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Public Consultation
Inland Revenue
Wellington

By email: PublicConsultation@ird.govt.nz

Re: Operational Statement ED0207a: Charities and ED0207b: Donee organisations

1. The New Zealand Law Society (Law Society) welcomes the opportunity to comment on the two parts of the exposure draft of the operational statement: *ED0207/a Part 1: Charities, and ED0207/b: Part 2: Donee organisations*.

2. By way of overall comment, the Law Society considers that ED0207a: Charities would benefit from a comprehensive review, and ideally recirculated in draft for further comment, before it is finalised and published. We recommend that some important aspects of the draft ED0207b: Donee organisations should also be revisited before it is finalised and published.

3. The Law Society appreciates that there is time pressure created by legislative changes that take effect on and from 1 April 2020, however we consider that it is important to get the two parts of the operational statement right so that they provide clear, accurate and practical guidance to charities, donee organisations and their board members, personnel, supporters and other stakeholders.

4. The Law Society also considers that both parts of the operational statement should apply on and from 1 April 2020, and accordingly should focus on the legislative framework applicable on and from that date. This should simplify some aspects of the drafting.

ED0207/a: "Charities and donee organisations: Part 1: Charities"

5. Rather than clearly setting out the Commissioner's views on how various tax concessions and related provisions are to be applied to charities and how the Commissioner will deal with practical issues arising, ED0207/a attempts to compile and summarise all possible tax (and other) rules that could apply to charities. The draft includes a number of errors, and very little explanation about how the Commissioner will deal with various practical issues.

6. It would be helpful if officials reviewed the structure and content of the draft to ensure that Part 1 of the statement is coherent and user-friendly, uses consistent terminology, accurately reflects the relevant legislation and case law, and provides clear guidance on important practical issues. Our comments on various aspects of the draft that require attention are outlined below.

Comments on general structure and drafting issues

7. It would be helpful if the contents of the draft was restructured so that after the summary of main points, the issues of what is a "charity" and the concept of "charitable purposes" are identified, the basic legislative framework for concessionary tax treatment of charities and the interrelationship with the Charities Act registration regime is addressed, and the charity income tax exemptions and related matters is discussed (see our further comments below regarding ordering the section on charity income tax exemptions).

8. The headings and subheadings used throughout the draft are confusing and do not help the user. For example, in the charity income tax exemption section ([16] to [54] of the draft) it is very difficult to follow the headings and identify whether a new point or just a sub-point is covered under the headings.

9. The terminology used throughout the statement should be clear and consistent. For example, itis preferable for the term "charities" to be used to refer to trusts, societies and institutions for charitable purposes of the type referred to in s CW 41(1) of the ITA (to avoid confusion with the term "charitable organisation" used in the ITA and "charitable entity" used in the Charities Act) and for the term "registered charities" to be used to refer to charities registered under the Charities Act. The suggestion at [5] of the draft that a "charity" under the ITA refers to an entity registered under the Charities Act is incorrect and misleading.

10. The draft includes a number of typos and other drafting errors that need to be addressed. For example: referring to 3 exemptions at [17] and then only listing 2 exemptions, unnecessarily repeating points (such as the ITA and Charities Act "charitable purpose" definition references in [20] and [21] and then again in [25] and [26]), the stray "that" in the penultimate line of [87], and the use of the word "treaty" rather than "treated" in [129]..

Comments on the discussion of charity income tax exemptions ([16] to [58] and [77] of the draft)

11. This section should clearly state at the outset that the statement just deals with the charity income tax exemptions under ss CW 41, CW 42 and CW 43 of the ITA, and not other exemptions under subpart CW of the ITA that might apply to income derived by a charity or other not-for-profit (such as the local/regional promotion body, amateur sports promotion body, and community housing entity exemptions).

12. The structure and headings used in the section would benefit from re-drafting so that it's clear whether a new point or just a sub-point is covered under each heading.

