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This paper contains advice that has been prepared by the Tax Working Group Secretariat for consideration by the Tax Working Group.

The advice represents the preliminary views of the Secretariat and does not necessarily represent the views of the Group or the Government.

Coversheet: **Charities and the not-for-profit sector**

Background Paper for Session 13 of the Tax Working Group
6 July 2018

Purpose of discussion

The attached paper is intended to help inform the Tax Working Group (the Group) about the charities and not-for-profit sector and some of the tax policy pressure points. The paper provides:

- An overview of the charity and not-for-profit sector;
- Current tax treatments that apply to groups within the sector; and
- Details of some key current policy issues we have identified.

The paper focuses on two key policy matters - donation concessions available to foundations, and business income. Accumulations of profits are an underlying issue for both of these matters.

Other key policy matters are also summarised in the paper, should the Group wish to consider a wider set of tax issues.

Key points for discussion

- Does the Group have any questions about the current policy settings for the charities and not-for-profit sector?
- What are the areas the Group wishes to focus on?
- What specific issues are the Group particularly concerned about?

Recommended actions

We recommend that you:

- a **Note** that the Secretariat suggests the following issues for inclusion in the Interim Report:
 - i. The treatment of charitable private foundations;
 - ii. The treatment of accumulations (including the potential to require a particular level of distribution each year).
- b **Indicate** the issues that you wish to include on charities in the Interim Report.

- c **Note** that submitters have raised concerns about the charitable exemption for active business income.
- d **Note** that the principle of competitive neutrality supports a view that active and passive income should be taxed at the same rate for any particular taxpayer.
- e **Note** that the principle of competitive neutrality establishes a case to provide a charitable exemption for active business income if the passive income of a charity is exempt.
- f **Indicate** how you wish to deal with the issue of the charitable exemption for active business income in the Interim Report.

Charities and the not-for-profit sector

*Background Paper for Session 13
of the Tax Working Group*

July 2018

Prepared by Inland Revenue and the Treasury

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Executive Summary

1. Charities and not-for-profits make important contributions to the wellbeing of New Zealanders. Yet the not-for-profit sector, and related tax legislation, are complex. The sector includes:
 - tax charities – whose status generally results in income tax exemption. This category includes organisations registered under the Charities Act 2005 and a small number of non-resident charities approved as a tax charity by the Commissioner;
 - donee organisations – whose status gives tax benefits to donors who make monetary donations to them. This category includes charities and organisations with cultural, philanthropic and benevolent purposes;
 - charitable organisations – organisations that benefit from various concessions under the FBT rules; and
 - other not-for-profit organisations – not otherwise covered above but with a public character and which can use tax exemptions or other administrative concessions provided for in the Inland Revenue Acts.¹
2. Within this paper we outline a framework for considering the broad issues of tax concessions and the not-for-profit sector. We then highlight some particular issues which are prominent either in the public mind or for the sector.
3. One of these is the tax exemption that applies to business income earned by charities. 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.
4. Officials note that New Zealand's review of the tax treatment of charities in 2001 and recent reviews of the tax system in Australia (2010) have not supported this perceived unfairness. In principle, the tax concession does not impart a competitive advantage because a trading operation owned by a charity faces the same incentives as a commercial entity when it comes to setting its prices. Its tax-exempt status alone should not lead to undercutting of rivals.
5. A second issue highlighted in this paper involves private foundations. Individuals are able to establish private charitable foundations and receive the same donation tax credit and gift deductions as they would if they donated to an arms'-length donee

¹ The Inland Revenue Acts include the Income Tax Act 2007, the Tax Administration Act 1994 and the Goods and Services Tax Act 1985.

organisation. Private foundations and their equivalents are not required to have arms' length boards and settlors are able to benefit from their foundations investing funds into businesses the settlors' control, or that are controlled by their associates. The extent of accumulation can be extremely high in some of these foundations, with minimal distribution for public benefit. There are integrity and fairness risks associated with private foundations; these may affect public perceptions of the tax system and thereby undermine social capital.

6. Attached to this report is an Annex containing information about the various benefits under the Inland Revenue Acts that charities and other not-for-profit organisations can access. Also attached to this report is an Annex containing a comparison of how New Zealand tax concessions compare to those in other jurisdictions; a summary of submissions made to the Tax Working Group (the Group) on charity-related matters; and a copy of the terms of reference to review the Charities Act 2005.

1. Introduction

Purpose

7. The Group asked the Secretariat to provide analysis on tax rules affecting charities and not-for-profits in New Zealand.

Content and scope

8. This paper provides:
 - An overview of the charity and not-for-profit sector;
 - Current tax treatments that apply to groups within the sector; and
 - Details of some key current policy issues we have identified.
9. The paper focuses on two key policy matters - business income and donation concessions available to foundations.
10. Other key policy matters are also summarised in the paper, should the Group wish to consider a wider set of tax issues.
11. Submissions made to the Group in respect of charity tax law have been considered in the preparation of this paper.
12. The paper applies the established principles of tax policy design to its analysis. Efficiency impacts link directly to physical and financial capital, while fairness and integrity impacts provide insights into impacts on social capital. The paper also notes impacts on Māori interests.

2. Background

The not-for-profit sector

13. Charities and not-for-profits make important contributions to the wellbeing of New Zealanders. The not-for-profit sector supports efforts to bolster our social, human, and natural capital. The economic activities of charities and not-for-profits – as the recipients of donations and the owners of business enterprises – also affect the accumulation of physical and financial capital in the New Zealand economy.
14. These contributions have increased over time. According to Statistics New Zealand, the number of not-for-profits rose from 97,000 in 2004 to 114,000 in 2013. Donations, non-government grants and membership fees to not-for-profits rose forty percent, from \$1.9 billion in 2004 to \$2.7 billion in 2013. In 2013 the sector contributed 4.4% to GDP.²
15. The not-for-profit sector includes 28,000 charities registered with the Department of Internal Affairs (DIA) – Charities Services under the Charities Act 2005. For the 2015-16 income year, DIA's register shows that charities earned gross income of \$18 billion and managed total assets of \$53 billion.
16. Inland Revenue's data shows that an increasing amount of business income is moving from the tax base into the tax exempt charity sector, with significant business such as Horizon Energy Distribution, Best Start Educare, and Go Bus recently being acquired by charities. DIA Charities Services has observed an increase in start-up businesses registering as charities and seeking wider donations to support their business activity.
17. The not-for-profit sector includes many small entities, such as clubs and societies, that are not eligible to be registered charities under the Charities Act as they do not operate for the public benefit or choose not to register because the costs of registration outweigh the benefits.
18. Although many charities are standalone organisations, a number of entities, such as local authorities and Māori authorities, have charities as part of their group structures (to varying degrees).
19. Tax concessions for the purposes of fringe benefit tax (FBT) and goods and services tax (GST) are not based on whether the relevant entity is a registered charity so the entities which access those concessions are a larger category than registered charities. Information in the Annex provides a summary of the tax treatment of not-for-profit organisations.

² This figure is sourced from the Non-profit institutions satellite account: 2013. Note that this analysis excludes charities that are public education institutions such as universities, which make up 20% of the assets of the registered charitable sector.

