trustee or member of staff in relation to the affairs of the charity, the High Court may make such order as it considers appropriate, including, presumably, ordering trustees to make good the loss to the charity.[458]

336. If the trading activity would put a charity's assets at significant risk, it becomes "advisable" to separate out its commercial activities into a separate subsidiary, although unlike England and Wales there is not a clear requirement to do so.[459] If the trading increases to "such an extent that the non-charitable activity becomes as a matter of fact an unauthorised non-charitable purpose", the charity's charitable status could be at risk.[460]

337. As with the other jurisdictions examined, the rules regarding charities running businesses in Ireland are clearly very complex. A compelling basis is required before introducing such complexity into New Zealand charities law. No such compelling basis has been demonstrated.

Imputation credits

338. In addition, the issues paper does not analyse the impact of the non-refundability of imputation credits, even though, as the 1995 Australian Industry Commission noted,

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[451] OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [10.31].
[452] OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [10.38].
[453] OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [10.37] - [10.38].
[454] OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [10.37].
[455] OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [10.39].
[456] OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [10.35].
[457] Charities Act 2009 (Ireland) s 74.
[458] OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [10.19].
[459] OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [10.49].
[460] OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [10.49].

they are highly relevant to the "competitive advantage" analysis.[461]

339. Dividend imputation is a mechanism used to prevent the double taxation of dividends: the underlying principle is that shareholders in a company should, as far as possible, be treated as if the income earned by the company were earned by the shareholders directly;[462] this principle is achieved by allowing a company to attach credits (imputation credits) that reflect the tax paid by the company to the dividends paid to its shareholders; the recipients of the dividends can then use these credits to reduce their own tax liability.

340. In New Zealand, the fact that imputation credits are not able to be refunded is relevant to the "competitive advantage" argument as it effectively forces tax-exempt entities such as registered charities to pay tax on their investments in New Zealand companies (because there is no tax liability against which such imputation credits might be offset). Non-refundability of charities' imputation credits is distortionary because it effectively biases charities' investment decisions *away* from investing in New Zealand companies (where any dividends received will effectively be taxed), towards investments where their income tax exemption will be effective (such as interest-bearing debt and shares in foreign companies offering unimputed rather than imputed dividends).[463] The distortionary impact of non-refundability was acknowledged by IRD in 2008:[464]

> New Zealand company tax is paid on income earned by New Zealand companies. This company tax paid can then be attached in the form of imputation credits to dividends paid to shareholders, so that, effectively, the company tax is seen as a withholding tax for the shareholder. If shareholders are subject to New Zealand tax they will have tax to pay on the dividend they receive and can use the imputation credits to pay all or part of that tax.
>
> If, however, the shareholder does not have to pay tax on the dividend – for example, if the shareholder is a tax-exempt charity – the imputation credits cannot be used and cannot be refunded. The benefit of the imputation credits is lost to the shareholder. Moreover, the dividend income earned by the tax-exempt shareholder has effectively been taxed at the company rate rather than at the shareholder's effective rate of zero percent.
>
> *One of the effects of this treatment is that tax-exempt organisations may choose investments that pay them a before-tax return (referred to as non-imputed income, such as interest) over those New Zealand shares that provide an after-tax return, such as imputed dividends.*
>
> This outcome is a concern for shareholders in New Zealand companies when those shareholders have a specific exemption from New Zealand income tax and consequently are not subject to tax on the dividends they receive. Registered charities are one example of a group that currently has a specific income tax exemption.

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[461] Industry Commission *Charitable organisations in Australia - Report no 45* 16 June 1995 at 318.
[462] Inland Revenue Department *Streaming and refundability of imputation credits: a Government tax policy discussion document* August 2008 at [4.8].
[463] Inland Revenue Department *Streaming and refundability of imputation credits: a Government tax policy discussion document* August 2008 at [1.11]; Industry Commission *Charitable organisations in Australia - Report no 45* 16 June 1995 at 271, 318 - 319. See also Inland Revenue Department *Tax and charities, a government discussion document on taxation issues relating to charities and non-profit bodies* June 2001 at [9.3] n 25.
[464] Inland Revenue Department *Streaming and refundability of imputation credits: a Government tax policy discussion document* August 2008: <taxpolicy.ird.govt.nz/en/publications/2008/2008-dd-imputation-credits> at [4.1] – [4.4], [1.11], [4.13] (emphasis added).

341. In other words, by denying registered charities the ability to have their imputation credits refunded, double taxation is not prevented, contrary to the underlying principle of the imputation system.

342. In 1995, the Australian Industry Commission specifically recommended a review to determine "the most cost effective way of removing the distortions in the investment policies of Community Social Welfare Organisations due to the dividend imputation system in Australia";[465] this recommendation was made in the context of a wider effort to "remove unwarranted incentives and disincentives which have accumulated over the years … and which may inhibit CSWOs from raising their own resources".[466]

343. Since 1 July 2000, surplus imputation credits (known as "franking credits") of charities have been able to be refunded in Australia,[467] leading to an inconsistency between Australia and New Zealand which was noted in the OECD report.[468]

344. New Zealand charities have long advocated for a similar change to be made in New Zealand.[469]

345. In 2001, IRD accepted that non-refundability of imputation credits discourages New Zealand charities from investing in domestic equity, but argued that it did not have sufficient *information* to assess the relevant fiscal cost.[470] In 2008, IRD raised concerns about charities being used in "tax planning" arrangements.[471]

346. Since then, however, the Charities Act 2005 has been introduced requiring registered charities to file annual returns; from 2015, those returns must be accompanied by financial statements providing comprehensive financial and non-financial information.

347. Despite the fact that these factors mitigated the original concerns raised by IRD, in 2018, IRD raised a new objection: although the background paper for the Tax Working Group's 6 July 2018 meeting primarily focused on private foundations and business income, it did contain a brief table of seven other issues that might be considered, including refundability of imputation credits.[472] The background paper devoted five sentences to this issue, ultimately dismissing it as having a "material fiscal cost"; however, there was no analysis of what that cost might be, or how it might compare with the associated benefits of removing a significant barrier to

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[465] Industry Commission *Charitable organisations in Australia - Report no 45* 16 June 1995 at 318 - 319 and recommendation 12.8.
[466] Industry Commission *Charitable organisations in Australia - Report no 45* 16 June 1995 at 424.
[467] Income Tax Assessment Act 1997 (Cth) s 207-115; DR K Henry AC, G Smith, Dr J Harmer, H Ridout, Professor J Piggott *Australia's future tax system – Report to the Treasurer* December 2009 (Henry Review) at 190. See also Inland Revenue Department *Streaming and refundability of imputation credits: a Government tax policy discussion document* August 2008 at [4.19].
[468] OECD Tax Policy Studies *Taxation and Philanthropy* (2020) 27 (OECD Publishing, Paris) at Box 3.1.
[469] See, for example, Philanthropy New Zealand *Getting more from your investment in NZ businesses* 3 December 2019: <philanthropy.org.nz/policy-briefs-and-submissions>. In Canada, a similar recommendation was made by the Ontario Law Reform Commission in 1996: "some thought might be given to extending the exemption to dividend income by making the dividend tax credit refundable for tax-exempt organisations" (Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 377).
[470] See also Inland Revenue Department *Tax and charities, a government discussion document on taxation issues relating to charities and non-profit bodies* June 2001 at [12.1] - [12.5].
[471] Inland Revenue Department *Streaming and refundability of imputation credits: a Government tax policy discussion document* August 2008 at [4.10], [4.28].
[472] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 20-21, table 3. The seven issues were: coherence of other income tax exemption categories; charities and the FBT exemption; not-for-profits and GST concessions; tax benefits for donee organisations; refundability of imputation credits; mutual organisations; and charities and donee organisations with charitable purposes not limited to New Zealand.

investment by New Zealand charities in New Zealand companies.

348. According to the minutes of the 6 July 2018 Tax Working Group meeting, refundability of imputation credits for charities was not discussed. In its September 2018 interim report, the Tax Working Group noted there had been a shift away from full imputation, particularly in European Union countries (reflecting a European Court of Justice ruling that imputation systems that only provide tax credits to domestic investors are discriminatory),[473] but recommended that the New Zealand imputation system be retained. The impact of non-refundability of imputation credits on charities was not discussed in the Tax Working Group's interim or final reports, despite the focus on potential competitive advantage.[474]

349. The issue of refundability of charities' imputation credits was included in the August 2019 tax policy work programme,[475] but has since been removed without having been progressed.[476]

350. Although the issue of non-refundability of imputation credits for charities was specifically out of scope for DIA's review of the Charities Act, some submitters raised the issue nevertheless, pointing out that some philanthropic charities were paid millions of dollars in imputation credits, funding which could have been invested back into the community where the impact would have been multiplied.[477]

351. New Zealand is a net importer of foreign capital: in the current environment of international instability and uncertainty, access to domestic capital is critical for the growth of most local firms. Unlocking the balance sheets of philanthropy would have significant flow-on benefits for New Zealand, and its economy.[478]

352. The question of refundability of imputation credits should not be dismissed as having a "material fiscal cost" without analysis of what that cost might be, and what offsetting benefits it might unlock. Changes to the tax settings for charities should not be made without a comprehensive analysis of the need to make imputation credits refundable to registered charities.

Business income – summary

353. The proposals in the issues paper to tax the unrelated business income of charities are misconceived. They are based on underlying assumptions that do not bear critical scrutiny. For example, the income tax exemption does not give charities an "advantage" in terms an ability to "expand more rapidly" than their competitors through a "faster accumulation of funds", but merely provides a degree of offset to the significant disadvantages charities otherwise face in their ability to access the level of capital needed to grow to an optimum size. Similarly, the business income tax exemption for charities does not "reduce government revenue" or "shift the tax burden to other taxpayers". To the contrary, charities' ability to run businesses to raise funds for their charitable purposes allows them to amplify their impact, and

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[473] Tax Working Group *Future of Tax: Interim Report* 20 September 2018 at 100.
[474] Tax Working Group *Future of Tax: Final Report* 21 February 2019 at [25]: "The current approach to the taxation of business is largely sound. The Group does not see a case to reduce the company rate at the present time or to move away from the imputation system".
[475] Inland Revenue Department *Government tax policy work programme: 2021-22*.
[476] OECD Tax Policy Studies *Taxation and Philanthropy* (2020) 27 (OECD Publishing, Paris) at 60 (box 3.1) noting that the refundable credit "is essentially additional income for the entity to use for its worthy purpose".
[477] Submission of JR McKenzie Trust. See also the submission of The Tindall Foundation.
[478] See, for example, the submission of The Ākina Foundation. See also Tax Working Group *Future of Tax: Interim Report* 20 September 2018 at 100 - 103.

reduces their dependency on donations and government funding. Removing the business tax exemption will raise no revenue and is more likely to increase government's costs.

354. In addition, the assumption that accumulating funds is somehow inconsistent with charitable purpose does not bear critical scrutiny and belies a fundamental misconception of the constraints to which charities are subject, including the important fiduciary duties.

355. IRD argues that taxing income accumulated income within charity businesses would "have financial implications for some affected charities":[479]

> For example, for profitable businesses reporting a taxable surplus it would reduce the amount of accumulated funds available to their businesses, which they would otherwise use to grow their net assets or ultimately pass on for charitable purposes.

356. However, this statement appears to misconstrue the legal constraints that charities operate under. It is not possible to have a "business masquerading as a charity": in order to access the income tax exemption, a charity carrying on a business must be itself registered, and therefore subject to the stringent requirements of the Charities Act. In addition, all activities carried out by a charity must be carried out in furtherance of its stated charitable purposes, and all its funds must ultimately be destined for charitable purposes. No one can make a private pecuniary profit from a charity lawfully. Business activity is not inherently nefarious; awareness should be raised, both within the public and government, that business is a legitimate and encouraged activity for charities.

357. Attempts to tax the unrelated business income of charities have failed all over the world. There is no evidence that removing the business income tax exemption for charities would make any difference whatsoever to the competitiveness of for-profit companies, or raise any material revenue.[480] Far from closing a "charitable tax loophole in the 1920s",[481] Britain has had to introduce a new legal structure, the Community Interest Company, to try to "workaround" the difficulties caused by the rules restricting charities running businesses. Similar workarounds have proliferated in the United States. However, the workarounds have not proved successful.

358. The "international precedents" referred to in the issues paper were introduced in different jurisdictions in a different century in different circumstances to address perceived problems that simply do not exist in New Zealand. The experience of other jurisdictions indicates that attempting to draw a line between "related" and "unrelated" business is not possible: no such line exists, and the considerable complexity created by attempting to draw one can never be alleviated by "guidance". Instead, the ever-increasing complexity created by endlessly trying to fill gaps and address unintended consequences ultimately results in a transfer of wealth from the charitable sector to the professional advice sector as New Zealand charities are distracted from their charitable purposes trying to fit their square pegs into round holes. More fundamentally, the issues paper's proposals regarding charities' business

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[479] Issues paper at [2.17].
[480] See the discussion in S Barker *Focus on purpose - what does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3, chapter 5.
[481] David Seymour *Charities tax loophole should be closed* 29 August 2023: https://www.act.org.nz/charities_tax_loophole_should_be_closed

and accumulation activities will hinder, rather than support, social enterprise.

359. New Zealand has the opportunity to be a world-leader in this space. There is simply not a compelling reason to subject charities to the issues paper's complicated proposals to tax the unrelated business income of charities.

360. Charities do not need more piecemeal, kneejerk, siloised reform rushed through without proper consultation, particularly when any issues regarding charities' business or accumulation activities, perceived or otherwise, can be more than adequately addressed by using existing tools. An approach of enforcing the fiduciary duties would address any concerns about "excess accumulation" by working with the underlying law, rather than cutting across it, while also protecting charities against harmful regulation, and enabling rather than hindering, important social enterprise activity.

361. In short, the UBIT proposals in the issues paper are a solution in search of a problem. They should not proceed.

362. All of the above said, the territorial restriction in section CW 42(1)(a) and (4) should nevertheless be removed. There does not appear to be any rationale for its existence other than the fact that it has been in place since 1916, for reasons that cannot now be identified. However, the world has changed considerably since 1916: for example, many pressing global issues, such as climate change, biosecurity, pandemic risk, human rights violations, global safety and stability, and many others, respect no borders yet are important to New Zealanders. New Zealand charities are currently not supported in their efforts to address such issues unless they operate primarily in New Zealand. Removing a complex and anomalous restriction should not depend on the introduction of a misconceived and unprincipled UBIT. Removal of the territorial restriction should be progressed irrespective of whether a UBIT is introduced or not.

CHAPTER 3 – PRIVATE FOUNDATIONS

363. Chapter 3 of the issues paper proposes the following cocktail of measures for charities:

(i) introducing a new concept of a "donor-controlled charity", being a registered charity that is "controlled by the donor, the donor's family, or their associates"[482] (something of an oxymoron given that donors cannot "control" a registered charity under current settings); and

(ii) imposing "investment restrictions", by requiring transactions between "donor-controlled charities" and their associates to be on arm's length terms (which they already are) or prohibited outright; and/or

(iii) introducing anti-avoidance provisions for specific arrangements involving transactions between a "donor-controlled charity" and associated persons; and

(iv) imposing annual minimum distribution requirements on "donor-controlled charities"; and

(v) providing exceptions to allow some "donor-controlled charities" to accumulate funds in certain circumstances.

[482] Issues paper at [3.1].

364. IRD sets out its rationale for these proposals as follows:[483]

> … Donor-controlled charities can enable tax avoidance and raise compliance concerns because of the control the donor or their associates can exercise over the use of charity funds.

365. In support of this statement, IRD puts forward 4 examples:[484]

- Circular arrangements, when the donor gifts money to a charity they control, claim a donation tax credit or gift deduction, and *the charity immediately invests the money back into businesses controlled by the donor or their associates*. While the investment may earn a market rate return, typically the investment income is accrued and no cash is actually paid to the charity for many years.

- In donor-controlled charities there can be a *significant lag* between the time of tax concessions [sic] for the donor and the charity, and the time of ultimate public benefit. This occurs when the donor-controlled charity accumulates most or all of its funds and makes no or very minimal charitable distributions.

- Arrangements when donor-controlled charities purchase assets from the donor or their associates *at prices exceeding what would normally be paid by unrelated parties*.

- Arrangements when donor-controlled charities regularly acquire goods or services from the donor or their associates, *on terms that would not normally exist between unrelated parties*.

366. However, a significant question arises as to whether any of these 4 examples in fact raise "tax avoidance and compliance concerns" that require a legislative response.

367. For example, the issues paper does not mention the control restriction in section CW 42(1)(c) and (5)-(8) of the Income Tax Act 2007, which "turns off" the business income tax exemption if a person with some control over the business is able to direct or divert an amount derived from the business to their benefit or advantage.

368. The issues paper also does not mention the rigorous process a charity must undergo in order to register as a charity in the first place. For example, Charities Services takes a very strict approach to conflicts of interest, and is unlikely to allow a charity to register if it did not have at least one independent "officer".[485] (To the extent that Charities Services' approach may lack a legislative footing, we note in passing that clause 49 of the draft Bill recommends codifying a broad, high-level duty on responsible persons of registered charities to disclose and manage actual or perceived conflicts of interest).[486]

369. The issues paper also does not mention the important fiduciary duties to which all registered charities are subject: it is very unlikely that a charity could purchase assets from a related party at non-market prices without breaching a fiduciary duty. Similarly, a charity could not invest money in a business controlled by one of its

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[483] Issues paper at [3.5].
[484] Issues paper at [3.6] (emphasis added).
[485] See Charities Services *Conflicts of interest and registering as a charity*: <www.charities.govt.nz/news-and-events/blog/conflicts-of-interest-and-registering-as-a-charity/>.
[486] See S Barker *Focus on purpose – what does a world-leading framework of charities law look like?* [2022] NZLFRR 3, recommendation 8.27, and Barker et al *The Law and Practice of Charities in Aotearoa New Zealand* 2ed (LexisNexis, 2024), chapter 8.

"officers" unless to do so was in the best interests of the charity's charitable purposes: every decision made by every registered charity must be made in good faith in the best interests of its stated charitable purposes. Acting in breach of fiduciary duty is "unlawful", and therefore already constitutes "serious wrongdoing", as that term is defined in the Charities Act, as discussed above. In other words, the examples raise issues of *enforcement of existing rules*, rather than indicating a requirement for more rules.

370. The issues paper also suffers from the same fundamental misconception underlying the proposals in chapter 2, namely that a charity accumulating funds is not applying them for the benefit of charitable purposes,[487] or that a charity can only further charitable purposes by distributing funds.[488] This assumption is fundamentally misconceived for the reasons discussed above (chapter 2, assumption 2). If there was genuine concern that a charity was inappropriately "hoarding" funds, the issue can be more than adequately dealt with by "questions from the monitoring authority";[489] that is, by simply asking how such accumulations are being made in good faith in the best interests of the charity's stated charitable purposes (with such questions informed by the comprehensive information now made available by means of the charities register, another factor not mentioned in the issues paper). It is often said that charity is a verb (a "doing" word): if a charity is unable to meet this test, there is a prima facie breach of fiduciary duty and clear grounds for intervention. However, if the charity can meet this minimum threshold, there is no reason for the state to intervene. Benefits to the public would in fact be maximised by respecting the independence of charities, for the reasons discussed above. There needs to be a balance between addressing situations of wrongdoing (to the extent that "wrongdoing" is even being suggested) and permitting charities to manage their own finances.[490] Given the diversity of the charitable sector, it is infinitely preferable to address issues on an individual exceptions basis, rather than by attempting to craft blanket prescriptive rules that will inherently fail to accommodate the diversity of human endeavour:[491] complex and arbitrary rules are unlikely to address targeted charities and will instead only serve to distract good charities from their charitable purposes (for example, by forcing them to distribute indiscriminately when in fact their charitable purposes may be best served by not doing so).

