

CONSULTATION > OFFICIALS' ISSUES PAPER

# **Taxation and the not-for-profit sector**

Issued: 24 February 2025

An officials' issues paper

**FIRST PUBLISHED**

February 2025 by Policy, Inland Revenue, PO Box 2198, Wellington 6140.

Taxation and the not-for-profit sector – An officials' issues paper



© Crown Copyright

This work is licensed under the Creative Commons Attribution 4.0 International Licence. In essence, you are free to copy, distribute and adapt the work, as long as you attribute the work to the Crown and abide by the other licence terms.

The document is available at

<https://www.taxpolicy.ird.govt.nz/consultation/2025/taxation-and-the-not-for-profit-sector>

## CONTENTS

<b>CHAPTER 1 - Introduction.....</b>	<b>4</b>
Introduction .....	4
Document outline .....	4
Making a submission.....	4
<b>CHAPTER 2 - Charity business income tax exemption.....</b>	<b>6</b>
Background .....	6
Policy framework.....	6
Accumulation .....	6
Competitive advantage.....	6
Reason for review.....	8
Implications of change .....	8
Policy design issues .....	8
Definition of unrelated business activity .....	8
De minimis for small-scale trading activities .....	9
Relief for distributed business income .....	10
Other considerations .....	11
<b>CHAPTER 3 - Donor-controlled charities .....</b>	<b>13</b>
Background .....	13
Policy framework.....	13
Reason for review.....	13
Policy design issues .....	14
Definition of donor-controlled charity .....	14
Restrictions on investments.....	14
Minimum distribution rule .....	15
<b>CHAPTER 4 - Integrity and simplification.....</b>	<b>17</b>
NFP and friendly society member transactions and related matters .....	17
Background .....	17
Policy framework .....	17
Reason for review .....	17
Income tax exemptions .....	19
Background .....	19
Policy framework .....	19
Reason for review .....	19
FBT exemption.....	20
Background .....	20
Policy framework .....	21
Reason for review .....	21
Tax simplification .....	21
Volunteers .....	21
Donation tax concessions.....	22
<b>Appendix .....</b>	<b>23</b>
Discussion questions.....	23
Chapter 2: Charities business income tax exemption.....	23
Chapter 3: Donor-controlled charities .....	23
Chapter 4: Integrity and simplification .....	23

## CHAPTER 1 - Introduction

### Introduction

- 1.1 New Zealand has long adopted a policy of providing tax concessions to charities and not-for-profits (NFPs) to support organisations that provide public benefit.
- 1.2 Today, the support provided to NFPs through the tax system includes income tax deductions and exemptions, tax concessions to some donors for donations made, goods and services tax (GST) concessions, and fringe benefit tax (FBT) concessions for certain employees.
- 1.3 Registered charities generally receive the most tax benefits, which reflects the public benefits they provide. Other NFPs receive limited income tax concessions because they do not have such a formal public benefit requirement.
- 1.4 Every tax concession has a “cost”, that is, it reduces government revenue and therefore shifts the tax burden to other taxpayers.
- 1.5 This officials’ issues paper is part of a review to determine the effectiveness of certain tax concessions, both in meeting their objectives, and relative to alternative methods of providing assistance. The review will consider a range of integrity measures as well as what improvements and simplifications can be made to some of the existing rules.
- 1.6 The Government’s tax and social policy work programme, announced in November 2024, includes reviewing elements of charities and NFPs. The work programme’s objectives include simplifying tax rules, reducing compliance costs, and addressing integrity risks.

### Document outline

- 1.7 The chapters in this issues paper cover the following topics:
  - Chapter 2 (Charity business income tax exemption) explores issues related to the charity business income tax exemption and the rationale for providing such an exemption. The chapter goes on to discuss a number of policy design issues that would need to be considered if the charity business income exemption were to be removed.
  - Chapter 3 (Donor-controlled charities) considers the integrity issues that arise from the absence of specific rules for donor-controlled charities in New Zealand. The chapter goes on to discuss policy design issues associated with donor-controlled charity rules, including how other countries have approached these issues.
  - Chapter 4 (Integrity and simplification) considers a number of integrity and simplification issues to protect against tax avoidance and evasion, and to maintain stable, predictable, and where possible, simple tax rules for the NFP sector.

### Making a submission

- 1.8 Officials invite submissions on the issues raised in this document, including the specific questions asked and any other issues relevant for officials to consider. A complete list of these questions can be found in the Appendix to this issues paper.

