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Taxation and the not-for-profit sector
C/- Mr David Carrigan
Deputy Commissioner, Policy
Inland Revenue Department
Wellington, 6140
New Zealand

Email: policy.webmaster@ird.govt.nz

31 March 2025

Dear David,

Taxation and the not-for-profit sector

Thank you for the opportunity to comment on the consultation on **Taxation and the not-for-profit sector** prior to its finalisation.

CPA Australia represents the diverse interests of more than 175,000 members, including over 3,300 members in New Zealand, working in over a 100 countries and regions supported by 19 offices around the world. We make this submission on behalf of our members and in the broader public interest.

We make the following summary comments and key points for your consideration:

The existing rules for charities in New Zealand are fit for purpose and do not require reform. The current framework provides a stable and well-understood basis for the operation of charitable entities, ensuring that they can effectively pursue their missions while benefiting from tax concessions. The definition of "charitable purpose" under the Income Tax Act 2007 is comprehensive, encompassing relief of poverty, advancement of education or religion, and other community-beneficial activities, which aligns with international standards and practices. This broad definition allows for flexibility and adaptability to the evolving needs of society.

The regulatory environment, including the ***Charities Act 2005***, provides robust mechanisms for registration, reporting, and monitoring of charities, ensuring transparency and accountability. Charities Services, under the Department of Internal Affairs, maintains a public register of charities, which enhances public trust and confidence in the sector.

Furthermore, the current tax concessions, including income tax exemptions and donation rebates, are well-targeted to support the charitable sector without imposing undue compliance burdens. The existing system strikes a balance between encouraging charitable activities and maintaining the integrity of the tax system.

In conclusion, the current rules governing charities are effective in supporting the sector's growth and contribution to society. Any changes to the existing framework should be approached with caution to avoid unnecessary disruption and to preserve the benefits currently enjoyed by the charitable sector.

Please refer to the Appendix for our response to the questions raised in the consultation paper. If you have any queries about this submission, please contact me on jenny.wong@cpaaustralia.com.au or Bill Leung, Tax Technical Advisor on bill.leung@cpaaustralia.com.au.

Yours sincerely,

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Acknowledgements

CPA Australia would like to acknowledge the following Tax Committee members for their input and guidance in shaping this submission:

- Mr Angus Ogilvie FCPA (Aust.), Chair of Tax Committee – New Zealand
- Mr Adrian Sawyer FCPA (Aust.), Tax Committee – New Zealand

Appendix

Detailed discussion

Response to discussion questions

Chapter 2: Charities 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?

CPA Australia acknowledges that a comparatively small number of charities run businesses. Arguments about levelling the playing field with private businesses are advanced by some.

However, we also recognise that many charities need to have some form of business income to supplement their revenue, particularly in the face of declining incomes and government grants.

There are several reasons why taxing business income might be considered.

1. **Competitive Neutrality**: One of the primary arguments for taxing charity income is to ensure a level playing field between charitable and non-charitable businesses. Charities that engage in business activities can have a competitive advantage over for-profit businesses because they do not pay income tax. This can lead to market distortions where charities can potentially undercut competitors due to their tax-exempt status, allowing them to accumulate capital more rapidly and expand their operations faster than their taxed counterparts. This competitive advantage is seen as unfair to other businesses that do not have the same tax benefits. However, we note that there seems to be very little data to support that this is an issue in the New Zealand context.

2. **Revenue Generation**: Taxing the income of charities could provide additional revenue for the government. This revenue could be used to fund public services or reduce the tax burden on other taxpayers. The exemption of charities from income tax means that the government forgoes potential tax revenue, which must be compensated for by higher taxes elsewhere or reduced public spending.

3. **Accountability and Transparency**: Imposing tax obligations on charities could enhance accountability and transparency. By requiring charities to file tax returns, the government can ensure that these entities are genuinely pursuing charitable purposes and not accumulating excessive funds without clear charitable objectives. This could also help prevent the misuse of charitable status for personal gain.

4. **Targeted Support**: Taxing charities could allow for more targeted support. Instead of a blanket exemption, the government could provide tax relief or subsidies to charities that meet specific criteria or demonstrate a significant public benefit. This approach could ensure that tax benefits are directed towards charities that provide the most value to society.

5. **Encouraging Efficiency**: Taxing charities might encourage them to operate more efficiently. Without the cushion of tax exemptions, charities would need to manage their resources more effectively to maintain their operations and achieve their charitable goals. This could lead to better use of resources and improved outcomes for the communities they serve.

The most compelling reasons not to tax charity business income in New Zealand are primarily based on the legislative framework provided by the ***Income Tax Act 2007***, specifically sections **CW 41** and **CW 42**, which outline the conditions under which income derived by charities can be exempt from tax:

1. **Charitable Purpose and Public Benefit**: The definition of a charitable purpose under the *Income Tax Act 2007* includes purposes that are beneficial to the community, such as the relief of poverty, advancement of education or religion, and other community-beneficial activities. The public benefit requirement is a key factor in determining whether an entity qualifies as a charity and thus can access tax exemptions. This ensures that the tax exemption is only available to entities that genuinely serve the public interest.

2. **Encouragement of Charitable Activities**: By exempting business income of charities from tax, the legislation encourages the growth and sustainability of charitable activities. This exemption allows charities to retain more of their income, which can be reinvested into their charitable purposes, thereby enhancing their ability to serve the community.

