

Tax incentives for giving to charities and other non-profit organisations

A government discussion document

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Foreword

In issuing this discussion document the government acknowledges the invaluable contribution the charitable, community and voluntary sectors make to New Zealand society. The options canvassed in this discussion document are aimed at reinforcing and encouraging giving by providing further incentives to those who donate money and/or give of their time and skills to charities and other non-profit organisations. Alternative mechanisms for achieving this objective are also discussed.

Among the reasons that the government wants to further encourage the act of giving to charities and other non-profit organisations is that they assist the government in furthering its own social objectives, such as increasing its support to those members of society in need and the provision of community benefits generally.

We acknowledge that the effect of favourable tax policies on charitable giving and the level of giving are not yet adequately understood and that the views in this area are divided, in particular, about whether tax-based incentives will actually persuade people who do not give to make philanthropy a more important part of their lives. Even so, it is generally accepted that tax incentives should reinforce an existing inclination to give and help make giving better informed and more effective.

We also acknowledge that tax incentives introduced in isolation are unlikely to change philanthropic behaviours and attitudes significantly. A range of promotional efforts seems to be required, including campaigns that educate and raise public awareness of the work of the charitable, community and voluntary sectors and other promotional strategies. The Australian and United Kingdom experience suggests that such strategies have the potential to change philanthropic behaviours and, in the longer-term, have a positive effect on them.

The challenge will be for the government and the charitable, community and voluntary sectors to work together to achieve an environment that encourages greater giving amongst New Zealanders.

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CONTENTS

CHAPTER 1	Introduction	1
	What the review aims to do	1
	Scope of the review	2
	The case for promoting charitable donations	3
	The relationship between tax incentives and charitable giving	3
	Criteria for assessing the options	5
	Summary of possible measures to promote charitable giving	5
	Timing of possible changes	6
	How to make a submission	6
CHAPTER 2	Tax rebates and deductions – options	8
	Tax rebate for donations by individuals	8
	Options for change	10
	Deduction mechanism for donations by individuals	11
	Company deduction for donations	12
	Options for change	13
	Māori authority deduction for donations	13
	Option for change	13
CHAPTER 3	Recognising the contribution of volunteers	15
	A volunteer's rebate	15
	Some important considerations	16
	Concerns about the proposal	16
	Other ways to recognise volunteers' time	17
	Other matters being considered	17
	Reimbursement payments to volunteers	17
	Honoraria	18
	The next step	19
CHAPTER 4	Tax incentives used in other countries	21
	United Kingdom	21
	Gift aid scheme	21
	Implications of a gift aid scheme in New Zealand	22
	Payroll giving	22
	Implications of a payroll giving scheme in New Zealand	23
	Shares and other property giving schemes	23
	Implications of such schemes in New Zealand	23
	Australia	24
	Private charitable trusts	24
	Implications of introducing private charitable funds in New Zealand	25
	Deductions for non-cash donations	25
	The next step	25
CHAPTER 5	Other ways of promoting charitable giving	27
Annex A	List of donee organisations in section KC 5(1)	29
Annex B	Registration requirements for charities	31

CHAPTER 1

Introduction

- 1.1 Charities and other non-profit organisations make a significant contribution to New Zealand society in almost every sphere of activity, from sports, recreation, arts, culture, and heritage to emergency and social services, health, education, conservation and the environment. There are an estimated 90,000 charities and other non-profit organisations operating in New Zealand; they vary in size, and many depend on the voluntary commitment of time and money of ordinary New Zealanders and businesses, as well as government funding.
- 1.2 Giving to charities and other non-profit organisations by individuals and businesses takes several forms – whether it is a matter of donating money, goods and services or time. While the overall magnitude of this giving is unknown, cash donations to charities and other non-profit organisations by individuals each year, as reported on tax returns, is estimated at \$356 million, which represents about one-sixth of the expenditure of the non-profit sector.
- 1.3 In New Zealand, charitable giving is encouraged by the availability of a tax rebate for individuals and by tax deductions for companies and Māori authorities, for cash donations they make to donee organisations. A donee organisation is an entity or trust whose activities are not carried out for the private pecuniary profit of any individual and whose funds are applied principally for charitable, benevolent, philanthropic or cultural purposes in New Zealand.¹ Some of the major donee organisations include churches, and social-service organisations.
- 1.4 Other countries often use other types of tax incentives to encourage philanthropy. They are discussed in chapter 4.

What the review aims to do

- 1.5 This discussion document has been issued as part of the government's commitment in its Confidence and Supply Agreement with United Future, to develop a new tax rebate regime for charities during the current term of Parliament. The aim is to encourage more New Zealanders to give of their money, skills and time, and to reinforce the concept of giving, to charities and to other non-profit organisations.
- 1.6 The review is looking at the current mechanisms by which the government provides assistance, through the tax system, to charities and other non-profit organisations in respect of donations they receive from individuals, companies and Māori authorities. It also involves an examination of alternative mechanisms that may help to reinforce and encourage charitable giving.

¹ The full criteria for donee organisation status and the list of organisations specifically named in section KC 5(1) of the Income Tax Act 2004 are set out in the annex A.

- 1.7 The review is consistent with wider government measures for developing the charitable and non-profit sector, including:
- The establishment of the Charities Commission, which was set up to administer a new registration, reporting and monitoring framework for charities. It is seen as an important factor in increasing philanthropy in New Zealand by improving the overall accountability and transparency of organisations that receive public monies through private donations or grants.
 - The *Government Policy on Volunteering (December 2002)*,² which is aimed at actively supporting and valuing a society with a high level of volunteering.
 - The government's policy of promoting and supporting our national identity by reinforcing the pride New Zealanders take in who we are and what we do.
- 1.8 Although the review focuses on promotion efforts to spur greater giving to charities and other non-profit organisations, it is acknowledged that there are other tax measures that may also support the development of the charitable and non-profit sector. They include making imputation credits to charities refundable for tax purposes and clarifying the current uncertainties relating to the tax treatment of payments to volunteers and honoraria recipients.
- 1.9 In the government's consideration of the initiatives canvassed in this discussion document, it is necessary to take into account the trade-off between increasing spending on assistance to charities and other non-profit organisations and increasing spending in other areas, such as transport, or other policy priorities, such as initiatives being considered by the Business Tax Review. The government seeks readers' views on the relative merits of each of the initiatives described in this discussion document so it can establish priorities and make choices that represent the best value for money.

Scope of the review

- 1.10 The review considers options for improving the existing rebate and deduction mechanisms and a new tax rebate that recognises the time given by volunteers to charities. The current tax mechanisms used in other countries to promote charitable giving, and their feasibility in the New Zealand context, are also examined, as are non-tax initiatives for promoting charitable giving.