371. When the rules applying in New Zealand are properly analysed, it becomes clear they are not "unusually loose",[492] and a serious question arises as to whether there is in fact a problem to be "fixed".

372. Chapter 3 of the issues paper appears directed at one charity: the Wright Family Charity Group (CC55444), which includes a childcare business operated by Best Start

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[487] Issues paper at [2.6].
[488] Issues paper at [3.17].
[489] Inland Revenue Department *Tax and charities, a government discussion document on taxation issues relating to charities and non-profit bodies* June 2001 at [9.8].
[490] Ann O'Connell "Taxation and the Not for profit Sector globally: common issues, different solutions" in Matthew Harding (ed) *Research Handbook on Not-for-profit law* (Edward Elgar, 2018) 388 at 411.
[491] C Decker and M Harding "Three challenges in charity regulation: the case of England and Wales" in M Harding, A O'Connell and M Stewart (eds) *Not-for-Profit Law: Theoretical and Comparative Perspectives* (Cambridge University Press, 2014) 314 at 329, 325.
[492] Issues paper at [3.12].

Educare Limited (CC54719) ("**BestStart**").[493] This case appears to have dominated the thinking of the Tax Working Group.[494]

Tax Working Group

373. As discussed above, according to the minutes of the Tax Working Group's 6 July 2018 meeting, most of the Tax Working Group's 1 hour discussion relating to charities centred around private foundations (or more particularly, their accumulations): even so, the minutes note that "more thinking is needed on the treatment of private foundations", and that "more thought should be given to the issue of [perceived] excessive accumulation", bearing in mind that "a number of charities in New Zealand have no liquidity to distribute".[495] The minutes also refer to the need for IRD to work closely with DIA on this issue, and to ensure that "any changes to the ability for charities to accumulate do not apply to charities with long-term or intergenerational objectives, such as disaster-relief funds and Māori charities". [496]

374. As also discussed above, prior to the 6 July 2018 meeting, officials had prepared a background paper which raised broadly the same points made in the issues paper.[497] To address their perceived concern that individuals could donate large sums to a foundation, receive a tax refund, then "circle it around through entities to re-invest into the individual's business",[498] the background paper suggested that it may be "useful to explore" whether the New Zealand tax system would benefit from a distinction between privately-controlled foundations and other charitable organisations, referring to specific rules "as occurs overseas" which ensure there are "reasonable distribution requirements and restrictions on the extent of investments in related-party businesses".[499] The minimum annual distribution requirements imposed on private ancillary funds in Australia and the rules for private foundations in Canada were specifically mentioned.[500]

375. However, in making these suggestions, officials made no mention of the non-distribution constraint, or the prospect of addressing any concern about "excessive accumulation" or unacceptable private benefit through simply enforcing the fiduciary duties; in addition, no mention is made of the impact of the new financial reporting rules for registered charities and how these may support the "questions from the monitoring authority" option put forward in the 2001 discussion document;[501] the importance of creating an enabling environment for social enterprise also appears to

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[493] See, for example, See M Nippert *Kidicorp's metamorphosis to Best Start Educare raises tax questions* NZHerald 11 July 2020: <www.nzherald.co.nz/business/kidicorps-metamorphosis-to-best-start-educare-raises-tax-questions/BB7ASNZMMJU46KRTO2EFQ43WQE/>.
[494] See the discussion in S Barker *Focus on purpose – what does a world-leading framework of charities law look like?* [2022] NZLFRR 3, chapter 5.
[495] Secretariat for the Tax Working Group *Minutes* 6 July 2018 at 4-5.
[496] Secretariat for the Tax Working Group *Minutes* 6 July 2018 at 4-5.
[497] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 15, 5 - 6 (emphasis added).
[498] Secretariat for the Tax Working Group *Minutes* 6 July 2018 at 5.
[499] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 16.
[500] Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 15 - 16.
[501] The rules came into force from 1 April 2015, meaning that annual returns were starting to be filed under the new rules from 30 September 2016, six months after balance date (Charities Act, s 41(1)) but only a few months before officials' July 2018 report.

have been overlooked.

376. The essence of officials' concerns regarding private foundations and charities' businesses appears to derive from the "BestStart" example.

BestStart

377. Briefly, the BestStart example involved the sale of a large childcare business undertaking to a charity (the Wright Family Foundation (CC50870)),[502] or rather to its wholly-owned subsidiary (Best Start Educare Limited, which is itself a registered charity (CC54719)).[503] The charitable purposes of the Wright Family Foundation include to advance the education and wellbeing of children, young people and their families.[504] Running the childcare business by definition furthers these charitable purposes.

378. In this case, the childcare business had been independently valued at $332 million and, as the charity had no start-up funds of its own, the sale of the shares in the business was effected by loan, to be repaid interest-free at the rate of $20 million per year. The sale did not include the physical childcare centres themselves: instead, as use of these centres is required in order to further the charitable purposes, ongoing arm's length rental payments are made by the charity back to the vendor as owner of the underlying property. While the provision of childcare is itself charitable as for the advancement of education, distributions to independent charities of approximately $2.5 million per annum are also made.

379. In principle, the BestStart example is remarkable only by the size of the figures involved: there is no legal impediment to a charity purchasing a successful business through which to carry out its charitable purposes. As New Zealand does not have a capital gains tax, the sale of the business was unlikely to have attracted income tax whether it was sold to a charity or to a for-profit business.[505] Now that the business is owned by a charity, the non-distribution constraint precludes anyone making a private pecuniary profit from the business: all funds must be ultimately destined for charitable purposes into perpetuity, as discussed above. The fact that the purchase price for the business is being paid off over time does not "convert a revenue stream into tax-free income".[506] Such pejorative language misleads the public into thinking there is a problem with the BestStart example; however, there is no legal impediment to a charity paying off an independently-valued purchase price in instalments, or making rental payments calculated on an arm's length basis to a related party. Subject always to the specific terms of its constituting document, it is perfectly lawful for a charity to pay market value for goods and services rendered in furtherance of its charitable purposes;[507] as New Zealand does not have a capital

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[502] See, for example, https://www.nzherald.co.nz/nz/kidicorp-a-leading-ece-provider-to-go-non-profit/MXQN4NW4K7CCH6VTQE3NRJZ6N4/.
[503] See M Nippert *Kidicorp's metamorphosis to Best Start Educare raises tax questions* NZHerald 11 July 2020: <www.nzherald.co.nz/business/kidicorps-metamorphosis-to-best-start-educare-raises-tax-questions/BB7ASNZMMJU46KRTO2EFQ43WQE/>.
[504] The charities' rules can be found on the charities register: Wright Family Charity Group (CC55444).
[505] New Zealand does make some inroads into a capital gains tax by treating some sales of capital property as being on revenue account for tax purposes. See, for example, subpart CB of the Income Tax Act 2007 (*Income from business or trade-like activities*).
[506] https://www.nzherald.co.nz/business/companies/banking-finance/charity-beststart-84m-loans-to-rich-listers-questioned/YTXHF43G5VGBZADEYMYPTB7UHM/.
[507] See Trusts Act 2019, sections 81 and 36, 37 and 28, and the discussion in Barker *Taxation of Charities in Aotearoa New Zealand* (LexisNexis, forthcoming).

gains tax, instalments of a capital purchase price are unlikely to be taxable no matter whether the purchaser is a charity or a for-profit business. Again, the sale is remarkable only by the size of the figures involved: there are unlikely to be many Kiwi businesses independently valued at $332 million. The government has expressly stated that it wants to encourage generosity.[508] High net worth individuals should in fact be encouraged to transfer their businesses to the charitable sector (which necessarily requires forever forfeiting their ability to extract private pecuniary profit from the business): once funds are impressed with charitable purpose, they must forever be destined for charitable purposes. It is in the public interest for important services such as childcare to be carried out by charities, who are subject to the transparency and accountability requirements of the Charities Act, and are required by law to be devoted to their charitable purposes (that is, they are not at the mercy of profit-seeking private shareholders). BestStart is merely a "tall poppy": the Wright family has done well and is giving back; they should be encouraged to do so.

380. However, there is no indication from the minutes of the 6 July 2018 meeting that *any* of these factors were considered. It would not be reasonable to subject New Zealand charities to a labyrinth of blanket, arbitrary, byzantine rules on the basis of "envious hostility"; it would be even more unreasonable to do so on the basis of *only one charity*. Even if the BestStart example was of legitimate concern (which has not been established), care must be taken not to create rules that impose unnecessary burdens on the vast bulk of charities that are good actors, in a failed attempt to address the 0.01% of charities who may be otherwise. One of the advantages of the current New Zealand charities law framework is its simplicity. As one commentator has put it, in attempting to create bright line quantitative rules to "slice and dice" the charitable sector into arbitrary categories, we "flirt rather shamelessly with the fallacy of the one true way" and risk "murdering to dissect, of basing our … theories on a cadaver of our own creation rather than on the flesh and blood charities that populate the real world".[509]A compliance approach that focuses on the 0.01% is likely to be counterproductive: bad actors will generally be able to find a way around complicated rules, leaving the vast majority who are good actors with a bureaucratic burden that is unlikely to make any difference.[510]

381. In our view, any potential problem with outlier charities who may be "hoarding" unduly, or breaching their fiduciary duties to somehow extract private pecuniary profit from a charity, can be more than adequately dealt with using the rules we already have in place. The fact that a handful of other jurisdictions did not have the wherewithal to enforce the fiduciary duties does not create a compelling basis for New Zealand to make the same mistake.[511]

The review of the Charities Act

382. The focus of the Tax Working Group on accumulations was picked up by DIA in its

[508] https://www.beehive.govt.nz/release/%E2%80%98twelve-days-giving%E2%80%99-encourage-generosity.
[509] Rob Atkinson "Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis and Syntheses" (1997) Stetson Law Review 395, 402-430 at 424.
[510] https://apnews.com/article/should-foundations-give-more-pandemic-777508711127b8d5b07f8ec8aa80fad2.
[511] Issues paper at [3.14]-[3.16].

February 2019 discussion document for the review of the Charities Act:[512]

> Holding accumulated funds without clear explanation *may* [sic] cause public concern that a charity is not using its funds for charitable purposes. For example, concerns have been raised regarding charities with businesses that apply very little or no funds to charitable purposes. Accumulating funds in a business or other investment over a long time can increase the risk that charitable funds are lost if it fails …
>
> Case study: Charity (accumulation of funds by a business)
>
> A charity group is made up of a trust that owns six related companies. The companies provide goods and services for the building industry. The charitable purpose of the trust is to provide grants for charitable purposes in the community.
>
> Over the past 10 years, the companies have provided on average $2.5 million in income to the trust annually.
>
> At the same time, the group's assets have grown from $30 million to $90 million. The trust has used accumulated funds and taken out loans to purchase $30 million in property. The property is rented by the six subsidiary companies.
>
> The trust makes charitable grants of $100,000 annually on average. That is about 4% of its income and less than 1% of its total assets.
>
> In this case, there has been large growth in assets over a long period and a relatively small amount distributed in grants. So far, most of the accumulation of funds by the trust has not advanced the charitable purposes of the trust.
>
> It is not only charities that operate businesses that have issues with large accumulation of funds. For example, the TWG's interim report raised concerns about accumulation by private foundations. Financial information on the charities register indicates the largest 25-30 foundations established by single donors or their families have total assets exceeding $1.7 billion. The TWG reported that the average proportion of net surplus by private foundations distributed over this three year period varies widely, from 10% to 92%.
>
> Other countries take different approaches to this issue. In England and Wales, all charities must include in their annual report their policy on reserves, stating the level of reserves held and why they are held. The charity needs to state if it does not have a reserves policy.
>
> In Canada, charities are required to spend a minimum amount each year on their own "charitable programmes" or on gifts to other charities.
>
> In Australia, private foundations that are registered private ancillary funds need to meet specific rules. If a private ancillary fund is a charity, it is required to have a minimum annual distribution of 5% of assets to charitable organisations.
>
> ? Should charities be required to be more transparent about their strategy for accumulating funds and spending funds on charitable purposes (for example, through a reserves policy)? Why? Why not?
>
> ? Should certain kinds of charities be required to distribute a certain portion of their funds each year, like in Australia?

383. The case study referred to in the extract above appears to relate to the Southern Cross Charitable Trust, which was deregistered in April 2015 for serious wrongdoing

[512] Te Tari Taiwhenua Internal Affairs *Modernising the Charities Act 2005: Discussion Document* February 2019 at 21 - 22 (emphasis added, footnotes omitted).

due to breaches of fiduciary duties.[513] A deregistered charity must divest itself of all its assets to registered charities or other tax-exempt entities within 12 months or pay tax on the balance.[514] Such a response appears eminently adequate: charities are already prevented from transferring value out of the charity through "non-arms length transactions or circular arrangements".[515] Existing rules are not "unusually loose".[516] On what basis are further measures considered to be required?

384. The issues paper complains that:[517]

> In New Zealand, individuals can established donor-controlled charities [sic] and access the same tax concessions [sic] as other widely supported charities. Donors can claim donation tax credits and gift deductions, as they would if they donated to an unrelated donee organisation at arm's length.

385. However, this statement misses the point. The "cap" on donations was lifted in 2008 precisely for the purpose of "encouraging philanthropy", a "culture of generosity in New Zealand", and to "remove tax barriers to even more generous contributions to charities".[518] On learning that the cap would be removed, the wealthy founder of Kathmandu made the following comments:[519]

> It's great what the Government has done to encourage philanthropy by removing the tax obstacles. **Hopefully it will encourage wealthy families and individuals to set up foundations, as has been occurring in Australia for a long time**.

386. Charitable giving did indeed increase following the amendments: New Zealanders were estimated to have given $2.67 billion to charitable and community causes in 2011, double the level estimated in 2006.[520] The increase was even more impressive given its coincidence with the onset of the global financial crisis in 2008.

387. The examples given in DIA's discussion document imply there is a problem with the current settings regarding charities' business and accumulation activities, when there is in fact no evidence of issues that could not be adequately addressed within the current framework. Such implications themselves undermine public trust and confidence in charities, by creating a perception that there is a problem to be "fixed" when the evidence base for such a claim has not in fact been made out.

388. It would be a mistake for New Zealand to chart a course through comparable jurisdictions selecting restrictive measures of considerable complexity, in isolation, without a consideration of their context, in a piecemeal fashion, and without an evidential basis indicating a need for reform. New Zealand has the opportunity to do things better and smarter. Why the rush, particularly when the stakes are so high?

Minimum distribution requirements

389. Minimum distribution requirements, in particular, are fraught with difficulty and were

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[513] https://www.charities.govt.nz/charities-in-new-zealand/legal-decisions/view-the-decisions/view/southern-cross-charitable-trust.
[514] Section HR 12 of the Income Tax Act 2007.
[515] Issues paper at [3.12].
[516] Issues paper at [3.13].
[517] Issues paper at [3.2].
[518] Inland Revenue Department *Tax incentives for giving to charities and other non-profit organisations – a government discussion document* October 2006 at [1.5], 15; Taxation (Annual Rates, Business Taxation, KiwiSaver, and Remedial Matters) Bill 2007 explanatory note at 2, and Inland Revenue *Taxation (Annual Rates, Business Taxation, KiwiSaver, and Remedial Matters) Bill – Commentary on the Bill* at 101.
[519] Mike Houlahan *Budget 07: charity gets a generous helping hand* NZ Herald 18 May 2007 (bolding added).
[520] Philanthropy New Zealand *Giving New Zealand: Philanthropic Funding 2011* (January 2012) at ii.

strongly opposed by submitters to the review of the Charities Act, as noted by DIA in its October 2019 regulatory impact statement:[521]

> There was very strong opposition from stakeholders to this option [of imposing minimum distribution requirements] in consultation from 2019-2021, either in principle or the proposed 5 percent of net assets. Stakeholders thought that this option was inflexible, did not recognise the careful planning and responses by charities, is an arbitrary intervention to an arbitrary problem, and would have significant adverse consequences on funding arrangements and behaviour. Lack of stakeholder buy-in will make it difficult to enforce.

390. Other objections to the imposition of minimum distribution requirements included the following:[522]

- if a charity is unable to meet the minimum requirements with surplus funds, they would have to use reserves or sell assets which will impact their ability to achieve their charitable purpose;
- it is inflexible to external influences outside of charities' control and how a charity may need to operate to achieve long-term goals;
- it may encourage charities to distribute the minimum, even if they could do more, or encourage riskier investments to generate higher returns;
- it could lead to damage to perpetual funds by requiring distribution of more funds than is available per year;
- any minimum distribution requirement is arbitrary and does not reflect the objectives and careful planning undertaken by Māori charitable organisations;
- restricting the ability to accumulate funds will adversely impact efforts to support the longterm prosperity of iwi; and
- "net assets" is not an appropriate indicator for various reasons, and the proposed five per cent baseline is short-sighted, and too high given the current low interest and low return market.

> There were some stakeholders were not opposed, or even favoured, the minimum distribution option in principle. These stakeholders cited passive charitable funders only distributing funding for administrative costs and professional service fees. Most of these stakeholders thought that a minimum distribution requirement *should only be enforced if it was paired with the benefit of a refund imputation credit scheme*.

391. The absence of any meaningful discussion in the issues paper regarding non-refundability of imputation credits is discussed above in the context of chapter 2.

392. The issues paper also does not draw attention to the fact that most countries do not impose minimum distribution requirements, and instead simply require disclosure of financial information, including surplus, and rely on public scrutiny to ensure funds are applied in pursuit of charitable purposes in a timely manner.[523] New Zealand already has the most comprehensive set of transparency and accountability requirements for charities in the world. Why is the option of using existing tools to address any particular concerns not canvassed in the issues paper?

