Deregistered charities
Susan Barker, CharitiesLaw Ltd, Wellington
looks at the process and consequences

The Charities Bill was substantially rewritten at Select Committee stage in response to hundreds of submissions. National Party members of the Social Services Select Committee made the following comments in the Select Committee’s report at 20:

The consultation process was inadequate with the original [charities] bill and we have major concerns that the redrafted sections of the bill should have been made available for a further period of sector wide consultation. We all know the devil is in the detail and if the bill gets it wrong, as the first draft definitely did the charitable sector will pay the price and we will see many charitable organisations close. There is the possibility that there are a number of structural issues in the bill remaining unaddressed and without a further period of consultation with the sector it is difficult to fully identify these.

There are indeed a number of structural issues in the Charities Act 2005, and the charitable sector is paying the price.

In July 2013, the Inland Revenue Department published an issues paper entitled Clarifying the tax consequences for deregistered charities. The IRD noted that 3,902 charities had been deregistered in the period since the charities register opened in February 2007 (at 10). This constitutes almost 15 per cent, or 1 in 6, of the approximately 26,000 charities currently registered. The number of charities deregistered is undoubtedly higher now, some 15 months later.

This level of deregistration has occurred despite the discretionary power to deregister a charity having been intended to be used in “only in the most extreme circumstances” (Select Committee report, at 8). As then Minister of Consumer Affairs, Hon Judith Tizard, noted at the Committee stage (12 April 2005) 625 NZPD 19967:

the deregistration power is discretionary — it is not obligatory. I would expect the Charities Commission to go through a range of choices and discussions with any charity before that charity is deregistered, but the commission should have the power, if it is clear that fraudulent behaviour is systemic in a charity, to deregister that charity quite quickly.

This reflects the original rationale for the Charities Act: the charitable sector had fought for decades to see a Charities Commission established, so that “bad” charities, involved in fraud, tax avoidance, or money laundering and the like, could be “weeded out”, and the public could have confidence in those that remained (see Barker, Gousmett and Lord, The Law and Practice of Charities in New Zealand, LexisNexis 2013, chs 4 and 5).

However, of the 3,902 deregistered charities, only three were deregistered for “serious wrongdoing”.

DEREGISTRATIONS

2,489 were deregistered for failing to file an annual return, a transgression that the charities regulator (previously the Charities Commission, and now the Department of Internal Affairs) advises will be dealt with less abruptly in future.

The balance of 1,410 charities are said to have been deregistered for the following reasons: “non-charitable purposes”; “did not meet registration requirements”; “did not produce evidence of charitable purposes”; and “voluntary deregistration”. In the writer’s experience, a large proportion of these will be “good” charities deregistered on the basis of fine, technical, and often controversial points of legal interpretation surrounding the definition of charitable purpose; alternatively, they will have “seen the writing on the wall” and deregistered voluntarily to avoid having a formal deregistration decision displayed on the charities regulator’s website.

It should also be noted that this figure of 1,410 does not include the many hundreds of other good charities that have been declined registered charitable status, or otherwise simply “burned off” by the process.

While some charities manage to survive non-registration (the Sensible Sentencing Trust being a notable example), they are the exception rather than the rule. Most charities that are denied registration struggle to survive: they struggle to challenge decisions of the regulator in the framework as it is currently structured; they struggle to gain funding as busy funders rightly or wrongly restrict funding to registered charities only; they struggle with issues of confidence and credibility, as the reasons for having been rejected by their own regulator are difficult to communicate to their stakeholders. As foreshadowed by the National Party in 2004, many are forced to close.

This problem will be exacerbated if provisions requiring deregistered charities to pay tax on the value of assets held are passed by Parliament (see proposed new ss CV 17 and HR 12 of the Income Tax Act 2007, as proposed to be inserted by the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill, currently before Select Committee). For charities that voluntarily deregister, these provisions are proposed to apply from 1 April 2014.

In addition, the exemption which allowed non-profits to offer debt securities to the public without needing to comply with the usual trustee, prospectus, and investment statement requirements is now limited to registered charities (see the Securities Act (Charity Debt Securities) Exemption Notice 2013, which replaced the previous Securities Act (Charitable and Religious Purposes) Exemption Notice 2003).

While not the case yet, there are concerns that eligibility for donor status and fringe benefit tax exemption may come to be limited to registered charities only. Increasingly, registered charitable status is the gateway to survival for a charity.
REDEFINING CHARITABLE PURPOSE

This makes it vital that the definition of charitable purpose is interpreted correctly, and that good charities with charitable purposes are able to gain registration.