20. Several policy setting changes have been introduced over the last decade:

- The Charities Act 2005 established the Charities Commission to promote trust and confidence in the charitable sector. The Charities Register was opened in 2007. When the Commission was disestablished in 2012, its core functions were transferred to the independent Charities Registration Board and the Department of Internal Affairs – Charities Services.
- From the 2008-09 income year, to provide greater tax incentives for charitable giving, the Government removed the \$630 maximum limit on the tax credit for donations made by individuals, removed the 5% deduction limit on donations made by companies and Māori authorities, and extended the company deduction to apply to close companies not listed on a recognised stock exchange.
- Payroll giving was introduced from January 2010. The rules provide a tax credit for gifts of money to a donee organisation that are deducted from an employee's pay. Employees receive an immediate reduction in tax by way of the tax credit each pay-period, eliminating the need to collect and keep receipts to claim tax relief on gifts at the end of the year.
- In 2012 Cabinet made the decision not to review the Charities Act 2005 but agreed to review the integrity and coherence of charities-related tax concessions. This led to the introduction of the deregistration tax rules, which impose income tax on the value of net assets of a deregistered charity which are held 12 months after the date of deregistration. Effectively, the rules ensure that if an entity has claimed income tax exemptions as a charity and has accumulated assets and income, these assets and income should always be destined for a charitable purpose, even if the entity is deregistered by the New Zealand charity regulator. The deregistration tax rules apply to charity deregistrations from 14 April 2014.
- For periods beginning on or after 1 April 2015 all registered charities have been required to prepare general purpose financial statements in line with new reporting standards. This change ensures there is a high level of transparency and accountability in the financial reporting of charities to help maintain public confidence in the sector. From the same date, changes to the Charities Act 2005 created statutory audit and review requirements for medium and large registered charities.

21. Past governments and Ministers have been reluctant to review the definition of “charitable purpose” in the Charities Act 2005 owing to the potential controversy and concerns that it would lead to a wider definition of “charitable purpose”, which would represent a greater fiscal cost in terms of tax concessions. We note that the definition of charitable purpose is out of scope for the current review of the Charities Act 2005 (see below).

Tax preferences for charities and not-for-profits

22. Registered charities in New Zealand are generally treated differently for tax purposes from taxpaying entities as a reflection of wider government objectives to support the work that charities do. This is consistent with charities in other jurisdictions, as outlined in Annex B.
23. This support is provided for in the Income Tax Act 2007, primarily through a tax exemption on passive and business income (subject to the restriction that business income is not applied to overseas purposes).
24. Income tax exemptions are a departure from the Government's broad-base, low-rate tax framework and should meet a high threshold before being given. Therefore, as a matter of principle, exemption from income tax is restricted to organisations that are both not-for-profits and operate for the public benefit – the main category being registered charities.
25. Other not-for-profit entities that fail to meet requirements for exemption from income tax are taxable on their income, but they can access a concessionary income tax deduction of up to \$1,000.
26. Charities and certain other not-for-profit organisations with New Zealand purposes are also eligible to be treated as a donee organisation, meaning that taxpayers can receive tax benefits for monetary donations they make to these organisations. The tax benefits, which are direct benefits for the donors rather than the recipient donee organisations, are:
 - the donation tax credit of 33¹/₃% of the value of any monetary donations made by an individual; and
 - tax deductions if the monetary donation is from a company or Māori authority.(The value of the tax benefit is capped at the individual's taxable income for the year, or the company or Māori authority's net income for the year.)
27. Further information on the donation tax credit is contained in Annex A.
28. Not-for-profit organisations "whose funds are applied wholly or mainly to charitable, benevolent, philanthropic or cultural purposes within New Zealand" are eligible for donee organisation status.
29. Donee organisations that do not meet the above "wholly or mainly" threshold test can apply for "overseas donee status" and this must be granted by Parliament. Overseas donee status is a stand-alone programme that is on the Tax Policy Work Programme.

30. Other tax concessions provided to the charitable sector include an exemption from FBT. Although salaries and wages provided to employees of charitable organisations have always been subject to PAYE, an FBT exemption applies to charitable organisations³ which provide fringe benefits to employees. However, the FBT exemption will *not* apply to the extent to which the employment consists of the carrying on by the organisation of a business whose activity is outside its benevolent, charitable, cultural or philanthropic purposes. The FBT concession was removed in 1990 but reinstated in 1991. Its removal has been considered or recommended by a number of reviews over the last 20 years, but various governments have decided to retain it. From 2014 the FBT exemption was narrowed slightly, changing the cap on the value of the exemption for short-term charge facilities (for example, vouchers) to the lesser of 5% of the employee's salary or wages for the tax year, or \$1,200.
31. The GST Act provides two key concessions for the not-for-profit sector. Firstly, the supply of donated goods and services by a non-profit body, for example the sale by a charity shop of donated clothing, is exempt. Secondly, except for exempt supplies (such as the sale of donated goods), input tax deductions can be claimed by non-profit bodies for all GST incurred for any activity that is not an exempt activity of a non-profit body. This means that a non-profit body can effectively purchase most of its goods or services GST-free and as a result non-profit bodies often claim GST refunds. Of the 19,000 non-profit bodies registered for GST purposes, 7,000 are registered despite the fact that their annual turnover does not exceed the \$60,000 compulsory registration threshold.

Responsibility for charity regulation

32. Regulation of charities is predominantly carried out by DIA Charities Services. In general, charities must be registered by DIA Charities Services to be a tax charity and qualify for income tax exemptions.
33. The Commissioner of Inland Revenue can also decide whether an organisation is charitable. In practice, Inland Revenue and DIA Charities Services have entered into a relationship protocol agreement. That agreement sets out an expectation that Inland Revenue will always work together with DIA Charities Services when it looks at an organisation's "charitable purposes". If the Commissioner arrives at a different interpretation, a joint Crown Law opinion can be requested to resolve the difference.
34. Inland Revenue is solely responsible for tax concessions given to donors. New Zealand currently has approximately 25,000 donee organisations, approximately three quarters of which are registered charities.

³ "Charitable organisation" is a defined term and has a wider meaning than simply organisations that are (or can be) registered charities. It essentially refers to donee organisations.

Related policy work that impacts on charities and not-for-profits

Review of the Charities Act 2005

35. The Minister for Community and Voluntary Sector, Hon Peeni Henare, announced terms of reference for a review of the Charities Act in May 2018, which is included in Annex D.
36. The purpose of the review is “to ensure that the Act is effective and fit for purpose. This comprehensive legislative review will focus on substantive issues arising under the Act, while recognising and building on the Act’s strengths.”
37. The terms of reference states the definition of charitable purpose will be outside the scope, as will “tax exemptions that result from registration under the Act”. However it notes “while tax exemptions sit outside scope of this review, the Tax Working Group may consider the tax treatment of charities in its work. Any interim findings of the Tax Working Group relevant to charities would be considered as part of this review.”
38. The terms of reference contains the following in-scope points which are potentially relevant for tax purposes:
 - “The extent to which businesses that solely raise funds for registered charities can register under the Act”
 - “The role, functions... and powers... of the charities regulator” (which could include powers to address excessive accumulation).
39. The review will be implemented this parliamentary term.

Tax Policy Work Programme

40. The Government’s tax policy work programme was released in May 2018. The Government priorities and coalition and confidence and supply agreement items include:
 - “Reviewing the appropriateness of the tax exemption for significant businesses associated with charities”
 - “Reducing the compliance costs experienced by small charities.”

3. Framework for the taxation of charities and not-for-profits

41. One of the key ways the Government supports the not-for profit sector is by providing not-for-profit organisations with favourable tax treatment. Many of the tax concessions have been reviewed several times previously and are of long standing.
42. In thinking about tax and the not-for-profit sector, we suggest the issues can be grouped into four categories:

(i) Who should be eligible to receive tax concessions? At present, tax concessions are directed at a variety of separately defined groups within the not-for-profit sector.⁴ A review of eligibility could result in the Government reviewing the definition of charitable purpose, although, as noted above, the definition of charitable purposes is not within the terms of reference of the current review of the Charities Act 2005. Alternatively, existing group definitions in the Income Tax Act can be amended, or concessions can be legislated specifically, as was most recently done in 2014 for community housing entities which were allowed to qualify for done organisation status and income tax exemption even if they were unable to register as charities.

(ii) What alignment should exist between the timing of tax concessions and ultimate public benefit? When Government provides a tax concession such as a donation tax credit or an income tax exemption to a charity, it may wish to ensure certain charities do not accumulate funds instead of providing public benefit. This may be because of concerns that benefits should be applied sooner rather than later, and/or because of risks that money accumulated may not, in the end, all be applied for charitable purposes. Introducing minimum distribution requirements, or taxing accumulated funds, would be examples of ways to achieve this. At the same time, there may be cases (for example, accumulations for an earthquake relief fund) where accumulations are appropriate.