- 1.9 Include in your submission a brief summary of the major points and recommendations you have made. Please indicate if officials from Inland Revenue can contact you to discuss the points raised, if required.
- 1.10 The closing date for submissions is 31 March 2025.
- 1.11 Submissions can be made:
- by email to [policy.webmaster@ird.govt.nz](mailto:policy.webmaster@ird.govt.nz) with "Taxation and the not-for-profit sector" in the subject line, or
  - by post to:  

Taxation and the not-for-profit sector  
C/- Deputy Commissioner, Policy  
Inland Revenue Department  
PO Box 2198  
Wellington 6140
- 1.12 Your submission will be proactively released on Inland Revenue's tax policy website. Submissions may be the subject of a request under the Official Information Act 1982. Please clearly indicate in your submission if you consider that any information should be withheld on the grounds of privacy, or for any other reason (contact information such as an address, email, and phone number for submissions from individuals will be withheld). Whether any information is withheld will be determined using the Official Information Act 1982.

## CHAPTER 2 - Charity business income tax exemption

### Background

- 2.1 Many of New Zealand's 29,000 charities registered under the Charities Act 2005 raise funds through business activities. These activities range from small op-shops to significant commercial enterprises.
- 2.2 Since 1940, income derived from charity business activities has been tax exempt, to the extent the charity's charitable purposes are carried out in New Zealand.<sup>1</sup>
- 2.3 Some tax-exempt business activities directly relate to charitable purposes, such as a charity school or charity hospital. Other tax-exempt business activities are unrelated to charitable purposes, such as a dairy farm or food and beverage manufacturer. It is the unrelated business activities that are the focus of this review.
- 2.4 The current tax policy setting makes New Zealand an international outlier. According to a 2020 OECD study,<sup>2</sup> most countries have either restricted the commercial activities that a charitable entity can engage in, or they tax charity business income if the business income is unrelated to charitable purpose activities. These countries have typically been concerned with a loss of tax revenue from businesses if a broader tax exemption was applied, unfair competition claims, a desire to separate risk from a charity's assets, and a desire to encourage charities to direct profits to their specified charitable purpose.

### Policy framework

#### **Accumulation**

- 2.5 Our income tax exemption framework for registered charities takes a "destination of income" approach. This means that income earned by registered charities is tax exempt because it will ultimately be destined for a charitable purpose.
- 2.6 This approach allows income to be accumulated tax free for many years within a registered charity, or within its registered business subsidiaries, before the public receives any benefit.

#### **Competitive advantage**

- 2.7 A criticism often levelled at this exemption is that it provides the trading activity with a competitive advantage over its tax-paying competitors. One element of a firm's normal cost structure, income tax, is not present in the case of the charity-run trading operation. It is argued that this "lower" cost could be used by a large-scale entity to undercut its competitors, to improve its market share or to deter new entrants.
- 2.8 Although the exemption does provide a *tax* advantage it does not provide a competitive advantage. Any one type of cost cannot be looked at in isolation.

---

<sup>1</sup> Section CW 42 of the Income Tax Act 2007

<sup>2</sup> OECD (2020), *Taxation and Philanthropy*, OECD Tax Policy Studies, No. 27, OECD Publishing, Paris, [https://www.oecd.org/en/publications/taxation-and-philanthropy\\_df434a77-en.html](https://www.oecd.org/en/publications/taxation-and-philanthropy_df434a77-en.html)

- 2.9 Because the tax-exempt entity can generally earn tax-free returns from all forms of investment,<sup>3</sup> the “after tax” return it expects from a trading activity is correspondingly higher than that of its taxed competitors. Therefore, an income tax-exempt entity cannot rationally afford to lower its profit margins on a trading activity because alternative forms of investment would then become relatively more attractive.
- 2.10 On this basis, the tax-exempt entity will charge the same price as its competitors. The tax exemption merely translates to higher profits and, hence, higher potential distributions to the relevant charitable purpose. Consequently, funding the charitable activity from trading activities is no more distortionary than sourcing it from “passive” investments, such as interest on bank deposits, or from direct fund raising.
- 2.11 Another concern is whether a tax exemption gives a charity a greater ability to use predatory pricing to gain an advantage. While a charity might be able to sustain lower prices and operating losses temporarily to out-compete others, the value of tax losses for taxable businesses mitigates this advantage. Taxable businesses can carry forward losses to offset future profits, reducing the impact of initial losses. Therefore, the argument that charities can use their untaxed retained earnings to engage in predatory pricing overlooks the mitigating effect of tax loss carry-forwards for taxable entities.
- 2.12 In summary, both charities and taxpaying businesses face the same pre-tax returns on their investments. A charity’s alternative to running a business (eg, investing in securities) is also tax free, so their opportunity cost remains the same.
- 2.13 However, there are various “second-order” imperfections in the income tax system that may need to be taken into account. For example:
- Charitable trading entities may have an advantage over non-charitable trading entities in that they do not face the compliance costs associated with a tax obligation. This lowers their relative costs of doing business.
  - The non-refundability of losses for taxable businesses can result in a disadvantage for such businesses relative to tax-exempt businesses, resulting in a higher relative rate of return for non-tax paying businesses over time when there has been a loss in one year.
  - The costs associated with raising external capital, such as negotiating with investors or banks, can be significant. These costs often make retained earnings the most cost-effective form of financing. Because charities’ retained earnings are higher, this may give them lower costs in raising capital. On the other hand, charities generally cannot raise equity capital (as private investors cannot receive a return).
- 2.14 Associated with the last bullet point, a charity could more generally have an advantage if it were to accumulate its tax-free profits back into the capital structure of its trading activities, enabling it, through a faster accumulation of funds, to expand more rapidly than its competitors. Arguably, however, such accumulation could potentially arise from any form of income earned by charities.