² Available on the website of the Office of the Community and Voluntary Sector at <http://www.ocvs.govt.nz/work-programme/volunteering.html>

- 1.11 There have been many calls from the charitable sector for the government to deal with the question of whether imputation credits to charities should be refundable for tax purposes. The government acknowledges the importance of this issue to the charitable sector. For this reason, it will be examined separately as part of a wider review of imputation credits, and who should be entitled to use those credits. The review is expected to take place in 2007.

The case for promoting charitable donations

- 1.12 Over the last decade there have been significant and sustained efforts around the world to increase charitable donations through changes in government policy. These efforts have focussed on three areas:

- improving the regulatory framework for charities and other non-profit organisations;
- developing tax incentives that favour charitable donations; and
- increasing institutional accountability and transparency of charities and other non-profit organisations.

- 1.13 Among the reasons that governments seek to promote charitable giving are:

- 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.
- Many of the activities of charities and other non-profit organisations provide wider benefits to society over and above the value of the benefits received by the recipient or supplier of the activity.
- 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. Also, the donations people make to such organisations provide an effective indicator of the extra goods and services people feel are needed.
- Because charitable activities use donated goods and volunteer labour they may be a more efficient way of providing social assistance than government programmes.

The relationship between tax incentives and charitable giving

- 1.14 Research undertaken by Johnson, Johnson and Kingman (2004) examined the promotional strategies, efforts and challenges for increasing philanthropy around the world. It was noted that many countries are debating the efficacy of more favourable tax policies in encouraging philanthropy, and that there is no clear consensus about the impact of tax incentives on the practice. While there are some who believe that the lack of tax incentives contributes to low

levels of charitable giving in many countries, many others believe there is little relationship between the two.³

- 1.15 Some empirical evidence suggests that tax incentives to donors can and do reinforce an existing inclination to give to charities and other non-profit organisations and can lead to larger donations being made, and that high-income people tend to be more responsive to tax incentives. For example, the Asia Pacific Centre for Philanthropy and Social Investment has undertaken research on the strategies that have been applied in different countries to encourage giving, especially by the wealthy in the United States, Britain and Australia.⁴
- 1.16 The general view is that tax incentives introduced in isolation are unlikely to change philanthropic behaviour or attitudes significantly. Rather, a range of initiatives is likely to be required, including better education aimed at promoting awareness of the activities of the charitable and non-profit sector, as well as other promotional strategies. This would have the potential to change philanthropic behaviours and, in the longer-term, have a positive effect on giving to charities and other non-profit organisations.
- 1.17 In 2002, Philanthropy New Zealand commissioned a survey on the individual giving behaviours and attitudes of New Zealanders. The results showed that there is a diverse range of motivations for charitable giving, and people like to give their money and time in different ways. While the main reasons for donating money to organisations or causes varied greatly among donors, the more frequent reasons they cited related to their trust in an organisation or cause and to altruism.
- 1.18 Respondents did not comment on tax rebates as either a reason to give or a reason not to give, nor were respondents questioned with particular reference to tax as an incentive for charitable giving.⁵
- 1.19 The philanthropic behaviours and attitudes of companies and Māori authorities have not been surveyed.
- 1.20 Understanding the motivations and the ways in which people prefer to give is important in considering how best to stimulate greater charitable giving by New Zealanders and how best to provide tax-based incentives to encourage it.

³ Johnson PD, Johnson SP and Kingman A, "Promoting Philanthropy Global Challenges and Approaches", International Network on Strategic Philanthropy, December 2004.

⁴ Asia Pacific Centre for Philanthropy and Social Investment, "How the wealthy give" (October 2004) and "Encouraging wealthy Australians to be more philanthropic" (February 2005).

⁵ BRC Marketing and Social Research, "The Philanthropy New Zealand 2003 Giving Attitudes Survey", Philanthropy New Zealand, 2003.

Criteria for assessing the options

- 1.21 A basic principle of the government's revenue strategy is that the use of tax exemptions and concessions will be considered only in the context of the full range of policy options and only if the benefits can be shown to outweigh the costs for New Zealand.
- 1.22 In assessing the merits of individual policy options, consideration should be given to the effect they would have on the growth of the charitable and non-profit sector in New Zealand and the resulting benefits to New Zealand. The policy options should also be fair. The costs of different policy measures that need to be considered include:
- the cost to businesses, community and voluntary organisations and individuals of complying with the tax rules – compliance costs;
 - the cost to the government of administering the tax rules – administrative costs; and
 - the costs that arise from the effects of the tax system on decisions to produce, consume, work, save and invest – deadweight costs.
- 1.23 Consideration of these benefits and costs will inevitably lead to policy trade-offs being made.

Summary of possible measures to promote charitable giving

A summary of measures presented in the discussion document is provided below.

Individual tax rebate for donations

- raising the threshold at which the rebate is capped;
- increasing the rate of the rebate claim; or
- a combination of both.

Company deduction for donations

- increasing the company deduction limit; and
- extending the company deduction to close companies not listed on a recognised stock exchange.

Māori authority deduction for donations

- increasing the Māori authority deduction limit.

A volunteer's rebate

- introducing tax relief for volunteers in the form of a tax rebate to recognise the value of the time given by volunteers to charities registered with the Charities Commission, which, like the tax rebate for cash donations, would be subject to limitations; or
- as an alternative to the volunteer's rebate, providing grants directly to charitable organisations.

Reimbursement payments to volunteers and honoraria recipients

- clarifying the uncertainties in the tax treatment of reimbursement payments to volunteers and honoraria recipients and reducing their compliance costs.

1.24 The discussion document also looks at other tax initiatives for encouraging charitable giving. If there is support for any of these initiatives the government will undertake further analysis on them before making a decision on their feasibility. This work would be carried out separately from the proposed changes shown in the summary.

Timing of possible changes

1.25 Any legislation resulting from this review is expected to be included in a taxation bill to be introduced in 2007. The government envisages any new measures taking effect from the beginning of the 2007-08 year, provided it is administratively and fiscally feasible. Tax relief from any new measures could be claimed at the end of the 2007-08 year.

How to make a submission

1.26 The government invites submissions on the relative merits of the measures presented in this discussion document. It also welcomes submissions on any similar measures that would reinforce and encourage charitable giving in New Zealand. Those who make submissions are asked to prioritise between the measures and to rank the relative importance of each.

1.27 Submissions should be made by 28 November 2006 and can be addressed to:

Tax and Charitable Giving Project
C/- Deputy Commissioner
Policy Advice Division
Inland Revenue Department
P O Box 2198
WELLINGTON

Or email: policy.webmaster@ird.govt.nz with "Tax and charitable giving" in the subject line.

- 1.28 Submissions should include a brief summary of major points and recommendations. They should also indicate whether it would be acceptable for officials from Inland Revenue and the Treasury to contact those making submissions and to discuss their submission, if required.
- 1.29 Submissions may be the subject of a request under the Official Information Act 1982, which may result in their publication. The withholding of particular submissions on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. Accordingly, those making a submission who feel there is any part of it that should be properly withheld under the Act should indicate this clearly.