3. **Territorial Restriction**: Section CW 42 imposes a territorial restriction, meaning that the exemption applies only to the extent that the charity's purposes are carried out within New Zealand. This ensures that the tax benefits are aligned with the national interest, supporting local charitable activities. If a charity's purposes extend beyond New Zealand, the income must be apportioned, and only the portion related to New Zealand activities is exempt.

4. **Control Restriction**: The exemption is also contingent on the control restriction, which prevents individuals with control over the charity from directing or diverting income for personal gain. This ensures that the tax exemption is not abused for private benefit and remains focused on supporting charitable purposes.

5. **Historical and Policy Considerations**: Historically, the exemption for charitable business income has been a long-standing feature of New Zealand's tax system, reflecting a policy decision to support entities that contribute to the public good. This policy is rooted in the recognition that charities play a vital role in society, and taxing their income could hinder their ability to fulfil their missions.

These reasons collectively form a robust framework that justifies the exemption of charity business income from taxation, ensuring that the benefits of such exemptions are directed towards enhancing public welfare and supporting charitable activities within New Zealand. For further details, one can refer to sections CW 41 and CW 42 of the *Income Tax Act 2007*, which provide comprehensive rules on the tax treatment of charitable income. On balance, CPA Australia favours the retention of the current rules.

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?

If the tax exemption for charity business income that is unrelated to charitable purposes is removed, several significant practical implications could arise:

1. **Increased Administrative Burden:** Charities would face increased administrative and compliance costs. They would need to maintain detailed records to distinguish between income related to charitable purposes and unrelated business income. This would require more sophisticated accounting systems and potentially more frequent audits to ensure compliance with tax obligations.

2. **Financial Impact on Charities:** The removal of the exemption could reduce the financial resources available to charities. Income that was previously tax-exempt would now be subject to taxation, potentially reducing the funds available for charitable activities. This could lead to a decrease in the scope and scale of services provided by charities, particularly those heavily reliant on business income.

3. **Impact on Charitable Activities:** Charities might need to reassess their business models and potentially reduce or eliminate certain business activities that are not directly related to their charitable purposes. This could lead to a refocusing of efforts on core charitable activities, but it might also result in the loss of innovative or entrepreneurial activities that indirectly support charitable goals.

4. **Revenue Generation for the Government:** Taxing unrelated business income could generate additional revenue for the government. This revenue could be used to fund public services or provide targeted support to charities that demonstrate significant public benefit. However, the overall impact on government revenue would depend on the scale of unrelated business activities conducted by charities.

5. **Potential for Legal and Policy Challenges:** The change could lead to legal challenges and policy debates about the definition of "unrelated business income" and the criteria for determining tax liability. This could necessitate further legislative and regulatory clarification to ensure consistent application of the new rules.

Overall, while the removal of the tax exemption for unrelated business income could address certain competitive and revenue concerns, it would also introduce new challenges for charities in terms of compliance, financial planning, and strategic focus. We submit that the definition of business income may become fraught with uncertainty and lead to an increase in subjective judgement.

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?

With not-for-profits and charities, a key issue relates to the purpose for which an (business) activity is being carried out, or as in the United Kingdom (UK), the "carrying out of a primary purpose." O'Halloran[1] states:

> "The profits from [primary purpose trading] are exempt from tax when carried on directly by the charity as a means of giving effect to one or more of its objectives and thereby fulfilling the charitable purposes as stated in its governing instrument. Examples of such trades would include: an art gallery or museum holding an exhibition and charging an admission fee; a school providing an educational service on a fee-paying basis; a theater selling tickets for a production that it is staging; or a hospital providing health care services on a fee-paying basis."

What is important is that the primary purpose trading is directly related to the charitable purpose of the entity, and therefore exempt from income tax. On the other hand, there is also "non-primary purpose trading", which O'Halloran states (at 67-68):

> "… [which] is intended to raise funds for the charity, as distinct from trading that furthers the charity's objectives, and is the UK equivalent of "unrelated business activity" in the United States … those profits will be liable to tax regardless of the ultimate destination of the income, and such trading may also, depending on the scale of this activity, threaten the charitable status of the organization."

A similar issue arises in the United States (US) with the **Unrelated Business Income Tax (UBIT).** O'Halloran cites the following in explanation (at 280):

> "Unrelated business income is produced from an activity that is conducted on a regular basis and is not directly related to an organization's tax-exempt mission. Income earned by an organization is treated as unrelated business income if it meets two basic requirements. First, the income is derived from a trade or business that is regularly carried on by the organization. Second, the income is earned from a trade or business that is not substantially related to the performance of the organization's exempt purpose or function. Even if profits from such activities are used by tax-exempt organizations to finance their exempt purposes, income that meets these two requirements generally is treated as unrelated business income [therefore liable to income tax under 26 U.S.C ss 511-14 of the **Internal Revenue Code** with respect to s 501(c)(3) tax-exempt organizations]."

Effectively, for most organisations that are charities or non-profits, an activity is an unrelated business (and subject to unrelated business income tax) if it meets three requirements:

1. It is a trade or business,
2. It is regularly carried on, and
3. It is not substantially related to furthering the exempt purpose of the organisation.