(iii) To what extent should tax concessions be provided? The level of tax expenditures in the form of tax exemptions, donation tax credits and deductions provided to the not-for-profit sector should be sufficient to achieve specific policy objectives.

(iv) How should tax concessions be targeted? The current tax concessions for charities are not indiscriminate. They take into account whether charitable funds and charitable purposes are limited to New Zealand, whether a charity's income is derived from a business or other sources, and in the case of the FBT exemption, whether the employees are employed in carrying out the organisation's charitable purposes. In some cases caps have been applied to the level of tax concessions, as is the case for the FBT exemption on short term charge facilities (vouchers).

⁴ Examples of separately defined groups include "tax charity" (income tax exemption), "non-profit organisation" (income tax deduction), "charitable organisation" (FBT), "non-profit body" (GST), "donee organisation" (donation and gift concessions and FBT concessions)

4. Policy settings the Tax Working Group may wish to consider

Philanthropic giving to private foundations with donee status

Extent of foundations established by individuals or their families

43. The most recent research into giving in New Zealand by Business and Economic Research Ltd (BERL) indicates that New Zealanders gave a total of \$2.788 billion to charitable and community causes in 2014.⁵ Typically this giving is from three sources: individuals, trusts and foundations, and business. The largest giving is personal giving, which accounted for more than half of the total in 2014 at \$1,373 million. Giving by trusts and foundations is the second largest component at \$1,181 million followed by business at \$77m.
44. There are currently about 1,100 registered charities which have identified themselves as "foundations" on the DIA Charities Register. Typically, these foundations are established as charitable trusts and do not undertake charitable work themselves but provide funds to others, including charities. A small proportion of these foundations have been established by a single donor or their family.
45. The word "foundation" in this paper is not used in a technical way but is used to refer to those types of closely-held charitable organisations which do not undertake charitable work themselves. Information published on the DIA Charities Register indicates the largest 25-30 foundations established by single donors or their families control total assets exceeding \$1.7 billion. Examples of those large foundations are listed in the table below. In aggregate, these foundations have reported total asset growth of over 6% per annum from 2015 to 2017. The average proportion of net surplus distributed to beneficiaries over this three year period ranges from below 10% to as high as 92%, according to financial information published on the DIA charities register.

*Table 2: Examples of foundations established by individuals or their families
(Sourced from the DIA Charities Services charities register)*

	Entity name	Summary of ultimate charitable purpose
1	Buchanan Charitable Foundation	All charitable purposes.
2	David Levene Foundation	Poverty, education, other.
3	Douglas Goodfellow Charitable Trust	Beneficiaries are medical and engineering students and schools.
4	Friedlander Foundation	Makes grants / loans.
5	Hugh Green Foundation	Medical research, poverty relief through education, community development, quality of life, emergency response.
6	Hutton Wilson Charitable Trust / Next Foundation	Promote environmental and educational excellence.
7	PH Masfen Charitable Trust	Makes grants.

⁵ "Giving New Zealand: Philanthropic Funding 2014", Business and Economic Research Ltd (Mark Cox, Fiona Stokes, Hugh Dixon), December 2015 (prepared for Philanthropy New Zealand)

8	The Tait Foundation	Educational purposes.
9	Tindall Foundation	Gives to NZ organisations and communities.
10	Wright Family Foundation	Makes grants to beneficiaries such as the Acorn Foundation (building strong communities).

Relevant law in New Zealand, Australia and Canada

46. Under current New Zealand law, individuals are able to establish private charitable foundations, or indeed any charitable organisation that meets the donee organisation definition, and receive the same donation tax credit and gift deductions as they would if they donated to an arms'-length donee organisation. Since the donation tax credit and gifting caps were raised in 2009, the amounts of these donor tax concessions have become significant.
47. Further, private foundations and their equivalents are not required to have arms' length boards. The settlors are able to benefit from their foundations investing funds into businesses the settlors' control, or that are controlled by their associates, sometimes on non-market terms. This includes funds for which donation tax credits or gift deductions have been claimed. It is also possible under current law for there to be minimal use of foundation funds for charitable purposes, with no particular distributions policy or rationale for accumulation except a desire for the fund to be self-sustaining in future or for foundation distributions to occur years after donation tax relief has been obtained.
48. DIA Charities Services monitors whether there are conflicts of interest and whether charity returns from investments made with related parties are at arms' length. In some cases, this can involve declining the registration of groups or removing charities from the register where there is information suggesting private benefit to trustees or related parties. However, in practice these issues can be difficult to identify and difficult to resolve. Over the most recent two years (2016 and 2017) DIA reported that they deregistered two charities due to no longer meeting charitable purpose requirements of registration, deregistered two charities for serious wrongdoing, issued three warnings, and their compliance activity resulted in four voluntary deregistrations.
49. Private foundations are subject to specific rules overseas. For example, in Australia, Private Ancillary Funds play a key role for private philanthropy. Their attraction includes tax deductions for donations into them and exemptions from income tax. However, they are subject to certain requirements such as having a minimum annual distribution of 5% of assets to charitable organisations and investing prudently in accordance with a written investment policy.
50. The Canadian system distinguishes between charitable organisations (which do charitable work), registered private foundations and registered public foundations. The difference between the two types of foundations is that a private foundation is controlled by a single donor or family through a board that is made up of a majority (more than 50%) of directors at non-arm's length. A public foundation is governed by a board that is made up of a majority of directors at arm's length. A private foundation is not allowed to engage in any business activity and the Income Tax Act

requirements are different for foundations. For example, a foundation must annually disburse 3.5% of its investment assets (averaged over two years).

Potential matters to consider

51. 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. Foundations could be subject to specific rules, as occurs overseas, which ensure that there are reasonable distribution requirements and restrictions on the extent of investments in related-party businesses.

Income tax exemption for business income earned by charities

52. The question as to whether business income derived by charities should continue to be tax exempt was the most common charity-related theme addressed by submitters to the Group. These views are summarised in Annex C.

Extent of business income in the charitable sector

53. Under current law, income derived from business activities of a charity, and income derived from business activities of an entity that is carried on for the benefit of a charity, is exempt from income tax. Qualifying activities range from op-shops run by a religious organisation, to tourism ventures owned by a charitable organisation. The appropriateness of this concession is sometimes questioned, including whether it confers an unfair competitive advantage for the trading operations of a charity.
54. It 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.
55. Examples of charities with significant commercial assets, as disclosed on the DIA Charities Register, are shown in the below table:

*Table 1: Examples of registered charities with large commercial assets
(sourced from the DIA Charities Services charities register)*

	Entity name	Summary of ultimate charitable purpose	Nature of business income
1	Best Start Educare Ltd	Provides a financial return to the Wright Family Foundation which makes grants to other charities with a focus on children, young people and their families.	Early childhood education and childcare centres (250 childcare centres operate under 7 brands).
2	Foundation Properties Limited	Provides funds for the Royal NZ Foundation for the Blind.	Rental income from commercial investment properties.
3	Horizon Energy Distribution Ltd	Provide a financial return to the Eastern Bay Energy Trust which makes grants to other charities.	Own and operate an electricity distribution network in the Eastern Bay of Plenty; an electrical contracting and infrastructure

			construction business; a heating, ventilation and cooling construction and servicing business; and an industrial refrigeration construction and servicing business.
4	Joan Fernie Charitable Trust Board	Makes grants to other organisations.	Farming (livestock, wool, forestry) located in Hastings.
5	Ngai Tahu Charitable Group	Provide and promote, for the benefit of Ngai Tahu Whanua, assistance to those who are needy, poor, sick or infirm; assistance in the development of employment opportunities, emergency relief services, etc.	Ngai Tahu Holdings Corp manages commercial activities which are primarily property investment, property development, farming, tourism, fishing and investment activity in NZ.
6	Pioneer Energy Limited	Provide a financial return to Central Lakes Trust which assists community projects and services.	Generator of electricity.
7	Seventh Day Adventist Church in New Zealand	To advance religion.	The group includes retirement village / elderly care and health food/nutrition activities (Sanitarium etc).
8	Tainui Group Holdings Limited (Waikato Raupatu Lands Trust and Group)	To uphold, support, strengthen and protect the Kingitanga; advance the interests of Waikato-Tainui, etc.	Primary industries, properties, equities, direct investments, fixed income.
9	Tait Limited	Provide a financial return to the Tait Foundation and the Tait Contel Charitable Trust for the advancement of education.	Multinational radio communications company based in Christchurch.
10	Trinity Lands Limited	To advance religion.	Dairy accounts for 80% of its business – it owns 21 dairy farms in the Waikato and is one of Fonterra's top 10 shareholders. It also manages kiwifruit orchards (16% of its business) and forests (700ha; 3% of its business).