CHAPTER 2

Tax rebates and deductions – options

- 2.1 Donations of money made by individuals, companies and Māori authorities are partly subsidised through the tax system. Individuals receive rebates, and companies and Māori authorities are able to claim deductions for money given to donee organisations.
- 2.2 The rebate is essentially a refund of a portion of a donation, which is calculated at a set rate. Deductions, on the other hand, reduce the donor's pre-tax income. A rebate or deduction effectively provides the donor with more after-tax income and reduces the "cost" of donating relative to the price of other goods and services consumed by the donor. Both forms of assistance are capped and are subject to limitations to make them easier to administer and to protect the revenue base.
- 2.3 This chapter presents a number of options for enhancing the current rebate and deductions to facilitate greater charitable donations to charities and non-profit organisations. The government invites submissions on these options.

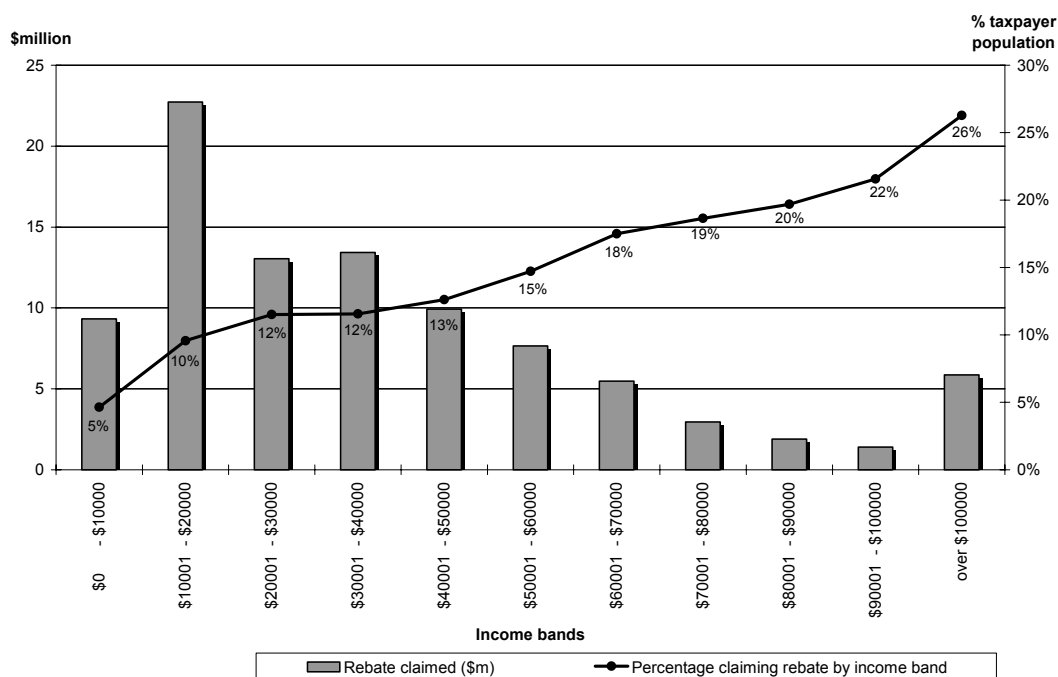
Tax rebate for donations by individuals

- 2.4 Individuals can claim a tax rebate at a set 33 1/3 cents in the dollar up to a maximum of \$1,890 for cash donations made to donee organisations. The maximum rebate is therefore \$630. The rebate is not available for donations which exceed the maximum amount, although any excess may be transferred to a spouse who has not used the full \$1,890.
- 2.5 Donations of \$5 or more that are supported by a receipt from the donee organisation qualify for the rebate. The sum of the donations claimed cannot exceed the taxable income of the individual in the year in which the rebate is claimed.⁶
- 2.6 The rebate is claimed through a separate process at the end of the year. Until 2000, individuals could claim their rebate as an offset against their income tax liability as part of their end-of-year tax return.
- 2.7 In the 2004-05 income year the total rebate claimed was \$94 million, an amount based on reported donations of \$356 million.

⁶ Section 41A(3) of the Tax Administration Act 1994 provides that the sum of the charitable donations and housekeeper payments must not be more than a taxpayer's taxable income in the tax year in which the donation and or payment is made.

2.8 Figure 1 shows the wide variety of income groups in New Zealand that claimed the donation rebate in 2005. Even though the proportion of people who claim a rebate increases as their income increases (from around 5 percent at \$10,000 to nearly 26 percent at \$100,000), those with annual taxable incomes under \$40,000 claimed 62 percent of the total rebate, or \$59 million. In addition, the proportion of those claiming the maximum rebate across all income bands ranged from 14 percent to 24 percent.

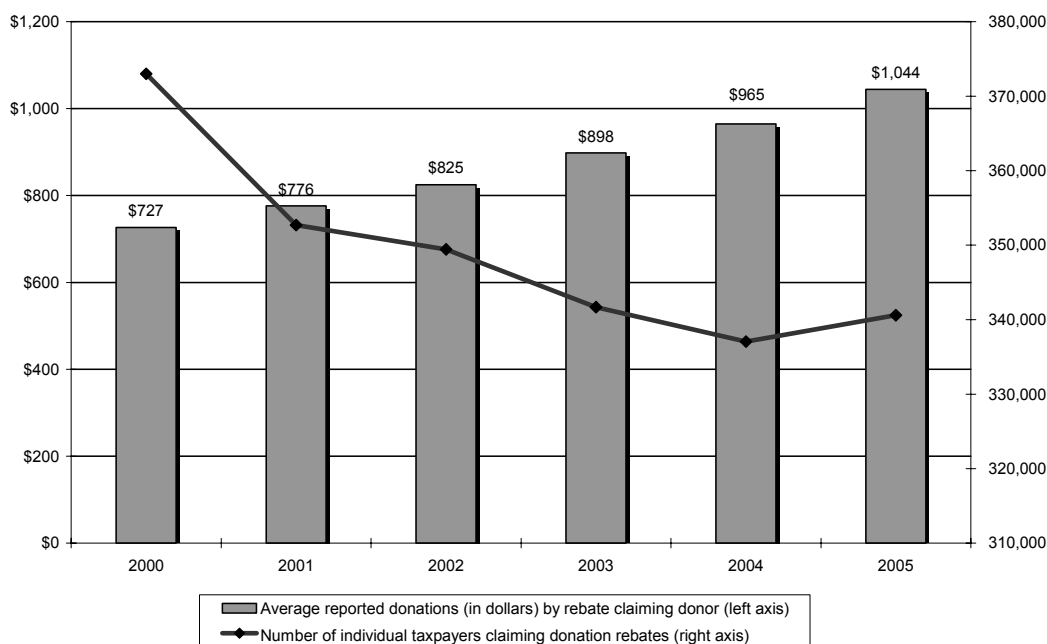
Figure 1: Donation rebates by taxable income for 2005



2.9 The donation threshold was last increased in 2003, from \$1,500 to \$1,890. This increase was in line with the increase in the Consumer Price Index from March 1990, when the threshold was last reviewed, to December 2001. At the time of the 2003 change, the government indicated that it looked forward to more frequent increases once better information was available to assess with confidence that the incentive is appropriately targeted.