This is subject to a number of modifications, exclusions and exceptions. In 2017 the accounting for tax purposes was changed such that nonprofits must calculate their taxes on each "trade or business" separately and not aggregate profits and losses of all entities. The IRS provides guidance in **Publication 598** (Rev March 2021) *Tax on Unrelated Business Income of Exempt Organizations.* This approach could be worth exploring for New Zealand if IR wishes to recommend a more significant change.

A provision in the ITA 2007 is also worth considering for amendment is s **CW 41 Charities: non-business income**, Section CW 41 could be amended to provide that primary purpose trading is exempt from income tax, along the lines of that in the UK. Section CW 41 (1) might be simply amended to read:

> "*Income derived directly from a primary purpose business* … is exempt income if …."

[1] Kerry O'Halloran, "The Profits of Charity: International perspectives on the law governing the involvement of charities in commerce" (Oxford University Press, 2012) at 67.

This would also require a review of **s CW 42 – Charities: business income**.

This should not be a complicated exercise, with the issue being the distinction between primary (or related) business activity and non-primary (or unrelated) business activity. However, this would need a clear distinction between these types of activities, preferably one made in legislation (which may need refinement through a public ruling, etc). Therefore, determining which definition to use for "unrelated business" in the context of taxing charity business income presents several challenges:

1. **Complexity and Ambiguity:** Different definitions may lead to varying interpretations of what constitutes an "unrelated business." This can create ambiguity and complexity, making it difficult for charities to understand their tax obligations. The lack of a clear, standardised definition can result in inconsistent application and increased compliance costs for charities.

2. **Balancing Flexibility and Precision:** A definition needs to be precise enough to provide clear guidance but flexible enough to accommodate the diverse activities of charities. Striking this balance is challenging, as overly rigid definition may not account for the unique circumstances of different charities, while overly broad definitions may fail to provide the necessary clarity.

3. **Alignment with Policy Objectives:** The definition must align with the broader policy objectives of supporting charitable activities while ensuring fair competition with for-profit businesses. This requires careful consideration of the economic and social impacts of different definitions, as well as their alignment with legislative intent.

4. **Administrative and Compliance Burden:** Implementing a new definition may increase the administrative burden on both charities and tax authorities. Charities may need to invest in new systems and processes to track and report unrelated business income, while tax authorities may face challenges in enforcing compliance and resolving disputes.

5. **Potential for Legal Challenges:** Any new definition is likely to be subject to legal scrutiny and potential challenges. Charities may contest the classification of certain activities as unrelated, leading to litigation and further complicating the tax landscape.

6. **Historical Precedents and International Comparisons:** The definition should consider historical precedents and international practices to ensure consistency and fairness. However, differences in legal and cultural contexts can make it difficult to directly apply international models to the New Zealand context.

These challenges highlight the need for a carefully considered approach to defining "unrelated business" that balances clarity, fairness, and administrative feasibility. A standardised definition, as suggested in the context of associated persons, might help address some of these issues by providing a coherent and consistent framework. CPA Australia believes that income earned through investments should be explicitly excluded from any proposed definition.

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?

While CPA Australia questions whether any reform is desirable or achievable, we do believe that any threshold should exclude any small and medium-sized charities for the reasons set out earlier in the document. Cost and administrative compliance will be significant and for that reason any de minimis threshold should be set above Tiers 3 & 4.

Including Tier 3 and Tier 4 charities in a de minimis exemption for unrelated business income taxation is important for several reasons:

1. **Resource Limitations**: Tier 3 and Tier 4 charities are typically smaller organisations with limited resources. They often lack the administrative capacity and financial resources to manage complex tax compliance requirements. A de minimis exemption would alleviate the compliance burden on these smaller charities, allowing them to focus their limited resources on their core charitable activities rather than on tax administration. This is consistent with the policy of reducing compliance costs for entities with limited resources.

2. **Proportionality and Fairness**: Applying a de minimis exemption ensures that the tax system is proportionate and fair. Smaller charities, which may engage in minimal unrelated business activities, should not be subject to the same tax obligations as larger organisations with significant business operations. This approach recognises the different scales of operation and ensures that the tax system does not disproportionately impact smaller entities.

3. **Encouragement of Charitable Activities**: By providing a de minimis exemption, the tax system can encourage the continued operation and growth of smaller charities. These organisations often play a crucial role in their communities, providing essential services and support. Exempting them from tax on small-scale business activities allows them to retain more of their income for charitable purposes, thereby enhancing their ability to serve the community.

4. **Administrative Efficiency**: From an administrative perspective, it is inefficient for tax authorities to dedicate resources to enforcing tax compliance on small-scale activities that generate minimal revenue. A de minimis threshold helps focus tax enforcement efforts on larger entities where the potential tax revenue is more significant, thereby improving the overall efficiency of the tax system.

5. **Consistency with Existing Policy**: The use of de minimis thresholds is a common practice in tax policy to simplify compliance and administration. For example, similar thresholds are used in other areas of tax law, such as GST registration and minor beneficiary rules, to ensure that the tax system is manageable for smaller entities. Applying a de minimis exemption for Tier 3 and Tier 4 charities aligns with this broader policy approach.