New Zealand and Australian tax reviews of business income

56. The 2010 Tax Working Group Review of the New Zealand Tax System did not look at this issue.⁶ Australia's most recent review of its tax system (the Henry review) considered this issue and concluded that the income tax concessions for not-for-profit organisations should be retained.⁷ It argued that in principle the tax concession does not impart a competitive advantage because:

- A trading operation owned by a charity has a profit maximising objective in order to grow the funds used to support the charitable purpose. This means the

⁶ *A Tax System for New Zealand's Future* Report of the Victoria University of Wellington Tax Working Group, January 2010.

⁷ *Australia's future tax system, Report to the Treasurer* December 2009.

trading operation faces the same incentives as a commercial entity when it comes to setting its prices and its tax-exempt status will not lead to it undercutting its rivals.

- As a charity can earn tax-free income from an alternative passive investment (for example, a bank deposit), the tax concession for trading income would not distort the charity's behaviour compared with a tax-paying entity.

57. To explain the reasoning a bit further, suppose that a taxpaying business can earn 5% pre-tax by putting money in a bank account, and is taxed at 28%. If this business is taxed comprehensively on all its investments (passive and active), the business will invest in all active business projects where the post-tax rate of return is above 3.6%, and the pre-tax rate of return is above 5%. It will stop at 5% pre-tax (3.6% post-tax) because at that point it can simply let money sit in the bank
58. Now consider a charity that is taxed at 0% on all its income. It will identify all investment projects that earn 5% pre-tax. Any investment project earning less than 5% will not be worthwhile, because it would prefer to earn 5% by putting the money in the bank.
59. What happens is that both businesses (0% taxpayer and 28% taxpayer) invest up until the rate of return on projects is 5% pre-tax. The charity has no incentive to invest at rates of return below this level when it could put the money in the bank and earn 5% without doing anything.
60. What if we decided that charities should be taxed on their active income?
61. In that case the charity will invest in business projects that earn 6.94% or above, but nothing below that. That is because if it identifies a business project that earns (say) 6%, it will only receive 4.32% after tax. Why would it do that when it can earn 5% passively? Ironically we will have introduced a significant investment distortion by exempting passive income but taxing active income.
62. The Henry Review acknowledged that in practice these conditions might not apply perfectly and some over-allocation of resources to the not-for-profit sector might result. However, because of the public benefits arising from not-for-profit activities, it concluded this was not a serious issue that warranted any policy change.
63. The 2001 review of Tax and Charities in New Zealand⁸ similarly considered that the tax concession did not deliver a competitive advantage. However, it noted that the tax-exempt status could enable faster asset accumulation than an equivalent taxpaying trading operation. Consequently, it proposed that trading operations owned by charities should be subject to standard income tax, but with an unlimited deduction for distributions made to the relevant charitable purpose. In other words, this proposal would prevent undistributed trading operation surpluses from accessing tax exemption.

⁸ *Tax and charities; a government discussion document on taxation issues relating to charities and non-profit bodies* June 2001.

64. Internationally, the approach to this issue is mixed. In 2011, the Australian Government announced it would tax retained income in not-for-profit trading operations. This policy was withdrawn in 2014 without having been implemented.
65. The United Kingdom does restrict the concession and only trading profits distributed to charitable purposes are tax-exempt.
66. Canadian charitable organisations can lose their registration if they carry out business activities unrelated to their charitable purpose (as is the case in the UK above a certain de minimis level); the business activities should be in a separate vehicle and subject to income tax. However, business activities “related” to the charitable purposes are acceptable. “Related” is a defined term and includes business conducted by uncompensated volunteers and excess capacity (for example Universities renting their buildings during vacations). Canada has also specified a disbursement quota. It requires registered charities to spend a minimum amount each year on its own charitable activities or on gifts to qualified donees (for example, other charities). The disbursement quota calculation is based on the value of a charity’s property not used for charitable activities or administration.
67. More international comparisons are contained in Annex B.
68. It should be noted that the above competitive neutrality analysis, that supports an exemption for active business income if passive income is exempt, applies to other entities such as wholly-owned subsidiaries of Māori authorities. Māori authorities are taxed at 17.5% on their passive income, but 28% on their active income if in a wholly-owned subsidiary. Competitive neutrality arguments would support taxing Māori authorities at 17.5% on both passive and active income in wholly-owned subsidiaries.

Other tax issues affecting charities and the not-for-profit sector

69. Table 3 outlines a number of other not-for-profit themed tax issues involving significant changes to policy settings. Whilst officials’ believe the most important tax policy matters for not-for-profits involve competitive neutrality and taxes on business income, accumulation and private foundations, these are additional matters which could be reviewed. We have drawn these issues to the attention of the Group in case it wishes to include any within the scope of its own review.

Table 3: List of tax matters affecting charities and not-for-profits that could be reviewed

Topic	Description
Coherence of other income tax exemption categories	There are several income tax exemptions introduced in the 1950s which are available for certain kinds of “association or society”, for example: bodies promoting scientific or industrial research; veterinary services bodies; and herd improvement bodies. A review of these exemption categories could establish whether they are necessary and still fit for purpose today, or whether they can be rationalised to improve the coherence of tax legislation.
Charities and the FBT exemption	Many charities are exempt from FBT. In contrast with the income tax exemption, there are not good efficiency grounds for this exemption. Wage and salary payments to charities’ employees are subject to PAYE just as non-charity employees are. It is therefore not obvious that payments through fringe benefits should be treated differently.
Not-for-profits and GST concessions	Currently non-profit bodies receive concessionary treatment in claiming GST input tax credits on most of their purchases (often in the form of refunds). There is a question as to whether greater alignment with other GST-registered taxpayers is warranted.
Tax benefits for donee organisations	A review of current settings could include: <ul style="list-style-type: none"> • whether a cap should be reintroduced on the tax benefits taxpayers receive for monetary donations to donee organisations; • whether the scope of the term “donee organisation” should be narrowed, for example to charities registered under the Charities Act 2005.
Refundability of imputation credits	As charities are exempt from income tax, they are unable to use imputation credits as, under current law, they cannot be refunded. As noted in a Government review in 2008, ⁹ the treatment of imputed dividends can distort charities’ investment decisions as the tax rules create a preference for debt investment (RWT is refundable) or overseas shares. The treatment has led charities to increasingly use look-through investment vehicles such as limited partnerships in order to escape a tax impost on equity-type investments. Charities have for many years sought a change to the treatment of equity investment in New Zealand shares to remove this distortion. However, there is a material fiscal cost connected with this issue.
Mutual organisations	There is some uncertainty and inconsistency in how the tax treatment of mutual organisations is applied to not-for-profit organisations. There could be a review of the current tax treatment of mutual organisations, as they apply to not-for-profits.
Charities and donee organisations with charitable purposes not	There could be a review of the coherency and effectiveness of current settings where charitable purposes are not limited to New Zealand. At present, business income is not wholly tax exempt if charitable <i>purposes</i> are not limited to New Zealand,

⁹ *Streaming and refundability of imputation credits, A government discussion document*, August 2008.