13. It would also be clearer if this section covered, in turn:

    (a) a short overview of the charity income tax exemptions for non-business, business and bequest income under ss CW 41 to CW 43;

    (b) the distinction between non-business and business income for the purposes of s CW 41 and CW 42;

    (c) the requirements that are common to both ss CW 41 and CW 42, namely charitable status, "tax charity" status and the council-controlled organisation exclusion. Issues

relating to resident vs. non-resident charities ([102] to [117] of the draft) should be addressed in this context, rather than later in the statement;

(d) the additional requirements that must be met for business income to be exempt, namely attribution of income to charitable purposes in New Zealand and no ability of specified categories of person to inappropriately direct or divert any amount from the business;

(e) the exemption for bequest income under s CW 43; and

(f) related/consequential matters, such as relief from withholding tax (in particular, RWT and NRWT) on account of tax-exempt status.

14. Various aspects of the draft's discussion of the requirements that need to be met under ss CW 41, CW 42 and CW 43 need to be reviewed and corrected and/or improved. For example:

(a) at different points, the draft incorrectly suggests that charitable status and meeting requirements for tax concessions are matters determined at the discretion of the authorities. Further, [21] and [26] of draft wrongly suggest that the Charities Registration Board "*determines an entity's 'charitable purpose'*", and [27] wrongly refers to "*the Commissioner's practice of treating charities as being eligible for the non-business income exemption*";

(b) the distinction between non-business and business income for the purposes of ss CW 41 and CW 42 needs to be discussed in more detail, as it is an important practical issue. The comments at [22] gloss over the issue, and the definition of "business" in s YA 1 and the deemed business income provisions in s CW 42(3) are not discussed at all;

(c) the discussion of the council-controlled organisation (CCO) exclusion from the exemptions under ss CW 41 and CW 42 ([27] to [29] and [52]) misleadingly fails to address the key point that the CCO definition in s YA 1 of the ITA is not the same as the CCO definition in the Local Government Act 2002, so that the exemptions can apply to income derived by many non-company CCOs that are charities;

(d) the section on apportionment of business income to charitable purposes in New Zealand under s CW 42 ([34] to [36]), including the example, does not clearly illustrate how to identify charitable purposes in/outside New Zealand and apportion business income to purposes in New Zealand. If the Commissioner considers that the approach taken to similar matters in IS 18/05 is potentially relevant or useful, the statement should also say so and cross-reference that item. The section should also make it clear that apportionment is not relevant at all if a charity is limited to charitable purposes in New Zealand;

(e) the section on specified categories of person not being able to inappropriately direct or divert any amount from a business under s CW 42 ([38] to [51]) should be restructured, and the content reviewed and corrected. For example, the current discussion does not address the terms of s CW 42(1)(c)(i) and (ii) of the ITA, nor does it address the terms of s CW 42(5)(b) of the ITA. The practical guidance in relation to the application of s CW 42(1)(c) and (5) to (8) should also be more definitive. For example, [41] of the draft dilutes the Commissioner's position in relation to there being no "material influence" where the establishment of any benefit or advantage has been undertaken in a (scientific) manner to

ensure that no more than market value is paid. Operational statement OS 06/02 provides that Inland Revenue "*will accept*" that there has been no material influence in this situation (at paras 22 and 67 of OS 06/02, citing *CIR v Dick* (2001) 20 NZTC 17,396). In contrast, [41] of the draft states that "*the Commissioner will likely accept that there has been no material influence*" [emphasis added] in this situation. There is no apparent basis for this dilution of the Commissioner's position; and

(f) in relation to the bequest income exemption under s CW 43, the time allowance to secure "tax charity" status should be noted, and the statement at [54] that the exemption is not available "*to the extent that the charity carries out its charitable purposes outside New Zealand*" is incorrect and should be deleted.

15. The comments regarding exemption from RWT ([55] to [58], and noting that [58] essentially repeats [55]) and regarding the non-application of NRWT to exempt income ([77]) should follow the discussion of the charity income tax exemptions under ss CW 41, CW 42 and CW 43. The RWT discussion should confirm that existing exemption from RWT will effectively roll over from 1 April 2020, and also confirm that Charities Act registration is the basis upon which registered charities will be "automatically" treated as RWT exempt.

16. Other related matters that might be covered in the charity income tax exemption discussion include, for example, charitable trust status under the trust rules and the tax-exempt treatment of trust distributions (noted below), the non-refundability of imputation credits attached to dividends even if a charity is tax-exempt, and the option of investing in "flow through" structures so that a tax-exempt charity's income from the investment is exempt.

