

31 January 2023

Tax Counsel Office

By email: [public.consultation@ird.govt.nz](mailto:public.consultation@ird.govt.nz)

**Re: PUB00392 – Charities – business income exemption**

1. The New Zealand Law Society Te Kāhui Ture o Aotearoa welcomes the opportunity to comment on the Tax Counsel Office discussion document *PUB00392 Charities – business income exemption* (the **Discussion Document**), which discusses the interpretative and practical issues a charity may face in applying section CW 42 of the Income Tax Act 2007 (**ITA**) to income it derives from a business carried out exclusively for charity.
2. This submission has been prepared with the assistance of the Law Society’s Tax Law Committee.<sup>1</sup>

**Meaning of ‘directly or indirectly’ in the context of s CW 42**

3. The Law Society agrees that the words ‘directly or indirectly’ in section CW 42 were not intended (and should not be used) to extend the test in section CW 42 to income not usually considered to be income from a business.
4. However, the placement of those words between ‘[i]ncome derived’ and ‘from a business’ does make it difficult to naturally read those words as relating not to ‘income derived from a business’ but instead to ‘a business carried on by, or for, or for the benefit of.’
5. The Law Society suggests that at the next available opportunity for legislative amendment, section CW 42(1) should be amended to:
  - (a) Relocate the words as follows: ‘Income derived from a business carried on, **directly or indirectly**, by or for, or for the benefit of...’; *or*
  - (b) Remove them entirely from the provision on the basis they are redundant, given the requirement in section CW 42(1)(aa) that the entity carrying on the business must itself be a registered charity. As noted at paragraph 119 of the Discussion Document, it is anticipated that in most cases where the test in section CW 42 applies, the income will be derived from a business carried on ‘by’ a registered charity (i.e. directly). Accordingly, there is no need for the terms ‘directly or indirectly’.

**Change in charitable purpose**

6. Paragraphs 224 to 230 of the Discussion Document consider what should happen when the intention of a charity changes with respect to the carrying on of its purposes in or outside New Zealand. More specifically, they discuss the situation where not all business income is distributed towards the charitable purposes, and some part is accumulated for future use. Based on the usage, the charity has then allocated all the business income as exempt under section CW 42. The Discussion Document considers whether, if in the future the charity

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<sup>1</sup> Further information about this Committee is available [here](#).

changes its intention and determines to carry out some overseas purposes, the Commissioner would be justified in reviewing the exempt allocation for the previous income years.

7. At paragraph 230, it is suggested that a change of intention does not necessarily mean that the split of business income in any prior period is no longer 'reasonable'. The Law Society agrees.
8. However, the Discussion Document also suggests that in some cases it may be necessary to re-open a prior period return (or to file a return, if no return was filed in the prior period), in order to achieve the purposes of section CW 42. An example is provided of when such a reopening or filing would be justified.
9. The Law Society considers it is unclear whether section CW 42 itself permits the Commissioner to re-open or require the filing of a prior period return based on the charity's intention (or even action) in a later tax period.
10. The example provided at paragraph 230 is suggestive of pre-planning by the charity; it deliberately accumulates business income while purportedly having an intention to carry out charitable purposes in New Zealand, and then determines to carry out purposes outside New Zealand once it no longer derives any business income. In such circumstances, the Commissioner should instead consider invoking the anti-avoidance provisions to wholly or partly deny the exempt status of the business income derived in previous income tax years and re-assess the charity on the business income in those years.
11. In other circumstances, the Commissioner might also consider asserting evasion. This may be appropriate where, for example, there is evidence or a pattern of behaviour indicating the charity did not in fact have the requisite intention in the earlier income year in which the income arose.
12. The Law Society considers that this approach would best give effect to section CW 42, without straining the parameters of the provision.
13. We hope this feedback is helpful. The Law Society is available to discuss this feedback further if that would assist. Please contact [aimie.bryant@lawsociety.org.nz](mailto:aimie.bryant@lawsociety.org.nz) should you wish to do so.

Nāku noa, nā



Taryn Gudmanz  
**Vice President**