The narrow approach taken by the Charities Commission to the definition of charitable purpose, and continued or perhaps even narrowed by the Department of Internal Affairs — Charities Services and the Charities Registration Board, has, in the writer's view, changed the law on the definition of charitable purpose without mandate: the Select Committee considering the Charities Bill specifically recommended that the definition be left unchanged (at 3).

It has been argued that the regulator has not changed the law, but has simply applied more rigour (see CAB SOC Min (12) 24/3 November 2012, at [13]). However, the problem with the pre-Charities Act regime was that IRD's approach to assessing whether purposes were charitable lacked rigour. Where the previous regime had been lacking was in monitoring charities to ensure that they continued to act in furtherance of those charitable purposes. This was the rationale for charities being required to submit annual returns under the Charities Act, and for the charities regulator being given specific power to inquire into charities. This was also the reason why the regulator was required to consider a charity's activities under s 18 of the Charities Act.

It is therefore perplexing that, in a climate of such limited resources, the charities regulator seems to prioritise expenditure of resources on denying registration to good charities on the basis of narrow, technical, and often controversial points of legal interpretation. An example is the deregistration of the National Council of Women (http://www.charities.govt.nz/assets/docs/registration/National-Council-of-Women-of-New-Zealand-Incorporated.pdf), following the controversial decision to deregister it in 2010 (http://www.charities.govt.nz/assets/docs/registration/deregistration/national-council-of-women-of-new-zealand-incorporated.pdf). These changes in registered charitable status are of enormous significance for a good charity of many decades' standing, and have occurred despite there being no material change in the charity's purposes or activities. A focus on monitoring charities to ensure the truly "bad" ones are "weeded out" would seem more appropriate.

In the writer's view, the narrow approach taken by the charities regulator to the interpretation of the Charities Act, including the definition of charitable purpose, is causing the loss of so many good charities, and having such a significant chilling effect, that the New Zealand charitable sector is in danger of being systematically deconstructed. The writer does not reach this view lightly.

If the charities regulator is interpreting the definition of charitable purpose incorrectly, what can be done? The process set out in the Charities Act by which the charities regulator is to be held to account for its decisions is for charities to challenge those decisions in the High Court (see Charities Act, s 59).

Under s 59(2), charities have 20 working days to file High Court proceedings. The period runs from the date of decision. If, as is often the case, the decision is not immediately communicated to the charity, this further reduces the time available within which a charity, often run by a board of volunteers, must absorb an adverse decision, find funding for and instruct a lawyer, and file proceedings.

Despite these significant difficulties, it is important for the sake of the definition of charitable purpose that charities do hold the charities regulator to account for its decisions.

It would help if the framework by which charities can appeal decisions of the regulator could be made more "user-friendly". Apart from the cost and time considerations, one obstacle that does not appear to be widely appreciated is that charities' ability to have a hearing of evidence appears to have been removed altogether: in establishing that their purposes are charitable, charities are being required to prove matters of fact without access to the time-tested mechanisms of our justice system by which matters of fact are established, such as the oral hearing of evidence and cross-examination. The conception of an appeal to the High Court under s 59 as an "appeal", rather than as a first instance hearing, appears to be being interpreted to mean that these mechanisms are to be denied to charities altogether.

This has led, in most cases taken under the Charities Act to date, to procedural wranglings as to whether the charity concerned could adduce further evidence (see Canterbury Development Corporation v Charities Commission [2010] 2 NZLR 707 (HC) at [104]-[106]; In Re Education New Zealand Trust (2010) 24 NZTC 24,353 (HC) at [58]-[63]; Re New Zealand Computer Society Inc (2011) NZTC 20,033 (HC) at [23]-[25]; Re Greenpeace New Zealand Inc (2011) 2 NZLR 815 (HC) at [27]-[33]; Liberty Trust v Charities Commission (2011) 3 NZLR 68 (HC) at [48]-[50]; Re Queenstown Lakes Community Housing Trust (2011) 3 NZLR 502 (HC) at [24]-[26]).

Further, in the two post-CDC cases where an application to adduce further evidence has not been made, the charities concerned seem to have been particularly disadvantaged by lack of evidence (see In Re Draco Foundation (NZ) Charitable Trust (2011) 25 NZTC 20,032 (HC) at [32]-[33], [48]-[49] and [77]; and Re The Grand Lodge of Antient Free and Accepted Masons in New Zealand (2011) 1 NZLR 277 (HC) at [49] and [54]). Further still, in the one Charities Act case where an application to adduce further evidence has been refused, the charity also appears to have been disadvantaged by lack of evidence (see Re New Zealand Computer Society Inc (2011) NZTC 20,033 (HC) at [79]).