Comments on the discussion of other tax concessions ([59] to [75] of the draft)

17. In relation to tax concessions other than the charity income tax exemptions, being concessions that are not strictly limited to charities, the statement should refer to such concessions but need not go into detail.

18. Donation tax incentives for gifts to charities that qualify as donee organisations (deductions for companies and Maori authorities, and donation tax credits and payroll giving tax credits for individuals) should at least be briefly summarised in Part 1 of the statement, with cross-references to Part 2 of the statement and other relevant Inland Revenue items (such as IS 18/05 and QB 19/10). The draft does not properly cover this.

19. The limited FBT exemption that is available to most donee organisations should also be briefly noted, with cross-references to Part 2 of the statement (in relation to donee organisation status) and BR Pub 17/06 (in relation to the application of the exemption). The lengthier discussion of the FBT exemption at [59] to [71] of the draft contains inaccuracies, and is not necessary in light of the other items. It is also important to note that other FBT exclusions/exemptions may be available to charities.

20. GST concessions for non-profit bodies should also be briefly noted, with cross-references to any relevant Inland Revenue items (although we note that there is no standalone item comprehensively dealing with the GST treatment of non-profit bodies, and some relevant items are work in progress). The short GST discussion at [72] to [75] of the draft is inaccurate and incomplete. For example:

(a) it fails to provide guidance on key issues such as the "non-profit body" definition, the "taxable activity" concept, "consideration" and "unconditional gifts", exceptions to associated person rules, and various other important issues;

(b) it touches on exempt supply and input tax deduction issues for non-profit bodies, but deals with important details, such as other types of exempt supplies that may be relevant to charities (especially financial services and housing) and, in relation to the on-supply of donated goods and services, it does not address important practical issues such as whether or not the Commissioner's administrative practice set out in Public Information Bulletin No 164 (August 1987) still applies; and

(c) it should cover GST record-keeping matters that are specific to GST-registered charities (currently noted at [87] of the draft).

Comments on the discussion of other tax compliance and administration matters ([79] to [94])

21. The statement refers in passing to the possibility of a charity having FBT and NRWT liabilities, but does not touch on other matters such as RWT or PAYE withholding tax liabilities and the tax treatment of payments to volunteers.

22. The administration/record-keeping requirements discussion ([80] to [88] of the draft) is important, and should cover the Commissioner's position on whether, and in what circumstances, general tax/business record-keeping requirements apply to a tax-exempt charity under the Tax Administration Act 1994, as well as the specific "gift exempt body" provisions noted in the draft. As noted above, GST record-keeping requirements that are only relevant to GST-registered charities should be noted in the GST section of the statement (if retained).

23. The section of the statement regarding changes to charities' rules ([89] to [91] of the draft), and in particular the Commissioner's consent to change provisions that require Commissioner or Inland Revenue approval of changes to a charity's rules, is important. This section should be separated out from the "Administrative Tax Requirements" section, and the statement itself should clearly spell out the Commissioner's consent (as in the case of OS 06/02, at paras. 13(l) and 81), rather than merely stating that the Commissioner "*will provide*" her consent. Also, if the statement is going to note the requirement to file/notify rule changes under other legislation, then it should be comprehensive.. At [91], the draft refers to the Charities Act and Incorporated Societies Act 1908 only, and does not refer other legislation that commonly applies to charities, namely the Companies Act 1993 and Charitable Trusts Act 1957.

24. The binding rulings section of the statement ([92] to [94] of the draft) is important, and should be expanded. In particular, it should cover the issue of whether, and in what circumstances, full and short-process rulings may be sought in relation to the application of the charity income tax exemptions and other concessions. Any other relevant Inland Revenue items on rulings matters should also be cross-referenced.

Comments on other aspects of the draft

25. The section on the tax implications of deregistration ([95] to [101] of the draft) should be re-structured and the content reviewed and corrected. The draft does not accurately reflect the terms of ss HR 12 and CV 17 (and related definitions) and the various changes that have been

made to the provisions, it includes an inappropriate reference to GST provisions (at the end of [99]), and it does not deal with a deregistered entity's 'transition' to a taxpayer entity (if applicable). More importantly, the discussion does not make it sufficiently clear that no income tax issue will arise at all under ss HR 12 and CV 17 if the entity continues to be tax-exempt under another exemption (noted in passing at [99]) or if it disposes of all of its assets within 12 months to another person for charitable purposes and/or in accordance with its rules as filed on the Charities Register.