---

<sup>3</sup> An exception is investment in domestic equity, because imputation credits are not refundable.

## **Reason for review**

- 2.15 The fiscal cost of not taxing charity business income unrelated to charitable purposes, particularly income that is accumulated, is significant and is likely to increase. Tax concessions for unrelated charity businesses reduce government revenue, and therefore shift the tax burden to other taxpayers.
- 2.16 Whether charity business income unrelated to charitable purposes should be subject to tax therefore depends on the level of support that the Government wants to provide to charities.

### **Questions for submitters**

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?

## **Implications of change**

- 2.17 A policy change to tax income accumulated within charity businesses would have financial implications for some affected charities. For example, for profitable businesses reporting a taxable surplus it would reduce the amount of accumulated funds available to their businesses, which they would otherwise use to grow their net assets or ultimately pass on for charitable purposes.
- 2.18 A policy change focusing on the charity business income tax exemption may also create a preference for some charities to invest in passive (non-business) investments if income from these investments remains untaxed.
- 2.19 Compliance costs for affected charity businesses would increase. However, the extent of those costs would depend on the policy design.

### **Question for submitters**

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?

## **Policy design issues**

- 2.20 This part of the chapter considers the policy design issues if the current tax exemption for charity business income was to be reviewed for accumulated, unrelated business income.

### ***Definition of unrelated business activity***

- 2.21 Distinguishing between related and unrelated business activities could be difficult in practice unless the legislation and associated guidance is clear. Most countries that tax commercial activities of charities will exempt business income that is related to a charitable purpose, and tax unrelated business income. There are many international precedents to follow.
- 2.22 In New Zealand the FBT rules already require some charities to distinguish between related and unrelated business activities. In addition, Inland Revenue

released a 2024 interpretation statement that provides guidance on when charities are carrying on a business.<sup>4</sup>

- 2.23 Some of the issues that could be subject to dispute include whether a trade or business exists, whether it is regularly carried on, and whether it substantially relates to a charitable purpose.
- 2.24 In countries where unrelated business income is taxed, certain unrelated commercial activities remain tax exempt, including:
- certain fundraising activities that are promoted primarily to raise money for the benefit of a charity,
  - charitable businesses that are substantially run by unpaid volunteers, and
  - businesses primarily engaged in selling donated goods or services, such as charity op-shops.

### **Question for submitters**

- 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?

### ***De minimis for small-scale trading activities***

- 2.25 Removing the tax exemption for unrelated businesses is likely to impose compliance costs for affected charities within the sector. This may be a problem for many charities, particularly those with small-scale trading activities that tend to not have professional in-house reporting expertise like larger charities and are often staffed by volunteers.
- 2.26 Countries that tax the commercial activities of charities typically apply thresholds to exempt small-scale trading activity that is unrelated to a charitable purpose. For example, the United Kingdom provides a small-scale trading tax exemption for unrelated business activity when the charity's annual turnover does not exceed £8,000, or 25% of a charity's annual turnover, subject to a maximum limit of £80,000.
- 2.27 A starting point for a de minimis exemption threshold in New Zealand could be based on a charity's financial reporting tier. In New Zealand, charities must report their financial information based on a tier system, which is determined by their annual expenses or operating payments and whether they have public accountability.
- 2.28 Approximately 12,000 of New Zealand's 29,000 registered charities reported business income in their published 2024 financial accounts. A summary of the number of these charities based on reporting tier is shown in the table below. Only a portion of these businesses would be carrying on activities unrelated to charitable purposes, however the exact number of unrelated businesses will be unknown until the term is formally defined.

---

<sup>4</sup> Charities – Business income exemption *Tax Information Bulletin* Vol 36, No 10 (November 2024): 36

<https://www.taxtechnical.ird.govt.nz/interpretation-statements/2024/is-24-08>

Table 1: Breakdown of 11,700 charities that reported business income in 2024<sup>5</sup>

Reporting Tier	Tier 1	Tier 2	Tier 3	Tier 4
Criteria (total expenses) <sup>6</sup>	Over \$33m	\$33m-\$5m	\$5m-\$140,000 (accrual-based accounting)	Under \$140,000 (cash-based accounting)
Proportion and number of charities reporting business income	1% (100)	10% (1,200)	45% (5,300)	43% (5,100)

- 2.29 A de minimis threshold that continues to provide tax exemption for Tier 3 and Tier 4 charities would, for example, limit the impact of a policy change to less than 1,300 charities that report annual expenses above \$5 million per annum.