393. The issues paper raises the suggestion of imposing annual minimum distribution

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[521] Regulatory Impact Statement at 44.
[522] Regulatory Impact Statement at 39.
[523] Ann O'Connell "Taxation and the Not for profit Sector globally: common issues, different solutions" in Matthew Harding (ed) *Research Handbook on Not-for-profit law* (Edward Elgar, 2018) 388 at 410.

requirements,[524] but does not provide any detail as to how such a proposal would work. A key difficulty with any minimum distribution requirement is its complexity.[525]

394. Broadly, there are 3 components to a minimum distribution requirement:

    (i) the **percentage figure** used in the calculation;

    (ii) the **revenue base** against which the percentage figure is applied; and

    (iii) **the types of expenditures** eligible to satisfy the requirement.[526]

395. Each component is problematic.

Percentage figure

396. The **percentage** of disbursement required must be fairly low (eg 3-5%) to take account of different economic conditions and the particular circumstances of affected charities.[527] The level proposed (and ultimately rejected) by DIA was 5%, which is at the top end of that scale (and exceeds most term deposit rates).[528] A 5% payout rate could easily mean an endowment charity would not be able to maintain its endowment or protect its capital base against inflation, reducing its ability to further its charitable purposes in future years. It may even lead to the gradual weakening and eventual disappearance of foundations.[529]

397. There is a need to balance the case for spending in the short-term on the one hand with maintaining capital for the future and investment to fund future programmes on the other. In other words, any minimum distribution requirement needs to strike a sensible balance between forcing current expenditures and permitting savings for future expenditures.[530] Many charities want to build up an endowment for perfectly legitimate reasons, and care must be taken not to make the minimum distribution so high that the income is not sufficient to be able to do so. In addition, the operational commitments of some charities may require more flexibility in planning for future contingencies than others, and therefore greater flexibility in the rate of savings permitted may be required. On that basis, there may be a case for different percentage rates for different types of charities, or the same charities at different times, further adding to complexity. The disbursement quota in Canada ranges from 3.5% to 5.[531]

398. However, whatever figure is chosen, it is bound to define an *arbitrary* line.[532] The experience of other jurisdictions is that a minimum disbursement requirement can become a *target*, effectively disincentivising charities from spending more than the minimum when they otherwise might have.

399. More fundamentally, as noted by the Tax Working Group itself, some charities may have no liquidity to distribute, and/or may be specifically prevented by their

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[524] Issues paper at [3.17].
[525] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 364.
[526] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 367.
[527] Ann O'Connell "Taxation and the Not for profit Sector globally: common issues, different solutions" in Matthew Harding (ed) *Research Handbook on Not-for-profit law* (Edward Elgar, 2018) 388 at 410.
[528] https://www.interest.co.nz/saving/term-deposits-1-to-5-years.
[529] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 278.
[530] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 367.
[531] https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/operating-a-registered-charity/annual-spending-requirement-disbursement-quota/disbursement-quota-calculation.html. See also Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 284.
[532] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 367 and 304.

constituting document from distributing capital: if a minimum distribution requirement was imposed, the trustees of some charitable trusts in particular could very easily be placed in an impossible position of either having to breach the terms of their trust deed in order to comply with the law, or having to break the law in order to comply with the terms of their trust deed.

Revenue base

400. To impose a minimum distribution requirement, it would also be necessary to decide to what figure the percentage amount should be imposed. Questions arise as to whether the **revenue base** should be based on net income, the value of assets, or some other figure, such as receipted donations (which might be defined to exclude endowments). Whichever option is landed upon, issues of definition and compliance arise.[533] DIA proposed a revenue base of "net assets",[534] presumably meaning all of an entity's assets less its liabilities. However, it does not seem reasonable to include all of a charity's assets in a calculation requiring distribution: in a climate of low interest rates, such a requirement may force charities to sell real property that is in fact needed to further their charitable purposes, purely to enable them to meet an arbitrary minimum distribution requirement.

401. In Canada, private foundations were required to disburse the greater of 5% of the value of their non-arm's length investments and 90% of the actual income therefrom, as well as 90% of their income from their other investments.[535] However, the unfairness of the minimum distribution requirements on the capacity of charitable organisations to accumulate sufficient assets to carry out their charitable purposes led to an administrative practice of the government monitoring agency "turning a blind eye" to warranted transgressions.[536] This practice was ultimately codified to provide for flexibility by providing for Ministerial discretion to allow ad hoc exceptions for individual charities to accumulate in appropriate cases, arguing that "the rationale supporting flexibility on this issue is quite strong and justifies considerable latitude".[537] For example, exceptions were made to permit charitable organisations to build up capital endowments with gifts intended for that purpose, or for a specified capital purpose approved by the Minister.[538] In addition, provision might need to be made for charities to apply to the Minister to obtain a discretionary exception for a shortfall. However, ad hoc flexibility introduces subjectivity and additional complexity and administration costs.

402. In terms of the revenue base, in Australia and the US, only investment assets are included in the calculation.[539] However, difficulty may arise in ascertaining how investment assets are to be valued. For example, Canada bases its minimum distribution calculation for a public foundation on the average total value of all its investment properties owned during the preceding 24 month period, as calculated in

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[533] Ann O'Connell "Taxation and the Not for profit Sector globally: common issues, different solutions" in Matthew Harding (ed) *Research Handbook on Not-for-profit law* (Edward Elgar, 2018) 388 at 410.
[534] Regulatory impact statement at 39.
[535] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 276.
[536] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 275.
[537] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 367.
[538] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 305.
[539] Private Ancillary Fund guidelines 2009 (Cth) made under the Tax Administration Act 1953 Cth; 26 USC 509(a)(3) (2006), mentioned in Ann O'Connell "Taxation and the Not for profit Sector globally: common issues, different solutions" in Matthew Harding (ed) *Research Handbook on Not-for-profit law* (Edward Elgar, 2018) 388 at 410.

a specified way. The underlying expectation is that the foundation should be earning a real rate of return on its investments close to or slightly more than 4.5%. The 4.5% figure is considered by many to be too high.[540]

403. Another question is whether restricted gifts (for example, to a library or for faculty) increase the expenditure requirement on other assets, or does the requirement apply fund by fund?[541]

404. The above difficulties raised the question of whether *net surplus* would be a better baseline. Research indicates that net surplus/income might be used as a baseline where there was concern about high fundraising or administrative costs.[542] In the US, an initial 15% tax was imposed on the undistributed income (defined as the difference between the distributable amount and the qualifying distributions) of a private foundation.[543] The distributable amount is calculated as a function of a prescribed minimum investment return (5% of the net fair market value of all non-operating assets of the foundation). If the undistributed income is not distributed within 1 year, there is a second tier tax of 100% of the remaining undistributed income. These disbursement provisions encourage private foundations to earn at least a 5% return on their investments and to distribute all of those earnings annually. Detailed regulations establish the valuation procedures. Detailed provisions also permit "set asides" for specific projects approved by the Secretary and for carrying forward excess qualifying distributions.[544]

405. North America is plagued with an "overhead myth",[545] which values charities based on how little they spend on "overhead" (such as staff salaries). Adherence to an overhead myth forces charities into a deprivation cycle, rewarding them for how little they spend as opposed to rewarding them for their big goals and accomplishments (even if that comes with big expenses).[546] Even though a minimum distribution requirement would presumably be intended to encourage spending by some charities, New Zealand should exercise considerable caution before attempting to introduce an unhealthy focus on charities' expenses as a percentage of income. Charities should be focused on their charitable purposes, even if it costs money to do that.

406. In addition, a focus on a percentage of net income/surplus can have a distortionary effect, by incentivising charities to place their investments in high growth, low-yield assets, to reduce the calculation base. It can also prevent charities from establishing endowments and/or erode their capital base. These were particular problems identified in Canada, leading to the change to an investment assets basis in 1984.[547] Calculation of income may also prove difficult: for example, should capital gains be

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[540] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 306.
[541] Evelyn Brody "Reforming tax policy with respect to nonprofit organisations" in Matthew Harding (ed) *Research Handbook on Not-for-profit law,* (Edward Elgar 2018) 484 at 499.
[542] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 276 and 368; Ann O'Connell "Taxation and the Not for profit Sector globally: common issues, different solutions" in Matthew Harding (ed) *Research Handbook on Not-for-profit law* (Edward Elgar, 2018) 388 at 410.
[543] Section 4942.
[544] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 324.
[545] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 305.
[546] See: https://www.ted.com/talks/dan_pallotta_the_way_we_think_about_charity_is_dead_wrong?language=en
[547] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 280 and 284.

included (and therefore disbursed)?

407. Another question is *when* the revenue base should be calculated: should it be the assets as disclosed in last year's financial statements, or should some other point in time be chosen? Should all assets be included, or only those after the date of enactment?[548]

Types of expenditure

408. Having determined the revenue base and the percentage figure, a decision would then have to be made on what **types of expenditures** would satisfy the minimum distribution requirement. For example, would legal and accounting costs qualify?

409. The choice of expenditures gives rise to further complexity, and a fundamental tension whereby perfectly acceptable expenditures made in furtherance of a charity's exclusively charitable purposes may be excluded from the calculations for minimum distribution purposes.[549]

410. Questions may also arise, for example, whether an endowment charity could satisfy the requirement by making a distribution to another endowment charity: could the latter endowment charity (with a different balance date) then satisfy the requirement by making the same distribution back to the original endowment charity? If so, nothing has actually been achieved by imposing the requirement at all. If not, complicated rules will be required concerning what types of expenditure will be counted for meeting the minimum distribution requirement. In Canada, the problem of inter-charity transfers was dealt with by a rule obliging public foundations to disburse 80% of the previous year's receipts from any registered charity, and requiring private foundations to disburse 100% of the preceding year's receipts from any registered charity. This new regime allowed exemptions for gifts that were endowments.[550] The Canadian experience provides a cautionary tale of the increasing complexity of any minimum distribution regime, as new rules are constantly needed to fill gaps and address unintended consequences. Fundamentally, this issue arises whenever attempts are made to draw bright line rules regarding activities in a fundamentally purposes-based area of law, as discussed above.

411. Another issue is *when* the calculation should take place: should it be based on one year's expenditure, perhaps as disclosed in last year's financial statements, or some other figure, such as average annual expenditures, say over a 5 or 7 year period?[551] In addition, when must the expenditure be disbursed in order to meet the minimum requirement: in the following year, or over a set period? For example, if a charity exceeds the minimum distribution requirement in a particular year, would it be able to carry the excess forward; if so, for how many years? Could it carry an excess back to meet a prior year's shortfall? The US imposes an excise tax if a charity disburses more than 7%, which seems counter-productive to the objective of encouraging gifting.[552]

412. Further difficulty arises as provisions may be needed to address quota shopping and

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[548] Evelyn Brody "Reforming tax policy with respect to nonprofit organisations" in Matthew Harding (ed) *Research Handbook on Not-for-profit law,* (Edward Elgar 2018) 484 at 499.
[549] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 368.
[550] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 284.
[551] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 367.
[552] https://www.forbes.com/sites/forbes-personal-shopper/2021/05/14/best-deals/?sh=483774342211.

disbursement avoidance, further adding to complexity.[553]

413. In addition, what happens if a charity does not meet the minimum distribution requirement? In Canada, charities were penalised with deregistration and conditional forfeiture of assets.[554] Later, charities were penalised with a penalty tax. However, donors or bequestors may not be happy to see their donated funds sequestered by government for failure to meet an arbitrary requirement that a charity may not in fact be able to meet. We understand that the penalty tax was not applied in practice.[555]

Definitional issues

414. Another fundamental issue is to whom such complex minimum distribution requirements would apply.

415. The issues paper suggests a concept of "donor-controlled" charity, the definition of which "could depend on the proportion of funds that the founder (or their associates) contributes to the charity or the control they have over the operation of the charity".[556] It is difficult to see how a charity could be "donor-controlled". Once funds are impressed with charitable purpose, they no longer "belong" to the donor and must be forever destined for charitable purposes. Officers of a registered charity (as now very widely defined) have important fiduciary duties to act in good faith in the best interests of the charity's charitable purposes in accordance with its rules. Charities Services does not permit a charity to register unless it has at least 3 officers.[557] How could a donor "control" a charity when the donor would be required to recuse themselves from decisions in which they are conflicted? Charities Services would be very unlikely to permit the charity to register if all 3 such officers were associated, as it would not be possible to manage conflicts of interest. The concept of "donor-controlled" does not make sense in charities law terms and should not be used.

416. The issues paper also falls into the trap of seeking to make a distinction between "charities that carry out charitable activities themselves, rather than just [sic] being fundraising charities".[558] Why is this issue being raised again when it was so comprehensively rejected as part of the review of the Charities Act? As discussed above, the term "fundraising charities" does not make sense as a matter of charities law: there is no such thing as a "charitable activity",[559] as an activity only takes its character from the purpose in furtherance of which it is carried out.[560] Canadian charities law suffers from a statutory reference to "charitable activities" that has been described as "ill-conceived", and the source of considerable difficulty, as discussed above.[561] New Zealand contains no such statutory reference; why then

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[553] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 307.
[554] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 276.
[555] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 309-310.
[556] Issues paper at [3.8].
[557] https://www.charities.govt.nz/im-a-registered-charity/officer-information/who-are-your-officers-and-what-do-they-do/.
[558] Issues paper at [3.9].
[559] See, for example, the discussion in S Barker "The myth of charitable activities" [2014] NZLJ 304.
[560] See *Vancouver Society of Immigrant and Visible Minority Women v Minister of National Revenue* [1999] 1 SCR 10 at [152], [144].
[561] See, for example, section 149.1 of the Income Tax Act (RSC, 1985, c1 (5th Supp) (Canada)). See also Report of the Special Senate Committee on the Charitable Sector *Catalyst for Change: A Roadmap to a Stronger Charitable Sector* June 2019 at 82, 95 and Advisory Committee on the Charitable Sector *Report #1 –*

would it import unhelpful terminology that confuses the important charities law distinction between purposes and activities? All activities of a charity are required to be carried out in furtherance of its charitable purposes; funding is merely a form of doing. Use of the term "fundraising charities" was strongly opposed by submitters to the review of the Charities Act and ultimately rejected as unworkable. Repeatedly raising the same issues is not a good use of taxpayer or charitable resources.

417. More fundamentally, any distinctions will be necessarily arbitrary and likely to create unfairness and incentives for arbitrage. Arbitrary lines will only create complexity in an area that should be principles-based and responsive to the way society works.[562] Minimum distribution requirements should not be imposed: charities should be encouraged to focus on their charitable purposes, not on whether they fall into arbitrary categories for the purposes of satisfying the dictates of ill-conceived and arbitrary rules.

Rationale in other jurisdictions

418. The issues paper specifically refers to the approach taken to minimum distribution requirements in Canada, Australia and the US, as if they presented a model that New Zealand should follow. However, the rules imposing minimum distribution requirements in other jurisdictions are in fact a cautionary tale, not least because were introduced in a different time and a different context to address perceived problems that simply do not exist in New Zealand.

419. For example, as discussed above, a key factor driving mandatory distribution requirements in other jurisdictions has been a desire to prevent abuses, on the basis that endowed charities were not subject to the same level of scrutiny as entities that receive donations from the public.[563] However, all New Zealand charities, without exception, are already subject to comprehensive transparency and accountability requirements,[564] providing tools of disclosure that enable scrutiny by government agencies and the public that was simply not available in countries such as Canada, Australia and the US when the minimum distribution requirements were imposed.[565]

420. In the US, the minimum distribution requirements were also introduced to address concern that private foundations were being used as a means of avoiding capital gains tax on intergenerational wealth transfers. However, New Zealand does not have a capital gains tax or an inheritance tax.

421. There was concern in Canada that the US rules were followed blindly, on the basis of only anecdotal evidence, mostly American, to support the claims of abuse.[566] In

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Towards a federal regulatory environment that enables and strengthens the charitable and nonprofit sector January 2021 "Examining the regulatory approach to charitable purposes and activities".

[562] *Re Greenpeace of New Zealand Inc* [2015] 1 NZLR 169 (SC) at [70].

[563] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 261 and 273; Ann O'Connell "Taxation and the Not for profit Sector globally: common issues, different solutions" in Matthew Harding (ed) *Research Handbook on Not-for-profit law* (Edward Elgar, 2018) 388 at 411. See also: http://archive.boston.com/news/nation/articles/2003/10/09/some_officers_of_charities_steer_assets_to_selves/.

[564] As discussed above, sections 42AB and 42AC of the Charities Act, inserted by the Charities Amendment Act 2023, allow regulations to be made permitting a small subset of very small charities to be exempted from the requirement to comply with External Reporting Board standards and instead require only minimum financial information. However, as at the date of writing, no such regulations have been made and appear unlikely ever to be made. For a fuller discussion, see Barker et al *The law and practice of charities in New Zealand* 2ed (LexisNexis, 2024).

[565] See for example: https://www.philanthropy.org.au/stories-anniversary-of-reform.

[566] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 272.

Canada, the minimum distribution rules were directed to foundations accumulating income with the intention of distributing it to their proprietors on dissolution. However, such action would not be possible in New Zealand: funds impressed with charitable purpose must always by definition be destined for charitable purposes or the charity would not meet the requirements for registration in the first place. This requirement is buttressed by section HR 12 of the Income Tax Act 2007, which (broadly) requires all assets of a deregistered charity to be distributed to another registered charity or tax-exempt entity within 12 months of deregistration or the charity must pay tax on the balance. Charitable funds cannot lawfully be used for private benefit (bearing in mind that incidental private benefits are not inconsistent with charitable purpose).[567]

422. In Canada, the Ontario Law Reform Commission recommended that less reliance be placed on a minimum disbursement regime as a method of ensuring that all charities are in fact devoted to charity, and more reliance be placed on direct supervision and the enforcement of more general standards,[568] such as an "exclusively charitable purpose" standard (which is, essentially, enforcing the fiduciary duties, or "purpose-based governance").[569] Similarly, in Australia, the Australian Industry Commission recommended that restrictions should not be placed on the accumulation of income of charitable trusts:[570]

> The Commission considers that the benefits of charitable trusts would be enhanced if they were given greater scope to accumulate funds because this would allow *better long term planning and flexibility and these benefits outweigh any increase in risk*. It would allow trusts to accumulate income which could then be used to acquire further income-producing assets. *The legal duty trusts have to their beneficiaries as well as the general restrictions on trustee investments provide sufficient safeguards on the investment decisions of trustees. The non-distribution constraint and trust deeds also provide appropriate protection against misuse of charitable funds*.

423. However, despite receiving this expert advice, it appears that Canada and Australia did not follow it. New Zealand has the opportunity to do things better and smarter: the existing law already contains adequate protections; they simply need to be used. By taking the approach of enforcing the fiduciary duties, any need to create complex new minimum distribution requirements to deal with any outliers would be obviated and New Zealand would not fall into the trap of over-regulating charities and demoralising voluntary effort.

Private ancillary funds

424. With specific reference to Australia, it should be noted that the rules for private ancillary funds (originally known as "prescribed private funds") were introduced in Australia *before* the charities register and the Australian Charities and Not-for-profits Commission were established in 2012. Private ancillary funds (as they are now known) were introduced in 2001 to provide a vehicle through which high net worth

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[567] *Latimer v Commissioner of Inland Revenue* [2004] 3 NZLR 157 (PC) at [35] – [36]. See also *New Zealand Society of Accountants v Commissioner of Inland Revenue* [1986] 1 NZLR 147 (CA) at 152.
[568] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 289.
[569] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 297, noting that "there is nothing in the exclusively charitable purposes test that obliges a charity to pursue its charitable purposes in a particular way. Investing donations to generate income for future charitable expenditure is just as valid a way of pursuing charity as spending the donations upon receipt".
[570] *Charitable organisations in Australia,* Industry Commission, Report No 45, 16 June 1995, Australian Government Publishing Service, Melbourne, p 251 and recommendation 10.1.

individuals and businesses could support charities.[571] While widely seen as having been successful in encouraging philanthropy in Australia,[572] the circumstances that led to the creation of the private ancillary fund regime in Australia do not apply in New Zealand.