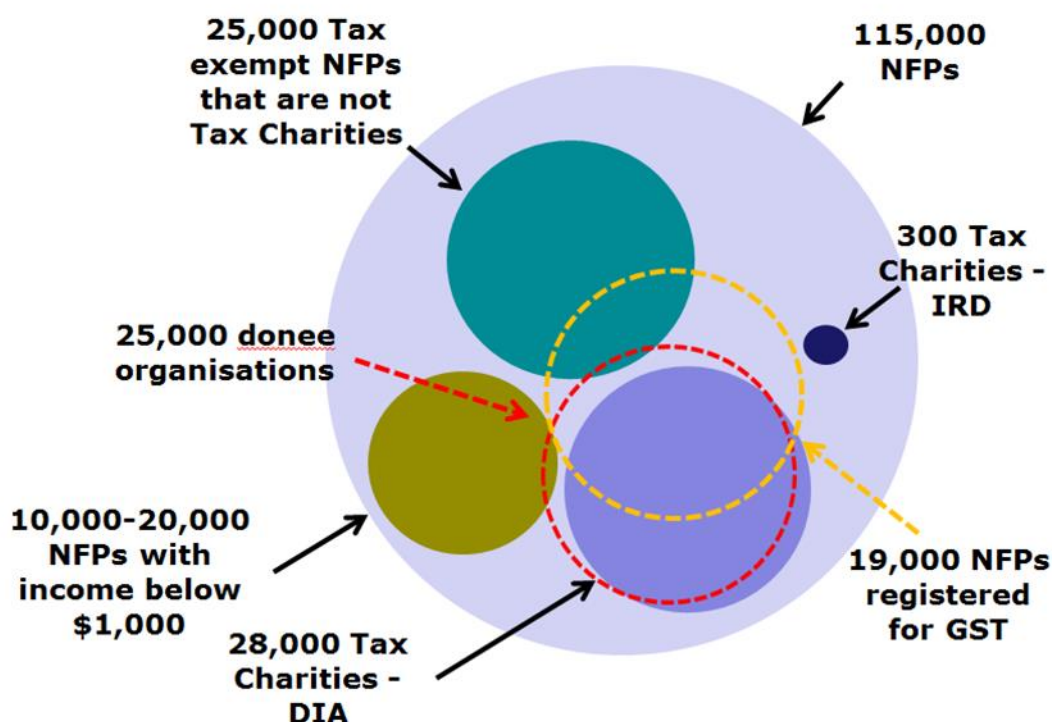
<p>limited to New Zealand</p>	<p>whereas donee organisations are subject to a separate test where <i>funds</i> must be applied wholly or mainly to charitable, benevolent, philanthropic, or cultural purposes within New Zealand. Any new settings should minimise the risk of income tax exempt entities being used for terrorism financing and money laundering, and ensure the proper operation of not-for-profit entities and their use of public donations and funds.</p>
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Annex A: Information about concessions under the Inland Revenue Acts for not-for-profit bodies

(i) Summary of all tax concessions for the not-for-profit sector

Figure 1 illustrates the main subsets within the not-for-profit sector that qualify for income tax exemption or income tax concessions as at June 2018. It also shows how GST and donee concessions apply across those subsets. Different concessions apply to different parts of the not-for-profit sector.

Figure 1: Summary of all tax concessions for the not-for-profit sector



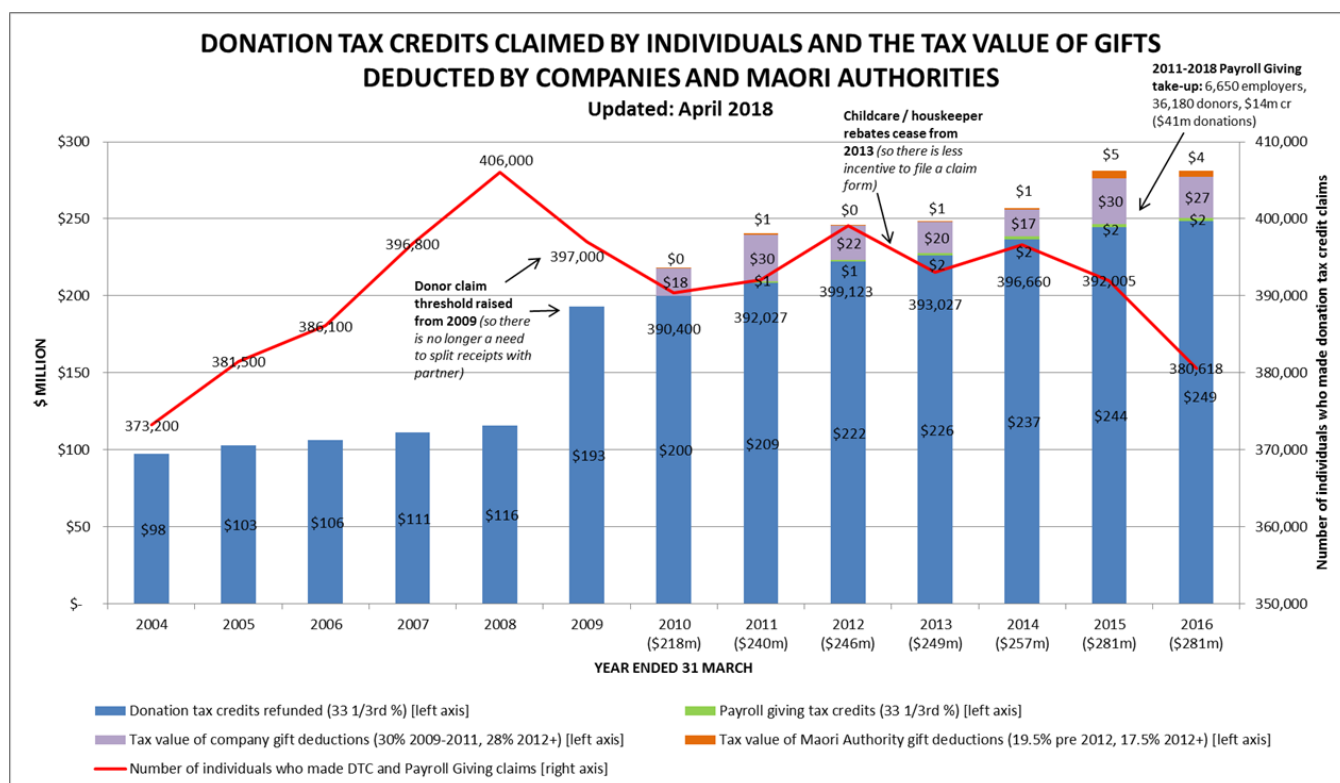
- There are about 115,000 entities coded as NFPs on Inland Revenue's records in 2018. All NFPs are entitled to an income tax deduction of up to \$1,000 (s.DV 8) and qualify for GST concessions if they have a taxable activity.
- About 28,000 NFPs are "tax charities" registered with DIA Charities Services. There are also about 300 non-resident tax charities registered with IRD. Tax charities are generally income tax exempt (unless they have business income and charitable purposes outside NZ).
- DIA Charities Services categorises charities using four tiers based on operating expenditure. In total, 95% of charities have operating expenditure below \$2m.
- About 25,000 NFPs qualify for specific income tax exemptions:
 - S.CW 46 Bodies promoting amateur games and sports (23,000)
 - S.CW 40 Local & regional promotional bodies (2,000)
 - S.CW 49 Bodies promoting scientific or industrial research (100)
 - S.CW 50 Veterinary services bodies (60)
 - S.CW 51 Herd improvement bodies (80)
 - S.CW 47 Racing clubs (200)

- About 20,000 NFPs have indicated to Inland Revenue they have net income below \$1,000 and do not file income tax returns (however, many may no longer be active so the range is shown as 10,000-20,000).
- About 25,000 NFPs are donee organisations. 2,000 are schools and education institutions; 22,500 are tax charities registered with DIA Charities Services; and about 500 have charitable, benevolent, philanthropic or cultural purposes but are not registered with DIA Charities Services. About 138 are “overseas donee organisations” approved under schedule 32. Most donee organisations qualify for FBT exemption.
- About 19,000 NFPs are GST registered, with 13,000 being registered charities. 56% of GST-registered charities paid GST (\$727m) and 44% received GST refunds (\$129m) for the 12-months ending March 2017. Donated goods and services are not subject to GST; NFPs with a taxable activity can deduct input tax on all goods and services other than those used to make exempt supplies.