2.10 Figure 2 plots the number of people claiming rebates for the period 2000 to 2005. It shows that the number of people claiming rebates steadily declined over that period, despite the increase in the rebate threshold in 2003. This decline was undoubtedly due in part to the removal of the requirement for a large number of individuals to file personal tax returns and to the introduction of a separate rebate claim process for donations and housekeeper rebates.

Figure 2: Rebate claiming donors



2.11 Figure 2 also plots average reported donations (in dollars) per donor claiming a rebate. It shows that even though the number of people claiming rebates has fallen, the average reported donation has been rising, from \$727 in 2000 to \$1,044 in 2005.

2.12 Total reported donations for the 2000-2005 period were.

Year	2000	2001	2002	2003	2004	2005
Total reported donations	\$271m	\$274m	\$288m	\$307m	\$325m	\$356m

Options for change

2.13 There are a number of possibilities for increasing the overall level of the current tax rebate for individuals. They include:

- raising the threshold (currently \$1,890) at which the rebate is capped;
- increasing the rate (currently 33 1/3 cents in the dollar) of the rebate claim; or
- a combination of both.

2.14 Raising the threshold would increase the tax benefit for people who donate more than \$1,890 a year. In 2005, at least 20 percent of people who claimed the rebate made donations of \$1,890 or more and, therefore, they claimed the maximum rebate of \$630.

2.15 The further away the current donations of taxpayers are from \$1,890, either above or below the threshold, the less likely it is that raising the threshold would have any effect on the amount of their donations.

2.16 The revenue cost of raising the threshold is estimated at:⁷

Threshold	\$1,890	\$2,120	\$3,000	\$5,000
Rebate claim	\$94m	\$108m	\$112m	\$116m
Revenue cost	\$0m	\$14m	\$18m	\$21m

2.17 On the other hand, increasing the rate would increase the tax benefit for every donor regardless of the amount donated. The revenue cost of increasing the rate is estimated at:

Rate	33 1/3%	39%	45%	50%
Rebate claim	\$94m	\$110m	\$127m	\$141m
Revenue cost	\$0m	\$16m	\$33m	\$47m

2.18 Therefore increasing the rate would be more likely to influence the donating behaviour of a greater number of donors.

2.19 Another option would be to adopt a combination of raising the threshold and increasing the rate. The revenue cost of adopting a threshold of \$2,120, which represents the Consumer Price Index-adjusted threshold since it was last reviewed in 2002, and increasing the rate is estimated at:

Rate	33 1/3%	39%	45%	50%
Rebate claim	\$108m	\$127m	\$146m	\$162m
Revenue cost	\$14m	\$32m	\$52m	\$68m

Deduction mechanism for donations by individuals

2.20 An alternative approach would be to allow individuals to claim a deduction rather than a rebate as was allowed before 1 April 1978.⁸ Under a deduction mechanism, charitable donations would be deducted from the donor's pre-tax income. This would mean that the tax value of charitable donations to donors would be determined by the donor's marginal tax rate.

⁷ The revenue cost figures in this chapter are based on officials' assessment of the amount people are contributing at the new thresholds according to the 2005 reported donations data. However, these estimates do not take into account any behavioural changes.

⁸ The deduction was allowed as a special exemption against income. See section 58 of the Income Tax Act 1976.

- 2.21 Under the current rebate system, donations are paid from after-tax income, so the tax value of donations to donors is set at 33 1/3 percent. For donors on marginal tax rates below 33 1/3 percent, the value of the tax rebate would surpass the amount of tax they would have paid on the income that had been donated. It could be argued, therefore, that the tax relief on charitable donations should be determined according to a donor's marginal tax rate.
- 2.22 A key concern with the deduction mechanism, however, is that low-income donors would be disadvantaged relative to their current position because the tax benefit of their donations would be of a lower value.
- 2.23 Delivering tax relief for charitable donations made by individuals by way of a tax deduction would represent a significant change but also would lead to increased compliance costs for some donors and increased administrative costs for Inland Revenue. These costs would arise because people who, at present, make donations but do not file a tax return would have to do so in order to claim the deduction against their taxable income and obtain the tax benefit of the rebate. This would likely affect an estimated 10 percent of individual taxpayers (340,580). Such a change would have the disadvantage of reversing the simplification benefits arising from past efforts to minimise personal income tax return-filing in New Zealand.
- 2.24 Moving to a deduction mechanism for cash donations by individuals would result in an estimated revenue gain to the government of \$22 million, excluding any compliance and administration costs involved.⁹

Company deduction for donations

- 2.25 Under section DB 32 of the Income Tax Act 2004, companies other than certain close companies¹⁰ are entitled to a limited deduction for cash donations made to donee organisations. This deduction extends to close companies whose shares are quoted on the official list of a recognised stock exchange.¹¹
- 2.26 The deduction for all donations made by the company in an income year cannot exceed 5 percent of the company's net income for that year. In this regard, the net income is the company's total income less deductions (excluding those allowed for the cash donations).

⁹ This revenue cost is based on the taxable income data for donors, the donation data, and the statutory tax rates for the 2005 tax year.

¹⁰ A company controlled by five or fewer people, as defined in section OB 1 of the Income Tax Act 2004.

¹¹ "Recognised exchange" is a defined term in section OB 1 of the Income Tax Act 2004.

- 2.27 The company deduction limits were last liberalised in the 2002-03 income year. Previously, there were monetary and percentage limits on donations made to one donee organisation and by one donor.

Options for change

- 2.28 Encouraging charitable donations by companies could be achieved by increasing the deduction limit to help reduce the cost of donating, and/or removing the current exclusion for close companies whose shares are not quoted on the official list of a recognised exchange. In the 2002-03 income year, the close company exclusion was relaxed for close companies whose shares are quoted on a recognised stock exchange. This change was justified on the basis that listed companies are subject to greater public scrutiny and disclosure requirements, whereas unlisted companies are not subject to the same level of oversight.
- 2.29 The government is interested in readers' views on whether extending the company deduction to close companies whose shares are not quoted on a recognised stock exchange would give rise to any concerns.
- 2.30 There is no readily available information on the amount of the deductions claimed by companies. Therefore it is not possible to say how much revenue would be forgone by the government if the deduction limit was increased and the close company exclusion was removed. A further difficulty in quantifying the revenue cost is that some companies use sponsorship rather than donations to support charitable activities as there is no monetary cap on deductions for sponsorship expenditure.

