To: the Finance and Expenditure Committee

On: the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill

3 February 2014

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INTRODUCTION

1. This submission is from SUE BARKER CHARITIES LAW, PO Box 3065, Wellington 6140.

2. We would like to appear before the Committee to speak to our submission. Our contact details are:

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ABOUT SBCL

3. Sue Barker Charities Law is a boutique law firm in Wellington specialising in charities law and public tax law. The firm acts for a number of charities affected by decisions of the charities regulator: the firm assisted the National Council of Women of New Zealand Incorporated to regain registered charitable status following its deregistration in 2010, and continues to act for them seeking to resolve tax issues arising from the period of deregistration. The firm's director, Sue Barker, also acted for a number of charities making submissions on the original Charities Bill in 2004, is a co-author of *The Law and Practice of Charities in New Zealand,* published by LexisNexis in 2013, and was a member of the Policy Advice Division of the Inland Revenue Department from 1993-1998.

BACKGROUND

4. Our submission primarily focuses on the provisions relating to the deregistration of charities, and community housing providers.

We welcome the initiative to clarify some of the tax consequences arising for charities who have received an adverse decision from the charities regulator. As was noted in the July 2013 Officials' Paper *Clarifying the Tax Consequences for Deregistered Charities*, current tax law does not adequately deal with the full range of tax consequences, and this creates confusion, uncertainty and additional compliance costs. As is also noted in the Officials' Paper, the charitable sector plays an important role in New Zealand society. The legislative and administrative regimes regulating charities should not impose unreasonable burdens upon them or expose them to significant undue risks.

In considering reform in this area, we believe it is critical to consider the background context. Importantly, the impetus for the establishment of a charities regulator in New Zealand had principally come from the New Zealand charitable sector itself. Concerns had been raised in the media, for example, about the accountability of charity fundraisers for ensuring that funds raised from the public were used for the purposes stated. The New Zealand charitable sector had for decades wanted a system of regulation to ensure that the public could have trust and confidence in charities. To put it simply, the system of regulation was intended to be a mechanism for removing "bad" charities.

It was therefore a shock to many people that the charities regulator proceeded to take a very narrow approach to the interpretation of the definition of charitable purpose. This

caused many "good" charities to be denied registered charitable status, and is widely considered to be incorrect as a matter of law. It is also widely considered to be "anti-charity", to the point that some even consider, with justification, that it is causing a systematic deconstruction of the New Zealand charitable sector.

However, a key difficulty for charities in establishing the incorrectness of the position taken by the charities regulator is that the mechanism in the Charities Act by which charities can challenge decisions of their regulator is fundamentally flawed. For example, in establishing that their purposes are charitable, charities are required to prove matters of fact, but are denied the ability to have any hearing of evidence whatsoever. There is no indication that such an un-level playing field was intended by the legislature, and we note the comments of the select committee considering the Charities Bill that a wholesale rewrite of the Bill at select committee stage was rushed through under urgency without proper consultation. We believe that many of the early cases decided under the Charities Act will be revisited in the fullness of time.

Another problem is that many charities are simply being "burned off" by the process. The current system of charities regulation is not working, and the large number of charities being denied registration is merely a symptom of that fact.

In that context, while we welcome the initiative to clarify the tax consequences for deregistered charities, we strongly submit that the problem needs be addressed at its source. The review of the Charities Act was part of the bargain originally struck when the Charities Bill was originally passed. A review of the Charities Act is urgently needed. The reasons given for its cancellation in November 2012 do not survive critical examination.[1]

This submission is made on the basis that any treatment of the symptoms should not delay the addressing of the underlying cause of the problem.

[1] For a discussion of this point see Barker, Gousmett and Lord *The Law and Practice of Charities in New Zealand,* LexisNexis 2013, chapter 10.

SUMMARY OF MAIN ISSUES

5. Our submission addresses the following issues in the context of the proposed provisions relating to deregistered charities:

(a) Charities that are deregistered may not have "ceased": the term "ceased charities" should not be used in this context.