26. In relation to the discussion of non-resident charities ([102] to [117]), as indicated above this should be included as part of the charity income tax exemption discussion, in to the context of addressing the "tax charity" status requirement that is common to both s CW 41 and s CW 42. Various aspects of the discussion of non-resident charities also need to be reviewed. For example, [107] and [108] appear to relate to donee organisation status, not tax charity status, and should be deleted, and the Commissioner's position on whether or not a non-resident charity that does not exclusively carry out its charitable purposes outside New Zealand can be approved as a "tax charity" under s CW 41(5)(c) should be specifically covered. Potential treaty relief from New Zealand tax for non-resident charities resident in treaty jurisdictions should also be noted in the statement.

27. The discussion of foreign trust disclosure rules ([118] to [121]) and FATCA and CRS reporting obligations might best be combined into a section on "Other disclosure and reporting regimes", and the discussion should be simplified, with cross-references to other Inland Revenue items.

28. In relation to the discussion of charitable trusts ([141] to [149]):

    (a) it is preferable to refer to "charitable trust" status under the trust rules and include a cross-reference to IS 18/01 (paras. 9.3 to 9.24) as part of the earlier section of the statement discussing the charity income tax exemptions, given that charitable trust status under s HC 13 is linked to exemption under ss CW 41 and CW 42. The statement should also be checked against IS 18/01 for consistency, and a particular aspect of IS 18/01 that may warrant a reference in the statement is confirmation of the tax-exempt treatment of distributions by charitable trusts that are complying trusts (at para. 9.23 of IS 18/01);

    (b) the discussion of boards incorporated under the Charitable Trusts Act 1957 should be deleted, or otherwise substantially revised. It may be preferable to simply note earlier in the statement that incorporation under the Charitable Trust Act is not the same as Charities Act registration, and is not directly relevant to eligibility for charity income tax exemptions and other tax concessions. If a fuller discussion of the Charitable Trusts Act is to be retained in the statement, it needs to be accurate. For example, the Act provides for the incorporation and registration of the trustees of a trust, the trustees for the general purposes of a society, or members of a society as a board, not the mere registration of charitable trusts; s 61A of the Act relating to the provision of recreation and leisure time facilities as charitable purpose (referred to at [146]) extends the concept of "charitable purposes" *for all purposes* (not just for the purposes of the Act); and s 38 of the Act (referred to at [146]) includes an expanded definition of charitable purposes that applies *only for the purposes of part 4 of the Act*; and

(c) if the statement is going to include comments on incorporation legislation, then it may also be appropriate to include comments on other incorporation legislation (in particular, the Companies Act 1993 and the Incorporated Societies Act 1908), not just the Charitable Trusts Act.

29. In relation to the discussion of Maori charities ([150] to [165]), a standalone item on Maori charities (or, more generally, Maori organisations) might be warranted. If the section is to be retained in the statement, it needs to be substantially revised. It should cover the specific modifications to the "*charitable purpose*" definitions in s YA 1 of the ITA and s 5 of the Charities Act that are directed at Maori organisations and marae. The draft correctly notes the unique treatment of certain trusts declared by Maori trust boards under s 24B of the Maori Trust Boards Act 1955, but it should also note that s 13(2)(b) of the Charities Act deems such trusts to meet the principal requirement for registration under s 13(1)(a) of that Act. The statement should more clearly state that apart from those provisions (and also the specific provisions relating to treaty settlement assets and marae under the deregistration tax rules), charity-related tax provisions apply to Maori organisations in the same way that they apply to other entities. It may also be appropriate to refer to the Maori authority tax rules (and the refundability of credits received by tax-exempt charities under those rules).

30. The Appendix to the draft currently includes the text of ss CW 41 and CW 42 only. It does not include s CW 43, definitions of terms such as "business", "charitable purpose", "council-controlled organisation" etc. in s YA 1, or any of the other legislative provisions referred to in the draft.