#### Question for submitters

- 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?

#### Relief for distributed business income

- 2.30 Any policy change is likely to reflect the broad principle, adopted by many countries, that only accumulated unrelated business income should be subject to income tax.
- 2.31 Officials note that the charitable sector has told the Government in previous consultations that accumulation of funds can occur for many good reasons.<sup>7</sup>
- 2.32 An important policy design issue is how to best target a tax on business accumulated surpluses and provide relief when accumulated surpluses are eventually distributed for charitable purposes.
- 2.33 Some countries only exempt a charity's business income if the business profit is distributed towards a charitable purpose within a given time period.
- 2.34 If the New Zealand tax exemption is removed for charity business income that is unrelated to charitable purposes, a deduction could be allowed for distributions (donations or dividends) paid to a parent charity of a charity

<sup>5</sup> These figures are sourced from publicly available data on the charities register. These are indicative only because the data is self-reported and Charities Services cannot verify its accuracy.

<sup>6</sup> The External Reporting Board (XRB) announced changes to the threshold size of some reporting Tiers in early 2024. This table shows the new thresholds that came into effect for reporting periods ending on or after 28 March 2024.

<sup>7</sup> This includes consultations undertaken by the Tax Working Group in 2018 and by DIA for the Modernisation of the Charities Act in 2019-2021.

business. This is generally the situation at present and would mean that income provided to the parent charity for charitable purposes during the tax year would effectively remain tax exempt. There may need to be anti-avoidance rules to ensure that amounts distributed by the business are not immediately re-invested by the charity back into the business.

- 2.35 To enable charities to accumulate funds for charitable use in later years, additional rules may be necessary. For example, policy design could consider the creation of a special memorandum account for registered charities that carry out unrelated business activity, similar to an imputation credit account or Māori authority credit account. New rules could allow credits for tax paid to be refundable when they are attached to dividends paid to their charitable parent in later years.

### **Question for submitters**

- Q5. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, do you agree that charity business income distributed for charitable purposes should remain tax exempt? If so, what is the most effective way to achieve this? If not, why not?

### **Other considerations**

- 2.36 Inland Revenue is aware of a number of complexities that may need to be considered if the policy direction is changed. For example:
- how a change could impact on the current territorial rule,
  - how a change could be applied to investments in businesses using hybrid structures such as limited partnerships, and
  - how a change could impact on the charity deregistration tax rules.<sup>8</sup>
- 2.37 If a charity's charitable purposes are not limited to New Zealand, its business income must be split on a reasonable basis between its charitable purposes in New Zealand and outside New Zealand. Only the part that is apportioned to the charity's charitable purposes in New Zealand is exempt from tax. This is sometimes referred to as the "territorial rule" or "territorial restriction".
- 2.38 Inland Revenue published an interpretation statement to clarify how the current territorial restriction can be applied.<sup>9</sup> Based on public submissions from that work, Inland Revenue is aware that there are compliance costs and ongoing practical issues with the territorial restriction. If the business income exemption is restricted to accumulated, unrelated business income for charities above a certain de minimis, there may be a case to review the existing territorial restriction.
- 2.39 Many charities choose to conduct business activities through limited partnership structures. Limited partnerships are treated as transparent for tax purposes<sup>10</sup> so income derived by a charitable entity through a limited partnership is tax exempt. If the policy settings change to tax unrelated business income, new

---

<sup>8</sup> Section HR 12 of the Income Tax Act 2007.

<sup>9</sup> Charities - Business income exemption *Tax Information Bulletin* Vol 36, No 10 (November 2024): 36

<https://www.taxtechnical.ird.govt.nz/interpretation-statements/2024/is-24-08>

<sup>10</sup> This means that income and expenses flow through to the partners, and partners are taxed separately.

rules may be required to ensure that unrelated business income earned through a limited partnership is taxable.

- 2.40 Some countries that tax the commercial activities of charities have special rules for limited partnerships. In Canada, which has a similar look-through treatment for limited partnerships, charities that hold more than 20% of the fair market value of all interests in a limited partnership are considered to be carrying on the business of the partnership and will not be registered as a charity if the business is unrelated to its charitable purpose.

### **Question for submitters**

- Q6. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what policy settings or issues not already mentioned in this paper do you think should be considered?

## CHAPTER 3 - Donor-controlled charities

### Background

- 3.1 The term “donor-controlled charity”, for the purpose of this issues paper, refers to a charity registered under the Charities Act 2005 that is controlled by the donor, the donor’s family, or their associates. Donor-controlled charities often referred to in other jurisdictions as private foundations typically take the organisation structure of charitable trusts or limited liability companies.
- 3.2 In New Zealand, individuals can establish donor-controlled charities and access the same tax concessions as other widely supported charities. Donors can claim donation tax credits and gift deductions, as they would if they donated to an unrelated donee organisation at arm’s length.