None of this sits well with s 3(b) of the Charities Act, under which a key purpose of the Charities Act is to "encourage and promote the effective use of charitable resources". Charities are reluctant litigants at the best of times. A charity that has managed to marshal sufficient resources to bring a case to court should be assisted to adduce all the evidence necessary to enable a proper examination of whether their purposes are charitable, for the sake not only of the particular charity concerned, but also for the development of charities law generally.

This becomes particularly critical as the consequences of failure to gain registered charitable status become increasingly high.
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Uncharitable attitudes to charity

Yet again, the number and range of articles in this Charities Issue of the Journal shows us that the reforms instituted under the Charities Act 2005 have far from laid all issues to rest. As Sue Barker shows, at the time the Bill was going through the House, the National Party opposition argued that it could lead to the crippling of the charitable sector. The reforms the current government has introduced, however, only nibble at the edges.

Governments are fond of passing Acts of Parliament granting powers to executive authorities and then saying that they will only be used in the most extreme circumstances. A recent example is offered by the power to obtain warrants for the arrest of student loan defaulters returning from overseas. As Barker shows, such assurances were given about the power to deregister charities. Since 2007, nearly 4,000 charities, or one in six of all charities, have been deregistered. Of these, nearly 2,500 were for failure to file an annual return.

Such failures can of course be an early indication of financial problems, whether criminal or negligent, but as every owner of a firearm knows, it is much easier for regulators to harass basically honest people over minor infractions than it is to get to grips with the real criminality the regulation is intended to deal with.

As ever, tax issues loom large. Michael Gousmett mentions the questionable interpretation of s LD 3 of the Income Tax Act 2007 by the Inland Revenue Department. He asks whether Parliament intended to include minor benefits to members in the expression “rights arising from membership”. Any lawyer outside the tax world would interpret that expression to mean only a right to a share in the distribution of assets when the organisation or fund is wound up. A benefit conferred and rescindable by the committee is not a “right”. The IRD however interprets it even to include even voting rights. This renders s LD 3(b) redundant and hence is contrary to basic principles of statutory interpretation (if there are any left). The IRD then falls back on the meaning of the word “gift” to exclude any sort of benefit in return, but this too renders subs (3) redundant if benefit is interpreted expansively.

The application of the word “gift” is currently being reviewed by the IRD, ie the fox is reviewing the design of the henhouse. Gousmett cites case law that is far from as absolute as the IRD’s interpretation of this basic word. A few simple examples suffice. The University of Otago has created a Court of Benefactors which its most “significant donors” are invited to join. This Court meets occasionally. Does this mean that from now on any major “donation” made to the University no longer qualifies as a “gift”? What about the naming of, say, the Owen Glenn Building at the University of Auckland? After all, naming rights on buildings are often the subject of commercial transactions. What about a brick in the wall of the new school building with one’s name on it? Or publication of one’s name on a list of donors? From there one builds up to artistic and musical endeavours which offer sponsors and donors a reduction on ticket prices, or an invitation to a reception with the cast and crew and a free glass of sherry? What if the full cost of the reception is charged but only “friends of the opera” are invited to attend?

How many staff of the IRD are to be involved in monitoring whatever precise level of recognition is considered acceptable?

In the hearing of Greenpeace v New Zealand Inc v Charities Board before the Supreme Court (SC 97/2012, hearing 1 August 2013), the Chief Justice raised another basic and interesting question which is whether charity involved assumption of responsibility for provision that would otherwise fall on the public ([2013] NZSC Trans 15 at 12 and see also at 10, 13, 14, 17, 22, 86, 87, 88). For better or worse, this would signal a substantial narrowing of the concept of “charity”, although it would be relatively easy in many cases to represent one’s advocacy as educational (discussed in the Transcript at 24–25).

Taxation is not the only driver of legal questions for charities. Charities are mostly either trusts or incorporated societies and both of those legal forms are themselves under review. The results of those reviews will inevitably impact on charities, many of which are small and informal and run entirely by volunteers. It is of course right to be concerned that donated funds are being properly directed but increasingly burdensome regulation is not necessarily the right answer. For a start, as with bank accounts, people who give their money to charities should be encouraged to assure themselves that the charity is doing a good job and not rely on the existence of regulation. In this way, people become involved in local and small charities and the charities become part of the fabric of civic society rather than just shakers of money boxes at street corners. Second, it is alleged that regulatory authorities become so burdened with the everyday processes of regulation that they are slow to respond to complaints of outright fraud and criminality. The level of regulation actually hinders the doing of the real job that regulators should be doing.

Fund raising and accounting are also subjects of articles in this issue. The fundamental question raised by oversight and regulation of charity is how a genuinely facilitative regime can be created which avoids turning, as regulators and politicians tend to do, to error avoidance.