425. In New Zealand, the charitable trust is the preferred structure for most charities,[573] a feature that sets New Zealand apart from most comparable jurisdictions. For example, in the United States, "the corporation is king", a phenomenon which dates from the aftermath of the revolution, when "antagonism to all things British included the legal doctrine of the charitable trust":[574] although the legal form of a charitable trust is available in the United States, it is not widely used, with unincorporated associations more commonly used for charities.[575] In Canada, the corporation had replaced the trust as the preferred vehicle for charities by the 1970s.[576] In Australia, England and Wales and Ireland, a common vehicle chosen for charity is the company limited by guarantee,[577] a structure not available in New Zealand following its abolition by the Companies Act 1993:[578] the rationale for requiring all companies in New Zealand to be limited by shares was that the effect of limitation by guarantee could be achieved by limiting shareholder liability to a specified amount in the company's constitution; on that basis, a separate classification of "company limited by guarantee" was not considered necessary.[579] However, it is difficult to limit a company by guarantee when the Companies Act requires every company to have at least 1 shareholder.[580] The effective unavailability of the company limited by guarantee structure may be a factor in the popularity of the charitable trust structure in New Zealand. However, in Australia, varying requirements across different states meant that establishing a charitable trust could pose considerable complexity and difficulty. At the time the private ancillary fund concept was introduced into Australia in 2001, there was no registration, reporting and monitoring regime for charities;[581] in addition, a company limited by guarantee may not have been seen as a "good structural fit" for encouraging philanthropy by high net worth individuals, due to issues of flexibility, control and administrative burden.[582] In addition, Australia has a

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[571] Australian Centre for Philanthropy and Nonprofit Studies *Celebrating 20 years of private ancillary funds* 9 October 2020: https://research.qut.edu.au/australian-centre-for-philanthropy-and-nonprofit-studies/research/celebrating-20-years-of-private-ancillary-funds/. See also Australian Tax Office *Public Ancillary Funds: Minimum annual distribution requirements* 23 July 2020: <www.ato.gov.au/Non-profit/Getting-started/In-detail/Types-of-DGRs/Public-ancillary-funds/?anchor=mindist#mindist>; and Australian Charities and Not—for-profits Commission *About us*: https://www.acnc.gov.au/about.

[572] Australian Centre for Philanthropy and Nonprofit Studies *Celebrating 20 years of private ancillary funds* 9 October 2020: https://research.qut.edu.au/australian-centre-for-philanthropy-and-nonprofit-studies/research/celebrating-20-years-of-private-ancillary-funds/.

[573] Te Tari Taiwhenua | Internal Affairs *Modernising the Charities Act 2005: Discussion Document* February 2019 at 24.

[574] M McGregor-Lowndes "An Overview of the Not-for-Profit Sector" in M Harding (ed) *Research Handbook on Not-for-Profit Law* (Edward Elgar, 2018) 131.

[575] M McGregor-Lowndes "An Overview of the Not-for-Profit Sector" in M Harding (ed) *Research Handbook on Not-for-Profit Law* (Edward Elgar, 2018) 131.

[576] See Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 4, 161, 270.

[577] See, for example, OB Breen and PA Smith *Law of Charities in Ireland* (Bloomsbury, 2019) at [7.04], [7.15].

[578] Companies Act 1993, section 10(b) and (c).

[579] See Te Aka Matua o te Ture - New Zealand Law Commission *A New Act for Incorporated Societies* (NZLC R129, 2013) at [2.8].

[580] Companies Act 1993, section 10(c).

[581] The federal registration, reporting and monitoring regime for charities was not established in Australia until 2012. See the Australian Charities and Not-for-profits Commission Act 2012 (Cth) and the Charities Act 2013 (Cth).

[582] See Justice Connect *Which incorporated legal structure should you choose?* 20 August 2024: https://www.nfplaw.org.au/free-resources/getting-started/legal-structure.

very complex deductible gift recipient ("**DGR**") regime which results in many charities being unable to attain DGR status,[583] (in contrast to New Zealand where every registered charity that applies its funds wholly or mainly to charitable purposes in New Zealand can attain donee status more or less automatically).[584]

426. In other words, there were many reasons why a new bespoke structure in the form of the "private ancillary fund" was considered necessary in Australia in 2001 to encourage philanthropy by high net worth individuals.

427. However, these limitations do not apply in New Zealand, which does not have the complexity of a multi-state structure, and where it is not at all difficult to establish a charitable trust, as evidenced by its status as the most popular structural form for charities. The trustees of a charitable trust in New Zealand also have the option of incorporating as a board under the Charitable Trusts Act 1957,[585] thereby enabling them to create a "corporate trustee" without the need to create and administer a separate legal entity.[586] Further, a charitable trust in New Zealand has the option of registering under the Charities Act, which allows it to access certain privileges, including tax privileges such as donee status, in return for subjecting itself to the comprehensive transparency and accountability disclosure requirements discussed above.[587] It is not clear what would be achieved by introducing a "private ancillary fund" structure in New Zealand, beyond providing a mechanism through which to impose "minimum distribution requirements", a proposal that was resoundingly rejected during the review of the Charities Act as "unnecessary, costly and arbitrary".[588]

428. The experience of other jurisdictions indicates that even attempting to introduce a minimum disbursement regime is likely to damage the sector/government relationship:[589]

> The whole process since the institution of the registration regime in 1967 has shaped the sector's perspective on the role of government in the charitable sector profoundly. Still, a decade after the 1981 to 1984 reform process, there is a great deal of scepticism and even fear about the motives of government regulation. For the most part, the presence of government is felt as antagonistic, counterproductive and unduly burdensome.

429. In other words, other jurisdictions do not provide a model for New Zealand to follow, but rather a cautionary tale. We **strongly oppose** the imposition of any mandatory distribution requirement: any benefits of doing so would be far exceeded by the

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[583] See Australian Charities and Not-for-profits Commission *Deductible gift recipients and the ACNC*: https://www.acnc.gov.au/tools/factsheets/deductible-gift-recipients-dgr-and-acnc.
[584] As discussed in more detail in the Tax volume.
[585] Charitable Trusts Act 1957, sections 7, 13.
[586] It is understood that a similar mechanism is available in some states in Australia, such as the Charitable Trusts Act 1962 (WA) (which is understood to have originally been based on the Charitable Trusts Act 1957 (NZ)).
[587] Registration is voluntary in New Zealand. See Charities Bill 108-1 (explanatory note) at 1; Ngā Ratonga Kaupapa Atawhai *Arotake Ā-Tau Charities Services Annual Review 2022/2023* at 14. Charities Services' Annual Review documents can be found on Charities Services' website at https://www.charities.govt.nz/about-charities-services/the-role-of-charities-services-/.
[588] Te Tari Taiwhenua | Internal Affairs *Regulatory Impact Statement: Modernising the Charities Act* (Report, 19 October 2021) at 34, 39, 44.
[589] Ontario Law Reform Commission *Report on the Law of Charities* (Toronto, 1996) at 286.

associated costs.

"Donor-controlled" charities – summary

430. It is not clear what "problem" might be addressed by introducing a new category of "donor-controlled charities".

431. It is not necessary to create a new and necessarily arbitrary category of charity, upon which new rules restricting investments and imposing minimum distribution requirements would be imposed, in order to have adequate oversight over charities' accumulation, distribution and investment (or any other) activities. When similar issues were raised as part of the review of the Charities Act, most stakeholders did not agree there was a problem that needed to be addressed. If an individual charity is genuinely abusing its privileges, existing rules already provide adequate protections that can achieve the desired outcomes on an exceptions basis without resorting to arbitrary, blanket rules that risk "killing the patient".[590] Such rules simply need to be used (supported by the comprehensive information now made available by the charities register).[591] There was "strong support" from the charitable sector for maintaining the status quo in this way.[592] There is in fact no compelling basis to proceed with the proposals set out in chapter 3.

432. Other countries that have made such distinctions did so at a time when comprehensive financial information in relation to charities was not readily available. However, as discussed above, New Zealand already has the most comprehensive transparency and accountability requirements for charities in the world. Having put charities to the trouble and expense of preparing this information and making it publicly available, it behoves New Zealand to *use* the information provided. Imposing new rules along the lines proposed in chapter 3 would involve the state second-guessing the operational and governance decisions of charities, which would in turn undermine the independence of the charitable sector, and create complexity, paradoxical uncertainty, and expensive and unnecessary bureaucracy and compliance costs. All of this would merely add "barnacles on a boat, causing a drag when all should be plain sailing".[593]

433. There needs to be a strong case for the creation of further rules. Any attempt to introduce further regulation should be carefully scrutinised for duplication, necessity and potential overreach. There is already enormous unmet legal need in the charitable sector; creating complex rules will only divert charitable resources away from charitable purposes towards compliance, while also increasing the administrative burden on the bureaucracy. Charities are already struggling, with increasing costs, increasing demands for services,[594] but diminishing revenue

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[590] Acting in breach of fiduciary duty is "unlawful", which constitutes "serious wrongdoing" as that term is defined in section 4 of the Charities Act. Serious wrongdoing is grounds for a number of responses under the Charities Act, including deregistration under section 32(1)(e).

[591] For reasons that are not clear, Charities Services does not enforce the fiduciary duties, as discussed in more detail in the Charities Volume.

[592] Te Tari Taiwhenua | Internal Affairs *Regulatory Impact Statement: Modernising the Charities Act* (Report, 19 October 2021) at 36.

[593] https://www.civilsociety.co.uk/news/hurd-quotes-hodgson--allegedly---sector-suffers-from-having-a-lot-of-knobs.html, referring to Lord Hodgson *Trusted and Independent: Giving charity back to charities* Review of the Charities Act 2006. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/79275/Charities-Act-Review-2006-report-Hodgson.pdf.

[594] In a LinkedIn comment on 22 March 2025, economist Shamubeel Eaqub noted that: "Non-profit organisations serving households spent 7.4% more last year (excluding inflation) - sadly the fastest growing

streams. We strongly oppose any move that establishes a path towards increased government control over charities' activities which will lead to a loss of autonomy and flexibility. The case for increasing complexity needs to be very strong before imposing further regulatory burden. We strongly submit that the case for further rules in this area has not been made out.

434. Over-regulating charities works against participation and progress, including the opportunities to be innovative and responsive.[595] Care must be taken that the legal settings for charities do not "kill the goose that lays the golden eggs".

CHAPTER 4 – INTEGRITY AND SIMPLIFICATION

435. In chapter 4, the issues paper proposes:

(i) taxing not-for-profit entities ("**NFPs**") on their profits from member transactions or subscriptions, forcing approximately 9,000 community organisations to be "stung by larger tax bills and compliance costs";[596]

(ii) removing the tax privileges for friendly societies and credit unions;

(iii) removing or significantly reducing the income tax exemptions for local and regional promotion bodies (section CW 40), herd improvement bodies (section CW 51), bodies promoting scientific and industrial research (section CW 49), veterinary service bodies (section CW 50), and non-resident charities carrying out their charitable purposes outside New Zealand (section CW 41(5)(c));

(iv) removing the exclusion from FBT provided to charitable organisations under section CX 25; and

(vi) implementing the recommendations of the regulatory stewardship review into donee status.

Mutual transactions

436. In our view, the proposals regarding mutual transactions, friendly societies and credit unions should not proceed. It does not make sense to impose larger tax bills and compliance costs on 9,000+ community organisations. Any additional revenue gathered would be far outweighed by the corresponding compliance and administration costs.

Local and regional promotion bodies

437. The proposal to remove or reduce the income tax exemption for local and regional promotion bodies should similarly not proceed.

438. We understand there are approximately 1,000 not-for-profit entities that qualify for

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part of the economy, dealing with the fallout of recession and fiscal austerity", referring to the GDP data which can be found here: https://www.stats.govt.nz/information-releases/gross-domestic-product-december-2024-quarter/.

[595] Similar comments were made in P McClure AO, G Hammond OAM, S McCluskey, Dr M Turnour *Strengthening for purpose: Australian Charities and Not-for-profits Commission – Legislative Review 2018* 31 May 2018 at 18, referring to the submission of Giving Australia.

[596] https://www.nzherald.co.nz/business/personal-finance/tax/inland-revenue-sets-sights-on-taxing-9000-clubs-societies-and-other-not-for-profits/PZTWSD2LEVGOZOK53BYCJAFGWI/.

the exemption for local and regional promotion bodies in section CW 40.[597]

439. Section CW 40 was originally inserted into the income tax legislation in 1950.[598] The rationale for the provision was described in Parliament as follows:[599]

> … the clause is designed to cover progressive associations, public-hall societies, beautifying societies, and similar bodies, providing the funds are used wholly for the purposes of improving the town or district or, failing that, some charitable purpose. The income of those organisations which at the present time is subject to taxation consists mainly of interest on bank deposits or similar small investments and does not amount to any substantial sum. Income from members' subscriptions or from donations is not under present law subject to tax.

440. In 1990, IRD described the objective of the provision as "to encourage the improvement of New Zealand cities, boroughs or districts".[600]

441. In addition to requiring a society or association to have a local and regional promotion purpose, section CW 40 also requires that the funds of the association or society must not be used, or be able to be used, for any *other* purpose that is not a charitable purpose. Gifts for the general benefit of a specified locality have been held to be charitable;[601] however, many charities have been unable to register under the Charities Act due to controversially narrow jurisprudential interpretations of the definition of charitable purpose (particularly in relation to "economic development").[602] For example, the application for registration by the Alexandra Blossom Festival Committee Incorporated was controversially declined.[603] Such charities are effectively forced to seek an alternative option of income tax exemption under section CW 40 because the fundamentals of the Charities Act are not sound.

442. However, exemption under section CW 40 does not carry with it a requirement to comply with the comprehensive financial reporting requirements of the Charities Act.[604] Interpreting the definition of charitable purpose too narrowly therefore defeats the true purpose of the Charities Act regime, which was to address a widespread lack of information about charities;[605] it also removes the protection provided by section HR 12 should a charity be deregistered. It does not make sense

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[597] Inland Revenue | Te Tari Taake *Tax statistics for charities and not-for-profits*, presentation prepared by Stewart Donaldson, Principal Policy Adviser, 16 September 2021, at 3.
[598] Land and Income Tax Amendment Act (No 2) 1950 (1950 No 87), section 5.
[599] Land and Income Tax Amendment Act (No 2) 1950, NZPD 27 November 1950 at 4601.
[600] Inland Revenue *Tax Information Bulletin* Vol 2 No 3 October 1990 Appendix D. This TIB no longer appears on IRD's website. Prior to discontinuing its Technical Rulings, IRD specifically referred to public relations organisations as falling within the provision (Technical Rulings, paragraph 58.12.2.3).
[601] *Re Queenstown Lakes Community Housing Trust* [2011] 3 NZLR 502 (HC) at [53].
[602] See discussion above in relation to "private pecuniary profit".
[603] Charities Commission decision *Alexandra Blossom Festival Committee Incorporated* 26 November 2009. See also Charities Commission decision *Venture Taranaki Trust* 26 January 2009; Charities Commission decision *Vision Manawatu Trust* 12 March 2009; Charities Commission decision *Runway Hawke's Bay Trust Board* 18 May 2009; Charities Commission decision *Balloons over Waikato Charitable Trust* 3 February 2010; Charities Commission decision 2010-16 *Piha Ratepayers and Residents Association Incorporated* 24 August 2010. It is not known how many other charities have been affected as most decisions made under the Charities Act 2005 are not published.
[604] Charities Act 2005, sections 41 to 42F.
[605] Property Law and Equity Reform Committee *Report on the Charitable Trusts Act 1957* (Wellington, February 1979) at 2: charitable trusts in particular were considered "uniquely free from supervision"; *Report to the Minister of Finance and the Minister of Social Welfare by the Working Party on Charities and Sporting Bodies* (Treasury, Wellington, November 1989) (the Sir Spencer Russell report) at iv - v, 10, 21, 63, 67; *Report by the Working Party on Registration, Reporting and Monitoring of Charities* 28 February 2002 at 21 - 22; Inland Revenue Department *Tax and charities, a government discussion document on taxation issues relating to charities and non-profit bodies* June 2001, foreword and [1.3], [2.6], [4.1], [7.2] - [7.8], [8.8], [8.15], [8.19], [8.23], [12.5].

to force genuine charities to operate outside of the Charities Act regime not least because, as the issues paper notes,[606] this creates "inconsistent tax outcomes for organisations that are factually similar".

443. The real problem resides in the Charities Act, not in section CW 40. We would strongly object to any removal or reduction of the exemption in section CW 40 prior to carrying out the much-needed first principles review of the Charities Act (which must be carried out independently of DIA as discussed above).[607] It is important to address issues at the level of source, rather than symptom.

444. As discussed above, the issues paper does not cite any authority in support of its proposition that "If the Government wishes to encourage a particular economic activity, it is preferable that this is done in a transparent way by direct funding rather than through the tax system".[608] Such statement reflects an underlying tax expenditure analysis that structurally ignores the "externalities" or the benefits provided by charities and other not-for-profit organisations. It is emphatically not preferable to substitute tax exemptions for a system of direct funding for the reasons discussed above. Underlying assumptions require critical examination before being acted upon.

Veterinary service bodies

445. We similarly do not see any need to remove the income tax exemptions for herd improvement societies, bodies promoting scientific and industrial research, or veterinary service bodies.

446. With respect to the latter, section CW 50 was originally introduced into the income tax legislation in 1955,[609] backdated to 1951.[610] Our understanding is that the purpose of the provision was to entice vets to work in rural areas to help farmers following World War II.[611] This conflicts with the comment made in the issues paper that the exemption was introduced "to allow veterinary service bodies to invest in better facilities and higher standards of service".[612] The issues paper adds that these entities are now "more established, undertake commercial trading activities outside their immediate services, and compete directly with tax-paying private veterinary practices).

447. However, in principle, there is no reason for treating business income differently from non-business income,[613] and questions have been raised as to the ongoing appropriateness of the territorial and control restrictions on the business income of charities in section CW 42. Despite this, some have raised concerns that the

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[606] Issues paper at [4.14].
[607] The Charities Amendment Act 2023 has not addressed any issue of concern to charities. Even the question of the financial reporting requirements for small charities, which was an issue raised in submissions, was not addressed by the Charities Amendment Act 2023: new sections 42AB and 42AC are merely a promise to make regulations, but no such regulations have been made.
[608] Issues paper at [4.10]
[609] Section 86(1)(oo) of the Land and Income Tax Act 1954, as inserted by section 8 of the Land and Income Tax Amendment Act 1955 (1955 No 91) (with bolding added).
[610] Land and Income Tax Amendment Act 1955 (1955 No 91) section 8(2).
[611] RNZ *Why some rural vet practices don't pay tax* 14 March 2016: https://www.rnz.co.nz/news/national/298891/why-some-rural-vet-practices-don't-pay-tax.
[612] Issues paper at [4.20].
[613] See Inland Revenue and the Treasury for the Tax Working Group *Charities and the not-for-profit sector: Background Paper for Session 13 of the Tax Working Group* 6 July 2018 at 3: "…the principle of competitive neutrality supports a view that active and passive income should be taxed at the same rate for any particular taxpayer".

exemption for business income for rural vet practices might give them an "unfair competitive advantage" over other vet practices that are subject to income tax.[614] Such arguments require critical examination, not least because they appear to overlook the fact that an entity claiming exemption under section CW 50 must be a not-for-profit entity, and therefore subject to the non-distribution constraint and the prohibition on private pecuniary profit just as charities are. These restrictions, which do not apply to a vet practice structured as a for-profit entity, preclude a veterinary service body claiming exemption under section CW 50 from being able to distribute profits to private owners or pay returns to private investors like a for-profit entity can. As with charities, these restrictions significantly impede the ability of not-for-profit entities to access capital, including the capital needed to grow to an optimum size. In other words, the comparison between for-profit and not-for-profit vet practice is not comparing apples with apples: when the issue is analysed rather than merely assumed, the income tax exemption for business income does not provide a "competitive advantage" but merely provides a degree of offset to the significant disadvantages a not-for-profit entity otherwise faces in accessing capital.