### Policy framework

- 3.3 The tax policy framework provides targeted tax concessions to charities that are registered under the Charities Act. There are currently no tax rules that specifically relate to donor-controlled charities.
- 3.4 The Charities Act requires related party transactions to be disclosed by medium and large charities in their financial accounts. From the 2024 year onwards, Charities Services also requires all medium and large charities to report annually on how they plan to use their accumulated funds.

### Reason for review

- 3.5 Unlike many countries, New Zealand does not distinguish donor-controlled charities from other charitable organisations. However, donor-controlled charities can enable tax avoidance and raise compliance concerns because of the control the donor or their associates can exercise over the use of charity funds.
- 3.6 Some examples Inland Revenue is aware of include:
- Circular arrangements, when the donor gifts money to a charity they control, claim a donation tax credit or gift deduction, and the charity immediately invests the money back into businesses controlled by the donor or their associates. While the investment may earn a market rate return, typically the investment income is accrued and no cash is actually paid to the charity for many years.
  - In donor-controlled charities there can be a significant lag between the time of tax concessions for the donor and the charity, and the time of the ultimate public benefit. This occurs when the donor-controlled charity accumulates most or all its funds and makes no or very minimal charitable distributions.
  - Arrangements when donor-controlled charities purchase assets from the donor or their associates at prices exceeding what would normally be paid by unrelated parties.
  - Arrangements when donor-controlled charities regularly acquire goods or services from the donor or their associates, on terms that would not normally exist between unrelated parties.

## **Policy design issues**

### ***Definition of donor-controlled charity***

- 3.7 If the Government were to introduce special rules for donor-controlled charities, it would first need to define them in legislation.
- 3.8 One issue to consider is the level of control that is required for a charity to be “donor controlled”. The definition of a donor-controlled charity could depend on the proportion of funds that the founder (or their associates) contributes to the charity or the control they have over the operation of the charity.
- 3.9 Another issue to consider is whether donor-controlled charities should include charities that carry out charitable activities themselves, rather than just being fundraising charities. International approaches to this issue vary. For example, in Canada, a charity is considered a private foundation if:
- a charity is controlled by a majority (more than 50%) of directors, trustees, or like officials that do not deal with each other at arm’s length, or
  - more than 50% of capital is contributed by a person, or a group of persons, not dealing with each other at arm’s length and who are involved with the private foundation.
- 3.10 Private foundations in Canada can carry out charitable activities themselves, but they are not allowed to engage in any business activities.
- 3.11 In Australia, private foundations typically structure themselves as private ancillary funds to obtain deductible gift recipient status and tax exemption. Private ancillary funds must distribute funds to other deductible gift recipients and cannot carry out charitable activities themselves.

### **Question for submitters**

- Q7. Should New Zealand make a distinction between donor-controlled charities and other charitable organisations for tax purposes? If so, what criteria should define a donor-controlled charity? If not, why not?

### ***Restrictions on investments***

- 3.12 Transactions between donor-controlled charities and their associates could be required to be on arm’s length terms or prohibited outright. This would limit the ability for donors to transfer value out of the charity through non-arm’s length transactions or circular arrangements. Instead, or in conjunction, anti-avoidance provisions could be introduced for the specific arrangements involving transactions with associated persons.
- 3.13 This approach was supported by the Tax Working Group in 2019, which found that the rules for private charitable foundations in New Zealand appear to be unusually loose.<sup>11</sup> The group recommended that the Government consider removing tax concessions for privately controlled foundations or trusts that do not have arm’s length governance or distribution policies.

---

<sup>11</sup> Future of Tax: Final Report Volume I - Recommendations (Reports by the Tax Working Group)  
<https://taxworkinggroup.govt.nz/resources/future-tax-final-report-vol-i>

- 3.14 Comparable international jurisdictions have rules restricting private foundations from engaging in non-arm's length transactions. Australia will only allow investment transactions to be on a non-arm's length basis if favourable to the fund or a deductible gift recipient. The United States restricts private foundations from making certain transactions with donors and their associates, including the sale or lease of property, lending money, and providing goods or services. There are also restrictions on private foundations making "jeopardising investments" that are high risk or speculative, such as commodity futures and options.
- 3.15 The UK does not have specific rules for donor-controlled charities but has specific anti-avoidance rules (called the tainted charity donation rules) that tackle abuse when there are circular transactions involving donations for all charities.
- 3.16 In the US, private foundations face restrictions on transactions with disqualified persons, such as substantial contributors, foundation managers, and certain family members. There are also restrictions on business holdings to limit a private foundation's influence over for-profit enterprises.

### **Question for submitters**

- Q8. Should investment restrictions be introduced for donor-controlled charities for tax purposes, to address the risk of tax abuse? If so, what restrictions would be appropriate? If not, why not?

