

**CENTRE FOR ACCOUNTING GOVERNANCE AND TAXATION  
RESEARCH**

**“SHOULD CHARITIES RECEIVE TAX INCENTIVES?”**

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**INTRODUCTION**

*The hardest thing in the world to understand is the income tax.* –Albert Einstein.

*Never criticise a man until you have walked a mile in his shoes –and then you have the shoes and he’s a mile away – **and who cares?*** – Billy Connolly.

One of the answers to Billy Connolly’s question is “We care”. We care about the environment, we care about people who are unemployed or families that are in trouble with budgets or teenagers, or both. We care about people with disabilities or illnesses. We care about animals, and we care about education and social issues of the day.

At least some of us care. Figures from the Statistics Department indicate that:

- over 1m volunteers gave more than 270m hours of unpaid labour to not for profits in 2004;
- there were 97,000 not for profit institutions identified as at October 2005;
- not for profit institutions contributed 2.6 per cent to NZ’s GDP in 2004 (\$3.6b);
- when volunteer labour is included, the contribution to GDP increases from 2.6 per cent to 4.9 per cent (\$6.5b);
- not for profit institutions had 105,000 paid employees;
- only 10% of NFP institutions employed paid staff.

**Not-for-Profits**

In terms of income;

|   |        |      |
|---|--------|------|
| -Sales of goods and services              |        |      |
| including government contracts            | \$4.9b | 61%  |
| -Interest and dividends                   | \$0.5b | 6%   |
| -membership fees, donations and grants    | \$1.9b | 24%  |
| -government grants (other than contracts) | \$0.7b | 9%   |
| Total                                     | \$8.0b | 100% |

These statistics are all in relation to not for profits. There are few comprehensive or reliable statistics for charities on their own, although Philanthropy NZ has undertaken some valuable research from the “giving” side of the equation. Not-for-profits have

been defined for the purposes of the satellite accounts from which this information was taken, as being entities that:

- are organised to the extent that they can be separately identified;
- are not for profit and do not distribute any surplus they may generate to those who control them;
- are institutionally separate from government;
- are in control of their own destiny;
- are non-compulsory in terms of both membership and members' input.

In commenting on the figures, Statistics Department notes:

*Most institutions – for profit or not for profit – are likely to meet some of the criteria. Therefore if any one criterion is looked at in isolation, an institution may appear to be in scope. For example, public companies meet four of the criteria but fail to meet the not for profit criterion. Government departments on the other hand, meet the not-for-profit criterion, but are not institutionally separate from government. A neighbourhood watch group is generally both not for profit and independent of government but it may not have the structure to meet the organisation criterion. – Statistics New Zealand.*

While these are the most reliable figures available to us, they are strongly believed to be under reported as many organisations simply do not appear on the radar screen of the Statistics Dept. For example, neighbourhood watch groups, many unincorporated charitable trusts, and so on.

## **Charities**

Now we need to move to the narrower sector of charity, where the information is not as clearly defined. Firstly, to be charitable, an organisation must be established for;

- the relief of poverty;*
- the advancement of education;*
- the advancement of religion; or*
- any other matter beneficial to the community – Charities Act 2005 sec 5(1).*

In addition, there is a requirement for the purpose to be of public benefit and not for private or personal gain. This requirement is supported, constrained, expanded, or confused by several hundred years of common and case law much of which has been established in the English court system.

While we are thinking of definitions, it should be noted that there are differences in definition between the Charitable Trusts Act, the Incorporated Societies Act, and the Charities Act, and between “institutions” and “trusts”. There are also variations from the definition of “not for profit” as used for the satellite accounts and for the Johns Hopkins survey.

In general, it is reasonably safe to conclude that while some not for profits are not charitable, all charities are included as not for profits. But some charities that have been incorporated under the Charitable Trust Act may not meet the requirements for registration under the Charities Act.

Of the 97,000 not for profits, about half are sports clubs and associated organisations and it is believed that about 25,000 meet the definition of charity. The first real support for that belief is likely to come when the Charities Commission completes its initial round of registrations late next year.

No matter how problematic the figures, there is little doubt that here in New Zealand we are dealing with a significant area of economic activity that involves a larger proportion of the population than almost any other.

### **Taxation incentives**

There are four major concessions that have an impact on charities:

- trading income and investment income is not subject to income tax;
- donors are entitled to receive a rebate of tax on their donations;
- gifts to charities are not subject to gift duty.
- fringe benefit tax is not payable on benefits provided to employees while they are engaged in charitable activities.

There are also minor concessions in other areas such as GST.