(ii) Donations subject to tax concession claims tax credit concessions

Figure 2 illustrates that there has been an increase in the amount claimed since the donations cap was removed in 2009, but that there has been a decline in the number of individuals making claims. The latter is caused in part by the removal of the cap, which meant many donation claims were no longer shared by members of the same household.

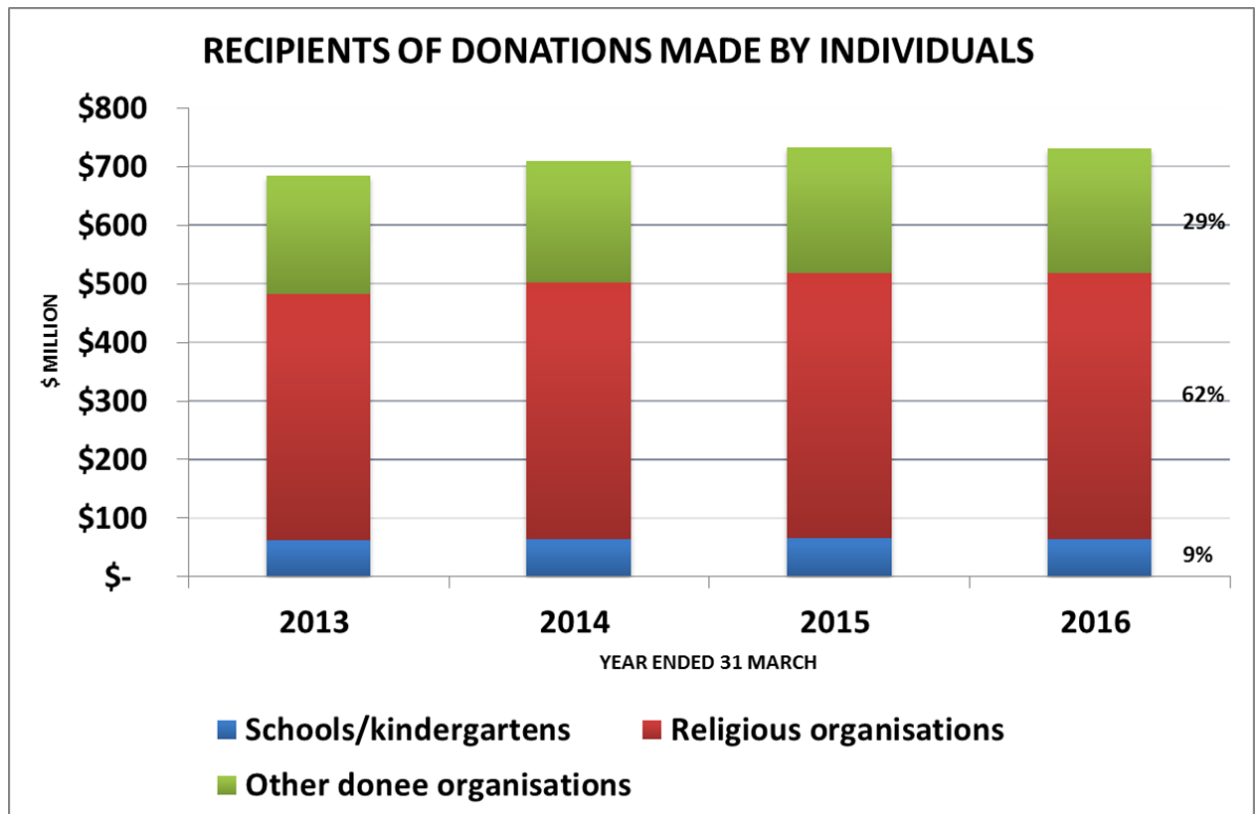
Figure 2: Donation tax concessions



(iii) Recipients of donations made by individuals who claimed donation tax credits

Figure 3 shows the type of donee organisations that have received donations subject to donation tax credit refunds over the last four years. It highlights that the majority of donation claims (62% in 2016) are made in respect of donations to religious organisations.

Figure 3: Recipients of donations made by individuals



Annex B: International Comparisons

The below table compares some of the New Zealand tax policy settings for the not-for-profit sector with international settings. It has been compiled by Inland Revenue staff and has not been reviewed or verified by overseas tax authorities. A comprehensive comparison of donation tax incentives for 26 countries was published by the Charities Aid Foundation in 2016.¹⁰

On the international front, reviews of the tax system on charities are currently underway in both the UK and Canada. In the UK a Charity Tax Commission was launched in October 2017 to undertake an 18-month review of the impact of the tax system on charities. The first public call for evidence is due in July 2018. In Canada, in January 2018 the Senate passed a motion to appoint a Special Committee of the Senate to review issues related to the charitable sector in Canada. The Committee's general mandate will be to examine "the impact of federal and provincial laws governing charities, non-profit organizations, foundations, and other similar groups, and to examine the impact of the voluntary sector in Canada."

	Policy setting	NZ	Other countries
	<i>Settings where NZ is generous compared to other countries</i>		
1	Income tax exemption for charity-owned business	The NZ charity regulator will register fundraising businesses as charities and they can access tax exemption, subject to a control and NZ purposes test in s.CW 42.	<p>Governments in the UK, USA and Canada tax unrelated business income, ie income from a charity's business if that business is unrelated to furthering the exempt purpose of the charity.</p> <p>In Canada, charitable organisations can lose their registration if they carry out unrelated business – these activities should be in a separate vehicle and subject to income tax. This is similar in Ireland.</p> <p>In the UK, business income is exempt if it is derived from a primary purpose of the charity (for example, a religious charity selling bibles), or profits from trading are carried out by charitable beneficiaries (e.g. disabled people selling goods for a charity that provides relief for disabled persons). Non-primary purpose trading is exempt only if it is subject to a small trading exemption (e.g. the turnover is not over £5,000). The profit has to be applied (or accumulated) for the charitable purpose.</p> <p>In the United States, the business activity must be <i>substantially related</i> to the organisation's purpose – only the generation of income to further the purpose isn't enough. The activities that</p>

¹⁰ "Donation states: An international comparison of the tax treatment of donations" Charities Aid Foundation, May 2016

			<p>generate the income must contribute importantly to accomplishing the organisation's exempt purposes .</p> <p>Australia does not tax unrelated charitable business income, but the Australian government had proposed doing so in the recent past.</p>
2	<p>Maximum donation concession claims</p> <p>(The deductible proportion of a donation and the overall maximum tax concession)</p>	<p>Individuals can claim a donation tax credit of up to 33 1/3 per cent of their taxable income.</p> <p>Companies and Māori authorities can claim income tax deductions up to their total net taxable income.</p> <p>NZ is relatively generous in relation to maximum concessions for donors, as it allows a tax concession that could exceed the amount of income tax an individual has paid in an income year. Most other countries have lower maximum claims and lower proportions which can be claimed as a tax concession.</p>	<p>The UK allows donations to get donation tax relief through payroll giving, but the tax relief depends on the rate of tax you pay. It also offers a Gift Aid scheme where charities and community amateur sports clubs can claim an extra 25p for every £1 donated.</p> <p>Canada, like New Zealand, uses a donation tax credit rather than a deduction from income. It allows a tax concession of between 15-33% of the amount donated, with the maximum donation claim being net income of CAD 75,000 (approx. NZD\$81,000). It also allows first-time donor super credits, which supplements the value of the donation tax credit by 25% for donations up to \$1,000.</p> <p>Australia, which allows deductions from income tax rather than donation tax credits, appears to be one of the few countries more generous than NZ in terms of a maximum claim, as it has adopted a spreading provision which allows donors to spread (apportion) their gift tax deduction over a period of up to five income years in certain circumstances.</p> <p>In the United States, 30-50% of contributions to charitable organisations may be deducted, up to 50 percent of adjusted gross income.</p> <p>In the EU, countries provide deductions from earned income between 20%-100% of the donated amounts, in most cases with caps that can vary between NZD equivalents between 3,500 and 840,000. Outliers include Sweden, which does not offer charitable tax deductions at all, and Finland, at the more generous end of the spectrum, allowing donation deductions up to €500,000 (NZD 840,000). However Finland will only allow such donations if the purpose is the development of science or art and the donation is made to a university with public financing (the intention is to advance private finance of universities). Typically these maximums apply to both individuals and death estates.</p>
3	GST concessions	NZ allows GST concessions to not-for-profit entities (input tax	In Australia, charities are not granted significant GST concessions. (The main concession is that they have a higher threshold requirement to register for GST).