(b) The use of the term "person" is problematic in the context of trusts and unincorporated societies: the term "entity" as defined in the Charities Act should be used instead.

(c) Charities are required to further their charitable purposes within the parameters of their constituting document. Documents such as business plans, setting out how the charity proposes to do that, can and do change over time. The proposed requirement to act in accordance with such information supplied at the time of applying for charitable status is not workable.

(d) The legislation should make it clear that the provisions taxing deregistered charities do not apply if the charity's income is exempt under another provision.

(e) The requirement to pay tax on the value of net assets should be deferred until 1 year after the "day of final decision", in a similar manner to the extension of the income tax exemption to that date in section CW 41.

(f) The words "*other than money*" should be deleted from proposed new section HR 12(2)(b): there is no rationale for excluding gifts of money from the proposed adjustment.

(g) We support the policy of protecting donors who have claimed donations tax relief in good faith, but we consider the consequences of deregistration on eligibility for donee status should continue to be dealt with at an administrative level.

(h) What is meant by the words "benevolent", "philanthropic" and "cultural" in the definitions of donee organisation and charitable organisation needs to be clarified.

(i) Section 59 of the Charities Act should be amended to provide a process for appealing decisions of the charities regulator that is more "fit for purpose".

6. In this submission the following abbreviations are used:

Charities Act: Charities Act 2005

Charities regulator*:* previously the Charities Commission, and now the Department of Internal Affairs – Charities Services and the Charities Registration Board

Charities Services*:* the Department of Internal Affairs - Charities Services

Income Tax Act: Income Tax Act 2007

Tax Administration Act: Tax Administration Act 1994

Officials' Paper: Officials' Issue Paper, *Clarifying the tax consequences for deregistered charities,* July 2013

IRD: Inland Revenue Department

CIR: Commissioner of Inland Revenue.

DEREGISTRATION OF CHARITIES

Clause 19 – new section CV 17

Charities may not be "ceased"

Issue

7. Proposed new section CV 17 is entitled "Ceased charities: taxation of tax-exempt accumulation". The word "ceased" should not be used as the charity may not be "ceased".

Submission

8. As was noted in the explanatory note to the original Charities Bill in 2004 at page 1, registration with the charities regulator is voluntary: an unregistered charity is still able to call itself a charity and collect funds from the public.

9. An entity that has been deregistered from the charities register may still continue as a charity. The reference to the charity having been "ceased" will not be correct in all cases, and its use is likely to be confusing.

10. New section CV 17 is actually directed at charities that have been *deregistered*, rather than charities that have "ceased": the term "deregistered" should be used in place of the term "ceased". The same reasoning applies to other proposed provisions where the term "ceased" has been used.

Recommendation

11. New section CV 17 should be renamed "*Deregistered charities: taxation of tax-exempt accumulation*".

12. Other references to "ceased charities" should be similarly amended. For example:

    - new section CW 41(6) should be renamed "*Further definition: grace period for deregistered charities";*
    - and in new section HC 31(1B), the reference to "ceased charities" in the last line should be deleted and replaced with a reference to "deregistered charities".

Clause 19 – new section CV 17 **Definition of "person"**

Issue

13. The provisions relating to deregistered charities in the income tax legislation should use the term "entity", as that term is defined in the Charities Act, rather than "person".

Submission

14. "Person" is not relevantly defined in the income tax legislation. The application of the term to charities that may be constituted as a trust, or as an unincorporated body of persons, is not particularly clear. For this reason, the Charities Act uses the concept of an "entity", which is specifically defined in section 4 of the Charities Act to mean "*any society, institution, or trustees of a trust*". In the context of the tax provisions for deregistered charities, it would be helpful for the income tax legislation to link in to this concept also.

Recommendation

15. The word "person" in new section CV 17 should be deleted and replaced with the word "entity", which should specifically be defined as per section 4 of the Charities Act.