Māori authority deduction for donations

- 2.31 Under section DV 11 of the Income Tax Act 2004, Māori authorities are entitled to deduct donations to donee organisations, in the same way as companies do, and to Māori associations. The deduction for donations made by a Māori authority in an income year cannot exceed 5 percent of the authority's net income for that year.
- 2.32 The deduction was extended to apply to donations to donee organisations from the 2002-03 income year. (Previously, the deduction was limited to donations made by Māori authorities to Māori associations.¹²)

Option for change

- 2.33 The most obvious way of promoting greater charitable giving by Māori authorities would be to increase the current deduction limit.

¹² A "Maori association" is defined in the Māori Community Development Act 1962.

- 2.34 As with the company deduction, there is no means by which the government can know how much it is spending on the Māori authority donations deduction as there is no readily available information. A key question for the government is whether the current limit represents a constraint on charitable donations by Māori authorities.

Special points for submissions

Submissions are sought on the following matters, in particular:

The tax rebate for donations by individuals

- Should the tax rebate be changed to a tax deduction?
- Are the current rebate threshold and rate a constraint on the money that individuals donate?
- If the tax rebate is retained, should the government raise the donations threshold, increase the rate, or do both?
- What would be an appropriate level for the donations threshold and rate?

Company deduction for donations

- Is the current 5 percent limit on donations made by companies a constraint on corporate giving and, if so, what would be an appropriate limit to encourage further donations by companies?
- If the company deduction for donations was extended to close companies not listed on a recognised stock exchange, what concerns may need to be dealt with?

Māori authority deduction for donations

- Is the current 5 percent limit on donations made by Māori authorities a constraint on their charitable giving and, if so, what would be an appropriate limit to encourage further giving by Māori authorities?

CHAPTER 3

Recognising the contribution of volunteers

- 3.1 Volunteering is an essential part of civil society. In recognising the vital contribution that volunteers make to New Zealand society, the government is seeking feedback on the desirability of introducing a tax rebate for individuals who donate their time to charities, in recognition of the value of the time they donate.
- 3.2 The development of a rebate to recognise the efforts of volunteers is also consistent with the *Government Policy on Volunteering (December 2002)*. That policy is aimed at achieving “a society with a high level of volunteering, where the many contributions people make to the common good through volunteering and fulfilment of cultural obligations are actively supported and valued.”
- 3.3 The rebate would not attempt to recompense all the time that volunteers give as that would not be possible. Moreover, recompensing volunteers’ time would be contrary to one of the basic tenets of volunteerism – that people contribute their time not for private pecuniary gain but because they believe their contribution will benefit the common good or fulfil a cultural obligation.
- 3.4 The 2003 Philanthropy New Zealand survey indicated that many people who give their money often give of their time and expertise as well. Forty-two percent of those surveyed participated in voluntary work. They reported that they had decided to volunteer for reasons of the cause itself and its focus, and their decision was deeply rooted in altruism and trust, which is very similar to the motivation for making charitable donations.¹³

A volunteer’s rebate

- 3.5 Volunteers would be eligible for the proposed tax rebate if they have given their time to a charity registered with the Charities Commission.¹⁴ Volunteers would be able to claim the rebate provided they have received a declaration certificate (such as a receipt) from the registered charity to which they have volunteered their time. The declaration certificate would show the number of hours volunteered.
- 3.6 Like the current tax rebate, the volunteer’s rebate would be subject to limitations. The number of hours for which a volunteer could claim the tax rebate would be capped and a nominal hourly rate would be set. The hourly rate would be the same for every volunteer and would not be dependent on factors such as individual expertise.

¹³ BRC Marketing & Social Research (2003) “The Philanthropy New Zealand 2003 Giving Behaviours and Attitudes Survey”, Philanthropy New Zealand, at page 7.

¹⁴ The registration requirements for charities are set out in annex B.

- 3.7 The declaration certificate would be used by a volunteer to claim the rebate through the current donations claim process. Like the donations rebate, a volunteer's rebate would be available only if the volunteer had derived a certain amount of taxable income for the year.

Some important considerations

- 3.8 Specifying a nominal hourly rate and a limit on the maximum number of hours in a year should simplify the operation of the proposed rebate for charitable organisations and minimise the compliance costs associated with valuing a volunteer's time. The government is interested in readers' views on how the nominal hourly rate and the limit on the number of hours in a year should be set.
- 3.9 Limiting the rebate to people who give their time to only charitable organisations that are registered with the Charities Commission should provide certainty as to whether a volunteer's time was eligible for the rebate. The attraction of limiting the volunteer's rebate in this way is that organisations registered with the Charities Commission will be subject to reporting and monitoring rules. The downside is that volunteers of sports, recreational clubs, other non-profit organisations and government agencies may not be entitled to the rebate unless the organisations are registered.
- 3.10 Because volunteers provide a very wide range of services for their organisations, the government would like to hear readers' views on whether the rebate should be limited to specific activities, such as help with fund-raising, office administration and social assistance. And if it should be limited, what types of volunteer services should it cover? Limiting the rebate to certain types of services might also help to make it more affordable and to target government resources better.
- 3.11 A further option for increasing the overall level of encouragement to individual donors is to provide that the volunteer's rebate is in addition to the current donations rebate.

Concerns about the proposal

- 3.12 There are some concerns with this proposal. One is that it would be necessary to rely on charities to validate the time that volunteers have served, although individual charities might not always have the time and resources to do that accurately. Whatever the time and resources available, however, it would mean a slight increase in compliance costs for both volunteers and charitable organisations, as well as an increase in administrative costs for Inland Revenue.
- 3.13 There is also a concern that the rebate would be inconsistent with the notion of volunteerism – that people give their time not for private pecuniary gain but because they believe they are contributing to the common good.

- 3.14 The revenue cost of introducing a volunteer's rebate would depend on the level of the hourly rate, the cap on hours and the number of volunteers claiming it. The estimated revenue cost of a volunteer's rebate based on a \$5 hourly rate, a cap of 52 hours a year, and 143,000 volunteers claiming the maximum rebate would be \$37.18 million.¹⁵

Other ways to recognise volunteers' time

- 3.15 Instead of providing a rebate to recognise the value of volunteers' time, the government could direct the funds to charitable organisations. Grants could be made on the same basis as the volunteer's rebate – that is, based on the number of volunteers in the organisation and the number of hours volunteered, with a cap on the number of hours eligible for the rebate. Alternatively, grants could be given to selected charities that have a high level of volunteering.
- 3.16 The key difference between providing grants and providing a tax rebate is that government funds would be directed to charities instead of volunteers.
- 3.17 A grant system, however, would not provide a direct incentive for individuals to donate their time and money, and might result in less effective targeting of government assistance, particularly if the government grants were not matched to the time and money donated.
- 3.18 The government is interested in hearing readers' views on whether a grant system would be a better alternative to the volunteer's rebate.