In summary, including Tier 3 and Tier 4 charities in a de minimis exemption for unrelated business income taxation supports the principles of fairness, efficiency, and encouragement of charitable activities, while recognising the unique challenges faced by smaller charitable organisations.

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?

To argue that charity business income distributed for charitable purposes should remain tax-exempt, even if the tax exemption is removed for unrelated business income, we can consider several points grounded in the principles and legislative framework governing charitable tax exemptions in New Zealand.

1. **Purpose of Charitable Tax Exemptions**: The primary rationale for providing tax exemptions to charities is to support their public benefit activities. Charities operate for the public good, often addressing needs that would otherwise fall to the government or remain unmet. The exemption from tax on income used for charitable purposes aligns with the policy objective of encouraging and facilitating charitable activities that benefit society. This is reflected in the legislative framework, where income applied to charitable purposes within New Zealand is generally exempt from tax under sections CW 41 and CW 42 of the *Income Tax Act 2007*.

2. **Distinction Between Business and Charitable Purposes**: The legislation distinguishes between business income and non-business income, with specific provisions for the exemption of business income when it is applied to charitable purposes. Section CW 42 provides that business income is exempt if it is derived by a registered charity and applied to its charitable purposes in New Zealand, provided certain conditions are met, such as the absence of control by individuals who could benefit personally.

3. **Policy Intent and Fairness**: The policy intent behind the exemption is to ensure that funds used for charitable purposes are not diminished by tax liabilities, thereby maximizing the resources available for public benefit activities. Removing the exemption for unrelated business income should not penalize charities that use their business income for charitable purposes. The fairness principle suggests that income genuinely applied to charitable purposes should remain exempt to avoid discouraging charitable activities and to maintain the integrity of the charitable sector's contribution to society.

4. **Compliance and Administrative Considerations**: Allowing the exemption for business income distributed for charitable purposes can reduce compliance and administrative burdens on charities. Charities often

operate with limited resources, and imposing additional tax liabilities on income used for charitable purposes could divert resources away from their core activities.

5. **Historical and Legislative Context**: Historically, the charitable exemption has been a longstanding feature of New Zealand's tax system, reflecting a societal consensus on the value of supporting charitable activities. The legislative history shows that the exemption for business income has been carefully crafted to balance the need for oversight with the encouragement of charitable work.

In conclusion, maintaining the tax exemption for charity business income distributed for charitable purposes aligns with the legislative intent, supports the public benefit role of charities, and ensures that resources are directed towards societal needs rather than tax liabilities. For further details, one can refer to sections CW 41 and CW 42 of the *Income Tax Act 2007*, which outline the conditions under which charitable income is exempt.

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?

If the tax exemption is removed for charity business income that is unrelated to charitable purposes, several additional policy settings and issues should be considered to ensure a fair and effective tax system for charities:

1. **Apportionment of Income**: The current framework under section CW 42 of the *Income Tax Act 2007* requires charities to apportion their business income between charitable purposes in New Zealand and those outside New Zealand. This apportionment should be reasonable and reflect the actual use of funds. Policymakers should consider providing clearer guidelines or safe harbour rules to assist charities in determining a reasonable apportionment, reducing compliance costs and uncertainty.

2. **Impact on Charitable Activities**: Removing the exemption for unrelated business income could impact the ability of charities to fund their charitable activities. Policymakers should assess the potential impact on the charitable sector and consider transitional measures or support to mitigate any negative effects on the delivery of charitable services.

3. **Encouragement of Charitable Giving**: The tax system plays a role in encouraging charitable giving. Policymakers should consider whether changes to the business income exemption might affect donor behaviour and whether additional incentives or adjustments to donation tax credits are needed to maintain or enhance charitable giving.

4. **Equity and Fairness**: The policy should ensure that the tax treatment of charities is equitable and does not disadvantage them compared to other entities. This includes considering the unique nature of charitable organisations, which often rely on volunteer labour and donated goods, and ensuring that the tax system recognises these contributions to society.

5. **Monitoring and Compliance**: Effective monitoring and compliance mechanisms should be in place to ensure that charities adhere to the new rules. This could include regular audits or reviews by the Inland Revenue Department to ensure that charities are correctly apportioning their income and complying with the new tax obligations.

These considerations aim to balance the need for a fair tax system with the recognition of the valuable role that charities play in society. For further details, one can refer to section CW 42 of the *Income Tax Act 2007*, which outlines the conditions under which charitable income is exempt.

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?

CPA Australia does not believe that any such distinction should be made.

1. **Complexity and Compliance Costs**: Introducing a distinction could add complexity to the tax system, increasing compliance costs for charities and administrative burdens for the Inland Revenue Department. This could be particularly challenging for smaller charities with limited resources.
2. **Potential for Unintended Consequences**: A distinction might inadvertently penalise charities that rely on significant donor support but still operate with a strong public benefit focus. It could also discourage large donations if donors perceive that their influence might lead to negative tax implications for the charity.
3. **Existing Safeguards**: Current regulations and oversight mechanisms, such as the requirement for charities to register with the Charities Services and adhere to reporting obligations, may already provide sufficient safeguards against misuse of charitable status.

There appears to be no known abuse of donor-controlled charities and in the absence evidence, rules setting aside donor-controlled charities from all other charities would lack any overarching purpose.

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?