It is extremely difficult to undertake any reliable calculations on the amount of tax that is foregone, or the amount of tax that might be payable if charities were subjected to the same tax regime as for profit enterprises.

Based on the Statistics Department figures for not for profits referred to earlier, the organisations included in the survey had a surplus of \$900m in the 2004 year. If we extract donations and grants from the income but leave in trading and investment income, and exclude financial grants from deductible expenditure, it would appear that the combined result was a deficit of around \$1.1b. We need to keep in mind;

- these figures are for not for profits, rather than charities alone; and
- the values do not reflect any of the contribution made by volunteers, or gifts made in kind.
- the Statistics Department figures are known to be understated.

The figures do, however, seem to suggest that there is not much tax to be gained from this source.

Some not-for-profits, and indeed some charities, are statutory bodies with legislation that provides an exemption from income tax. The Community Trusts are examples. Other not-for-profits, such as sporting bodies, receive taxation incentives under different sections of the Income Tax legislation.

The second major concession is by way of rebate on donations. The rebates are claimed by individual taxpayers by way of a separate return filed each year. The IRD figures indicate that in the 2004-2005 year, around \$95m was refunded to taxpayers under this heading, which reflected some \$280m-300m in donations to a specified list of donee organisations that have been approved by the IRD. The list includes

charities, not for profits, and some other organisations that do not meet the accepted definition of charity or not for profit.

There is a statutory cap on the amount that has been able to be claimed as a rebate, and the cap is very low by international standards. The current taxation bill before parliament at present proposes that the cap be removed with effect from 1 April next. This places New Zealand among the more generous nations in relation to the recognition of donors.

I am not aware of any research that provides useful information about the magnitude of tax savings from either the gift duty exemption or the exemption from fringe benefit tax, which are the third and fourth categories of tax incentive.

### **Taxed areas**

There are two major areas where the amounts available for charitable purposes are significantly depleted by taxation.

The first area is in relation to imputation credits on dividends from New Zealand companies. These are not available to non-tax paying investors. Consequently, there is a significant reduction in the amounts available from the Community Trusts, the Electricity Trusts, and the large endowed trusts, such as the Tindall Foundation, the McKenzie Trust, and the Dilworth Trust. The grants from these trusts are not necessarily confined to charities.

The second area is in relation to the gaming or “pokie machine” trusts where the gaming tax takes a significant part of the total proceeds from each machine. A further amount goes to the site owners and the remainder is available for community and charitable grants. This is a complex issue as the objectives of the trusts are more aligned to enabling gaming to be undertaken than to support the community, and the cost/benefits to a community are open to considerable debate.

It can be argued that the amounts of tax involved go back to the community by way of targeted programmes or general grant assistance to community programmes. Decisions about government spending are of course made by the government and not by the trusts or by members of the community in that capacity.

### **Background to taxation incentives**

This presentation is too brief to allow a thorough examination of the background to the relationship between the not for profit sector, or the charity sector, and the government. The relationship is covered in useful and interesting detail in a working paper published in September 2006 as part of the Johns Hopkins Comparative Nonprofit Sector Project. This is a collaborative effort by scholars around the world to understand the scope, structure, financing, and role of the nonprofit sector using a common framework and approach. This project began in 1991 and is now running in more than 40 countries. The paper is entitled, “*Defining the Nonprofit Sector – New Zealand*”.

The paper traces the development of the sector from early beginnings around the 1850's, through the growth of the late 19<sup>th</sup> and early 20<sup>th</sup> centuries, to the creation of the welfare state, and through the challenging and changing period of the 1980's to the present day.

What emerges from the study, is a history of a constantly changing relationship with the state, as the responsibility for the delivery of social and community services moves from community to the state and back again, depending upon the changing ability of each to fund and deliver the services needed by individuals and families in the community at each point in history. That changing relationship and responsibility seems likely to continue into the medium term future at least.

This changing relationship is not unique to New Zealand. A research paper entitled "*Blurred Boundaries and Muddled Motives*" was published by the W K Kellogg Foundation in the US in 2003 and described a world of shifting social responsibilities. While the paper focussed on the boundaries between for profit and not for profit organisations, it contained useful and relevant information about the blurred boundaries between a wider range of sectors.