Other matters being considered

- 3.19 The government is already reviewing the related matter of what is the proper tax treatment of reimbursement payments to volunteers and people who receive honoraria from charitable organisations.

Reimbursement payments to volunteers

- 3.20 Many volunteers receive small payments as reimbursement for the actual or estimated expenses they incur in carrying out their volunteer duties. For instance, a volunteer may be reimbursed for travel expenses on an actual basis, or paid \$5 per day as reimbursement for the estimated cost of buying lunch. The proper tax treatment of these reimbursement payments is not clear under current law.

¹⁵ The number of volunteers claiming the maximum rebate is based on the Philanthropy New Zealand Survey finding that 42 percent of the New Zealand population aged 18 years and over currently undertake unpaid work (1.3 million). It is also assumed that the proportion of people claiming the volunteer's rebate would be the same as those claiming a donation rebate (11 percent).

- 3.21 Under present law, such payments are treated as income, and volunteers are required to file income tax returns and provide proof of their expenses in order to claim deductions for expenditure incurred. In practice, however, adopting this approach imposes considerable compliance costs on volunteers, particularly when payments received in relation to volunteering are the only payments a person receives that are not subject to withholding tax or PAYE. This approach also imposes unnecessary administrative costs on Inland Revenue when payments are small and not of an income nature.
- 3.22 As a result, certain administrative practices have developed within Inland Revenue, mainly with a view to minimising compliance costs for volunteers. When reimbursement payments appear “reasonable” and not excessive, Inland Revenue does not require volunteers to file an income tax return and provide documentary evidence of their expenses.
- 3.23 The government’s view is that the compliance costs faced by volunteers should be reduced, and the tax treatment of payments to volunteers should be clarified to provide certainty for volunteers and volunteer organisations. One possible way of achieving this would be to exempt from income tax reimbursement payments below a specific threshold.
- 3.24 Reimbursement payments up to a set amount could reasonably be considered to have been provided to cover actual expenses that have been, or will be incurred – and then treated as exempt income. The volunteers who received the payments would not have to file income tax returns in respect of the payments. Volunteers and their organisations would have to decide what level of accountability was necessary.
- 3.25 Reimbursement payments over the set amount would be subject to the current tax rules as to whether they constituted income and, if so, how much of the income would be taxable. In that case, it would be necessary for a volunteer to file an income tax return and produce evidence of amounts claimed as deductions. Tax would be payable when there was an element of “profit”. It would be possible to preserve the “exempt income” status of the payments up to the set amount. However, that would be inconsistent with the treatment of other taxpayers, who are required to support claims for deductions with evidence of expenses incurred.

Honoraria

- 3.26 A further issue concerns small honoraria. Such payments are often made to office holders to reimburse them for the expenses they may incur in the performance of their duties (such as travel expenses or the cost of office supplies). Under current law, honoraria and any associated payments (including reimbursement for actual expenses) are classified as withholding payments, and withholding tax is deducted at 33 cents in the dollar.

- 3.27 Like volunteers, people who receive honoraria can incur considerable compliance costs, particularly when small honoraria are the only payments they receive. Under the law, all taxpayers who receive withholding payments are required to file income tax returns at the end of the income year, are liable for ACC levies when the amount owing is more than \$50, and must provide proof of their expenses in order to claim deductions.
- 3.28 The government's view is that the correct amount of withholding tax should be deducted at source, to avoid the situation where too much tax is deducted by way of the withholding tax and recipients are required to wait until they file an income tax return to claim expenses. One possible option would be to allow the payer of the honoraria to determine what amounts should be exempt from tax – in other words, the amount of income that the person would be able to claim as a tax deduction. The compliance costs would be on the payer in assessing whether the payment should be exempt from tax.

The next step

- 3.29 The government will make a decision on how and when these matters are to be dealt with following the consultation process on the initiatives outlined in this discussion document.

Special points for submissions

Volunteer's rebate

- Should a rebate for recognising volunteers' time be adopted, even though the rebate may be viewed as inconsistent with the notion of volunteering?
- If it were adopted, what should the nominal hourly rate be and how should it be set?
- Likewise, what should be the limit on the number of hours in a year and how should it be set?
- Should the rebate form part of the current donation rebate or be in addition to the current donation tax rebate for individuals?
- Should the rebate be limited to volunteers who give their time to charities that are registered with the Charities Commission only?
- Should the rebate be limited to specific activities and, if so, what activities should be covered?
- Would a grant system be a better alternative to a volunteer's rebate?

Other matters

- What is the best way to resolve the problems relating to the current tax treatment of reimbursements payments to volunteers and of honoraria?
- What should be the set amount under which reimbursement payments to volunteers are considered exempt income?
- Should volunteers who receive reimbursement payments over the set amount be required to file an income tax return for the total amount, or only for that part that is over the set amount?
- Should honoraria payments up to a certain level be treated as exempt income?

CHAPTER 4

Tax incentives used in other countries

- 4.1 This chapter examines the tax incentives for encouraging charitable donations offered by other countries, with particular emphasis on the United Kingdom and Australia. It also assesses the implications of introducing these incentives in New Zealand and invites readers' views on whether the government should consider them further.

United Kingdom

- 4.2 The United Kingdom encourages charitable donations through the gift aid scheme and tax deductibility for cash donations and property provided to charitable organisations.

Gift aid scheme

- 4.3 The gift aid scheme was introduced in 2000 and applies to all individuals and companies who make cash donations from their after-tax income. In general, the tax paid by the donor on the amount donated can be reclaimed by a registered charity if the donor has provided the charity with a gift aid declaration and the charity can establish an audit trail.
- 4.4 The amount of the tax that can be claimed back depends on the amount of tax that has been deducted from the income on which a charity is claiming. To reclaim the tax, the charity returns a schedule for each income year listing the donors, the dates of the donations and the amounts donated. The tax to be reclaimed is calculated on the total amount donated and is at the basic tax rate, which is 22 percent. This means that a donation of £10 made under the scheme would be worth £12.82 to the charity. (The amount of tax that may be reclaimed is $22/78$ multiplied by the dollar value of the donation. In the example, the tax to reclaim would be equal to £2.82.)
- 4.5 Donors who pay tax at a rate higher than the basic rate can claim the difference between the higher rate and the basic rate, which had not been claimed by the charity, through their own tax return. Since April 2004, donors have been able to give the difference between the higher rate and basic rate directly to a charity, which means that the original donation could be worth even more to the charity.
- 4.6 There is no limit on the donations that may be claimed or the tax that may be reclaimed by the charity.
- 4.7 The scheme replaced the highly complex Deed of Covenant scheme, which involved donors entering into legally enforceable commitments to make regular donations to a charity for a period of more than three years.