ED0207/b, "Charities and donee organisations: Part 2: Donee organisations"

31. The Law Society does not have the same degree of concern regarding the drafting of ED0207/b which focuses more on the practical application of the rules relating to donee organisations, and is much clearer and easier to read.

32. There are, however, various aspects of the draft that would benefit from review, as outlined below.

33. In the summary at [1] (in the first three points) and in various other places (for example, [19], [20], [25], [51] and [52]), the draft suggests that donee organisations will either be for charitable purposes (in which case both Charities Act registration and Inland Revenue approval/listing will be required from 1 April 2020) or for purposes *other than* charitable purposes, i.e. benevolent, philanthropic or cultural purposes (in which case only Inland Revenue approval/listing will be required). An entity or fund may, however, have *both* charitable *and* other purposes (for example, an entity or fund for charitable, benevolent, philanthropic and cultural purposes), which will preclude Charities Act registration. The relevant aspects of the statement need to be amended to address this.

34. In the summary at [1] (fourth bullet point) and later in the draft (for example, at [16]), the statement should more clearly address whether, and in what circumstances, separate Charities Act registration and Inland Revenue approval/listing will be required for a fund dedicated to New Zealand purposes. Presumably, the Commissioner's position is that separate Inland Revenue approval/listing will always be required for such a fund (even in the event that the

entity administering the fund is approved/listed), whereas (as indicated at [16]) separate Charities Act registration will only be required if the entity administering the fund is not already on the Charities Register (noting that many, perhaps most, registered charities do not separately register funds for specific purposes under the Charities Act, even in circumstances where such funds may technically be subject to a separate trust arrangement).

35. At [6], the introductory description of donation tax credits for individuals should refer to "*a* refundable *tax credit of ~~up to~~ 33⅓% of such gifts (for gifts up the amount of their taxable income)*".

36. At [11], the "council-controlled organisation" example should either be deleted or clarified, as it suggests that CCOs are not eligible for exemption from income tax whereas many CCOs qualify for exemption (for example, CCOs treated as local authorities for tax purposes and charitable non-company CCOs).

37. At [13] to [15], the draft refers to the principal category of donee organisation under s LD 3(2)(a), and should more clearly state that the discussion relates solely to this category. At [13], the draft incorrectly omits the words "*wholly or mainly*", and the third bullet point at [15] similarly does not refer to or reflect the "*wholly or mainly*" requirement. Use of the term "*established*" in both [13] and [15] also does not reflect the wording of s LD 3(2)(a), which simply refers to an entity's *funds being applied* wholly or mainly to charitable or other qualifying purposes in New Zealand.

38. At [21], the statement should make it clear that the 75% threshold is an administrative safe harbour adopted by the Commissioner, not a definitive threshold set by the legislation in relation to the "*wholly or mainly*" requirement under s LD 3(2)(a).

39. It is important that the statement includes guidance regarding the Commissioner's position on the meanings of the terms "benevolent", "philanthropic" and "cultural", as set out at [25] to [27], but the statement should be very clear about the source of its statements regarding the meanings of these terms and that the statements are not definitive. The draft puts forward meanings that are arguably much *narrower* than the plain meanings of the relevant terms, in circumstances where the basis for this is not clearly set out and the decisions of "*the courts*" are not specified (and presumably they do not relate to the interpretation of the terms in this particular legislative context). An interpretation statement or similar item on these terms may be warranted.

40. At [28], the final sentence stating that entity's aims or purposes "*should be carried out in New Zealand*" is unnecessary and inaccurate, and should be deleted.

41. The discussion of "*private benefit*" at [32] and [33] should reflect and discuss the actual wording of the donee organisation provisions, which refer to an entity not carried on for the "*private pecuniary profit*" of an individual.

42. At [36], the reference to a registered charity's surplus on winding up having to be used for charitable purposes "*in New Zealand*" is incorrect.

43. The discussion of funds dedicated to New Zealand purposes (at [37] to [42]), should be expanded to cover "*public*" funds under s LD 3(2)(d), not just funds under s LD 3(2)(c). The discussion also appears to have been lifted from QB 19/10 and uses the terms "*specified*

purposes" and "*required purpose*" that are not used elsewhere in the statement, and the first sentence of the first bullet point under [38] should be deleted (or shifted to an earlier part of the statement). As noted above, the position in relation to separate Charities Act registration and Inland Revenue approval/listing of s LD 3(2)(c) and (d) funds should also be more clearly addressed in the statement.