*"It is..... not new for the private, governmental, and non profit sectors to overlap and to use or benefit from one another in carrying out their missions. Government has always relied on universities and nonprofits to do research that often leads to innovations that become the profitable products of the private sector. Government agencies partner with non profits to provide services. Non profits use their voice and advocacy power to persuade government to increase services or change its own practices and those of private industry. Private industry has funded non profits. And non profits have often partnered with private businesses to address socioeconomic issues."*

A recent New Zealand discussion document referred to the government subsidising charities by providing tax incentives. It can be equally argued that charities subsidise the government by providing services for a lesser cost than the government would incur if it provided the services directly. Some estimates indicate that charities provide \$5 in services for every \$1 received from the government, due to the multiplier effect of voluntary labour, monetary donations and bequests, and gifts in kind. This is an argument that will undoubtedly continue as long as there are blurred boundaries between the responsibility of the government in a welfare state, and the responsibility of the community, or of charities.

In October 2006 the New Zealand government issued a discussion document entitled "*Tax incentives for giving to charities and other non-profit organisations*". The document suggested that "*among the reasons that governments seek to promote charitable giving are:*

1. *Charities and other non-profit organisations help governments to further their social objectives, such as increasing support to the disadvantaged members of society and fostering a more caring and cohesive society.*

2. *Many of the activities of charities and other non-profit organisations provide wider benefit to society over and above the value of the benefits received by the recipient or supplier of the activity.*
3. *The activities of charities and other non-profit organisations may be more responsive to the needs of society than government programmes, since donors and charities can often respond more quickly to changing social needs.*
4. *Because charitable activities use donated goods and volunteer labour they may be a more efficient way of providing social assistance than government programmes.”*

The discussion document goes on to acknowledge that there is no clear consensus around the world about the extent to which tax incentives on their own significantly affect giving behaviour or attitudes, but that they are effective when used in conjunction with a range of other measures such as education and promotion of awareness.

It is interesting to note in this regard that there is anecdotal evidence emerging of a slowdown in charitable giving in New Zealand at present, apparently because some potential donors are awaiting the lifting of the rebate cap in April next year. If this is an accurate perception, then it may be that donor behaviour is actually more influenced by the availability of rebates than has been assumed in the past.

I am aware that the four reasons listed above can be seen as reasons for general government financial support for charities and not for profits, and not as specific reasons for tax incentives. Two aspects strengthen and support the case for tax incentives:

The first is the clear message that tax exemptions send to the community at large, including donors and community organisations, that the government supports these organisations, and wishes to take positive steps to enhance their ability and capacity to provide services.

The second aspect relates simply to the cost benefit issues. For thousands of small community organisations, staffed essentially by volunteers, and with almost infinite unmet need in their communities, the compliance costs of preparing and filing tax returns are considerable, and the penalties for getting something wrong can be enormous. Why would a volunteer knowingly accept the risks and the responsibility? Generally volunteers are there to serve the cause represented – not to prepare tax returns which bring risks but little return to the cause.

The Honourable Mr Dunne, speaking to the Conference of the Association of Development and Alumni Professionals in Education at the end of October, said: *“...the clear intention of this change is to encourage those who are already donating substantial amounts to non-profit causes to donate even more generously....”* and *“... (the measures) represent a significant first step towards recognising the importance of charitable giving in helping to deliver the services we need to make a positive difference in our communities.”* and still later in the same address *“The over-arching consideration for the government is to make it easier for ..... volunteers and*

*..... organisations that make up the..... sector to comply with their tax obligations so they can get on with their primary functions.*

The words contained in these messages will be heard by some before they fade, but the practical outcome, the tax incentives, will continue to be known to many throughout the whole community to reflect the value that government places on charitable and not for profit activity.

And from the government perspective, there is little to be gained in monetary terms, as the amount of earned and taxable income appears to be small, and the opprobrium attracted from pursuing small and charitable organisations through the court system for tax arrears is enormous.

## **Conclusion**

*“From sports coaching for school children to volunteer fire fighters, from food banks and meals on wheels to preparing kai for a tangi, from budget advice to the hikoi of hope, .....New Zealanders in their thousands contribute to the well-being of the nation, both as paid workers and as volunteers. Through a wide range of iwi and community organisations, they deliver essential social, environmental and cultural services and provide the glue that holds our communities together.*

*Releasing the full potential of this collective effort requires strong relationships between government and community organisations, between the Crown and iwi, between Maori and tauiwi .....All New Zealanders benefit when the interactions between the sectors are based on.....mutual accountability and a climate of trust and respect.”*

Tax incentives are a practical demonstration of government support and recognition. Should charities receive them? I believe so, without reservation, but I acknowledge that for each of us the answer to the question lies in the personal values that each of us cherishes, and the individual perspective we bring to bear on the issue.

*“What is most important? It is people, people, people. We should not create policies that are like the fishing net that snares and strangles but like the surging tide that uplifts and carries forward.”*

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