448. On that basis, there is no cause for concern: the purpose of section CW 50 is to encourage farmers to set up clubs and take responsibility for helping bring vets to their areas.[615] There is nothing to indicate that the need to support vets to locate their practices in rural areas has been removed:[616]

> The Veterinary Association represents all vets, including clubs. Its president … said she was worried about the impact any changes could have on vulnerable rural farming communities … Disrupting a structure that at the moment is working and hopefully providing support for rural communities – the timing is important.

449. There is no principled basis to remove or disrupt the exemption.

450. However, there is much that could be done to use consistent terminology in relation to the not-for-profit sector across the statute book.[617]

FBT

451. The issues paper proposes to remove the exclusion from FBT provided to charitable organisations under section CX 25.

452. In support of this proposal, IRD argues there are "weak efficiency grounds" for continuing this exclusion because it "distorts the labour market".[618] However, no evidence is provided to support this claim. The reality is quite the opposite: many charitable organisations struggle to attract and retain staff because they simply do not have the funding to pay them adequately (or often even offer any certainty of continued employment). The FBT exclusion merely provides a degree of support for charities rather than any "distortion".

453. IRD also argues that the exclusion for charitable organisations "creates an incentive for organisations and employees to negotiate for non-cash remuneration and in doing

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[614] RNZ *Why some rural vet practices don't pay tax* 14 March 2016: https://www.rnz.co.nz/news/national/298891/why-some-rural-vet-practices-don't-pay-tax.
[615] RNZ *Why some rural vet practices don't pay tax* 14 March 2016: https://www.rnz.co.nz/news/national/298891/why-some-rural-vet-practices-don't-pay-tax.
[616] RNZ *Why some rural vet practices don't pay tax* 14 March 2016: https://www.rnz.co.nz/news/national/298891/why-some-rural-vet-practices-don't-pay-tax.
[617] See the discussion in *Taxation of Charities in Aotearoa New Zealand* (LexisNexis, forthcoming).
[618] Issues paper at [4.27].

so, pay less tax than if they were paid salary and wages".[619] This assertion ignores the reality of employment in the charitable sector. Most people moving from the for-profit sector to the not-for-profit sector take a considerable pay cut, even for work that is considerably more difficult.

454. IRD argues that the exemption "lacks coherence" because universities are excluded when other tertiary institutions are not.[620] Surely a better solution would be to simply extend the exclusion to universities, rather than removing the exclusion altogether.

455. IRD then argues that one of the aims of the review of current FBT settings is to reduce compliance costs and that the justification for the exclusion for charities has therefore been removed. It is difficult to see how imposing FBT on charities would "reduce compliance costs", no matter what changes are made to the FBT regime.

456. It should be noted that the Bill which originally proposed to insert the FBT regime in 1984 did not contain any exclusion for charitable organisations.[621] Opposition National Party members were trenchant in their criticism of the impact the proposed FBT regime would have on charities:[622]

> They started off by saying they would tax the Plunket nurses because they took their cars home at night. They were going to tax ministers of the church, and the scout commissioners who garaged cars owned by the Scout Association of New Zealand at home at night.
>
> …
>
> I mentioned the case of the poor vicar who takes his family to the beach. If he prays while he is there the church does not have to pay the fringe benefit tax, but, if he forgets, it does.

457. In response to submissions, the proposed FBT regime was substantially changed at select committee stage, including by inserting an exclusion for charities. Hon RO Douglas, then Minister of Finance, described the exclusion as follows:[623]

> The final change …, which relates to an aspect of policy, is the exemption [sic] that has been provided for charitable institutions. **Organisations that have been approved for the purpose of the tax rebate for donations under section 56A of the Act will be exempt from the fringe benefit tax to the extent that the benefit is not provided to employees of a business carried on by the charity**. These amendments … address many of the objections to this clause that were raised at select committee.

458. The original exclusion for charities was accordingly in the following terms (with bolding added):[624]

> "Fringe benefit", in relation to an employee and to any quarter, means any benefit that consists of –
> … -

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[619] Issues paper at [4.27].
[620] Issues paper at [4.28].
[621] Income Tax Amendment Bill (No 2) 1984 (75-1) clause 34, definition of "fringe benefit" in proposed new section 336N of the Income Tax Act 1976.
[622] Income Tax Amendment Bill (No 2) 1984 (75-2) NZPD 461 (15 March 1985) at 3700 per Hon Bill Birch, and Income Tax Amendment Bill (No 2) 1984 (75-3) NZPD 462 (22 March 1985) at 3927 per Mr Doug Graham.
[623] Income Tax Amendment Bill (No 2) 1984 (75-2) NZPD 461 (15 March 1985) at 3722 per Hon Roger Douglas (with bolding added).
[624] Section 336N(1) of the Income Tax Act 1976 as inserted by section 34(2) of the Income Tax Amendment Act (No 2) 1985 (1985 No 59) with effect from 1 April 1985.

> but does not include –
>
> …
>
> (h) Any benefit that, in any quarter, is provided or granted by or on behalf of any **employer, being a society, institution, association, organisation, trust, or fund to which, in the quarter, section 56A(2) of this Act applies**, to an employee of that employer:
>
> Provided that this paragraph shall not apply to any such benefit to the extent that the benefit is used, enjoyed, or received, whether directly or indirectly, **primarily and principally in relation to**, in the course of, or by virtue of, any employment, in relation to the employee, that consists of any activity or activities performed by the employee **in the carrying on, by the employer, of a business**:

459. In other words, the exclusion originally applied to organisations subject to section 56A(2) of the Income Tax Act 1976, which contained the requirements for donee status. Section 56A(2) has since been rewritten as section LD 3(2) and schedule 32 of the Income Tax Act 2007. "Donee organisations" may have been chosen as the recipient of the FBT exclusion due to the increasing number of charities specifically mentioned by name in section 56A(2) (now schedule 32). When the FBT regime was introduced in 1985, there was an acute lack of information about charities:[625] the original FBT regime predated the registration, reporting and monitoring framework of the Charities Act 2005 by more than 2 decades. As a result, there was very little government monitoring at the time of whether charities were continuing to pursue their stated purposes over time.[626] Whatever the reason may have been, the original FBT exclusion applied to donee organisations, with a carveout for benefits received by an employee "primarily and principally" in relation to a business carried on by the donee organisation.

460. The reason for the carving out benefits received by employees in relation to a business carried on by the donee organisation is similarly not clear: the original exclusion was simply stated to apply to charities "except for business activity".[627]

461. Opposition National Party members complained about the way the Bill was handled:[628]

> … the taking of urgency, the reporting back, the lack of a reprinted or published Bill, and the second reading debate taking place without the public being given time to absorb and assimilate the changes made by the select committee

462. Hon WF Birch stated that "the next National Government will thoroughly review the fringe benefit tax and remove anomalies such as the provision to tax work-related

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[625] See, for example, Property Law and Equity Reform Committee *Report on the Charitable Trusts Act 1957* (Wellington, February 1979) at 2: charitable trusts in particular were considered "uniquely free from supervision"; *Report to the Minister of Finance and the Minister of Social Welfare by the Working Party on Charities and Sporting Bodies* (Treasury, Wellington, November 1989) (the Sir Spencer Russell report) at iv - v, 10, 21, 63, 67; *Report by the Working Party on Registration, Reporting and Monitoring of Charities* 28 February 2002 at 21 - 22; Inland Revenue Department *Tax and charities, a government discussion document on taxation issues relating to charities and non-profit bodies* June 2001, foreword and [1.3], [2.6], [4.1], [7.2] - [7.8], [8.8], [8.15], [8.19], [8.23], [12.5].

[626] See discussion in M McGregor-Lowndes and B Wyatt (eds) *Regulating Charities: the Inside Story* (Routledge, 2017) at 185.

[627] Income Tax Amendment Bill (No 2) 1984 (75-2) NZPD 461 (15 March 1985) at 3697 per Mr Trevor de Cleene.

[628] Income Tax Amendment Bill (No 2) 1984 (75-3) NZPD 462 (22 March 1985) at 3922 per Hon WF Birch.

vehicles that do not provide a private benefit".[629]

463. The following year, the Labour Government amended the legislation to specifically prevent local authorities and public authorities from accessing the FBT exclusion for donee organisations, with retrospective effect to 1 April 1985 (the date of commencement of FBT).[630] The Labour Government then removed the FBT exclusion for donee organisations altogether from 1 October 1990.[631]

464. However, following a change in government at the general election held on 27 October 1990, the new National Government reinstated the exclusion in June 1991, with retrospective effect to 1 October 1990.[632] The reinstated FBT exclusion was in broadly similar terms, as follows (with bolding added):[633]

> (h) Any benefit that, in any quarter or (where fringe benefit tax is payable on an income year basis pursuant to section 336TB of this Act) any income year, is provided or granted by or on behalf of an **employer, being a charitable organisation,** to an employee of the employer:
>
> Provided that this paragraph shall not apply to any such benefit to the extent that the benefit is used, enjoyed, or received, whether directly or indirectly, **primarily and principally in relation to**, in the course of, or by virtue of, any employment, in relation to the employee, that consists of any activity or activities performed by the employee **in the carrying on, by the employer, of a business**:

465. A new definition of "charitable organisation" was inserted at this time, in the following terms:[634]

> "Charitable organisation" in relation to any quarter or (where fringe benefit tax is payable on an income year basis pursuant to section 336TB of this Act) any income year, means any society, institution, association, organisation, trust, or fund (not being **a local authority, a public authority, or a university**) to which, in the quarter or income year, as the case may be, section 56A(2) of this Act applies

466. In other words, the FBT exclusion continued to apply to "donee organisations", other than local authorities, public authorities, and now also universities. Benefits received by an employee "primarily and principally" in relation to a business carried on by the charitable organisation continued to be carved out.

467. We agree that the exclusion of universities, local authorities and public authorities from the definition of "charitable organisation" (paragraph (b) of the definition) is problematic. It means, as the issues paper notes, that benefits provided by universities to their staff may be subject to FBT, when the same benefits provided to staff of other tertiary institutions may not.[635]

468. A similar situation arises more broadly: private schools that are charities may be able to provide non-cash benefits to their teachers excluded from FBT, whereas those

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[629] Income Tax Amendment Bill (No 2) 1984 (75-3) NZPD 462 (22 March 1985) at 3921 per Hon WF Birch.
[630] Income Tax Amendment Act 1986 (1986 No 3), section 34(1)(a) and (11) (amending paragraph (h) of the definition of "fringe benefit" in section 336N of the Income Tax Ac 1976).
[631] Income Tax Amendment Act (No 2) 1990 (1990 No 63), clause 32(6) and (11), which repealed paragraph (h) of the term "fringe benefit" with effect from 1 October 1990.
[632] Income Tax Amendment Act (No 3) 1991 (1991 No 47), section 23(4) and (9).
[633] Section 336N(1)(h) of the Income Tax Act 1976, as amended by section 23(4) of the Income Tax Amendment Act (No 3) 1991 (1991 No 47).
[634] A new definition of "charitable organisation" was inserted into section 336N(1) of the Income Tax Act 1976 by section 23(1) and (9) of the Income Tax Amendment Act (No 3) 1991 (1991 No 47) (with bolding added).
[635] Hon Dr Michael Cullen, Minister of Finance, Minister of Revenue *Streamlining the taxation of fringe benefits – a government discussion document* 11 December 2003 at [10.3].

same benefits, if provided to teachers in state schools, may be subject to FBT.

469. Officials also raised the following concern:[636]

> … benefits provided to university staff are specifically not exempt but benefits provided to staff of other tertiary institutions may face the legal uncertainty over whether polytechnics, colleges of education and wananga are public authorities

470. The carveout for local authorities, public authorities and universities also means that, while charities are able to access the FBT exclusion, other local or public bodies that may perform a similar function are not.[637] Local authorities in New Zealand are facing enormous infrastructure deficits and significant questions as to whether current funding and financing models will be able to support the growing national infrastructure pipeline.[638] Universities and public authorities are also facing enormous financial pressures.[639] Reinstating access to the FBT exclusion for local authorities, public authorities and universities may help to alleviate some of this pressure.

471. The FBT exclusion for charitable organisations has often been described as "inefficient and incoherent", with definitions that are "unclear and inconsistent".[640] Nevertheless, it provides important support for charities and other not-for-profit organisations who are operating in an increasingly precarious environment, with increasing costs, increasing demand for services, increasing difficulty in attracting volunteers, ever-increasing regulation (which, in relation to charities, is too often made in haste without proper consultation or analysis of the potential consequences), ever-increasing misperceptions (such as whether it is appropriate for charities to spend on "administration costs"),[641] yet diminishing revenue streams. These factors can make it acutely difficult for charities and other not-for-profit organisations to attract and retain staff.[642] Being able to offer non-cash benefits to staff, without having to engage in what is acknowledged to be a very complex FBT regime that is "difficult to understand and hard to comply with",[643] is an important support for charities that should remain in place for as long as the FBT regime itself remains.[644]

The business exception

472. The FBT exclusion for charitable organisations is set out in section CX 25(1), which

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[636] Inland Revenue and the Treasury *Recognising salary trade-offs as income – an officials' issues paper* 18 April 2012 at 18, footnote 16. However, it is not clear whether this statement is intending to refer to the FBT exclusion or to exemption from income tax.
[637] Hon Dr Michael Cullen, Minister of Finance, Minister of Revenue *Streamlining the taxation of fringe benefits – a government discussion document* 11 December 2003 at [10.3].
[638] See New Zealand Infrastructure Commission | Te Waihanga *Is local government debt constrained? A review of local government financing tools* Wellington 2024.
[639] See, for example, John Gerritsen *NZ universities facing a 'liquidity crisis" – briefing* RNZ 20 February 2024: https://www.rnz.co.nz/news/national/509620/nz-universities-facing-a-liquidity-crisis-briefing and RNZ *How many public sector roles are going, and from where?* 20 June 2024: https://www.rnz.co.nz/news/political/513456/how-many-public-sector-roles-are-going-and-from-where.
[640] Inland Revenue | Te Tari Taake *Fringe benefit tax: regulatory stewardship review* 29 August 2022 at [42].
[641] See, for example, human and hope *Administration costs are crucial for charities* 15 April 2024: https://humanandhope.org/human-and-hope/posts/administration-costs-are-crucial-for-charities
[642] Inland Revenue and the Treasury *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill – Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill* March 2013 (published 7 June 2013) AT 83.
[643] Inland Revenue | Te Tari Taake *Fringe benefit tax: regulatory stewardship review* 29 August 2022 at [35].
[644] Officials argue (Inland Revenue and the Treasury *Recognising salary trade-offs as income – an officials' issues paper* 18 April 2012 at [2.43]) that the FBT exclusion for charitable organisations may provide a charitable organisation with a "competitive advantage both in terms of attracting employees and when

is in the following terms (with bolding added):

> A charitable organisation that provides a benefit to an employee does not provide a fringe benefit except **to the extent to which** –
>
> (a) the employee receives the benefit **mainly in connection with their employment**; **and**
>
> (b) the employment consists of the carrying on by the organisation of a **business whose activity is outside its benevolent, charitable, cultural, or philanthropic purposes**.

473. Paragraphs (a) and (b) of section CX 25(1) are known as the "business exception": the FBT exclusion for charitable organisations is not available to the extent to which the employee receives the benefit "mainly" in connection with their employment in a business that is "outside" the charitable organisation's benevolent, charitable, cultural or philanthropic purposes (referred to below as the organisation's "specified purposes").

474. The "business exception" to the FBT exclusion for charitable organisations is problematic in a number of respects.

What constitutes a "business"?

475. In the first instance, it is not always clear whether any particular activity carried on by a charitable organisation constitutes a "business". IRD interprets the term "business" very broadly, as follows:[645]

> Many [charitable] organisations engage in activities on a continuous and ongoing basis, commit time, money and effort to those activities, and conduct a large volume of transactions, with the intention of making a surplus. **Such organisations that carry on this type of activity are carrying on a business**, as that term is defined in s YA 1.
>
> A [charitable] organisation carrying on a business (eg, a private school operated by a charitable trust) may still qualify for the FBT exclusion even though it makes a profit. Just because an organisation carries on some activities for profit does not prevent the organisation from being a [charitable organisation] for FBT purposes, so long as the activity is not being carried on for the personal gain of an individual …

476. Due to the breadth of the above interpretation of the term, many activities carried out by charitable organisations could fall within the concept of a "business", including, potentially, service activities delivered by charities under a government contract,[646] thereby triggering a requirement to assess whether the business exception to the FBT exclusion applies in respect of any non-cash benefits provided

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competing with other entities to provide services. To the extent that the FBT exemption attracts employees away from other organisations, it may be economically inefficient as it can enable the tax-exempt entity to expand at the expense of non-exempt entities". With respect, given the significant difficulties charities have in attracting and retaining staff, such concerns appear very overstated.

[645] Inland Revenue | Te Tari Taake *BR Pub 22/06 Fringe Benefit Tax – Charitable and other Donee Organisations and Fringe Benefit Tax* 31 May 2022 at [39] – [40] (with bolding added).

[646] Although government contracts may make only a "contribution" to the cost of providing a service rather than fully funding it. Research commissioned by Social Service Providers Aotearoa in August 2019 found that services are underfunded by at least $630 million annually. See Martin Jenkins *Social service system: the funding gap and how to bridge it* Research funded jointly by social service providers and philanthropic organisations August 2019: https://www.sspa.org.nz/resource-library/article/social-service-system-the-funding-gap-and-how-to-bridge-it at 6. See also S Barker *Focus on purpose - what does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3, chapter 1.

to employees. Such an assessment can be very complex, as discussed further below.

477. In September 2024, IRD issued an interpretation statement regarding the business income exemption in section CW 42 that made the following comments:[647]

> Charities that engage in activities on a continuous and ongoing basis, commit time, money and effort to those activities, and conduct a large volume of transactions, with the intention of making a surplus are carrying on a "business", as s YA 1 defines that term. This is the conclusion even though the object of the business is directed to charitable ends, not private pecuniary gain.
>
> Sometimes a charity engages in activities on a continuous and ongoing basis, commits time, money and effort to those activities, and conducts a large volume of transactions **without a profit-making intention**. For example, a charity that deliberately undertakes an activity on a loss-making or breakeven basis. Such activities will **not** be a business, as s YA 1 defines that term …

478. This wording differs from the wording proposed in previous consultation drafts,[648] and is a very helpful clarification made in response to consultation: both aspects of the "two-fold inquiry" must be satisfied.[649] Clarification that this interpretation also applies in an FBT context would be helpful.