### ***Minimum distribution rule***

- 3.17 To mitigate concerns about unrestricted accumulation and a significant timing mismatch between the tax benefit and the ultimate public benefit being achieved, donor-controlled charities could be required to make a minimum distribution each year for charitable purposes.
- 3.18 There is international precedent for minimum distribution rules. Australia, Canada, and the US require private foundations to distribute a minimum amount each year:
- In Australia, private foundations that are registered private ancillary funds are required to distribute 5% of the market value of the charity's net assets in the previous year to charitable organisations. If this 5% is less than \$11,000, the fund must distribute at least \$11,000 (or the remainder if the fund is worth less) if the fund's expenses are paid from its assets or income.
  - In Canada, private foundations must spend a minimum amount each year on charitable activities or qualifying disbursements. This amount is set at either 3.5% or 5% of the average value of the charity's property not directly used in charitable activities or administration, depending on whether the value of the property is above or below \$1 million.
  - In the US, private foundations must distribute 5% of the fair market value of their non-charitable-use assets.
- 3.19 Some countries also provide exceptions to the minimum annual distribution, often to allow foundations to accumulate funds for specific projects. In Australia, private ancillary funds can apply to the Commissioner of Taxation to reduce their minimum annual distribution. In the US, a foundation that distributes in excess of the minimum annual distribution can carry forward the excess distribution for up to five years to fund any later shortfall.

**Question for submitters**

- Q9. Should donor-controlled charities be required to make a minimum distribution each year? If so, what should the minimum distribution rate be and what exceptions, if any, should there be for the annual minimum distribution? If not, why not?

## CHAPTER 4 - Integrity and simplification

4.1 This chapter considers several integrity and simplification issues, to protect against tax avoidance and evasion and to maintain a stable, predictable and, where possible, simple tax system. The issues involve:

- NFP member transactions and related matters,
- certain income tax and FBT exemptions, and
- tax simplification that could benefit volunteers and donors.

### **NFP and friendly society member transactions and related matters**

#### ***Background***

4.2 This section discusses:

- the policy framework for NFPs,
- whether NFPs and friendly societies (including credit unions) should pay tax on member trading transactions, and membership subscriptions and levies, and
- whether the law should be simplified for small NFPs to minimise their compliance costs.

#### ***Policy framework***

4.3 NFPs are generally subject to income tax under the broad-base, low-rate policy framework. There are three exceptions:

- NFPs that qualify for a specific income tax exemption (such as the exemption for registered charities or the exemption for bodies promoting amateur games and sport),
- NFPs that have net income of no more than \$1,000, provided their constitution prohibits them from distributing property to members (this concession is intended to reduce compliance costs for small NFPs), and
- NFPs that are permitted by their constitutions to make distributions to members can reduce their taxable income to the extent they distribute profits on member transactions back to members as a rebate. This tax concession provides a similar result to what would otherwise be provided under the common law mutuality principle.<sup>12</sup>

#### ***Reason for review***

4.4 Many NFPs are mutual associations, that is, a body or association of people acting together to further an objective, which is often to provide benefits to members. Mutual associations supply or receive goods or services to or from members. Examples of mutual associations include clubs, societies, trade associations, professional and regulatory bodies, and industry councils.

---

<sup>12</sup> The common law mutuality principle provides that an association of people does not derive taxable income from transactions within its circle of membership, based on the idea that persons cannot make a profit from trading with themselves.

- 4.5 Up until the early 2000s, Inland Revenue's guidance was that mutual associations were not liable for income tax on income from transactions with their members (including trading transactions, and membership subscriptions and levies). Inland Revenue subsequently withdrew its public guidance on the mutual association rules on the basis that it did not reflect the correct view of the law in relation to member transactions. Inland Revenue meanwhile remained of the view that subscriptions and levies were of a capital nature and tax exempt.
- 4.6 Inland Revenue has reconsidered these issues and has prepared a draft operational statement that sets out the Commissioner's updated view on these rules. Its release has been delayed until submissions on this Issues Paper have been considered. The draft operational statement currently states that:
- The application of the common law principle of mutuality is limited by the mutual association rules in the Income Tax Act 2007.
  - These rules mean that trading, and other normally taxable transactions with members, including some subscriptions, are taxable income regardless of whether the common law principle of mutuality would apply.
  - Most NFPs would not qualify for mutual treatment anyway because their constitutions would prohibit distribution of surpluses to members including on winding up (thus preventing the necessary degree of mutuality).
- 4.7 The updated view in the current draft operational statement is consistent with the policy intention of the mutual association rules. However, it has the potential to impact approximately 9,000 NFPs that may not currently be paying tax on profits from member transactions or subscriptions (when those subscriptions are business income or income under ordinary concepts).
- 4.8 The general policy settings for member transactions, outlined above, are inconsistent with the rules that apply to friendly societies and credit unions. These entities have a specific legislative tax exemption for all income except income that is derived from a business carried on beyond their membership. This means that income from member trading transactions and all non-business income is currently tax exempt.