CPA Australia does not support the introduction of investment restrictions for donor-controlled charities to address the risk of tax abuse for the following reasons:

1. **Existing Safeguards**: The current tax framework already includes provisions to prevent tax abuse by ensuring that income derived by charities is used for charitable purposes. Section CW 42 of *the Income Tax Act 2007* requires that no person with control over the business can direct or divert income for non-charitable purposes. This control restriction is designed to prevent misuse of charitable funds and ensures that the income is applied to the charity's objectives.
2. **Flexibility in Investment**: Charities, including donor-controlled ones, often rely on investment income to fund their activities. Imposing investment restrictions could limit their ability to generate income, thereby reducing the resources available for charitable purposes. This could be counterproductive, as it might hinder the charity's ability to fulfil its mission.
3. **Administrative Burden**: Introducing investment restrictions would likely increase the administrative burden on charities, requiring them to track and report on their investments in detail. This could divert resources away from their core charitable activities and increase compliance costs, particularly for smaller charities with limited administrative capacity.
4. **Potential for Unintended Consequences**: Investment restrictions could lead to unintended consequences, such as discouraging donations from individuals who wish to have some influence over how their contributions are used. This could reduce overall charitable giving and negatively impact the sector.
5. **Encouragement of Charitable Activities**: The tax system aims to encourage charitable activities by providing tax exemptions. Restricting investments could undermine this objective by making it more difficult for charities to sustain their operations and expand their impact.
6. **Equity and Fairness**: It is important to ensure that any measures introduced are equitable and do not disproportionately affect certain types of charities. Donor-controlled charities may have legitimate reasons for their governance structures, and blanket restrictions could unfairly penalise them.

In conclusion, while the risk of tax abuse is a theoretical concern, the existing legal framework provides mechanisms to address this risk without the need for additional investment restrictions. The focus should remain on ensuring compliance with existing rules and supporting the charitable sector's ability to carry out its public benefit activities effectively. For further details, one can refer to section CW 42 of the *Income Tax Act 2007*, which outlines the conditions under which charitable income is exempt.

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?

The question of whether donor-controlled charities should be required to make a minimum distribution each year involves balancing the need to ensure that charitable funds are actively used for public benefit against the administrative and operational flexibility required by charities.

CPA Australia does not support any change to the status quo for the following reasons:

1. **Operational Flexibility**: Charities, including donor-controlled ones, often need flexibility in managing their funds to respond to changing circumstances and opportunities. A rigid minimum distribution requirement could hinder their ability to plan for long-term projects or to accumulate reserves for future needs, such as capital projects or economic downturns. This flexibility is crucial for the sustainability and effectiveness of charitable activities.

2. **Existing Oversight Mechanisms**: The current regulatory framework already includes mechanisms to ensure that charities use their funds for charitable purposes. For instance, charities must be registered and comply with reporting requirements, which provide transparency and accountability. These mechanisms can be strengthened, if necessary, without imposing a minimum distribution requirement.

3. **Potential for Unintended Consequences**: Imposing a minimum distribution requirement could lead to unintended consequences, such as encouraging charities to make distributions that are not strategically aligned with their mission, simply to meet the requirement. This could result in inefficient use of resources and undermine the charity's long-term goals.

4. **Administrative Burden**: A minimum distribution requirement would add an administrative burden on charities, requiring them to track and report distributions in detail. This could divert resources away from their core activities and increase compliance costs, particularly for smaller charities with limited administrative capacity.

5. **Diverse Nature of Charities**: Charities vary widely in their size, mission, and operational model. A one-size-fits-all minimum distribution requirement may not be appropriate for all charities. For example, some charities may focus on accumulating funds for a specific future project, while others may operate on a more immediate distribution model.

If a minimum distribution requirement were to be considered, it would be important to set a reasonable rate that reflects the diverse nature of charities and to allow for exceptions where appropriate. Exceptions could include situations where a charity is saving for a large capital project, experiencing financial hardship, or operating in a sector with cyclical funding needs.

In conclusion, while ensuring that charitable funds are used effectively is important, the existing regulatory framework provides mechanisms to achieve this without imposing a minimum distribution requirement. The focus should remain on enhancing transparency and accountability through existing oversight mechanisms.

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.**

To address the impact of the Commissioner's updated view on not-for-profits (NFPs), particularly smaller NFPs, several policy changes could be considered:

1. **Increasing and/or Redesigning the Current $1,000 Deduction**: The current $1,000 deduction threshold for NFPs could be increased or redesigned to remove small-scale NFPs from the tax system. This would reduce compliance costs and administrative burdens for smaller NFPs, allowing them to focus more on their charitable activities. The threshold could be adjusted to reflect inflation or the average operating costs of small NFPs, ensuring that only those with significant income are required to engage with the tax system.

This approach aligns with the principle of reducing compliance costs for smaller entities, as highlighted in various discussions on tax simplification.

2. **Modifying Income Tax Return Filing Requirements for NFPs**: Simplifying the filing requirements for NFPs could significantly reduce their administrative burden. For instance, smaller NFPs could be allowed to file a simplified return or be exempt from filing if their income falls below a certain threshold. This would be consistent with the approach of reducing compliance costs for small entities and ensuring that the tax system does not impose unnecessary burdens on organisations with limited resources.