When is a business "outside" the specified purposes?

479. If the charitable organisation is found to be carrying on a "business", the next question is whether that business is within or "outside" the organisation's specified purposes (section CX 25(1)(b)).

480. In the original provision as inserted in 1985, the business exception applied if the benefit arose "primarily and principally" in relation to employment in "a business".[650] This wording was not substantially changed when the provision was reinstated in 1990, or when it was reordered as section CI 1(m) of the Income Tax Act 1994.

481. However, when the provision was rewritten as CX 21(1) of the Income Tax Act 2004, the business exception was altered so that it applied only to businesses that were "outside" the purposes of the charitable organisation. It is not clear why this change was made: limiting the ambit of the business exception to the FBT exclusion for charities was not identified as a policy change in schedule 51 of the Income Tax Act 2007 (*Identified changes in legislation*), or even referred to in the commentary to the Bill.[651] The changed wording simply appeared in the Bill as introduced in 2002.[652]

482. In a sense, the change is helpful to charities, as it limits the scope of businesses likely to be subject to FBT. However, it can be very difficult to determine whether any particular business activity falls "within" or "outside" an organisation's purposes.[653] As illustrated by attempts to draw a distinction between "related and unrelated" businesses, or "primary and non-primary purpose trading", in other

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[647] Inland Revenue | Te Tari Taake *Interpretation Statement IS 24/08 – Charities – business income exemption* 16 September 2024 at [30]-[31] (bolding added).
[648] Inland Revenue | Te Tari Taake *Exposure Draft Interpretation Statement: PUB00465 Charities – business income exemption,* released for consultation from 2 February 2024 to 15 March 2024, at [26] – [27].
[649] *Grieve v Commissioner of Inland Revenue* [1984] 1 NZLR 101 (CA) at 110, discussed above in the context of section CW 42.
[650] Section 336N(1)(h) of the Income Tax Act 1976.
[651] Hon Dr Michael Cullen, Minister of Finance, Minister of Revenue *Income Tax Bill 2002 – Commentary.*
[652] Income Tax Bill 2002 (11-1), clause CX 22(b).
[653] See, for example, the discussion in Industry Commission *Charitable organisations in Australia - Report no 45* 16 June 1995 at 309 – 310.

jurisdictions and discussed above, there is no "bright line" articulating on which side of the line a particular business might fall, and attempts to draw one create considerable complexity, that only serves to increase administration and compliance costs for little, if any, corresponding benefit.[654]

483. IRD takes the following approach to determining whether a business is within or outside a charitable organisation's purposes:[655]

> In the Commissioner's view, … activities (including business activities) undertaken to carry out the [specified objects of a charitable organisation] or directly facilitating the carrying out of those objects (including administrative or clerical activities) will be within the [specified] objects of the organisation for the purposes of s CX 25. However, trading activities carried on to raise funds for the organisation that do not in themselves carry out the charitable purposes of the organisation will not be within the [specified objects of a charitable organisation] for the purposes of s CX 25. This is the case even if all the funds raised form the activity are applied to the [charitable] organisation's purpose.
>
> Therefore, the Commissioner considers activities will be carried on *within* a [charitable] organisation's purposes when they:
>
> - are the performance of the [charitable] organisation's specified purposes; or
> - directly facilitate the carrying out of a [charitable] organisation's specified purposes.
>
> Activities the Commissioner considers will usually be characterised as being carried on *within* a [charitable] organisation's specified purposes include:
>
> - the carrying out of the [charitable] organisation's specified purposes;
> - appeals for funds for the [charitable] organisation's specified purpose;
> - passive investment and management of the [charitable] organisation's funds, so long as the organisation does not carry on a business of fund investment; and
> - the administration of the above activities.
>
> On the other hand, business activities that are carried on to raise funds for the [charitable] organisation and that are not of themselves achieving a [charitable] organisation's specified purposes, or which do not directly facilitate those purposes, will be treated as business activities outside the purposes of a [charitable] organisation. This is the case even if the profits from such business activities are used to fund the [charitable] organisation and thereby help it carry out its specified activities. For example, a clothing thrift shop run by an animal welfare organisation is a business activity that is *outside* the organisation's object of caring for animals.

484. In other words, an opportunity shop run by a charitable organisation to raise funds for its charitable purposes may be considered "outside" its purposes and therefore *prima facie* subject to FBT in relation to any non-cash benefits provided to employees employed in the shop.[656] However, this will not always be the case:[657]

> It will be a question of fact in each case whether the business activities of a [charitable] organisation are activities that are not of themselves achieving the organisation's specified purposes. It is, therefore, possible that two [charitable] organisations may carry out similar business activities, with different FBT consequences for each

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[654] See the discussion in S Barker *Focus on purpose - what does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3, chapter 5.
[655] Inland Revenue | Te Tari Taake *BR Pub 22/06 Fringe Benefit Tax – Charitable and other Donee Organisations and Fringe Benefit Tax* 31 May 2022 at [51] – [53].
[656] Inland Revenue | Te Tari Taake *Operational Statement OS 22/04 – Charities and Donee Organisations Part 1: Charities* 10 October 2022 at [139].
[657] Inland Revenue | Te Tari Taake *BR Pub 22/06 Fringe Benefit Tax – Charitable and other Donee Organisations and Fringe Benefit Tax* 31 May 2022 at [54].

> organisation. An example of this is where a qualifying organisation operates retail stores selling goods with a view to making a profit. This type of activity would generally be considered to be outside an organisation's specified purposes, although for some organisations such an activity might fall within their purposes. For example, if the operation of a particular retail store served the purpose of creating job opportunities for a group that the organisation was established to assist, or if the goods were provided at low cost to a group the organisation was established to assist. This business activity may be considered to be achieving the organisation's specified purposes.

485. The key difficulty with attempting to draw a distinction between businesses "within" and "outside" a charitable organisation's purpose lies in an underlying collision of concepts. Business is inherently an activity, rather than a purpose. As discussed above, charities are unusual in that they are defined by their *purposes* rather than by their activities or their underlying legal structure:[658] all activities of a charity must, by definition, be carried out in furtherance of the charity's purposes as articulated in its constituting document.[659] The focus of the common law is on ensuring that charities' activities further those stated charitable purposes and, otherwise, says very little about charities' activities. Attempts to draw a distinction between businesses "within" or "outside" the organisation's purposes therefore create a "false dichotomy",[660] as all activities must be carried out in furtherance of the organisation's specified purposes. Attempts to draw bright lines in relation to activities in an inherently principles- and purposes-based area of law are fraught with difficulty.[661]

486. A better approach would be to work with the underlying law rather than trying to cut across it. As discussed above, charities are subject to the "destination of funds" principle: all funds of a charity must, by definition, ultimately be destined for its charitable purposes. Those involved with a charity have important fiduciary duties to act in good faith to further the charity's stated charitable purposes in accordance with its rules.[662] There is nothing inherently nefarious about business activity, even if a charity is carrying on a business to raise funds for its charitable purposes. Indeed, in a climate of increasing scarcity of resources, charities in fact should be encouraged to run businesses to raise funds for their charitable purposes, to diversify their income streams, work towards self-sustainability, and reduce their dependency on donations and government funding. Charities running such businesses are, by definition, "social enterprises".[663] Rather than putting arbitrary barriers in the way of much-needed social enterprise activity,[664] a better approach would be to enforce the

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[658] See, for example, M McGregor-Lowndes, M Turnour, E Turnour *Not for profit income tax exemption: is there a hole in the bucket, dear Henry?* 26 Australian Tax Forum 601.
[659] See, for example, Trusts Act 2019 sections 24 - 26, Incorporated Societies Act 2022 sections 54, 56, and Companies Act 1993 sections 131, 134, duties which merely codify the underlying common law, as discussed in more detail in the Charities Volume, chapter 6 (*Registering*).
[660] See *Commissioner of Taxation of Australia v Word Investments Ltd* [2008] HCA 55 at [24].
[661] As noted in Report of the Special Senate Committee on the Charitable Sector *Catalyst for Change: A Roadmap to a Stronger Charitable Sector* June 2019 at 82.
[662] See, for example, Trusts Act 2019 sections 24 - 26, Incorporated Societies Act 2022 sections 54, 56, and Companies Act 1993 sections 131, 134, duties which merely codify the underlying common law, as discussed in more detail in the Charities Volume, chapter 6 (*Registering*).
[663] Being organisations using business methods to create positive social outcomes (that is, their charitable purposes, which must, by definition, operate for the benefit of the public). See the discussion in S Barker *Focus on purpose - what does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3, chapter 5.
[664] The New Zealand government has acknowledged the importance of supporting social enterprise activity. See Impact Initiative *A Roadmap for Impact* April 2021 at 5 - 6. Indeed, former British Prime Minister, Gordon Brown HonFRSE, argues there is "no route to the future that does not have social enterprise at its centre": L Joffre "Ex-PM Gordon Brown: 'There is no route to the future that does not have social enterprise at its centre'" Pioneers Post 27 November 2020.

fiduciary duties, to ensure that all activities are indeed being undertaken to further the charity's stated charitable purposes in accordance with its rules.[665] If a charity considers in good faith that a particular activity would further its stated charitable purposes in accordance with its rules, the minimum threshold is met, and the onus would then fall to those who allege otherwise, to demonstrate that the decision was or could not have been made, if they wished to take further action, such as denying a tax privilege in any particular case. Such an approach would be infinitely less complex than attempting to draw, administer and comply with complex, blanket, arbitrary rules.

487. Attempts to make a distinction between businesses within and outside a charitable organisation's purposes make no sense from a charities law perspective, and only serve to create unnecessary barriers to charitable work. While the attempt to make a distinction might originally have been made in an effort to alleviate the harshness of the business exception for charities, a better approach would be to remove the business exception altogether. As discussed above, the purpose of the various privileges for charities is to support their work: this purpose would be better furthered by allowing them an exclusion from FBT, whether benefits are provided to employees in connection with a business run by the charity or not.

When is the benefit received "mainly" in connection with such a business

488. The business exception creates further difficulty in its requirement that the employee receives the benefit "mainly" in connection with their employment in a business "outside" the organisation's specified purposes (section CX 25(1)(a)).

489. The word "mainly" replaced the words "primarily and principally" when the FBT exclusion for charitable organisations was rewritten as CX 21(1) of the Income Tax Act 2004. This change occurred consistently throughout the rewrite process, and was not intended to result in a substantive change in meaning, as discussed above. IRD interprets the word "mainly" in section CX 25(1)(a) as synonymous with "primarily".[666]

490. IRD argues that the "mainly" requirement recognises that a charitable organisation may provide benefits to people who are acting in different capacities for an organisation:[667]

> It is not unusual for people to be employed by an organisation in a particular role and for those same people to also provide additional or different services to the organisation, for example, on a voluntary (unpaid) basis.
>
> In the Commissioner's view, the purpose of the wording in s CX 25(1)(a) is to clarify that a potential liability for FBT will arise only where an employee receives a benefit from a [charitable] organisation mainly in their employment capacity and not in some other capacity (eg, in their voluntary capacity).
>
> …
>
> … a benefit will be provided to an employee of a [charitable] organisation if the benefit arises primarily in connection with their employment. If an employee is only employed

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[665] See the discussion in S Barker *Focus on purpose - what does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3, chapters 2 and 8.
[666] Inland Revenue | Te Tari Taake *BR Pub 22/06 Fringe Benefit Tax – Charitable and other Donee Organisations and Fringe Benefit Tax* 31 May 2022 at [31] – [32].
[667] Inland Revenue | Te Tari Taake *BR Pub 22/06 Fringe Benefit Tax – Charitable and other Donee Organisations and Fringe Benefit Tax* 31 May 2022 at [29] – [33].

> by a [charitable] organisation, and does no voluntary work, then any benefits provided to that employee will be provided in connection with their employment. But, if, for example, an employee is both employed by and works as a volunteer for a [charitable] organisation, it will be necessary to determine in which capacity the benefit primarily arises.
>
> If a benefit arises equally in connection with both their capacities, the benefit will be provided mainly in connection with the capacity in which the employee is predominantly engaged.

491. Determining whether a benefit is received "mainly" in an employee's capacity as an employee of the targeted type of business, rather than in some other capacity, has the potential to be very complex.

Apportionment

492. Further difficulty arises because of the words "except to the extent to which" in section CX 25(1). These words "contemplate apportionment" in the context of the business exception to the FBT exclusion,[668] which IRD explains as follows:[669]

> Just as a person may work for a [charitable] organisation in different capacities (eg as a volunteer or as an employee), an employee may also be employed by a [charitable] organisation in different activities, some of which may be within the organisation's specified purposes and some of which may be outside those purposes.
>
> …
>
> … in the Commissioner's view, in s CX 25(1)(a) the word "mainly" places the focus on establishing the principal reason for the employee receiving the benefit. For example, whether the employee received the benefit mainly in connection with their employment or mainly in connection with their role as a volunteer. If it is mainly received in connection with volunteer service, the benefit is not a fringe benefit. However, if the benefit is provided mainly in connection with employment (ie, s CX 25(1)(a) is satisfied) then any volunteer service is disregarded for the purposes of s CX 25(1)(b). This is because only employment is considered for the purposes of applying the second limb of the exclusion in s CX 25(1)(b).
>
> Unlike in s CX 25(1)(a), there are no words in s CX 25(1)(b) to qualify the phrase "to the extent to which". This means that, for the purposes of s CX 25(1)(b), the words "to the extent to which" should be given their ordinary meaning (ie requiring apportionment). Therefore, under s CX 25(1)(b) a [charitable] organisation will be subject to FBT only **to the extent to which** that benefit is provided to an employee in connection to their employment in a business activity that is outside the organisation's specified purposes.
>
> In summary, the Commissioner considers FBT will apply only to benefits provided to an employee **mainly in connection with their employment**, and then only **to the extent to which** those benefits are received in connection with **employment in a business carried on outside** a [charitable] organisation's purposes. Where an employee is employed in different activities across a [charitable] organisation and one or more of those activities is a business activity outside the organisation's purposes, the benefits provided need to be apportioned so only the benefits relating to the employment in the business activity carried on outside the organisation's specified purposes are treated as fringe benefits. In the Commissioner's view, any apportionment

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[668] Inland Revenue | Te Tari Taake *BR Pub 22/06 Fringe Benefit Tax – Charitable and other Donee Organisations and Fringe Benefit Tax* 31 May 2022 at [65].
[669] Inland Revenue | Te Tari Taake *BR Pub 22/06 Fringe Benefit Tax – Charitable and other Donee Organisations and Fringe Benefit Tax* 31 May 2022 at [57], [63] – [ ] (bolding in original).

> should be reasonable and reflect the reality of the situation.

493. Determining "the extent to which" a benefit is received "mainly" in connection with an employee's employment in a business outside the organisation's purposes also has the potential to be very complex. As IRD noted in its recent regulatory stewardship review,[670] administrative costs of FBT are perceived to be "higher than the value of the benefits for the employee and the revenue for the Government".[671]

Discussion

494. As can be seen from the above discussion, the FBT exclusion for charitable organisations has a reasonably tortured history. It was originally included as something of an afterthought in 1985, then removed in 1990, before being reinstated in 1991. In 1998, the Committee of Experts on Tax Compliance recommended its repeal, on the basis that FBT "is intended to be a substitute for the income tax that would otherwise be paid by the employee, if the fringe benefit were taxable as ordinary salary and wages".[672] In 2001, the government agreed: as employment income was taxable, there was no reason that employees of charities should be exempt from tax on remuneration paid in kind.[673] However, there was strong opposition to the removal of the FBT exclusion for charitable organisations, on grounds such as the following:[674]

    (a) having to pay FBT would reduce the amount of funds charities have available for charitable purposes;

    (b) employees of charities are paid less than market salaries, and fringe benefits partly redress this;

    (c) the compliance costs would be particularly severe on small charities, which do not have the resources to pay a tax accountant to calculate any FBT liability;

    (d) bigger charities may undertake less efficient practices in order to reduce their FBT liability.

495. As a result, the issue was referred for consideration as part of a wider review of FBT, which culminated in the December 2003 government discussion document entitled *Streamlining the taxation of fringe benefits*.[675] The 2003 discussion document considered there was no tax policy justification for the FBT exclusion for charitable organisations:[676]

> FBT relates to income earned by the employee rather than the income of the employer, even though the tax is paid by the employer. The current FBT [exclusion] for charities, therefore, advantages employees of charities because they pay less tax than other

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[670] Inland Revenue | Te Tari Taake *Fringe benefit tax: regulatory stewardship review* 29 August 2022.
[671] Inland Revenue | Te Tari Taake *Fringe benefit tax: regulatory stewardship review* 29 August 2022 at 47, referring to SA Carr and C Chan *New Zealand's Fringe Benefit Tax 20 years on: An Empirical Investigation into Employers' Perception* New Zealand Journal of Taxation Law and Policy (2004) Vol 10, No. 3 at 245 – 270.
[672] Rt Hon Sir I McKay, T Molloy QC, Professor J Prebble, J Waugh *Report to the Treasurer and Minister of Finance by a Committee of Experts on Tax Compliance* December 1998 at [4.22]
[673] Inland Revenue Department *Tax and charities, a government discussion document on taxation issues relating to charities and non-profit bodies* June 2001 at [12.7].
[674] Hon Dr Michael Cullen, Minister of Finance, Minister of Revenue *Streamlining the taxation of fringe benefits – a government discussion document* 11 December 2003 at [10.3].
[675] Hon Dr Michael Cullen, Minister of Finance, Minister of Revenue *Streamlining the taxation of fringe benefits – a government discussion document* 11 December 2003 at [1.20].
[676] Hon Dr Michael Cullen, Minister of Finance, Minister of Revenue *Streamlining the taxation of fringe benefits – a government discussion document* 11 December 2003 at [10.5] – [10.7].

> employees on the same total remuneration.
>
> There is no tax policy reason why one set of employees should be treated directly from any other purely because of who they work for or because the remuneration is paid in kind. Given that the true value of the benefit normally accrues to the employee rather than the employer, the fact that the employer is exempt from income tax is not a relevant consideration. The contrast is more obvious when it is considered that employees of charities are taxed on their cash remuneration through the PAYE system in the same way as other employees.
>
> Apart from equity issues, the main concern with any FBT [exclusion] is the flow-on distortions that are created from having some form of remuneration that is not taxable. For example, the [exclusion] provides an incentive for further fringe benefits to be substituted for cash remuneration, increasing the relative tax advantage.

496. However, the review did not recommend that the FBT exclusion for charitable organisations be removed:[677]

> *Compliance costs*
>
> Although removing the [exclusion] for charities would remove any distortions that the [exclusion] creates, it would increase compliance costs for charities. Charities would have to pay tax on benefits, which could mean higher costs or lower cash payments to employees.
> …
>
> The government's view, after weighing up the various factors, is that the [exclusion] for employees of charitable organisations should be retained. But given the policy reasons that militate against the [exclusion], the government is not in favour of extending it to other groups that may be similar but who are not charities. Although this may give rise to distortions, any extension would likely lead to greater distortions, as well as erode the tax base.