### **Questions for submitters**

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

- increasing and/or redesigning the current \$1,000 deduction to remove small scale NFPs from the tax system,
- modifying the income tax return filing requirements for NFPs, and
- modifying the resident withholding tax exemption rules for NFPs.

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

## **Income tax exemptions**

### ***Background***

- 4.9 This part of the chapter discusses several income tax exemptions available to NFPs that appear to have become out-of-date and may not be fit for purpose today.

### ***Policy framework***

- 4.10 Specific tax concessions are generally inconsistent with New Zealand's broad-base, low-rate tax framework. If the Government wishes to encourage a particular economic activity, it is preferable this is done in a transparent way by direct funding rather than through the tax system.

### ***Reason for review***

- 4.11 Officials consider the following exemptions, most enacted in the 1950s, may no longer be fit for purpose.

#### *Exemption for local and regional promotional bodies*

- 4.12 Local and regional promotional bodies are formed to advertise, beautify, or develop a city or district to attract trade or tourists or develop public amenities.<sup>13</sup>
- 4.13 Initially this exemption applied to the small-scale activities of progressive associations, public hall societies, beautifying societies or similar bodies. However, it is now being accessed by some much larger entities with significant assets and income.
- 4.14 Some entities apply for this income tax exemption when they are unable to register under the Charities Act 2005. This creates inconsistent tax outcomes for organisations that are factually similar.

#### *Exemption for herd improvement bodies*

- 4.15 Herd improvement bodies are established mainly to promote the improvement of dairy cattle standards in New Zealand.<sup>14</sup>
- 4.16 This exemption was originally intended to apply to smaller less financially robust organisations but now applies to some larger well-funded organisations.

#### *Exemption for bodies promoting scientific and industrial research*

- 4.17 Bodies promoting scientific or industrial research are tax exempt provided they are non-profit organisations dedicated solely to research that benefits the public.<sup>15</sup>
- 4.18 The context in which scientific and industrial research is conducted has changed significantly since the introduction of the exemption. Advances have been made in technology, changes in funding models have occurred, and research has become increasing commercialised.

---

<sup>13</sup> Section CW 40 of the Income Tax Act 2007

<sup>14</sup> Section CW 51 of the Income Tax Act 2007

<sup>15</sup> Section CW 49 of the Income Tax Act 2007

### *Exemption for veterinary service bodies*

- 4.19 Veterinary service bodies are associations, clubs, or societies established mainly to promote efficient veterinary services in New Zealand.<sup>16</sup>
- 4.20 This exemption was introduced to allow veterinary service bodies to invest in better facilities and higher standards of service. These entities are now more established, undertake commercial trading activities outside their immediate services, and compete directly with tax-paying private veterinary practices.
- 4.21 This and other industry sector specific exemptions may be difficult to justify under a broad-base, low-rate tax policy framework.

### *Exemption for non-resident charities with no charitable purpose in New Zealand*

- 4.22 Non-resident charities operating entirely outside New Zealand can apply to the Commissioner for a tax exemption on their non-business income earned in New Zealand.<sup>17</sup>
- 4.23 There is no requirement for these entities to report regularly to the Commissioner or to be recorded on any public register for transparency purposes. This has raised integrity concerns when the entities have begun to operate inside New Zealand or started to earn business income here.
- 4.24 It is the officials' view that there are weak grounds to provide this tax exemption when other non-resident entities are subject to tax on their New Zealand non-business income.

#### **Question for submitters**

Q12. What are the likely implications if the following exemptions are removed or significantly reduced:

- local and regional promotional body income tax exemption,
- herd improvement bodies income tax exemption,
- veterinary service body income tax exemption,
- bodies promoting scientific or industrial research income tax exemption, and
- non-resident charity tax exemption?

## **FBT exemption**

### ***Background***

- 4.25 Benefits provided by a charitable organisation to its employees while they are carrying out the charitable purposes of the organisation are exempt from FBT. This exemption has been in the FBT rules since 1985, although it was removed for a brief period in 1990.

---

<sup>16</sup> Section CW 50 of the Income Tax Act 2007

<sup>17</sup> Section CW 41(5)(c) of the Income Tax Act 2007

## **Policy framework**

- 4.26 The rationale for introducing and maintaining this exemption was to support the charitable sector. Specific reasons included enabling charities to offer more competitive salary packages at a lower cost to the charity (thereby increasing funds available for charitable purposes) and reducing compliance costs.