16. Other references to "persons" in the context of deregistered charities should be similarly amended. For example:

- in new section CW 41(1)(aa), the words "person who" in the first line should be deleted and replaced with "entity that". The words "they are" on the 4th line should be deleted and replaced with the words "it is".
- Subparagraph CW 41(1)(aa)(i) should be similarly amended as discussed below.
- In new section CW 41(5)(c), the words "a person" should be replaced with the words "an entity".

Clause 21 – amendment to section CW 41

Compliance with information supplied at the time of applying for charitable status

Issue

17. The information supplied at the time of applying for charitable status can include business plans, and other information regarding activities that will necessarily change over time. The requirement to act in accordance with such information is not workable.

Submission

18. The proposed amendment to section CW 41 allows the income of a deregistered charity to remain exempt from income tax from the day on which it was originally registered until the day of final decision. The "day of final decision" is proposed to be defined in section YA 1 as the later of the day the person is removed from the register, and the day on which "*all reasonably contemplated administrative appeals and Court proceedings, including appeal rights, are finalised or exhausted in relation to the person's charitable status".* The proposed continuation of the exemption can be cut short if the person "*fails to act in accordance with the relevant constitutional documents or other information supplied to the Charities Commissioner or Board at the time of applying for charitable status"* (proposed new section CW 41(aa)(i)).

19. We note in passing that "Charities Commissioner" is a typographical error and should read "Charities Commission". We also note that "Board" does not appear to be defined for the purposes of the section, and suggest that section YA 1 include a definition of "Board" as "the Charities Registration Board, established by section 8 of the Charities Act 2005". Section CW 41 would then need to include "Board" in its list of defined terms. Alternatively, it would be more streamlined to insert into section YA 1 a new definition of "charities regulator", defined as either the Charities Commission, the Department of Internal Affairs – Charities Services, and/or the Charities Registration Board, as appropriate. Consequential amendments to section CW 41 would then be made as needed. Although the Charities Registration Board has responsibility for registration and deregistration of charitable entities under section 8 of the Charities Act 2005, in practice, this power is largely delegated to the Department of Internal Affairs under sections 8 and 9 of the Charities Act; information is generally given to the Department of Internal Affairs, rather than to the Charities Registration Board, when applying for registered charitable status. A generic definition of "charities regulator" would have the advantage of circumventing all of these issues.

20. The commentary to the Bill states at page 68 that the amendments to section CW 41: "*should afford entities a greater level of certainty that, for tax purposes, they should be able to rely on the decision made by Charities Services to recognise that entity as charitable in purpose. This protection, however, only applies when the deregistered charity has acted in accordance with all the information and evidence that Charities Services used to make its registration decision. If an entity has ceased to act in accordance with the evidence or information provided to Charities Services, then that entity*

should not be able to take advantage of the decision to register it. Therefore, entities that have continued to be compliant with their constitutions and other supporting information provide at the time of registration will not be liable for tax in periods before they were deregistered, and if they dispute their deregistration, not before the date their dispute is finally decided".

21. We support the decision to limit retrospective tax liabilities for charities that have acted in good faith and been deregistered on the basis of a "change in jurisprudential interpretation of what is charitable and what is not". This is particularly the case given that the consequences for a deregistered charity to have to enter the tax base at a historical date can be extremely onerous and disproportionately penal. However, we are concerned that the requirement to act in accordance with "*information supplied to the [charities regulator] at the time of applying for charitable status*" is not workable.

22. The charitable sector had worked for decades to see the establishment of a charities regulator and register. Their reason for doing so was so that "bad" charities could be weeded out, and the public could have confidence in charities that were registered. Prior to the introduction of the Charities Act, there was widespread concern that there was no regime for monitoring charities. The mischief that was sought to be addressed by the Charities Act was charities that were not acting in accordance with their constituting documents. This was the rationale behind section 18 of the Charities Act, by which the charities regulator must "have regard to" an entity's activities in considering an application for registration. While section 13 of the Charities Act requires that an entity's *purposes* must be charitable, the reason for looking to *activities* in section 18 is to be clear that those activities are being carried out in furtherance of an entity's charitable purposes.