Implications of a gift aid scheme in New Zealand

- 4.8 The main difference between the United Kingdom's gift aid scheme and New Zealand's current rebate system is that, under the former, at least part of the tax benefit of charitable donations may be claimed by donee organisations, instead of the full tax benefit being claimed by donors. Therefore, it has the potential to increase the overall level of donations made to donee organisations, provided that donors do not decrease their level of donations in response to the lower tax benefit they receive from their donations. Under New Zealand's rebate system, donors can choose to give a portion of the tax benefit they receive by donating part of their rebate back to donee organisations. Alternatively, they can nominate a donee organisation to receive the full tax benefit of their charitable donations as part of the claim process.
- 4.9 Another difference between the gift aid scheme and New Zealand's rebate system is that the value of the total tax benefit under the gift aid scheme is dependent on the donors' marginal tax rates – as donors on higher marginal tax rates can claim the difference between their rate and the basic rate claimed by charities. The concern about having tax benefits that are dependent on marginal tax rates is outlined in paragraph 2.22.
- 4.10 The current rebate system could potentially be modified to ensure that donee organisations receive the full tax benefit of the tax rebate that is currently received by individual donors. Instead of donors claiming a rebate, donee organisations could be allowed to claim 33 1/3 percent of the amount donated up to a cap of \$1,890 per donor. Similarly, donee organisations could be allowed to receive the value of the deduction received on the donations made by companies and Māori authorities. This change would shift compliance costs from donors to donee organisations as donee organisations would be required to file a schedule of donations and keep receipts of donations.

Payroll giving

- 4.11 The United Kingdom also operates a pre-tax payroll giving scheme. This scheme is available to any employee who pays income tax through the PAYE system and who chooses to make charitable gifts through an employer-operated payroll system. The employer deducts the amount of the gift from the employee's salary before deducting tax. The payment is usually passed on to an approved payroll giving agency, which forwards the money to the chosen charity.
- 4.12 There is no limit on the level of donations that can be made for which tax may be claimed under this scheme.

Implications of a payroll giving scheme in New Zealand

- 4.13 A pre-tax payroll giving scheme enables a simple and convenient way for employees to make regular donations through their pay. Donors receive the tax benefit immediately, and do not have to wait until the end of the financial year to claim. The recipient organisation benefits from certainty of donations being received on a regular basis and lower administration costs.
- 4.14 If the tax rebate limits were maintained, compliance costs would be incurred by employers in monitoring each employee's level of donations to ensure that the maximum rebate was not exceeded, particularly if employees changed jobs during the year. Compliance costs for employers would also arise in passing the donation on to the charity.
- 4.15 Payroll giving would involve administrative costs for Inland Revenue, since levels of rebates claimed would have to be matched against payroll giving to ensure that the rebate limits were adhered to.
- 4.16 In addition, because the scheme involves a deduction mechanism, there are likely to be concerns about fairness, and compliance and administrative costs due to increased filing of tax returns. (See paragraphs 2.22 to 2.23).
- 4.17 It would be possible to use the current payroll system to receive most of the benefits that pre-tax payroll giving results in, without the need to move to a deduction mechanism. At present, some New Zealand employers make deductions for donations from their employees' after-tax income and pay these amounts to a nominated charity or a "clearing house". The employee claims a donation rebate in the normal way. This method increases the regularity and certainty of donations to charities, although tax benefits can still only be accessed at the end of the year.

Shares and other property giving schemes

- 4.18 In 2002, the government in the United Kingdom introduced a new tax relief measure for shares and other property donated to charities. In general, an amount equal to the market value of the donated investments (plus miscellaneous costs) is permitted as a deduction against the donor's gross income.

Implications of such schemes in New Zealand

- 4.19 The 2001 *Tax and Charities* discussion document concluded that the idea of allowing donations other than in cash to qualify for the tax rebate for individuals and the tax deduction for companies should not be pursued. There was concern at the time that this extension would have led to increased compliance costs for taxpayers and administrative costs for Inland Revenue, since it would have given rise to questions as to the valuation of the non-cash donations.

- 4.20 If the giving of shares and other property to charities were to be eligible for the current tax rebate, individuals would need to determine the value of the non-cash donations and claim them as a donation in their tax rebate claim form. A company or Māori authority would claim a deduction up to the 5 percent taxable income cap. While the value of shares in publicly listed companies is readily available, there would be difficulties in valuing the shares in private or unlisted companies. To resolve these difficulties, any tax relief could be restricted to shares in listed companies only.

Australia

- 4.21 In Australia, philanthropy is encouraged by way of tax deductibility of donations made to charitable organisations. Since 1999, the Australian government has introduced a suite of income tax measures to encourage greater corporate and personal philanthropy. These measures were in response to the report on philanthropy in Australia by the Business and Community Partnerships Working Group on Taxation Reform.¹⁶ Among these initiatives were the introduction of workplace giving (similar to the United Kingdom's payroll giving scheme), a new private charitable trust regime and a range of deductions for donations of cash and property.¹⁷
- 4.22 Initial research indicates that the total amount donated and claimed as deductions by individual Australian taxpayers increased by 11 percent after the measures had been enacted.

Private charitable trusts

- 4.23 Australia's Prescribed Private Trust Regime was introduced in 1999. It enables individuals, families and businesses to establish their own private trusts for philanthropic purposes. Donations made to these trusts are deductible to the donor. There is no limit on the donations that may be eligible for tax deduction by the donor. The trusts must disburse their funds for charitable purposes. These trusts provide a planned formal mechanism for giving, which offers greater control for donors.
- 4.24 Applications for prescribed private trust status are made to the Australian Tax Office (ATO). Limits apply to the accumulation of money within these trusts, such that investment income can be accumulated only at a rate equal to the Consumer Price Index, with the rest disbursed for charitable purposes. A simple annual return is filed with the ATO outlining the source of the funds and the payment of funds to various gift deductible recipients (charitable organisations) as well as the extent and recipients of management fees.

¹⁶ "Report on philanthropy in Australia", Business and Community Partnerships Working Group on Taxation Reform, March 1999.

¹⁷ www.partnerships.gov.au, "Taxation Initiatives to Encourage Philanthropy".

Implications of introducing private charitable funds in New Zealand

- 4.25 In New Zealand, anyone can set up a trust as a donee organisation and donors can receive tax relief for donations made to the trust.
- 4.26 There is no limit on donations that are eligible for tax relief in Australia, whereas in New Zealand, tax relief on donations made to charitable trusts would be restricted by the current rebate limits or the company or Māori authority deduction limits. Therefore any increase in the current rebate limit or the company or Māori authority deduction limit would also increase the tax relief received by taxpayers who make donations to charitable trusts.