3. **Modifying Resident Withholding Tax (RWT) Exemption Rules for NFPs**: The RWT exemption rules could be modified to provide greater flexibility for NFPs. For example, smaller NFPs could be automatically exempt from RWT on certain types of income, or the process for obtaining an exemption could be simplified. This would help reduce the administrative burden on NFPs and ensure that they are not disadvantaged by complex tax rules.

4. **Providing Transitional Support and Guidance**: As the Commissioner's updated view may require NFPs to adjust their operations, providing transitional support and guidance could help them navigate the changes. This could include offering workshops, online resources, and direct support from Inland Revenue to ensure that NFPs understand their obligations and can comply with the new requirements effectively.

5. **Engaging in Consultation with the NFP Sector**: Engaging with the NFP sector to gather feedback and insights on the proposed changes can help identify potential issues and ensure that the policy is practical and effective. This consultation process can also help build trust and cooperation between the government and the NFP sector.

These policy changes aim to balance the need for a fair tax system with the recognition of the valuable role that NFPs play in society. They also seek to ensure that smaller NFPs are not disproportionately affected by the updated view and can continue to contribute to their communities effectively.

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

The removal of current tax concessions for friendly societies and credit unions would have several implications, both positive and negative, which need to be carefully considered:

1. **Impact on Credit Unions and Friendly Societies**: Credit unions and friendly societies may face increased financial pressure if tax concessions are removed. These organisations often operate with limited resources and serve niche markets, such as providing savings and loan facilities to members. The removal of tax exemptions could reduce their ability to offer competitive rates and services, potentially impacting their viability and the financial well-being of their members.

2. **Compliance Costs**: The removal of tax concessions would likely increase compliance costs for credit unions and friendly societies. These organisations would need to adapt to new tax obligations, including filing tax returns and managing tax liabilities. This could be particularly burdensome for smaller entities with limited administrative capacity.

3. **Regulatory Considerations**: The regulatory framework for credit unions and friendly societies is already quite prescriptive, with restrictions on borrowing, lending, and investment activities. Any changes to their tax status would need to be carefully coordinated with regulatory requirements to avoid unintended consequences, such as reducing their ability to meet prudential requirements or serve their members effectively.

4. **Potential for Restructuring**: If tax concessions are removed, some credit unions and friendly societies may need to restructure to maintain their financial viability. This could involve changes to their governance structures, business models, or service offerings. Such restructuring could incur significant costs and require careful planning and support from regulatory bodies.

5. **Social and Economic Impact**: Credit unions and friendly societies often play a vital role in providing financial services to underserved communities. The removal of tax concessions could impact their ability to fulfil this role, potentially leading to reduced access to affordable financial services for certain groups. Policymakers would need to consider the broader social and economic implications of such a change.

In conclusion, any change would pose significant challenges and risks. Policymakers should carefully weigh these factors. In the absence of any pressing need for reform, CPA Australia favours the status quo.

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?**

- **local and regional promotional body income tax exemption**

The removal of the income tax exemption for local and regional promotional bodies, as provided under section CW 40 of the *Income Tax Act 2007*, would have two specific implications.

1. **Impact on Public Amenities and Tourism**: The removal of the exemption could lead to a decrease in the activities aimed at promoting tourism and public amenities, as these bodies might have less financial capacity to invest in such projects. This could have a broader economic impact, potentially reducing tourism and related economic activities in the regions they serve.

2. **Potential for Reduced Donations and Sponsorships**: If these bodies rely on donations or sponsorships, the removal of the tax exemption could make them less attractive to donors or sponsors who might prefer to support tax-exempt entities. This could further reduce their funding and operational capacity.

- **herd improvement bodies income tax exemption**

The income tax exemption for herd improvement bodies, as outlined in section **CW 51** of the *Income Tax Act 2007*, provides that income derived by a herd improvement association or society is exempt if the association or society is established mainly to promote the improvement of the standard of dairy cattle in New Zealand, and none of its funds is used for the private pecuniary profit of a member, proprietor, shareholder, or associate. The removal of this exemption would have two specific implications:

1. **Impact on Dairy Industry:** The removal of the exemption could lead to a decrease in activities aimed at improving dairy cattle standards, which could have a broader impact on the dairy industry in New Zealand. This could affect the quality and productivity of dairy cattle, potentially impacting the competitiveness of New Zealand's dairy industry.

2. **National Significance:** Originally, herd improvement bodies were considered of national significance, which justified their tax-exempt status. Removing the exemption could be seen as a shift in policy regarding the importance of these bodies to national interests.

- **veterinary service body income tax exemption**

The income tax exemption for veterinary service bodies is outlined in section **CW 50** of the *Income Tax Act 2007*. This exemption applies to income derived by veterinary associations, clubs, or societies established mainly to promote efficient veterinary services in New Zealand, provided that none of their funds is used for the private pecuniary profit of any member, proprietor, shareholder, or associate. Additionally, the income derived by the Veterinary Council of New Zealand is also exempt.

If this exemption were removed, it could lead to a decrease in activities aimed at improving veterinary services, which could have a broader impact on animal health and welfare in New Zealand. This could affect the quality and availability of veterinary services, potentially impacting the agricultural sector and pet owners.

