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Taxation and the not-for-profit sector
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SUBMISSION on 'Taxation and the not-for-profit sector' issues paper

1. Introduction

Thank you for the opportunity to make a submission on the Issues Paper: Taxation and the not-for-profit sector (the Issues Paper). This submission is from Consumer NZ, an independent, non-profit organisation dedicated to championing and empowering consumers in Aotearoa. Consumer NZ has a reputation for being fair, impartial and providing comprehensive consumer information and advice.

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2. Problem definition in the Issues Paper

The Issues Paper does not appear to contain a clear problem definition which makes offering clear solutions a challenge. The Paper notes both the desire to increase Crown revenue and to address the abuse of charitable status by entities engaging in commercial activities to supplement their income.

In seeking to address the abuse of charitable status, the IRD should consider the following matters:

- The size of the problem. This is currently absent from the Issues Paper.

- The compliance costs and administrative burden that moving from the status quo will place on charities seeking to carry out their mission and work for public benefit. Analysing costs and carrying out an apportionment process will be both costly and time-consuming and could result in a tax loss position anyway, which could worsen the tax revenue generation problem.
- Assessing whether the tax system and levers are the most appropriate mechanism for change. We support taking an evidence-based approach to minimising abuse of charitable status and suggest that approach is more appropriately undertaken by the Department of Internal Affairs as the lead agency on charities.
- The impact on financial sustainability for charities genuinely engaged in public good activities.
- The enhanced reporting requirements from 2024 for charities to declare and explain any accumulated funds and the reason they are holding reserves. It would be beneficial to allow a period to assess the results of this new requirement before making any decision on the Issues Paper.

If the problem to be addressed is primarily one of Crown revenue generation, we respectfully suggest there are better and less socially damaging alternatives to generating revenue than risking the potential of undermining charities engaged in public good activities.

3. Other general comments on the Issues Paper

New Zealand has a large charitable sector that provides significant and critical services to the public. Charities provide services from caring for children, running community events, teaching extra-curricular skills, coaching and providing sporting events, keeping organisations accountable, protecting the environment and advocating for citizens.

"Charities are often the final backstop - they look after those who for whatever reason cannot look after themselves... Charities hold a very important role in supporting and giving voice to the voiceless"!

The sector is already over-stretched and under resourced. Officials will no doubt receive many submissions stressing the point that, with some notable exceptions, the charitable sector in New Zealand is struggling financially. We agree and note that this consultation adds stress to an already stressed sector reeling from funding cuts, falling membership and an increasingly challenging donation landscape.

In other jurisdictions, many of the services provided by charities are funded or better supported by the Government. In the absence of this support, it is vital that the charitable

¹ https://www.linkedin.com/posts/impact-investing-network_the-report-activity-7295651668929454082-FRXN/?utm_source=share&utm_medium=member_desktop&rcm=ACoAAAUX2ZIBvCfS_Iz65jOj_V4u_gB0iCvurMA

sector in New Zealand remains financially viable, or the burden of providing these services will either fall to the Government, or not be provided, resulting in widespread social harm.

This includes consumer advocacy, the charitable purpose with which Consumer NZ is most familiar. To contextualise the preceding point, it is a source of immense surprise when Consumer NZ staff speak with counterparts overseas and discuss the fact that Consumer NZ receives no funding for its advocacy work from the New Zealand Government, even though the Government's own data shows that Consumer NZ is the most well-known, effective and trusted source of consumer information relied on by the New Zealand public².

Our work is one example of how the charitable sector in New Zealand provides immense value to society and our democracy. Given the diversity of the sector, that value can be difficult to quantify.

As a charity representing the public at large, much of the advocacy work Consumer NZ undertakes is a direct result of requests from Government agencies for input on policy work. This work benefits greatly from the input Consumer NZ provides on behalf of the New Zealand public, but, notwithstanding the significant demands for engagement and expert opinion, including market research data compiled at direct cost to Consumer NZ, no direct funding is made available by the New Zealand Government for this work.

We suspect expectations within Government agencies can be influenced by the resources the private sector is able to dedicate to its lobbying activities. Clearly, most charities will never possess the resources available to the tech, banking, energy, supermarket or aviation sectors, to name a few. There is a clear imbalance of power here that would be increased if charities engaged in advocacy work lost existing tax benefits.

The tax benefits afforded to charities providing genuine public benefit go some way to addressing the delta between the public need for their charitable activities and the cost to provide them. To be clear, in Consumer NZ's case, the tax benefits we receive do not cover anywhere near the cost of the services or value we provide the New Zealand public. While it is not in scope, this review could easily have considered whether further benefits could be applied to appropriate charities to address this imbalance, bearing in mind the pressure many charities are currently under and noting that if charities are forced to close, the burden for providing those services will fall to Government.

4. Answers to specific questions in the Issues Paper

We have provided responses to specific questions from the Issues Paper below.