		can be claimed on all purchases, as long as the not-for-profit has a taxable activity)	<p>In the UK, VAT can only be reclaimed on taxable goods and services, unless they are below the de minimis level. Charities are generally subject to the same VAT rules as any other organisation.</p> <p>Ireland provides no general exemption from VAT, with some very limited exemptions.</p> <p>Canada provides more limited GST relief to charities than NZ. There is also provincial sales tax (PST) in Canada that is similar to GST and that also applies to charities. GST/PST applies to most activities supplied by non-profits. There are limited exemptions available for certain supplies under specific conditions – for example, charities may be able to make GST exempt supplies but cannot claim input tax on their purchases.</p>
4	Donations to religious organisations	NZ allows tax concessions for donations to religious charities under the general gifting rules	Australia does not provide tax concessions to donations made to religious organisations. The UK, the United States, Canada, Singapore, Holland, France and Germany do. In Germany, church donations are fully deductible (unlike general donations that are only 20% deductible).
5	Donations to schools	NZ allows tax concessions for donations to schools under the general gifting rules	<p>Australia only allows donations to school building funds.</p> <p>The UK allows donation concessions, generally if the school is registered as a charity, with some limited exceptions. There is no blanket tax rebate for donations to state schools that are not charities in the UK.</p> <p>In the United States, schools have to be registered as charities with the IRS for donors to get a donations rebate. Deductions can be claimed for donations made to qualified organisations, which includes most non-profit schools that operate exclusively for educational and literary purposes. However, a donation may not be tax deductible if the school engages substantially in other activities unrelated to charitable, scientific, humanitarian or religious purposes. Donations to school district programs that do not operate for profit and are solely supported by state and local governments also qualify.</p> <p>In Canada, it appears that only donations paid to some schools (religious and secular) can qualify for a tax concession. Donations to state schools do not appear to qualify.</p>
6	Tax concessions to charity employees	NZ allows fringe benefit tax concessions for employees of certain charities and donee organisations	<p>In the UK there are no employee concessions unless they have taken a vow of poverty (eg ministers of religion), in which case they are fully tax-exempt.</p> <p>In Australia, the fringe benefit tax rebate reduces the fringe benefit tax liability to between 47% and 49% of the tax which is otherwise payable. Public benevolent institutions and health promotion charities are exempt from the fringe benefit tax entirely.</p>

			Canada does not have any tax exemptions for employees of charities.
7	Donations to foundations	NZ allows donations to charitable foundations without imposing restrictions	Australia and Canada impose restrictions and minimum distribution requirements on foundations which qualify for donation tax concessions.
8	Donations in kind	NZ limits donation concessions to monetary donations only	Many countries allow donations “in kind” including Australia, Canada, the UK, the United States, Singapore and Germany.
9	Imputation credit refundability	NZ does not allow imputation credits to be refunded to exempt recipients.	Australia allows franking credits to be refunded to entities that meet certain eligibility criteria. The entity must be any of the following: (i) a registered charity endorsed by the ATO as exempt from income tax, (ii) an income tax exempt deductible gift recipient endorsed by the ATO in its own right, (iii) an income tax exempt deductible gift recipient listed by name in the tax law, (iv) an income tax exempt relief fund declared by the Treasurer to be a developing country relief fund (v) a prescribed income tax exempt institution that is eligible for a refund under the regulations, (vi) an income tax exempt institution eligible for a refund under an Australian Government law other than the income tax law. ¹¹
10	Distinctions between business income and non-business income	NZ distinguishes business income and non-business income for tax exemption purposes, for example business income is taxable when charitable purposes are conducted overseas.	Australia does not make the same distinction as NZ between business and non-business income (the UK and Canada are not directly comparable because they tax unrelated business income).

¹¹ Source: ATO website - https://www.ato.gov.au/Non-profit/Statements-and-returns/In-detail/Frinking-credit-refunds/Refund-of-franking-credits-endorsed-entities-information/?page=2#Eligible_organisations

Annex C: Submissions to the Tax Working Group

A number of submissions to the Tax Working Group expressed some support for the current tax concessions for charities and not-for-profits. A few submissions also proposed a number of enhancements to existing concessions, or introducing new concessions (particularly with respect to volunteers and donations). However, almost as many submissions argued for the removal of the charitable income tax exemption for for-profit businesses.

Some submitters proposed that imputation credits should be refundable for charities as their exemption from income tax means that imputation credits they receive are unable to be used.

Some technical refinements were also proposed in relation to the tax rules for deregistered charities and GST issues that commonly arise for charities and not-for-profits.

There were eleven themes in the submissions, summarised below:

- (i) Business income exemption (11 in total)
- (ii) Retention of current charitable tax concessions (10)
- (iii) Greater tax concessions for donations (donated goods, cultural giving, Gift Aid, koha definition) and volunteer concessions (10 in total)
- (iv) Link between charitable status and tax exemptions (6)
- (v) Tax concessions for social enterprises (3)
- (vi) Imputation credit refundability (3)
- (vii) Deregistration tax (3)
- (viii) Income tax exemption for veterinary services bodies and herd improvement bodies (removal) (1)
- (ix) GST issues that commonly arise for charities (1)
- (x) Further research required in areas such as organisations that are denied charitable status, honoraria compliance, and the link between tax policies and economic benefits (1).
- (xi) Charities law issues which are more relevant for the Charities Act review (12)

Here is a summary of comments relating specifically to the business income tax concession:

Issue: Support for retaining the charitable business income exemption Submissions

Four submitters specifically recommended that the charitable tax exemption for business income should remain. There is no evidence of competitive advantage, and there are flow-on benefits to society from charities running businesses, as they can provide employment opportunities. The income tax exemption offsets the disadvantages that charities face in accessing capital (as they cannot offer a private return to any investor like a for-profit entity can). In order to qualify for the exemption

the business is required to have restrictions in their deed or constitution on where profits can go, so that they can only be ultimately applied to charitable purposes.

Business operations provide greater cashflow certainty as charities are not reliant on annual funding rounds. Firm rules on what proportion of profits must be distributed are inappropriate as charitable businesses need the flexibility of making their own decisions about the prudent retention of capital – particularly if the business is in a sector which experiences years of volatile profitability.

Issue: Charitable business income exemption should be removed

Submission

Seven submitters proposed the removal of the charitable income tax exemption for businesses as it confers an unfair competitive advantage.

Some submitters proposed that businesses could rely on the charitable gift deduction to make tax free distributions to charities instead of having a tax exemption themselves.

One submitter provided a detailed alternative proposal for taxing charities' business income, which involved the implementation of a "charity credit account" similar to the imputation credit account. Charitable businesses would be taxed on their profits like any other for-profit entity, but receive a 28% credit that they can attach to distributions to its charitable owner. This submitter proposed that the tax exemption for charities' passive income also be removed following implementation of the proposal to tax charities' business income.