23. In furtherance of section 18, the charities regulator requires that an entity provide information about its current and proposed activities when applying for registered charitable status. As discussed above, the reason for considering this information is to establish that those activities would indeed further the entity's charitable purposes. However, an entity is not legally forever bound to comply with any such information about its current and proposed activities. There may be any number of ways by which the entity's constituting document, and in particular the charitable purposes expressed in that document, may be furthered. Income tax exemption cannot turn on complying with a business plan or other information supplied at the time of applying for registration that may subsequently have become superseded. There is no legal requirement for it to do so: plans and activities can and should change over time.

24. The legal requirement is for an entity to comply with its constituting document, whether it be a trust deed, statute, set of rules, constitution, or whatever it may be. That constituting document may be amended over time, even replaced, but it will be always speaking in one form or another and must

always be complied with. For that reason, the reference to the "relevant" constituting document is not clear. The reference should simply be to the constituting document. If there happens to be more than one constituting document (eg a statute together with a trust deed) both must be complied with at all times, and together they effectively are the entity's "constituting document": section 33 of the Interpretation Act 1999 provides that words in the singular include the plural.

25. In addition, the requirement that an entity comply with its constituting document is consistent with the original rationale for the Charities Act: monitoring. The concern is that the entity carries out activities in furtherance of its charitable purposes as set out in its constituting document, not that its activities should be fossilised as per the documentation submitted with its original application for registration.

26. In addition, the requirement to act in accordance with information supplied at the time of applying for registration will become increasingly anachronistic and irrelevant as time passes.

Recommendation

27. New section CW 41(1)(aa)(i) should be deleted and replaced with the following: "*the day on which the entity fails to act in accordance with its constituting document*"

28. New section CW 41(6) should be deleted and replaced with the following:

"*Further definition: grace period for deregistered charities*

(6) An entity that is removed from the register of charitable entities under the Charities Act 2005 is a ***tax charity*** *in the period starting on the day it is registered on the register and ending on the earlier of the following days:*

(a) the day on which the entity fails to act in accordance with its constituting document:

(b) the day of final decision."

Clause 107 – new section HR 11

What if another exemption is available

Issue

29. Proposed new section HR 11 is expressed to apply if a charity "*ceases to meet the requirements to derive exempt income under section CW 41 or CW 42*". However, a charity that has been deregistered may nevertheless be exempt from income tax under an alternative provision, such as section CW 40 (*Local and regional promotion bodies),* section CW 46 (*Bodies promoting amateur games and sports),* proposed new section CW 42B for community housing providers etc. Section HR 11 should make it clear that its application is overridden if another exemption applies.

Submission

30. It may seem obvious that if a deregistered charity is exempt under another provision then it will not be subject to income tax and an initial tax base will not need to be established. However, in the interests of plain language drafting, and of reducing compliance costs in the future, it would be helpful to make this clear: the legislative drafting should make it clear that section HR 11 does not apply if an entity's income is exempt under another provision.

31. As discussed above, it would be clearer for section HR 11 to refer to the "entity", as that term is defined in the Charities Act, rather than the "person", and we note that section HC 31, on which proposed new section HR 11 is based, uses this formula: section HC 31 refers to the assets "of the trust", rather than of the trustees of the trust, and specifically provides in section HC 31(2) for who is to make the various choices given by the section.

32. As also discussed above, a charity that has been deregistered is not necessarily "ceased" as a charity, and the use of the term is unhelpful: the term "deregistered" should be used in place of "ceased". We also recommend the phrase "date of cessation" be deleted and replaced with the term used in section HC 31: "the date of the change in circumstances". This has the advantage of consistency of comparable provisions.