44. The discussion of "*overseas donee status*" (at [58] to [63]), notes that the overseas donee needs to be a "*New Zealand*" entity., The statement should more clearly address this requirement (including, for example, whether or not it is sufficient for an entity to be a non-resident charity that is registered under the Charities Act on account of having a sufficiently strong connection with New Zealand).

45. In section on "*gifts of money by individuals*" (at [66] to [70]), should cover the payroll giving rules under ss LD 4 to LD 8 that provide an alternative way for individuals to claim a tax credit (against PAYE) in relation to donations to donee organisations. At [69], the draft refers to an "IR256" claim form, which is presumably intended to be a reference to the "IR526" claim form. At [70], the draft briefly refers to the new time bar provision for donation tax credit claims, but the discussion does not cover the four year period for making such claims. It would assist users if the statement were to cover all such timing aspects in relation to donation tax credit claims, and also clarify Inland Revenue's position on whether the relevant provisions are to be applied to all gifts for a particular tax year (i.e., one claim per tax year) or to each gift or aggregation of gifts in respect of which a donation tax credit claim is made.

46. The discussion on company and Maori authority deductions for gifts (at [73] to [79]), references the new exclusions for gifts taken into account under the deregistration rules (at [75] and [78]). These references should be explained in more detail or should include a cross-reference to the discussion of the deregistration rules in ED0207/a. Also, at [76] the cross-reference to [103] should be a cross-reference to [99].

47. In relation to the discussion of the limited FBT exemption for charitable organisation (at [80] to [84]), the approach taken in the draft may also be appropriate for ED0207/a (see the earlier comments on this aspect of ED0207/a) and the two parts of the statement dealing with the FBT exemption should be consistent.

48. As to to the discussion on the "gifts" (at [88] to [92]), the statement would ideally address the issue of debt forgiveness (although the timing of the Government's proposed legislative response to the Court of Appeal decision in *Commissioner of Inland Revenue v Roberts* [2019] NZCA 654 may preclude this) and also related matters, such as donations to a donee organisation in circumstances where there is a debt owed to the donor. Alternatively, this statement and also QB 16/05 should be flagged to be reviewed and updated once the proposed debt forgiveness changes, and also other litigation regarding "gifts" for donation tax incentive purposes, have been resolved.

49. The conclusion at [98] in relation to "Crowdfunding platforms" (see also [96] to [98]), that a donation receipt should only be issued for the amount of a donation less any fees charged by the crowdfunding service, should be reviewed. While the particular details of the arrangements might impact on the outcome, if the crowdfunding service is being used by the donee

organisation, with that organisation incurring such fees rather than the donor, the gift of money made by the donor to the organisation should be the full amount of the donation.

50. At [101] to [102], there is a brief reference to the payroll giving rules. Those rules should be referred to earlier in the statement, in the section regarding "Gifts of money by individuals" starting at [66]. At [102] there is also another reference to an "IR256" claim form, which is presumably intended to be a reference to the "IR526" claim form.

51. Record-keeping requirements is discussed at [103] to [107]. Our earlier comments regarding the discussion of record-keeping requirements in ED0207/a similarly apply. The two parts of the statement dealing with record-keeping requirements should be consistent..

52. Further the Appendix to the draft does not include the 1 April 2020 changes to the donee organisation provisions, relating to Charities Act registration and Inland Revenue approval/listing, that are discussed in the draft. The Appendix also does not include relevant definitions under s YA 1 (such as the "charitable purpose" and "charitable organisation" definitions), the FBT exemption under s CX 25, and the "gift exempt body" definition and related provisions under the Tax Administration Act 1994.

Next steps

The Law Society would be happy to discuss these comments further with officials if that would assist with developing and finalising the two parts of the operational statement. The convenor of the Law Society's Tax Law Committee, Neil Russ, can be contacted via Law Reform Adviser, Emily Sutton (Emily.Sutton@lawsociety.org.nz).

Yours faithfully

Andrew Logan
Vice President