497. Instead, an exception for short-term charge facilities was inserted in 2006 (section CX 25(3)).

498. Despite this, IRD continues to push for its removal. Following a regulatory stewardship review of FBT, IRD released a report in August 2022 describing the FBT exclusion for charitable organisations as "inefficient and incoherent".[678] The report recommended further work be undertaken on FBT along the following lines:[679]

> Our recommended approach would be to commission a policy project at the upper end of the spectrum with the aim of re-establishing the remuneration basis of the tax, modernising FBT and reducing compliance costs. This policy project would involve full consultation per the generic tax policy process. The rules should then be the subject of a comprehensive communications campaign and enhanced data capture so that failings can be more clearly identified. Finally, non-compliance should be addressed …

499. Hence, the issues paper brings the FBT exclusion for charitable organisations "up for removal" again. The current approach towards charities can reasonably be described as "hostile". Charities have managed to "push back" against unhelpful proposals many times in the past. However, after almost 20 years of "regulation" under the Charities Act 2005, the capacity of the charitable sector to engage in democratic processes, and also trust and confidence in charities more broadly, appear to have

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[677] Hon Dr Michael Cullen, Minister of Finance, Minister of Revenue *Streamlining the taxation of fringe benefits – a government discussion document* 11 December 2003 at [10.8] and [10.11].
[678] Inland Revenue | Te Tari Taake *Fringe benefit tax: regulatory stewardship review* 29 August 2022 at [42].
[679] Inland Revenue | Te Tari Taake *Fringe benefit tax: regulatory stewardship review* 29 August 2022 at [9].

been fundamentally undermined, in direct contrast to the stated purposes of the Act.[680] When the vibrancy with which charities engaged in submissions on the original Charities Bill 108-1 in 2004 and 2005 is compared with today, the New Zealand charitable sector now appears to be a significantly-depleted shadow of its former self. In addition, the disestablishment of the Charities Commission appears to have resulted in there being no agency prepared to "speak up" for the charitable sector in the way the Charities Commission was originally intended to do.[681] Even so, despite the truncated consultation period and unfortunate timing, it is important that charities "push back" again: the experience of Canada is that, once unhelpful proposals for charities become enshrined in legislation, it can be many decades before they are revisited again.[682]

500. To summarise, the FBT exclusion in section CX 25 is an important support for charities that should remain in place for as long as the FBT regime itself remains,[683] irrespective of the outcome of the current review of FBT settings.

Not-for-profit deduction

501. On a more positive note, the issues paper also proposes increasing and/or redesigning the current $1,000 deduction in section DV 8 of the Income Tax Act to "remove small-scale NFPs from the tax system".

502. We understand there are approximately 90,000 entities coded as not-for-profit entities on Inland Revenue's records and therefore currently entitled to the $1,000 deduction.[684]

503. Section DV 8 was originally inserted into the legislation in 1972.[685] The original $500 limit was increased to $1,000 in 1979.[686] The Government's tax policy work programme for 2019-20 included the "$1,000 NFP deduction threshold" amongst items "that could potentially be subject to policy change and sector consultation".[687] However, as at the time of writing, the $1,000 limit remains in place, and the matter no longer appears on the Government's tax policy work programme.[688]

504. The $1,000 limit has not been increased for more than 45 years (a time when $1,000 was broadly equivalent to $4,318.84 in today's dollars).[689] It would be helpful to increase the limit to $5,000 to reduce the number of small community organisations

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[680] Section 3(a) of the Charities Act 2005 provides that the purpose of the Act is to "promote public trust and confidence in the charitable sector".
[681] See the discussion in S Barker *Focus on purpose - what does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3, chapter 8.
[682] See the discussion in S Barker *Focus on purpose - what does a world-leading framework of charities law look like?* 10 April 2022 NZLFRR 3, chapters 4 and 5.
[683] Officials argue (Inland Revenue and the Treasury *Recognising salary trade-offs as income – an officials' issues paper* 18 April 2012 at [2.43]) that the FBT exclusion for charitable organisations may provide a charitable organisation with a "competitive advantage both in terms of attracting employees and when competing with other entities to provide services. To the extent that the FBT exemption attracts employees away from other organisations, it may be economically inefficient as it can enable the tax-exempt entity to expand at the expense of non-exempt entities". With respect, given the significant difficulties charities have in attracting and retaining staff, such concerns appear very overstated.
[684] Inland Revenue | Te Tari Taake *Tax statistics for charities and not-for-profits*, presentation prepared by Stewart Donaldson, Principal Policy Adviser, 16 September 2021, at 1.
[685] Section 10(5) of the Land and Income Tax Amendment Act (No 2) 1972 (1972 No 17) (with bolding added).
[686] Section 52 of the Income Tax Amendment Act 1979 (1979 No 18).
[687] Inland Revenue Department *Government tax policy work programme 2019-20* 8 August 2019 *Charities*: <taxpolicy.ird.govt.nz/work-programme/government-tax-policy-work-programme-2020-21#charities>.
[688] Inland Revenue Department | Te Tari Taake *Government tax and social policy work programme*, issued November 2024: https://www.taxpolicy.ird.govt.nz/work-programme.
[689] See CPI Inflation Calculator: https://www.in2013dollars.com/us/inflation/1979?amount=1000.

that are required to file an income tax return.

Volunteers

505. The issues paper also proposes treating honoraria payments for volunteers as salary and wages, to reduce compliance costs and asks for any other suggestions on "how to reduce tax compliance costs for volunteers".

506. In the course of considering the Taxation (International Taxation, Life Insurance and Remedial Matters) Bill 233-1, consideration was given to exempting honoraria from income tax altogether. However, this option was considered too costly to explore further in the economic and fiscal climate existing at that time.[690]

507. Volunteering Auckland pointed out at the time that individuals who carry out voluntary activities independently of any formal organisation are unable to claim any reimbursement of costs incurred, and submitted that such costs should be deductible against other income.[691] This submission was also not accepted at the time, on the basis that such costs would not have a sufficient "nexus" with income to be deductible for tax purposes (the general permission in section DA 1 only allows deductions for expenditure to the extent to which it has been "incurred" in deriving income).[692] However, officials considered there could be a case for treating costs incurred in carrying out voluntary activities, where they cannot be reimbursed, as being equivalent to a cash "donation", and recommended this suggestion be further explored as part of the work on other tax incentives for encouraging a culture of generosity in New Zealand.[693]

508. In that context, consideration was given to ways of recognising the vital contribution volunteers make to New Zealand society,[694] including by introducing a tax rebate or grant for individuals who donate their time to charities, in recognition of the value of the time they donate.[695] Volunteers would be able to claim the rebate if they have a declaration certificate (such as a receipt), from the registered charity to which they have volunteered their time, showing the number of hours volunteered.[696] Like the donations tax credit, the volunteer's rebate would be available only if the volunteer

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[690] Inland Revenue and the Treasury *Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill – Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill – Supplementary Paper to Volume 3* May 2009 (published 30 June 2009) at 19.
[691] Inland Revenue and the Treasury *Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill – Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill – Supplementary Paper to Volume 3* May 2009 (published 30 June 2009) at 20.
[692] Inland Revenue and the Treasury *Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill – Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill – Supplementary Paper to Volume 3* May 2009 (published 30 June 2009) at 20.
[693] Inland Revenue and the Treasury *Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill – Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill – Supplementary Paper to Volume 3* May 2009 (published 30 June 2009) at 20.
[694] Inland Revenue Department *Tax incentives for giving to charities and other non-profit organisations – a government discussion document* October 2006, chapter 3.
[695] Inland Revenue Department *Tax incentives for giving to charities and other non-profit organisations – a government discussion document* October 2006 at [3.1].
[696] Inland Revenue Department *Tax incentives for giving to charities and other non-profit organisations – a government discussion document* October 2006 at [3.5].

had derived a certain amount of taxable income for the year.[697]

509. Further consideration of these issues would be helpful.

Donation tax credits

510. Finally, the issues paper asks for suggestions on how to improve the current rules regarding donation tax credits.

Gift aid

511. The United Kingdom encourages charitable donations through a "gift aid scheme". Under this scheme, tax paid by the donor on an amount donated can be reclaimed by a registered charity, rather than the donor, if the donor has provided the charity with a gift aid declaration and the charity can establish an audit trail.[698]

512. Questions have arisen from time to time as to whether a similar "gift aid" scheme should be introduced into New Zealand. For example, the Cultural Philanthropy Taskforce made the following comments in 2010:[699]

> Gift aid is the most significant remaining tax initiative New Zealand can consider. Gift aid is not a new tax incentive but rather a redirection of existing tax relief. It enables the tax benefit of charitable donations to go to the donee (the organisation) rather than the donor. This means the donee receives a greater cash donation without any change in giving levels.
>
> Gift aid is a tax-effective giving mechanism accessible to all taxpayers, irrespective of their income level or tax rate. **In the United Kingdom, gift aid tax relief adds at least 20 percent to the value of donations to charities**. This means a donation of £10 would actually be worth £12 to the recipient charity, because the recipient organisation also gains the additional tax relief otherwise owing to the donor. In 2009-10 charities in the United Kingdom claimed more than £1 billion in gift aid tax relief on donations from individuals alone – nearly 10 times more than the £106 million those community organisations received in total payroll giving donations.
>
> In 2010 Minister of Revenue Hon Peter Dunne asked the Taskforce, and a limited number of other agencies, for feedback on implementing gift aid in New Zealand. His officials proposed two options …
>
> Our response to the Minister in August this year firmly supports option one (which draws on the United Kingdom's scheme whereby charities are able to claim the tax benefit of charitable donations on behalf of the donor). Each donee organisation (rather than each donor) files a gift aid claim with Inland Revenue. Placing the responsibility on donee organisation enables them to proactively seek tax relief on a greater range of qualifying donations. And the donee organisation is, naturally, more motivated than the donor to make a gift aid tax relief claim.
>
> We cannot overlook the success of a provision that has operated effectively in the United Kingdom for the past 20 years, accounting for around 90 percent of all tax effective giving in that country, despite the complexity of some of the scheme's rules.
>
> Despite some administrative drawbacks, the UK government has remained strongly

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[697] Inland Revenue Department *Tax incentives for giving to charities and other non-profit organisations – a government discussion document* October 2006 at [3.7].
[698] See Inland Revenue Department *Tax incentives for giving to charities and other non-profit organisations – a government discussion document* October 2006 at [4.2] – [4.10].
[699] Cultural Philanthropy Taskforce *Growing the pie – increasing the level of cultural philanthropy in Aotearoa New Zealand,* presented to the Minister for Arts, Culture and Heritage, Hon Christopher Finlayson, December 2010 at 12 - 13 (with bolding added).

> committed to gift aid and has been working with charities to simplify some aspects of the scheme to increase take-up. These discussions could usefully inform the design of a simplified Option One gift aid scheme in New Zealand.
>
> In summary, gift aid maximises the value of current donations, encourages increased and new giving, and helps created a wider culture of philanthropy."

513. Consequently, the Taskforce strongly recommended that the government prioritise work on gift aid and commit to a timeline for its design and implementation.

514. Following release of the Cultural Philanthropy Taskforce's recommendations, "gift aid" was included as an item on the government's tax policy work programme for 2012-2013.[700] However, the issue appears to have "fallen off" the work programme from 2014. We understand that preliminary research was undertaken by IRD, which found that introducing a gift aid scheme in New Zealand would be advantageous from a tax administration point of view, in the sense that it would require dealing with 20,000 or so organisations claiming tax relief, rather than 400,000 or so donors; however, it was not clear that IRD's computer systems would be able to cope with the complexity of a gift aid scheme.

515. Since then, there have been significant developments and it is understood that IRD's computer system now would have capacity to cope with a gift aid scheme.

516. In the meantime, informal types of "gift aid" do already operate in New Zealand. For example, a donor may change their bank account with IRD so that their refund for donations tax credits goes directly to the charity. In its June 2012 newsletter, the Charities Commission (as it was then) pointed out that:

> … charities requesting donation tax credits from their donors should make it clear that if a donor changes their account details (held by Inland Revenue) to those of the charity, and all or some of their tax credits go to the charity for a particular year, they need to advise Inland Revenue to change the bank account back again in the following year.
>
> Otherwise, Inland Revenue will continue to pay all their tax credits to the charity's bank account rather than the donor's.

517. Alternatively, a donor might simply donate their refund to a donee organisation themselves. In fact, by donating their refunds back every year, the donor could create "up to 50% more charitable impact" through a process known as "tax staging".[701]

518. However, the system is hostile to intermediaries, including in relation to payroll giving, as discussed further below.

Payroll giving

519. In designing a payroll giving system, the relevant parties need to decide on the role of any intermediaries.[702]

520. As an alternative to forwarding payroll giving donations directly to donee organisations itself, an employer might instead forward them to an intermediary, to

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[700] Inland Revenue | Te Tari Taake *Government tax policy work programme for 2012-2013*: https://www.taxpolicy.ird.govt.nz/work-programme/2012-13.
[701] See The Gift Trust *How to give 50% more to the causes you care about, at no extra cost* 5 February 2024: https://thegifttrust.org.nz/2024/02/05/how-to-give-50-more-to-the-causes-you-care-about-at-no-extra-cost/.
[702] Inland Revenue *Special report on payroll giving – a new tax credit* 13 October 2009 at 3.

pass on the donations on the employer's behalf.[703] Use of intermediaries was specifically identified by the Government as a means of mitigating employers' compliance obligations, and thereby facilitating payroll giving.[704] Setting up intermediaries is one of a range of measures that overseas countries have used to support and promote payroll giving.[705]

521. One type of intermediary is a "central payment provider"; however, it appears that this option was considered a step too far in 2009:[706]

> Officials see clear simplification benefits for employers and employees in using payment intermediaries. However, catering for a central payment provider is likely to involve considerable change to the design of the proposed scheme and significant cost which would defer implementation of payroll giving for at least another 12 months. It may be that the concept of a central payment provider could be revisited after the scheme has "bedded" down.

522. Another type of intermediary is a "facilitating intermediary", which might provide facilitation services, such as education and support to assist employers to implement payroll giving.

523. However, a key type of intermediary is a "payment intermediary", that receives and distributes payroll donations to charities.[707] In the United Kingdom, every payroll giving transaction is made through a payment intermediary:[708] payroll giving schemes are administered by "Payroll Giving Agencies" that have been approved by HM Revenue and Customs; employers establish a payroll giving scheme by entering into a contract with an approved Payroll Giving Agency. As at 30 November 2024, there were 22 approved Payroll Giving agencies in the United Kingdom.[709]

524. In addition to helping to alleviate the costs associated with payroll giving for employers, payment intermediaries enable employees to donate to their chosen charity confidentially. Employees give the name of the charity they wish to donate to directly to the Payroll Giving Agency, which ensures the confidentiality of the employee's chosen charity.[710] Using a payment intermediary can also potentially enable employees to give to a wider group of charitable organisations.

525. Payroll Giving Agencies in the United Kingdom typically charge an administration fee for transferring monies to the chosen charity. Employers might choose to pay the

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[703] Inland Revenue *Payroll giving: providing a real-time benefit for charitable giving – a government discussion document* 27 November 2007 at [1.3].
[704] Inland Revenue *Payroll giving: providing a real-time benefit for charitable giving – a government discussion document* 27 November 2007 at [2.18] and [1.3].
[705] Inland Revenue *Payroll giving: providing a real-time benefit for charitable giving – a government discussion document* 27 November 2007 at [5.2].
[706] Inland Revenue and the Treasury *Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill – Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill* April 2009 at 98.
[707] Inland Revenue *Payroll giving: providing a real-time benefit for charitable giving – a government discussion document* 27 November 2007 at [5.5].
[708] HM Revenue and Customs *Guidance – Chapter 4: payroll giving* 27 March 2024: https://www.gov.uk/government/publications/charities-detailed-guidance-notes/chapter-4-payroll-giving at [4.1.2]: "Any employee whose employer deducts Income Tax under normal Pay As You Earn (PAYE) rules and who has contracted with a Payroll Giving Agency (Agency) can give to charity direct from their salary". See also Inland Revenue *Payroll giving: providing a real-time benefit for charitable giving – a government discussion document* 27 November 2007 at [5.5].
[709] See MH Revenue & Customs *Guidance – approved agencies for Payroll Giving* 13 May 2024: https://www.gov.uk/government/publications/payroll-giving-approved-agencies/list-of-approved-payroll-giving-agencies.
[710] Inland Revenue *Payroll giving: providing a real-time benefit for charitable giving – a government discussion document* 27 November 2007 at 19.

fee (which can be deducted from business profits for tax purposes), allowing the charities to receive more money. However, administration fees are usually deducted from employees' donations before they pass them on to the charity.[711] While this approach reduces the amount of the donation that is received by the chosen charities, the cost may still be significantly less than the cost of other forms of fundraising for charities.[712]

526. The New Zealand payroll giving scheme contemplates the use by employers of PAYE intermediaries.[713] A "PAYE intermediary" is defined in section YA 1 of the Income Tax Act 2007 to mean a person accredited as a PAYE intermediary by the Commissioner of Inland Revenue under section 124I of the Tax Administration Act 1994 (*Application for approval as PAYE intermediary*), and who has entered into an agreement with an employer, applying to employees of the employer, that has been approved by the Commissioner under section 124O of that Act (*Employer's arrangements with PAYE intermediaries*). In addition, the person must have entered into such agreements with not less than 10 employers.[714] As the payroll donation tax credit provisions are part of the PAYE rules,[715] it makes sense for employers who already have a PAYE intermediary to have such intermediary handle their payroll donations as well.[716]

527. However, a PAYE intermediary appears to be a separate concept from the "payment intermediary" concept used in the United Kingdom payroll giving system (being an intermediary set up solely to receive and distribute payroll donations, rather than to handle an employer's entire payroll).

528. In New Zealand, if an employer or PAYE intermediary transfers a payroll donation to an entity that is not a donee organisation, the tax credit is extinguished (section LD 6, as discussed above). On its face, this could preclude a payment intermediary from receiving payroll donations for the purpose of distributing them to the designated recipient charities, unless the payment intermediary was itself a donee organisation.