Annex D: Terms of reference to review the Charities Act 2005

Context of review

Charities form a significant part of New Zealand's not-for-profit sector. With more than 27,000 registered charities, the charitable sector makes an important contribution to New Zealand society, founded on the Treaty of Waitangi.

In 2001 the Government announced its intention to introduce registration, reporting and monitoring requirements for organisations claiming charitable status. A working party of charitable sector representatives was appointed and recommended that a Charities Commission be established and provided powers to register, monitor, assist and educate charities. The Charities Act (Act) was enacted in 2005, with the aim of promoting public trust and confidence in the charitable sector.

Over ten years have passed since the first charity was registered under the Act. Significant change has taken place in that time. This includes: changes in the charitable sector's wider operating environment (for example, increasing pressure on volunteers); the disestablishment of the Charities Commission and establishment of the independent Charities Registration Board; the introduction of financial reporting standards for registered charities; and a new tax that applies to deregistered charities.

The legislative regime promotes public trust and confidence in the charitable sector through its treatment of charitable entities, and through the regulator's actions. Charitable entities can voluntarily apply for registration, which brings both benefits and obligations. For example, charities must report annually and that information is publicly available. The regulator also has responsibilities including registering charities, maintaining a charities register, providing education and assistance, and monitoring compliance.

The Government considers the fundamentals underpinning the Act are fit for purpose. These include:

- provision for the registration of charities;
- the voluntary nature of registration;
- public access to information about charities; and
- the obligation on charities to file annual returns with financial statements.

Stakeholders in the charitable sector have sought a review of the Act for a number of years. The Government agrees that it is timely to review whether the Act is working effectively for the charitable sector, volunteers, our communities (including Māori) and the wider public, the Government, and others with an interest. The review will take into account the experiences of stakeholders over the last 13 years, and lessons from other jurisdictions.

Purpose of the review

The purpose of the review is to ensure that the Act is effective and fit for purpose. This comprehensive legislative review will focus on substantive issues arising under the Act, while recognising and building on the Act's strengths.

Scope of the review

Matters within scope

Substantive policy matters within the scope of the review are:¹²

1. Matters relating to additional purposes of the Act
 - Whether any additional purposes of the Act are necessary (while recognising that the Government considers the fundamentals of the Act are fit for purpose).
2. Matters relating to the regulatory framework
 - The role, functions, structure, powers, accountability and appeal ability of the charities regulator (currently, the independent Charities Registration Board and the Department of Internal Affairs – Charities Services);
 - The purpose and content of the publicly-accessible charities register;
 - Funding for the regulator to administer the legislation (including the mix of Crown funding and fees from the charitable sector);
 - Mechanisms to challenge or appeal decisions of the charities regulator, including decisions over the interpretation of 'charitable purpose', and to support the development of case law;
 - Offences and penalties. For example, creating intermediate sanctions as alternatives to deregistration, or issuing penalties after an entity has been deregistered but before it is wound up; and
 - Regulation of third-party fundraisers (that is, professional fundraisers or commercial operators that fundraise on behalf of a charity).
3. Matters relating to registration and deregistration
 - Registration requirements (not including the definition of 'charitable purpose'), and the ability to backdate the registration of an entity;
 - Deregistration requirements;
 - The extent to which businesses that solely raise funds for registered charities can register under the Act; and
 - The extent to which registered charities can advocate for their causes and points of view.
4. Matters relating to the obligations of registered charities
 - The obligations of registered charities; and

¹² While this list of fourteen bullet points is comprehensive, the list does not identify all of the specific issues that could fall under each bullet point (e.g. bullet point two would cover more specific issue of regulator's independence). Further exploration will occur during the review.

- The obligations of individuals on governance boards and in senior management roles in registered charities, including looking into governance standards for registered charities.

5. Links to other legislation

- The interface between the provisions of the Act, and provisions in the Incorporated Societies Act 1908 (and proposed Incorporated Societies Bill), Charitable Trusts Act 1957 and the Trusts Bill (with the aim of better alignment).

Matters outside of scope

As a legislative review focussing on substantive policy issues, operational issues fall outside of scope.

The following matters are also outside scope:

- The definition of ‘charitable purpose’;
- Tax exemptions that result from registration under the Act;
- Regulation of the broader not-for-profit sector; and
- Contracting arrangements for government services.

While tax exemptions sit outside scope of this review, the Tax Working Group may consider the tax treatment of charities in its work. Any interim findings of the Tax Working Group relevant to charities would be considered as part of this review.

Governance arrangements for decision-making on the review

The Minister for the Community and Voluntary Sector (the Minister) will be the key decision-maker on the review, subject to decisions that require Cabinet approval.

The Minister will engage with the Attorney-General, and others whose portfolios are touched by this review. This includes the Ministers of Finance; Revenue; Commerce and Consumer Affairs; Justice; Housing and Urban Development; and Health. It also includes the Ministers for Māori Development; Arts, Culture and Heritage; Social Development; Children; Seniors; and Sport and Recreation.

The Department of Internal Affairs (the Department) is the lead agency. The Minister for the Community and Voluntary Sector will provide strategic direction to the Department of Internal Affairs.

Working level arrangements

The Department of Internal Affairs will work closely with:

- (a) a Core Reference Group (CRG);
- (b) the regulator; and
- (c) other government officials (including those supporting the Tax Working Group).

At key points, the Department will also seek input from:

- (d) the Sector User Group (SUG); and

(e) the wider charitable sector, and members of the public.

The diagram below shows the governance and working level arrangements:



(a) Core Reference Group – role and six member composition

CRG's role will be to work with the Department to identify issues and possible solutions, within the scope of this review. With the group's small size, it is also intended that the Department will be able to test ideas with this group, before the Department advises the Minister.

CRG is intended to comprise six people, who bring a variety of perspectives and experiences. Given the size and reach of the charitable sector, the intention is to bring together the broadest possible range of views, skills and experiences.

SUG will be asked to appoint three of its members to CRG. SUG is an established group of 25 member organisations that provides broad representation from the charitable sector. The Department of Internal Affairs expects the three SUG members who join CRG to seek SUG's input, and the Department will also look to use SUG at key points.

The Department will also look to invite three members onto CRG. The intention is these members bring diverse views, skills, and/or experiences, including Te Ao Māori perspective, and the perspective of small charities.

(b) Regulator

The regulator is the three member independent Charities Registration Board, and also Charities Services (within the Department of Internal Affairs).

(c) Other government officials

The Department will also look to work closely with officials from the Treasury and Inland Revenue (including those supporting the Tax Working Group); officials from the Ministry of Business, Innovation and Employment; Ministry of Justice; Ministry for Culture and Heritage; Te Puni Kōiri; Sport and Recreation New Zealand; Ministry of Health; Ministry of Social Development; Oranga Tamariki; and the Crown Law Office.

(d) The Sector User Group

As described earlier, CRG would seek SUG's input, and the Department would also look to use SUG at key points.

(e) The wider charitable sector, and members of the public

The involvement in the review of the wider charitable sector and the public will also be crucial. For example, public submissions on an options document will be sought, as well as workshops on key issues. Public submissions would also usually be called for by select committee if a Bill was to amend the Act.

Timeframe for the review

The review is expected take between two to three years. This review is expected to start when the Minister seeks, and Cabinet approves the review's terms of reference in early 2018. It is expected to finish with the passing of a Bill to amend the Act.

The table below outlines an indicative timeline:

Phase	Timing	Review activities/steps
One	Dec 2017 – May 2018	Develop draft terms of reference, then test and revise
		Cabinet approval of final terms of reference
		Publicly announce review
Two	May 2018 – August 2018	Identify issues and possible solutions, to help inform options development
		Cabinet approval of an options document
Three	August 2018 – Dec 2018	Consult and receive submissions on options document
		Develop policy
		Cabinet approval of policy decisions
Four	2019	Development of draft legislation
Five	2020	Passage through the House of a Bill to amend the Act