- **bodies promoting scientific or industrial research income tax exemption**

The income tax exemption for bodies promoting scientific or industrial research is provided under section **CW 49** of the *Income Tax Act 2007*. This exemption applies to income derived by a society or association established mainly to promote or encourage scientific or industrial research, provided that the society or association is approved by the Royal Society of New Zealand and none of its funds is used for the private pecuniary profit of a member, proprietor, shareholder, or associate. This exemption does not apply to Crown Research Institutes.

If this exemption were removed, two specific implications could arise:

1. **Impact on Research and Development (R&D)**: The removal of the exemption could lead to a decrease in activities aimed at promoting scientific or industrial research, which could have a broader impact on innovation and technological advancement in New Zealand. This could affect the competitiveness of New Zealand's industries and their ability to innovate.
2. **Eligibility for R&D Tax Incentives**: Currently, entities that receive exempt income under section CW 49 are eligible for the R&D Tax Incentive, which allows them to claim R&D tax credits. If the exemption were removed, these bodies might still be eligible for the R&D Tax Incentive, but they would need to manage their tax liabilities differently.

- **non-resident charity tax exemption?**

In New Zealand, non-resident charities can qualify for certain income tax exemptions, but there are specific conditions and limitations that apply. The key provisions are found in sections CW 41 and CW 42 of the *Income Tax Act 2007*.

1. **Non-Business Income Exemption**: Under section CW 41, non-resident charities can be exempt from income tax on their non-business income if they are approved as a "tax charity" by the Commissioner. To qualify, the charity must not be able to register with Charities Services due to an insufficient connection to New Zealand, and it must carry out its charitable purposes overseas. The charity must also not be carried on for private profit and should be recognised as charitable by overseas regulators.
2. **Business Income Exemption**: Section CW 42 provides an exemption for business income, but this is generally limited to income used for charitable purposes within New Zealand. Non-resident charities with business income used to carry out charitable purposes in New Zealand must be registered with Charities Services to be eligible for this exemption. Business income applied overseas is not exempt.
3. **Approval Process**: Non-resident charities seeking tax charity status must apply to the Commissioner and provide evidence of their charitable status and the reasons they cannot register with Charities Services. This includes demonstrating that they are not resident in New Zealand, carry out all charitable purposes overseas, and are recognised as charitable by overseas authorities.
4. **Double Tax Agreements**: If a non-resident charity does not qualify for the exemption under section CW 41, it may still be eligible for relief from New Zealand taxation under a double tax agreement between New Zealand and the charity's country of residence.

Overall, while non-resident charities can access certain tax exemptions in New Zealand, these are contingent on meeting specific criteria and often require approval from the Commissioner.

If the tax exemption for non-resident charities were removed, two specific implications could arise:

1. **Impact on Charitable Activities**: The removal of the exemption could lead to a decrease in charitable activities carried out by non-resident charities in New Zealand, as they might have less financial capacity to invest in such projects. This could have a broader impact on the communities and causes they support.

2. **Double Tax Agreements**: Non-resident charities might seek relief from New Zealand taxation under a double tax agreement between New Zealand and their country of residence. However, this would depend on the specific terms of the relevant agreement.

Overall, the removal of the tax exemption for non-resident charities would likely lead to increased financial and administrative burdens on these organisations, potentially reducing their ability to fulfil their charitable objectives effectively. For more detailed analysis, one could refer to sections CW 41 and CW 42 of the *Income Tax Act 2007*, which outline the provisions related to income and exemptions for charities.

Overall impact to all sectors

Common to all sectors in question 12 are the following consequences that would arise if the tax exemption were to be removed:

1. **Increased Tax Liability**: These bodies would become subject to income tax on their income, which was previously exempt. This would increase their tax liability and potentially reduce the funds available for their primary activities, such as promoting scientific or industrial research. The exemption currently allows these bodies to use all their funds for these purposes without the burden of income tax. Without the exemption, they would need to allocate a portion of their income to tax payments, which could reduce their operational capacity.
2. **Administrative and Compliance Costs**: These bodies would face increased administrative and compliance costs associated with preparing and filing income tax returns. This could be particularly burdensome for smaller organisations that may not have the resources to manage these additional requirements efficiently.
3. **Equity and Fairness Considerations**: The removal of the exemption could raise questions about equity and fairness, particularly if similar exemptions remain in place for other types of organisations, such as charities or educational institutions. This could lead to calls for a broader review of tax exemptions to ensure consistency and fairness across different sectors.

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?

If the compliance costs associated with Fringe Benefit Tax (FBT) are reduced following the current review of FBT settings, and the exemption for charities is removed or reduced, several implications could arise and a largely similar to the previous question:

1. **Increased Tax Liability for Charities**: Charities would be required to pay FBT on benefits provided to their employees, which were previously exempt. This would increase their tax liability and potentially reduce the funds available for their charitable activities. The exemption currently allows charities to use all their funds for charitable purposes without the burden of FBT. Without the exemption, they would need to allocate a portion of their resources to tax payments, which could reduce their operational capacity.

2. **Impact on Charitable Activities**: The removal or reduction of the exemption could lead to a decrease in charitable activities carried out by these organisations, as they might have less financial capacity to invest in such projects. This could have a broader impact on the communities and causes they support.

3. **Equity and Fairness Considerations**: The removal of the exemption could address equity concerns, as it would align the tax treatment of employees of charities with those of other organisations. Currently, employees of charities may receive untaxed fringe benefits, which can create a tax advantage compared to employees in other sectors. Removing the exemption would ensure that all employees are treated similarly for tax purposes.