529. Following amendments made in 2019, most donee organisations must now be registered charities. The fact that a payment intermediary charges for the services it provides should not inherently be a barrier to obtaining registered charitable status and therefore donee status: the law is clear that charities may charge for their services;[717] indeed, the very fact that the income tax legislation exempts the business income of charities (section CW 42) makes it clear that charities may run businesses, and may make a profit from those businesses.[718] As noted by the House

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[711] Gov.uk *Payroll giving*: https://www.gov.uk/payroll-giving
[712] Inland Revenue *Payroll giving: providing a real-time benefit for charitable giving – a government discussion document* 27 November 2007 at [5.6].
[713] Section 124ZG of the Tax Administration Act requires the "employer or PAYE intermediary" to transfer a payroll donation to the recipient.
[714] Section YA 1 of the Income Tax Act 2007, definition of "PAYE intermediary", paragraph (a)(iii).
[715] The PAYE rules are defined in section YA 1 of the Income Tax Act 2007 by reference to section RD 2(1). Section RD 2(1)(b) refers to section LD 4 (*Tax credits for payroll donations*).
[716] See also IR 617 "Payroll Giving" page 6: "if you use a payroll intermediary you can still choose to offer payroll giving to your employees".
[717] See for example *DV Bryant Trust Board v Hamilton City Council* [1997] 3 NZLR 342 at 349; *In Re Resch's Will Trusts* [1969] 1 AC 514 (HL) at 540 and 542; *Scottish Burial Reform and Cremation Society v Glasgow Corporation* [1968] AC 138 (HL) at 147, 149 and 156; *Commissioners of Inland Revenue v Yorkshire Agricultural Society* [1928] 1 KB 611 (CA) at 623; *Re Tennant* [1996] 2 NZLR 633 (HC) at 640; *Commissioner of Taxation of the Commonwealth of Australia v Word Investments Ltd* [2008] HCA 55 at [24] and [27]; *Tasmanian Electronic Commerce Centre Pty Ltd v Commissioner of Taxation* [2005] FCA 439 at [42].
[718] *Bicycle Victoria Inc v Commissioner of Taxation* [2011] AATA 444 at [52].

of Lords in *Scottish Burial Reform and Cremation Society v Glasgow Corporation* [1968] AC 138:[719]

> … the appellants make a charge for the services which they provide. But **it has never been held that objects, otherwise charitable, cease to be charitable if beneficiaries are required to make payments for what they receive**. It may even be that public demand for the kind of service which the charity provides becomes so large that there is room for a commercial undertaking to come in and supply similar services on a commercial basis. But no authority and no reason has been put forward to hold that when that stage is reached the objects and activities of the non-profit-earning charitable organisation cease to be charitable.

530. Similarly, as noted by the House of Lords in *Re Resch's Will Trusts* [1969] 1 AC 514 (HL):[720]

> … if the purposes of the hospital are otherwise charitable, they do not lose this character merely because charges are made to the recipients of benefits…**they are bound by the trusts declared in the will under which any money received by them must be applied exclusively for the general purposes of the private hospital**. As regards these purposes, it appears, from the evidence already summarised, that the making of profits for the benefit of individuals is not among them.

531. A registered charity must, by definition, be a not-for-profit entity, subject to the prohibition on private pecuniary profit and the non-distribution constraint, as discussed above. A registered charity must also have exclusively charitable purposes (Charities Act 2005, section 13(1)). Any charges made by a payment intermediary that is structured as a charity must therefore be applied to its stated charitable purposes, and must forever be destined for charitable purposes, even if its rules are amended and even on winding up. Payments to staff of market value wages for carrying out the services are entirely consistent with these principles.

532. However, given the narrow approach currently being taken to interpreting the definition of charitable purpose, in practice, it has proved difficult, if not impossible, for a payment intermediary to obtain donee status, even if it meets all the legal requirements for registration under the Charities Act.

533. This difficulty creates a significant barrier to uptake of payroll giving. There are a number of practical issues that make it essential for a payroll giving intermediary to have donee status. For example, donations must be passed to the recipient donee organisation within the legislated timeframe. Timing issues can arise in this context, particularly if the employer passes the funds to the intermediary late in the timeframe, leaving the intermediary insufficient time to disburse the funds within the timeframe required. The additional risk this creates is not helpful in an environment where employer take up of payroll giving is key to its success. Allowing the payment intermediary to be a donee organisation would allow the statutory timeframe to be met by the employer's transfer to the intermediary, which would significantly alleviate this barrier to uptake of payroll giving. As a registered charity, the payment intermediary would be subject to the oversight of the Charities Registrar, and the reporting and monitoring requirements of the Charities Act.

534. In addition, it is common for payroll intermediaries in the United Kingdom to offer a "charity account" facility to employees. This facility allows employees to save money

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[719] *Scottish Burial Reform and Cremation Society v Glasgow Corporation* [1968] AC 138 (HL) at 147.
[720] *Re Resch's Will Trusts* [1969] 1 AC 514 (HL) at 540.

to their charity account for disbursement at a later date, using a login to their charity account. Such a facility is particularly helpful, for example, for gathering together funds to pay school donations: if an employee was to pass payments on account of their school donations in small weekly amounts, this would significantly increase administration costs for schools, and indeed many schools are simply not set up to be able to accept payment of the donations in this way. To be able to make small regular payments through a payroll giving scheme, and accumulate funds in a "charity account" for passing to the school ultimately in one lump sum, would be a significant win-win for all concerned. If the payroll giving intermediary was itself a donee organisation, such a facility could operate without placing the parties at risk of breaching the reasonably short legislative timeframes.

535. An intermediary may also be much better equipped than an employer to manage the process of verifying approved donee organisations, thereby further reducing potential risk for the employer.

536. Arguably, as funds are held in trust for the employee, a payroll intermediary should not need to be a donee organisation itself. Arguably, a payment intermediary would only receive the payroll donations as agent or bare trustee, such that a "transfer" to the payment intermediary may not have occurred for the purposes of section LD 6 (which requires the transfer to be made to a donee organisation). However, clarification of this point to allow payment intermediaries who are not themselves donee organisations to operate would be very helpful in terms of facilitating the uptake of payroll giving. Such an approach would also assist with issues of employer perception in terms of acceptability to use of payroll intermediaries who are not themselves donee organisations. Alternatively, changing the legal framework of the Charities Act to allow all charities that meet the legal requirements for registration to register would have the important side effect of facilitating uptake of payroll giving, as discussed further in *The Law and Practice of Charities in Aotearoa New Zealand*, chapter 8 (*Reforming*).

537. Payment intermediaries may not be appropriate for all employers: for example, payment intermediaries add another step between the donor (employee) and the receiving charity, and some have raised concerns about intermediaries having control of donor information and the relationship with donors.[721] However, removing current barriers to the use of payment intermediaries would do much to facilitate payroll giving.

538. The select committee considering the Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill made a number of changes to the payroll giving provisions, but also noted that:[722]

> The size of the bill, and the depth and breadth of the material it covers, have made our consideration more difficult than it might have been otherwise. In trying to meet the report due date for the bill, we and our committee consideration processes have been put under considerable pressure.

539. It may be that the issue of payment intermediaries was therefore simply not able to be fully considered at the time. The issue of "payroll giving intermediaries" was

[721] Inland Revenue *Payroll giving: providing a real-time benefit for charitable giving – a government discussion document* 27 November 2007 at [5.4] and [5.6].
[722] Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill 233-2 (select committee report) at 3.

included as an item on the government's tax policy work programme for 2012-2013.[723] However, it ceased to appear from 2013-2014. Further consideration of this issue would be helpful.

540. In addition to allowing payment intermediaries to obtain donee status, or alternatively allowing payment intermediaries that are not themselves donee organisations to assist employers with payroll giving, there is much work that could be done to assist the New Zealand payroll giving scheme to reach its full potential. The focus in New Zealand to date appears to have been more on process (such as verification systems) rather than on desired outcomes (such as increased participation). Following disbandment of the Payroll Giving Early Adopters Engagement Group in 2011, little resource appears to have been deployed into promoting payroll giving.[724]

541. By contrast, the United Kingdom government has deployed considerable resource into promoting and encouraging participation in payroll giving, such as through promotion campaigns, and financial incentive schemes,[725] including matching donations, and providing grants to employers for setting up payroll giving to encourage them to sign up. The United Kingdom government also supports a "Payroll Giving Quality Mark" accreditation,[726] to recognise and reward organisations of all sizes for offering and promoting Payroll Giving to their employees: organisations are given points for employee participation, paying the administration fees, matching donations, hosting events, and running digital promotions.[727] Organisations that achieve a Payroll Giving Quality Mark receive a certificate and logo to use on their company materials. Other initiatives include providing funding to the Institute of Fundraising to operate a "Payroll Giving Centre" (a comprehensive online information centre about payroll giving aimed at business, charities and the general public).

542. Another initiative that would be usefully considered is an "employee portability mechanism": providing a mechanism whereby employees can continue their payroll giving activity when they change employer would help to reduce attrition in giving when people change jobs, and start to exert some additional pressure on those employers who do not offer a scheme to do so:[728]

> Charities would retain these valuable regular contributions to their income, allowing them to retain donors as they change jobs, rather than incurring the substantial costs of recruiting new donors.

543. Ultimately, a multi-layered approach is required to achieve the full potential of payroll

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[723] Inland Revenue | Te Tari Taake *Government tax policy work programme for 2012-2013*: https://www.taxpolicy.ird.govt.nz/work-programme/2012-13.
[724] Inland Revenue *Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill – Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill* November 2018 (published 18 January 2019) at 46.
[725] Inland Revenue *Payroll giving: providing a real-time benefit for charitable giving – a government discussion document* 27 November 2007 at 19.
[726] Inland Revenue *Payroll giving: providing a real-time benefit for charitable giving – a government discussion document* 27 November 2007 at 20.
[727] See Association of Payroll Giving Organisations *One stop shop for payroll giving*: https://www.payrollgivingorgs.co.uk/payroll-giving-quality-mark/.
[728] United Kingdom Philanthropy Review *A call to action to encourage more people to give and people to give more* June 2011 at 20.

giving. Other recommendations to transform payroll giving include:[729]

(a) *Business leadership*: encouraging chief executives to "champion payroll giving in the workplace, and lead by example", by giving through their own payroll.[730] Chief executives and senior management need to demonstrate engaged leadership by signing up for payroll giving themselves; ensuring that employees know about existing schemes, how they work and the advantages of giving in this way; and by having more schemes in place. Uptake should be promoted and celebrated and more corporates should increase the value of employee donations with matching.

(b) *Ten per cent minimum*: all organisations should achieve a minimum of 10% uptake in payroll giving amongst employees, and aspire to the 35% level achieved in the United States.

(c) *Highlighting and celebrating performance*: payroll giving could become a much more important element of company performance by requiring uptake levels to be reported in company accounts (a "what gets measured gets managed" approach). A requirement for reporting uptake levels would also identify those organisations and sectors that are excelling in this activity, allowing the opportunity to celebrate and reward at a local and country-wide level. Reporting in this manner, rather than isolating payroll giving as a human resources or corporate responsibility issue, would also bring a focus on payroll giving to the board table, and encourage the necessary leadership to achieve an initial 10% uptake.

(d) *Charities*: with robust tracking of payroll giving, and shared data, charities would have the opportunity to build stronger relationships with their payroll giving donors; keep them informed of the impact their donations have made; and thank them for their gift efficiently.

544. However, business uptake around payroll giving in New Zealand will depend on how its importance is perceived and valued by businesses. While much research confirms the business benefits associated with workplace giving, it may lack "the substance and emotional connection required to make it a compelling proposition for employers to embrace".[731] The business benefits of payroll giving need to be communicated if payroll giving in New Zealand is to reach its full potential:[732]

> Companies must take the lead in bringing business and society back together. The recognition is there among sophisticated business and thought leaders, and promising elements of a new model are emerging. Yet we still lack an overall 'framework' for guiding these efforts, and most companies remain stuck in a 'social responsibility' mindset in which societal issues are at the periphery, not the core.
>
> … we believe it can give rise to the next transformation of business thinking …
>
> Realising it will require leaders and managers to develop new skills and knowledge –

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[729] United Kingdom Philanthropy Review *A call to action to encourage more people to give and people to give more* June 2011 at 6, 19.
[730] United Kingdom Philanthropy Review *A call to action to encourage more people to give and people to give more* June 2011 at 6.
[731] Australian Charities Fund Research Report *Brand considerations: workplace giving* Research report October 2012 at 7.
[732] Australian Charities Fund Research Report *Brand considerations: workplace giving* Research report October 2012 at 28, referring to M Porter *The Big Idea: Creating Shared Value* Harvard Business Review, January 2011.

> such as a far deeper appreciation of societal needs, a greater understanding of the true bases of company productivity, and the ability to collaborate across profit/non-profit boundaries.
>
> Businesses, acting as businesses, are the most powerful force for addressing the pressing issues we face.

ANOTHER RECOMMENDATION: PUT UNCLAIMED MONEY TO BETTER USE

545. Organisations such as Inland Revenue, the Treasury, the Māori Trustee, Public Trust and others hold hundreds of thousands of dollars of unclaimed money, only a small portion of which is claimed each year.[733]

546. In January 2020, IRD issued a consultation document regarding unclaimed money, seeking to modernise and simplify the administrative processes which underlie the operation of the Unclaimed Money Act 1971.[734] We submitted at the time that the various "pots" of unclaimed money should be amalgamated into a "social fund", along the lines of "Big Society Capital" (now "Better Society Capital"),[735] and put to work for the benefit of the community?[736]

547. Better Society Capital has been an enormous success in the UK:

> Since 2011, we have helped the social impact investment market grow twelve-fold to over £10bn. This capital has financed social purpose organisations tackling everything from homelessness to mental health and fuel poverty.

548. We did not receive a response to our submission and unclaimed money is not canvassed in the issues paper. However, in this current period of fiscal constraint, and particularly given the difficulties charities currently face in accessing funding, we remain of the view that this issue would be usefully explored.

CONCLUSION

549. We trust this is helpful, and would be happy to be contacted to discuss any of the above points.

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[733] Inland Revenue Te Tari Taake *Unclaimed money*: <www.ird.govt.nz/unclaimedmoney>.
[734] https://www.taxpolicy.ird.govt.nz/publications/2020/2020-ip-unclaimed-money.
[735] See: https://bettersocietycapital.com/.
[736] For a discussion of this issue, see Tessa Vincent "Let's put unclaimed money to good use" 4 February 2021: <www.charitieslawreform.nz/blog/lets-put-unclaimed-money-to-good-use>.

Submission to Inland Revenue: Taxation and the Not-for-Profit Sector

1. Introduction

Howick Baptist Healthcare Limited Group (HBH Group), is a group of charitable companies providing aged care services on a 'not for profit basis', including serviced apartments and social & low cost rentals to elderly residents.

2. Charity Business Income Tax Exemption

- **Q1: What are the most compelling reasons to tax, or not to tax, charity business income? Do the factors described in 2.13 and 2.14 warrant taxing charity business income?**

  As a not for profit organisation HBH relies on income from these activities that directly relate to its charitable purpose. We are concerned with the proposed IRD policy taxing income from these activities. It will have a huge impact on our ability to provide the care to our elderly residents. The aged care sector is fee for service business and it's already short funded. The land and buildings are not funded, and the sector needs to self-raise those funds

  All services provided to residents, contribute to their well-being and any allied services enhance the quality of life for residents.

  Taxing income from these related activities would directly impede HBH's ability to provide comprehensive care, contrary to its charitable purposes as defined in its constitution, and likely reduce the number of residents we are able to house at a time when the demand for care is increasing exponentially. This would place additional burden on Te Whatu Ora to rehouse these kaumatua.

  Acknowledge that HBH, as a larger entity, can manage increased compliance, but this would divert resources from essential care services.

  While this is a disadvantage for taxable businesses, it should not justify taxing income that directly supports charitable aged care.

  Retained earnings are crucial for HBH to reinvest in facilities and services, directly benefiting residents. Taxing these earnings would hinder HBH's ability to maintain and improve its services.

- **Q2: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be the most significant practical implications?**

  Clear definitions of "unrelated business income" are essential to avoid ambiguity.

- **Q3: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what criteria should be used to define an unrelated business?**

  "Unrelated" should be strictly defined as activities that have no direct or indirect benefit to the residents or the provision of aged care services.

For example within the context of HBH:

Related: Operation of all cares within facilities (including providing accommodation within independent living units), as these directly address the specific needs of residents.

Unclear: Potential income from leasing space to healthcare professionals (e.g., physiotherapists/Hairdresser) or private tenants within HBH facilities. Even though this should be considered related due to enhancing residents' access to healthcare except the private tenancy.

- **Q4: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be an appropriate threshold to continue to provide an exemption for small-scale business activities?**

  There is a need to protect smaller charities. That will reduce the compliance and administrative costs for the charities as well as IRD. In our opinion Tier 3 and Tier 4 charities, be exempted. Would the subsidiary be exempted if it's below the threshold whereas the parent company is not. Or would IRD consider the threshold for the entire group as a whole & not separate the subsidiaries?

- **Q5: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, do you agree that charity business income distributed for charitable purposes should remain tax exempt? If so, what is the most effective way to achieve this? If not, why not?**

  We strongly agree that income distributed for charitable purposes must remain tax-exempt, as this aligns with HBH's constitutional purpose.

  We support the idea of a special memorandum account. We need clear rules to prevent the tax avoidance, but overly complex rules will unnecessarily increase the administrative burden.

- **Q6: If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what policy settings or issues not already mentioned in this paper do you think should be considered?**

  It will impact on HBH's ability to maintain and develop its facilities to meet the evolving needs of the aging population.

  It will potentially affect HBH's long-term financial planning and stability, which is crucial for ensuring continuity of care.

  It is important to recognize the unique financial structure of charitable companies like HBH, where surpluses are reinvested into services rather than distributed as profits, as outlined in clause 1.3 of the Constitution.

3. Donor-Controlled Charities

HBH's- shares are held by charitable organisations, and as such, given the focus of the IRD paper, HBH may choose to make brief comments on the principles of transparency and accountability during further consultation.

- **Q7: Should New Zealand make a distinction between donor-controlled charities and other charitable organisations for tax purposes? If so, what criteria should define a donor-controlled charity? If not, why not?**

  All charities, including HBH, should be held to high standards of transparency and accountability to maintain public trust.

- **Q8: Should investment restrictions be introduced for donor-controlled charities for tax purposes, to address the risk of tax abuse? If so, what restrictions would be appropriate? If not, why not?**

  We support measures to prevent tax abuse but ensure they do not hinder the legitimate charitable activities of organizations like HBH, which are governed by a constitution that prioritizes charitable purposes.

- **Q9: Should donor-controlled charities be required to make a minimum distribution each year? If so, what should the minimum distribution rate be and what exceptions, if any, should there be for the annual minimum distribution? If not, why not?**

  We acknowledge the arguments for a minimum distribution rule but suggest that alternative mechanisms, such as robust reporting requirements and independent audits, could achieve similar goals for charitable companies.

4. Integrity and Simplification – No comments on questions under this section.

31 March 2025 8:21PM

“To: Inland Revenue Department Subject: Submission on Proposed Taxation of Churches and Not-for-Profit Sector Dear Sir/Madam, I am writing to express my concern regarding the proposed taxation changes affecting churches and not-for-profit organisations.

Churches play a vital role in our communities, providing spiritual support, charitable services, and social outreach that benefit countless individuals, including the most vulnerable in society. Introducing a tax on churches would negatively impact fundraising efforts, limit community support programs, and place additional financial strain on faith-based organisations that rely on voluntary contributions. Many churches operate with minimal resources, and any new tax burden could significantly affect their ability to serve the community. I urge the government to reconsider this proposal and recognise the valuable contribution that churches and not-for-profits make to the social fabric of New Zealand.

Thank you for considering my submission.

Sincerely,

Fr. Prakash SOMU”