33. We also query why section HC 31 allows for a market value option in the valuation of financial arrangements (section HC 31(4)(a)), but proposed new section HR 11(3) does not. A charity that is deregistered may have been in existence for years if not decades, and may never have previously had to deal with issues of income tax. Entering the tax base may be a very complicated exercise for such a charity, which may very likely be run by volunteers and may simply not have resources to seek expensive tax advice. Allowing charities the same market value option for valuing the consideration for financial arrangements that is currently available to charitable trusts under section HC 31 seems a practical and sensible option in this context.

Recommendation

34. We recommend that the legislation clarify that section HR 11 does not apply if the deregistered entity's income is exempt from tax under a provision other than section CW 41 or CW 42.

35. We also recommend that a market value option be inserted

into section HR 11(3) along the lines of current section HC 31(4)(a).

36. We also recommend that the references in section HR 11 to: "person" be replaced with "entity"; "ceased charities" be replaced with "deregistered charities"; and "the date of cessation" be replaced with "the date of the change in circumstances".

Clause 108 – new section HR 12

Extension to day of final decision / gifts of money should not be excluded from the proposed adjustment

Issue

37. Proposed new section HR 12 requires deregistered charities to pay tax on the value of net assets held on the day they are deregistered, less certain adjustments. The applicable date should be the day of final decision, not the date of deregistration.

Submission

38. Proposed new section HR 12 requires deregistered charities to pay tax on the value of net assets held on the day they are deregistered, with adjustments for assets distributed for charitable purposes in the year after deregistration, and for any assets (other than money) gifted or lent to the charity while it was deriving exempt income. The section applies on and after the day the charity is deregistered, with that day being defined in the section as the "end date".

39. But what if the charity appeals the decision to deregister it? Such an appeal could take a significant period of time, much longer than a year. A charity in such a position may obtain an interim order reinstating it to the register while its appeal is being determined, but what if it doesn't? Such a charity would then face having to pay tax on the value of its net assets as at the date of deregistration, only to have to unwind the position at a later date if its appeal was ultimately successful. The proposed amendments to section CW 41 allow a deregistered charity to remain exempt from income tax until the "day of final decision", which is proposed to be defined as later of the day of deregistration and the day on which all reasonably contemplated administrative appeals and Court proceedings, including appeal rights, are finalised or exhausted in relation to the entity's charitable status. The requirement to pay tax on the value of net assets in section HR 12 should be deferred until 1 year after the day of final decision, in a similar manner to the extension of the income tax exemption to that date in section CW 41.

40. Section HR 12(2)(b) proposes to exclude from the amount of assets on which tax is payable, assets that were gifted or left to the entity while it was deriving exempt income under section CW 41 or CW 42. However, many charities will have some if not many years in which they derive no "income". The adjustment should not turn on whether the entity was *actually deriving* exempt income under section CW 41 or CW 42 but rather on whether it was *eligible* to do so. If the entity was not actually deriving exempt income at the time an asset was gifted or left to the entity, that factor should not of itself cause the charity to have to pay tax on the value of that asset, should the charity subsequently become deregistered.

41. It is not clear why money is excluded from the adjustment proposed in section HR 12(2)(b). As currently worded, the section encourages donors to make gifts or bequests to charities in kind, rather than in money: a charity that is subsequently deregistered would have to pay tax on any gifted money held after deregistration, whereas it would not have to pay such tax if an equivalent gift had instead been made in kind. The commentary to the Bill states at page 70 that the