## **Reason for review**

- 4.27 There are weak efficiency grounds for continuing this exemption because it distorts the labour market. The current position creates an incentive for organisations and employees to negotiate for non-cash remuneration and in doing so, pay less tax than if they were paid salary and wages.
- 4.28 Further, the current exemption lacks coherence. For example, universities are specifically excluded from the exemption, but other tertiary institutions are not.
- 4.29 Historically, one of the arguments against applying FBT to the charitable sector was to help save compliance costs. However, one of the aims of the current review of FBT settings is also to reduce those compliance costs.<sup>18</sup> Therefore, these concerns may no longer be as relevant as in previous years.

## **Question for submitters**

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?

## **Tax simplification**

### **Volunteers**

- 4.30 Officials are interested in ways to lower tax-related compliance costs for volunteers. One issue we are aware of relates to the tax treatment of honoraria.
- 4.31 Honoraria payments are given as a token of appreciation for voluntary services or contributions. They are not a contractual obligation but rather a gesture of gratitude, and the amount is not necessarily tied to the market value of the service provided.
- 4.32 Honoraria are treated as schedular payments for tax purposes. This means several compliance cost issues arise, such as requiring volunteers to account for ACC levies.
- 4.33 Simplifications were introduced from 1 April 2019 for volunteers for Fire and Emergency New Zealand (FENZ). This means volunteers are treated as receiving salary or wages, which can reduce tax compliance costs for volunteers.

---

<sup>18</sup> The Government's Tax and Social Policy Work Programme, published in November 2024, refers to a review of the FBT rules as part of the "economic growth and productivity" workstream <https://www.taxpolicy.ird.govt.nz/work-programme>

### **Question for submitters**

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

### **Donation tax concessions**

- 4.34 In 2023–2024 Inland Revenue conducted a donation tax credit (DTC) regime regulatory stewardship review.<sup>19</sup> This review aimed to assess whether the regime is operating as intended, achieving its outcomes, and remaining fit for purpose. As part of this review there were almost 3,000 customer responses. The report highlighted low levels of awareness and uptake of the scheme, for example:
- only 57% of those surveyed were aware the regime existed,
  - only one in five people that make donations claim the DTC for all their donations.
- 4.35 This review was published on 10 February 2025 together with a departmental response to the recommendations.
- 4.36 The policy-related recommendations were:
- delink DTCs from income tax to allow for more real-time payments, for example when DTCs are refunded before year-end and closer to the time a donation is made,
  - allow Inland Revenue to collect data from donee organisations to pre-fill DTC claims and streamline the DTC claiming process, and
  - introduce a three-month grace period so donee status is retained if a deregistered charity is re-registered within three months.
- 4.37 It is important to note that in its response to the review, Inland Revenue indicated that these recommendations require system, administration, and policy changes, which would have to be considered against other priorities.

### **Question for submitters**

Q15. What are your views on the 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?

---

<sup>19</sup> <https://www.taxpolicy.ird.govt.nz/publications/2025/rs-dtc-regime>

## Appendix

### Discussion questions

#### **Chapter 2: Charities business income tax exemption**

- Q1. What are the most compelling reasons to tax, or not to tax, charity business income? Do the factors described in 2.13 and 2.14 warrant taxing charity business income?
- 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?
- 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?
- 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?
- Q5. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, do you agree that charity business income distributed for charitable purposes should remain tax exempt? If so, what is the most effective way to achieve this? If not, why not?
- Q6. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what policy settings or issues not already mentioned in this paper do you think should be considered?

#### **Chapter 3: Donor-controlled charities**

- Q7. Should New Zealand make a distinction between donor-controlled charities and other charitable organisations for tax purposes? If so, what criteria should define a donor-controlled charity? If not, why not?
- Q8. Should investment restrictions be introduced for donor-controlled charities for tax purposes, to address the risk of tax abuse? If so, what restrictions would be appropriate? If not, why not?
- Q9. Should donor-controlled charities be required to make a minimum distribution each year? If so, what should the minimum distribution rate be and what exceptions, if any, should there be for the annual minimum distribution? If not, why not?

#### **Chapter 4: Integrity and simplification**

- Q10. What policy changes, if any, should be considered to reduce the impact of the Commissioner's updated view on NFPs, particularly smaller NFPs? For example:
- increasing and/or redesigning the current \$1,000 deduction to remove small scale NFPs from the tax system,
  - modifying the income tax return filing requirements for NFPs, and
  - modifying the resident withholding tax exemption rules for NFPs.
- Q11. What are the implications of removing the current tax concessions for friendly societies and credit unions?

*Income tax exemptions*

Q12. What are the likely implications if the following exemptions are removed or significantly reduced:

- local and regional promotional body income tax exemption,
- herd improvement bodies income tax exemption,
- veterinary service body income tax exemption,
- bodies promoting scientific or industrial research income tax exemption, and
- non-resident charity tax exemption?

*FBT exemption*

Q13. If the compliance costs are reduced following the current review of FBT settings, what are the likely implications of removing or reducing the exemption for charities?

*Tax simplification*

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

Q15. What are your views on the 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?