² <http://mbie.govt.nz/dmsdocument/28961-new-zealand-consumer-survey-2024-survey-findings-pdf>

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

In our submission, given the public good charities provide New Zealand society and the costs associated with providing those services, there is no compelling reason to tax charity business income. The factors outlined at 2.13 and 2.14 provide advantages to charitable entities that non-charitable entities do not and should not enjoy. As noted above, this helps (but does not completely) address the delta between what it costs to provide publicly beneficial services and what most charities are able to earn.

If there is an issue with registered charities carrying on business activities that do not align with or support their charitable purpose, that is a matter for ongoing monitoring by the Department of Internal Affairs. In our view, if the Issues Paper is primarily concerned with halting abuse of charitable status to gain a commercial advantage, the most logical starting point to address that abuse is the charitable status of the alleged abuser, rather than changes to the tax system that could have unintended consequences for charities operating within the spirit of the law.

One of the most compelling reasons not to tax charity business income is the additional administrative burden it will place on charities and the likelihood that, in carrying out an apportionment process of income and expenditure, the business arm will end up in a tax loss position and therefore not result in a payment anyway. Charities will just end up paying accountants to assist in this process and it won't result in the increased revenue that Government is seeking.

We note also that some charities invest in securities as part of their reserves policies. These reserves are crucial for many charities, including Consumer NZ, to weather the storms over time and help them through downtimes when other income sources are difficult to come by. Reserves help charities to keep paying employees and operating the organisation. If securities were taxable, it would reduce the ability to do this, perhaps leading to job losses or closures that could have been prevented.

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?

As a starting point, business income that is unrelated to charitable purposes would need to be clearly defined. If the issue is addressing what is acceptable to be defined as a charity, this becomes something other than a tax question.

It would be useful for officials to provide information to assist submitters in understanding the extent to which charities are carrying out 'unrelated business activity'. While there are examples cited regularly in the media, beyond these high-profile examples the extent of the problem is not clear. As a result, it is unclear what the revenue upside would be from

removing the exemption and whether this would justify the administrative burden on all parties.

Depending on the definition of 'unrelated business activity' it is possible that some charities will have a mixture of activities. Splitting out what activity is unrelated to charitable purposes would be time consuming work, leading to compliance costs. For what could be a relatively small revenue yield for the Government, a charity could face further distraction from its charitable work or, in extreme cases, be forced to close.

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?

Distinguishing between related and unrelated business activities is complex and would be difficult to implement in practice, particularly given the broad range of charities that exist in New Zealand and the diversity of the activities they undertake.

Many charities are struggling to survive and regularly post annual deficits even under the existing tax benefits. These charities rely on a diverse range of activities and their reserves to stay afloat. Revenue sources are often not guaranteed year to year, meaning ongoing viability is precarious. Under a broad definition of 'unrelated business' some activities charities engage in to diversify their income may appear similar to services also offered by non-charities (for example healthcare, disability or education services). While activities may be similar, the rationale for undertaking them is different. Commercial entities are focused on profit as an end goal. Most charitable entities are focused on delivering their charitable purpose, a fundamental pre-requisite for which is financial viability.

It is our submission that if an activity is clearly linked to supporting an entity to provide its charitable purpose, it shouldn't be taxed.

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?

We consider \$5m is too low. While the proposed change may only impact 1,300 charities, there is a significant difference between a charity operating at the lower end of Tier 2 and a charity with income over \$15m. The proposal would have a significant impact on Tier 2 charities at the lower end and, if implemented, could force some charities in Tier 2 to stop operating. The criteria are also all based on expenses only. Many charities use unpaid volunteers to deliver against their charitable purpose whilst maintaining the required level of income/profitability.

If a threshold has to be applied, we suggest raising it to \$15m to avoid this risk and considering whether basing this threshold on expenditure alone is the most appropriate mechanism.

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

In our submission, subscriptions and levies should continue to be treated as non-taxable membership transactions. Subscriptions and levies are the life blood of many charities, and while some charities provide services to members in return for subscriptions, those subscriptions fund the broader charitable purposes of those charities, as well as the services provided.

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?

Consumer NZ takes the view that we cannot make informed comments on FBT settings until we have seen the outcome of the current review. It would be beneficial to see the proposed changes first and to allow comment on these changes before considering the removal or reduction of the exemption for charities.

However, we continue to agree with the original rationale for the FBT exemption, namely to support the charitable sector including enabling charities to offer more competitive salary packages at a lower cost, thereby increasing funds available for charitable purposes, and reducing compliance costs.

It can be extremely challenging to attract the right talent to roles in the charitable sector given the salaries on offer under the existing FBT settings. Any removal or reduction would amplify that problem.

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?

As a charitable organisation that relies heavily on member donations, we outline on our website that if a person donates, they may be able to claim a tax credit for a donation of \$5 or more.

Our view is that this adds to the incentives to make a donation, even if a person doesn't actually end up claiming the credit.

Any additional incentives to donate are important to charitable organisations. Every dollar counts.

ENDS