rationale for the adjustment for donated assets is that "*these assets were not funded by non-taxed income or through a tax-preferred source*". For a charity, there is no fundamental difference from a tax perspective between a gift of an asset or of money: neither is likely to constitute "income", and neither is funded from non-taxed income or through a tax-preferred source. It is simply a gift. From the donor's perspective, a tax credit or deduction may be available for gifts of money, whereas it is not available for gifts in kind. Importantly, however, section LD 3(3) specifically excludes testamentary gifts from the ambit of these tax privileges to donee organisations. Accordingly, a bequest of money to a charity could not of itself be said to have been funded from non-taxed income or through a tax-preferred source (and section CW 43 (*Charitable bequests)* does not alter that, simply providing a grace period following the date of death for a charity to become registered). Accordingly, there is no rationale for the distinction between gifts of assets and gifts of money in the context of bequests. In addition, the government has considered extending section LD 3 to in-kind gifts to charities, acknowledging that such gifts are to be encouraged (see for example the October 2006 discussion document *Tax incentives for giving to charities and other non-profit organisations,* paragraph 4.28, and the discussion in *The Law and Practice of Charities in New Zealand,* paragraphs 3.626 to 3.631). This further underscores that the distinction between in-kind gifts and gifts of money should not be perpetuated by a provision such as section HR 11(2)(b). The words "*other than money*" should be deleted from section HR 12(2)(b).

42. As before, it would be clearer for section HR 12 to refer to the "entity", as that term is defined in the Charities Act, rather than the "person", as discussed above.

43. As also discussed above, as charities that are deregistered will not necessarily have "ceased" as a charity, references to "ceased" charities should be replaced with references to "deregistered charities"*.*

Recommendation

44. We recommend that subsections (1) and (2) of proposed new section HR 12 be deleted and replaced with the following:

"*HR 12 Deregistered charities: taxation of tax-exempt accumulations*

(1) This section applies to an entity on and after the day of final decision in respect of that entity.

(2) The entity has an amount of income, derived on the day that is a year after the day of final decision, equal to the greater of zero or the value of net assets that the entity held on the day of final decision, but ignoring:

(a) assets distributed for charitable purposes in the year after the day of final decision; and

(b) assets gifted or left to the entity when the entity was eligible to derive exempt income under section CW 41 or CW 42."

Clause 110 – section LD 3

Consequences of deregistration on eligibility to be a donee organisation

Issue

45. The consequences of deregistration on eligibility to be a donee organisation should continue to be dealt with at an administrative level.

Submission

46. Clause 110 proposes to insert new subsection (ab) into section LD 3, specifically conferring donee status on registered charities, and therefore providing that donations to registered charities are eligible for the donations tax credits/deductions. The commentary to the Bill states at page 72 that this amendment "*would ensure donors have a greater level of certainty that their donations tax relief will not ordinarily be reversed in circumstances where they have made a bona fide monetary gift and the entity they have donated to is later deregistered".* We support the policy of protecting donors who have claimed donations tax relief in good faith.

47. Loss of registered charitable status does not necessarily mean loss of donee status. The tests for donee status and registered charitable status are different, and not all registered charities are eligible for donee status, just as not all donee organisations are eligible to be registered charities. For example, section LD 3 requires that a donee organisation's funds are applied "wholly or mainly" to a range of purposes, including charitable purposes, "within New Zealand". Many registered charities that further their charitable purposes overseas, and that are not separately listed on schedule 32 of the Income Tax Act, do not satisfy this requirement and are therefore not eligible for donee status, despite being registered as charities. The fact that overseas-focused entities are eligible for registered charitable status is discussed in the charities regulator's fact sheet, *International charitable activities and the Charities Act.*[2] The proposed amendment to section LD 3 will allow registered charities to have donee status even if they carry out their charitable purposes wholly or mainly overseas. It will therefore allow donations to those internationally-focussed organisations to be eligible for donations tax credits. This will render schedule 32 of the Income Tax Act, and the careful vetting process by which overseas charities are able to become listed on Schedule 32, largely redundant.[3] It is not clear if this result is intended.