4. **Potential for Salary Restructuring**: Charities might respond to the removal of the exemption by restructuring their remuneration packages, potentially reducing fringe benefits and increasing cash salaries to minimise FBT liabilities. This could lead to changes in how employees are compensated.

5. **Administrative and Compliance Costs**: While the review aims to reduce compliance costs, the removal of the exemption could still result in increased administrative burdens for charities, as they would need to track and report fringe benefits for tax purposes. However, if the review successfully simplifies FBT compliance, the overall administrative burden might be mitigated.

6. **Policy and Economic Considerations**: The government may need to consider the broader economic and social impacts of removing the exemption, as charities play a significant role in providing services that complement government programs. The removal of the exemption could affect the level of support charities can provide to the community.

Overall, while reducing compliance costs could ease some administrative burdens, the removal or reduction of the FBT exemption for charities would likely lead to increased financial burdens on these organisations, potentially affecting their ability to fulfil their charitable objectives effectively.

Tax simplification

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

Extending the FENZ (Fire and Emergency New Zealand) simplification as an option for all Not-For-Profits (NFPs) could have several implications and benefits:

1. **Reduced Compliance Costs**: Extending the FENZ simplification to all NFPs could significantly reduce compliance costs. The FENZ model involves treating certain payments as subject to PAYE, which simplifies tax administration by reducing the need for individual volunteers to file income tax returns for small amounts of income. This approach could be beneficial for NFPs by streamlining tax obligations and reducing administrative burdens.

2. **Increased Efficiency**: By using the PAYE system, NFPs could ensure that taxes are withheld at the source, which minimizes the risk of non-payment or late payment of taxes. This system is more efficient as it places the tax obligation on the payer rather than the individual payees, which is particularly useful when dealing with a large number of volunteers or small honoraria payments.

3. **Encouragement of Volunteering**: Simplifying tax compliance for volunteers could encourage more people to volunteer, as the administrative burden and potential tax liabilities associated with volunteering would be reduced. This could lead to increased participation in charitable activities and greater support for community initiatives.

4. **Equity and Fairness**: Extending the simplification to all NFPs would ensure a level playing field among different types of organisations, as all would benefit from reduced compliance costs. This could address concerns about horizontal equity, where similar entities are treated differently under the tax system.

5. **Potential Challenges**: While the simplification could reduce compliance costs, it may also require changes to existing systems and processes within NFPs to accommodate the new approach. Additionally, there may be concerns about the potential for reduced accuracy in tax calculations and the risk of tax avoidance if the system is not carefully monitored.

Other Suggestions to Reduce Tax Compliance Costs for Volunteers:

- **Exempt Reimbursement Payments**: One suggestion is to exempt reimbursement payments below a specific threshold from income tax. This would reduce the need for volunteers to file tax returns for small reimbursement amounts, thereby lowering compliance costs.

- **Simplified Tax Code for Volunteers**: Implementing a simplified tax code declaration specifically for volunteers could help ensure they are not erroneously classified as employees, which would reduce the complexity of tax compliance for both volunteers and NFPs.

- **Clear Guidelines and Education**: Providing clear guidelines and educational resources to NFPs and volunteers about the tax treatment of reimbursements and honoraria could help reduce uncertainty and ensure compliance with tax obligations.

Overall, extending the FENZ simplification to all NFPs and implementing additional measures to reduce compliance costs could enhance the efficiency and effectiveness of the sector, encouraging greater volunteer participation and support for charitable activities.

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?

The review highlights several key areas for improvement, including the need for better valuation mechanisms for non-cash donations, the potential for adopting international best practices such as the **UK's Gift Aid scheme**, and the introduction of private charitable trusts similar to those in Australia. These initiatives are designed to encourage more donations by providing clearer and more attractive tax incentives.

One of the main challenges identified is the difficulty in valuing non-cash donations, which could lead to tax avoidance and increased compliance costs. To address this, the review suggests modifying the current system to provide tax rebates instead of deductions for non-cash donations, which could simplify the process and reduce the risk of abuse.

Additionally, the review suggests increasing public awareness and education about the benefits of charitable giving, as seen in the UK and Australia, where campaigns have successfully fostered a culture of philanthropy. This could involve targeted efforts to inform potential donors about the impact of their contributions and the tax benefits available.

To further improve the current donation tax concession rules, it may be beneficial to consider the following suggestions:

1. **Expand the Scope of Eligible Donations**: Allow deductions for a wider range of non-cash donations, such as shares and other property, with appropriate valuation safeguards to prevent abuse.
2. **Increase the Rebate Cap**: Raising the cap on the tax rebate for individual donations could incentivize larger contributions from high-income donors, who are typically more responsive to tax incentives.
3. **Simplify the Process**: Streamline the process for claiming tax benefits on donations, possibly through digital platforms, to make it more accessible and user-friendly for donors.
4. **Encourage Corporate Giving**: Consider increasing the deduction limits for corporate donations and removing exclusions for close companies to encourage more corporate philanthropy.

These measures, combined with ongoing efforts to promote transparency and accountability within the charitable sector, could significantly enhance the effectiveness of New Zealand's donation tax concession framework.