48. Although certainty is desirable, in our view, the consequences for donors of donations made to a charity that is subsequently deregistered would be better dealt with at the administrative, rather than the legislative, level. The commentary notes at page 70 that: "*The Government accepts that Inland Revenue should be able to reverse tax relief in certain circumstances, but this power should not be used as a matter of course. In particular, this power should only be available in circumstances when a donor had knowledge at the time of claiming the relief that the entity did not satisfy any of the*

[2] http://www.charities.govt.nz/assets/docs/information-sheets/international-charitable-activities.pdf.

[3] Schedule 32 will remain relevant for donee organisations whose purposes are not exclusively charitable.

requirements to be a donee organisation, or when the donor was involved in fraud in relation to the donation and the donee organisation, or when the requirements substantiating that a bona fide monetary gift has been made are not met under general law". These factors can all be dealt with under current law, and are not necessarily addressed by making all registered charities donee organisations.

49. We understand that IRD is currently working on guidelines of the various limbs of section LD 3, that is, what constitute "benevolent", "philanthropic", "cultural" or "charitable" purposes for the purposes of section LD 3 of the Income Tax Act. These guidelines could be usefully expedited.

Recommendation

50. That proposed section LD 3(2)(ab) be deleted, and administrative guidance on section LD 3 be expedited.

Clause 123 – section YA 1 **Definition of "charitable organisation" for the purposes of the exemption from FBT**

Issue

51. Some amendments to the proposed amendments to the definition of "charitable organisation" are recommended.

Submission

52. Although the commentary makes it clear at page 71 that a deregistered charity may still fall within the definition of "charitable organisation" for the purposes of the exemption from FBT, if it applies its funds wholly or mainly to charitable, benevolent, philanthropic, or cultural purposes within New Zealand, or is listed in schedule 32 of the Income Tax Act, the proposed amendment to the definition of "charitable organisation" appears to suggest that a deregistered charity will eventually cease to fall within the definition of "charitable organisation" as a matter of course. However, registration as a charitable entity is not a prerequisite to either the exemption from FBT, or donee status (which essentially uses the same definition). This fact does not appear to be widely understood in practice. It would be helpful to make the distinction between the various limbs of the definitions clear, for example by clarifying what is meant by "benevolent", "philanthropic" and "cultural" purposes, and whether the differences in the statutory definitions of charitable purpose in the Income Tax Act and the Charities Act are intended to be substantive (and whether an entity whose purposes are found not to be charitable under the Charities Act may nevertheless have purposes that are considered to be charitable under the Income Tax Act). While we accept that consistency is desirable, we note that consistency of the statutory definition of charitable purpose across the two Acts should at least be the starting point.

53. As discussed above, the word "person" should be replaced with the word "entity", as that term is defined in section 4 of the Charities Act.

54. As also discussed above, the requirement to act in accordance with information supplied at the time of applying for charitable status such information, and should be replaced with a requirement for an entity simply to act in accordance with its constituting document.

55. We also suggest, as also discussed above, that section YA 1 include a new definition of "charities regulator", defined as either the Charities Commission, the Department of Internal Affairs – Charities Services, and/or the Charities Registration Board, as appropriate, with consequential amendments made as necessary. Alternatively, if the term "Board" is to be used, it needs to be defined.

56. We understand that IRD is currently working on guidelines of the various limbs of section LD 3, that is, what constitute "benevolent", "philanthropic", "cultural" or "charitable" purposes for the purposes of section LD 3 of the Income Tax Act. These guidelines could be usefully expedited.

Recommendation

57. The proposed amendments to the definition of "charitable organisation" in section YA 1 should be amended as above, and administrative guidance on section LD 3 (which will inform

the various limbs of the definition of "charitable organisation") should be expedited.

Clause 123 – section YA 1 **Definitions of "day of final decision" and "net assets"**

Issue

58. Some amendments to the definitions of "day of final decision" and "net assets" are recommended.

Submission

59. As discussed above, the word "person" should be replaced with the word "entity", as that term is defined in section 4 of the Charities Act.

60. Further, as also discussed above, references to charities that have "ceased" should be replaced with references to charities that have been "deregistered".

Recommendation

61. The proposed definition of "day of final decision" in section YA 1 should be amended to replace the reference to "person" with references to "entity", as that term is defined in section 4 of the Charities Act.

62. The proposed definition of "net assets" in section YA 1 should be amended to replace the reference to "Section HR 12 (Ceased charities…)" with a reference to "Section HR 12 (Deregistered charities…)".

Deregistered charities

Other issues

Issue

63. We submit that some other issues should be addressed in the context of these reforms relating to deregistered charities.

Submission

64. The tax consequences for charities that have been *declined* registration, as opposed to *deregistered*, can be just as complicated, and should also be addressed as part of these reforms.

65. More fundamentally, the approach being taken to the definition of charitable purpose, and the Charities Act generally, by the charities regulator is too narrow, even "anti-charity", and needs to be amended. In our considered view, the narrow approach of the charities regulator is incorrect as a matter of law, and will ultimately be found to be so. The approach is also contrary to the original rationale for the establishment of the Charities Act in the first place, which was to monitor "bad" charities, not to deregister so many "good" charities on the basis of fine, black-letter, and by no means universally accepted legal distinctions. The approach is arguably causing a systematic deconstruction of the charitable sector in New Zealand and is of very real concern.

66. Given this, and if the promised review of the Charities Act is not to take place, the most helpful amendment that could be made would be to the process by which decisions of the charities regulator can be appealed. Under the current regime, charities are being forced to prove important questions of fact in establishing that their purposes are indeed charitable, while being denied the opportunity to have any hearing of evidence whatsoever. An appeal to the High Court within 20 working days, or such further time as allowed by the High Court, requires charities to be legally represented within an impossibly short timeframe. The current processes do not provide a "level playing field" for charities, and are not engendering public confidence that the process is delivering up the right decisions. Tax consequences will more comfortably follow if there is confidence in the underlying determinations that have been made. Section 59 of the Charities Act should be amended to provide a process for appealing decisions of the charities regulator that is more "fit for purpose". We would be happy to discuss this point further if that would be helpful.

Recommendation

67. Some amendments to the Charities Act should also be made in the context of these reforms.

COMMUNITY HOUSING PROVIDERS

Clause 29 – proposed new section CW 42B

Proposed new income tax exemption for community housing entities

Issue

68. The proposed specific tax exemption for community housing entities demonstrates the clear public benefit that such entities provide. It also demonstrates, in our view, that the decision that the purposes of the Queenstown Lakes Community Housing Trust were not charitable on the basis of the private benefits to individuals is not correct and should be revisited.

Submission

69. Proposed new section CW 42B is effectively a statutory override of the High Court decision in *Re Queenstown Lakes Community Housing Trust* [2011] 3 NZLR 502 (HC). In that case, the decision of the charities regulator to deregister the Queenstown Lakes Community Housing Trust on the basis that its purposes were not charitable was upheld by the High Court.

70. In our view, the QLCHT case demonstrates the very narrow approach to the definition of charitable purpose that is being taken by the charities regulator. It also demonstrates how the process by which charities can appeal decisions of the charities regulator is not working, and is in fact impeding charities' ability to hold their regulator to the account.

71. While the proposed amendment to provide a specific income tax exemption for "community housing entities" as defined is welcomed, in our view it, by definition, demonstrates the clear public benefit that such entities provide. Any private benefit to individuals is merely incidental to the overriding public benefit, and is not inconsistent with charitable status. Instead of providing specific tax exemptions when the charities regulator takes a damaging narrow approach, it would be preferable to get the underlying law right: the purposes of the Queenstown Lakes Community Housing Trust are clearly charitable in our view under the 4th head of charity (*other purposes beneficial to the community).*

Recommendation

72. That the mechanism by which charities can hold their regulator to account be amended so that the public can have confidence that the underlying decisions are correct.