Deductions for non-cash donations

- 4.27 In Australia, the following measures provide tax relief for non-cash donations by way of a tax deduction.
- Donors may receive a tax deduction for gifts of property held by the donor for more than 12 months and valued in excess of \$5,000, including environmental and heritage property donated to approved environmental organisations. (2001)
 - Deductions for donations of property valued in excess of \$5,000, and donations of cultural property made through the Cultural Gifts Programme, may be spread over a period of up to five income years. (2002)
 - Bequests of property and gifts of cultural property made through the cultural gifts programme are exempt from capital gains tax, thus maximising the appreciated value of these gifts for tax deduction purposes. (1999)
- 4.28 Adopting any of these measures in New Zealand would recognise the value of non-cash donations and could encourage more donations of this kind. However, a key concern for the government is the difficulty of valuing non-cash donations, which could result in tax avoidance as well as significant compliance and administrative costs. In addition, the concerns relating to a deduction mechanism as outlined in paragraphs 2.22 to 2.23 would also arise. Even so, it would be possible to modify these measures so that donors received tax rebates instead of tax deductions for their donations.

The next step

- 4.29 If there is support for any of the initiatives raised in this chapter, the government will undertake further analysis on them before making any decision. Further consultation might also be required. This work would be carried out separately to the review of the existing tax rebates and deductions.

Special points for submissions

Submissions are sought on the following matters:

- Would payroll giving provide a better mechanism for promoting charitable giving in New Zealand?
- Would the United Kingdom's gift aid scheme be more effective?
- Would it be a good idea to allow non-cash donations to be deductible for tax purposes?
- Would it be a good idea to adopt Australia's Prescribed Private Trust Regime?
- Could any of these ideas be modified to be better suited to the New Zealand environment while still encouraging donations?

CHAPTER 5

Other ways of promoting charitable giving

- 5.1 Until recently, the promotion of philanthropy in many countries has largely focussed on changes in government policy that sought to reduce constraints on its growth. Often these changes would include making improvements to the regulatory environment for the charitable and non-profit sector, developing tax incentives that favour charitable donations and introducing measures to increase the accountability and transparency of organisations in the sector.
- 5.2 International evidence suggests that a more pluralistic approach to promoting philanthropy has a greater positive effect on its growth. This approach involves a range of strategies and organised efforts to “grow” philanthropy through public awareness campaigns, donor leadership, and donor education.
- 5.3 Promotion efforts to spur greater charitable giving have been undertaken in both the United Kingdom and Australia.
- 5.4 The United Kingdom’s Giving Campaign sought to encourage a broad culture of giving and to increase the number of donors and the amount given. The campaign targeted specific audiences, including the wealthy and their advisors, employees and employers, and young people. The key themes included encouraging a culture of giving amongst the British public; improving the public perception of the charitable sector; and getting young people into the habit of giving both their money and their time to the sector.
- 5.5 In Australia, the Prime Minister’s Community Business Partnership has focussed on identifying and addressing incentives and impediments to corporate social responsibility and encouraging a culture of giving in Australia.
- 5.6 In New Zealand, creating an environment that promotes philanthropy has taken a big step forward with the enactment of the Charities Act 2005 and the creation of the new Charities Commission. The Commission has an important role to play in improving the overall accountability and transparency of charities and raising public awareness about the sector. The information collected by the Commission should enable a better understanding of how charitable donations and grants are being used by the sector.
- 5.7 Promotional efforts to encourage the giving of time include Sports and Recreation New Zealand’s “Cheers Volunteers” campaign, as well as smaller promotional activities related to International Volunteer Day and Volunteer Awareness week. Philanthropy New Zealand’s booklet *A Toolkit for Giving, the rewards of generosity*¹⁸ is one example of the promotional efforts to encourage greater giving in New Zealand and to make giving better informed and more effective for donors.

¹⁸ Philanthropy New Zealand, “A Toolkit for Giving, the rewards of generosity”, 2004.

- 5.8 The Philanthropy New Zealand research on the giving behaviours and attitudes of individual New Zealanders showed that educating and informing New Zealanders in general will not only encourage those who give to do so more or more often, but may also encourage those who currently do not donate to do so. People were particularly interested in knowing a charity's main type of work; who benefits from the activities of the charity; how its money is spent; and the honesty and reliability of a charity.
- 5.9 The government is interested in readers' views on what further initiatives can be employed to encourage increased generosity and to support any tax measures that may arise out of this discussion document.

ANNEX A

List of donee organisations in section KC 5(1)

A “donee organisation” includes:

- a society, institution, association, organisation, or trust which is not carried on for the private pecuniary profit of any individual and the funds of which are, in the opinion of the Commissioner, applied wholly or principally to any charitable, benevolent, philanthropic, or cultural purposes within New Zealand
- a public institution maintained exclusively for any one or more of the purposes within New Zealand specified in the first bullet point
- a fund established and maintained exclusively for the purpose of providing money for any one or more of the purposes within New Zealand specified in the first bullet point, by a society, institution, association, organisation, or trust which is not carried on for the private pecuniary profit of any individual
- a public fund established and maintained exclusively for the purpose of providing money for any 1 or more of the purposes within New Zealand specified in the first bullet point
- the Red Cross Society Incorporated
- the Pacific Leprosy Foundation
- the Leprosy Mission New Zealand Incorporated
- the Volunteer Service Abroad (Incorporated)
- the Commonwealth Foundation
- the Sir Walter Nash Vietnam Appeal
- the Food Bank of New Zealand
- the Norman Kirk Memorial Trust Fund
- the United Nations International Children's Emergency Fund (UNICEF)
- World Vision of New Zealand (Incorporated)
- Save the Children New Zealand (and its branches)
- Sport and Recreation New Zealand
- Christian World Service
- Caritas Aotearoa-New Zealand
- “Raphael” (The Ryder-Cheshire Foundations of New Zealand)
- New Zealand Sports Foundation (Incorporated)
- The New Zealand Society for the Intellectually Handicapped (Incorporated)
- Amnesty International
- The Evangelical Alliance Relief Fund (TEAR Fund)
- CORSO (Incorporated)
- Operation Hope (Aid Ship to Africa)
- The New Zealand Rotary Clubs Charitable Trust
- Alhay Buhay Foundation Trust
- Cyclone Ofa Relief Fund
- Water for Survival
- International Christian Aid (ICA)
- Christian Children's Fund of New Zealand Limited (CCFNZ)
- Cyclone Val Relief Fund
- Channel 2 Cyclone Aid for Samoa
- Community Action Overseas (Oxfam NZ)
- The Winston Churchill Memorial Trust

- The Fred Hollows Foundation (NZ)
- Christian Blind Mission International (New Zealand)
- Four Sherpa Trust
- Adventist Development and Relief Agency
- Mobility Equipment for the Needs of Disabled Trust
- The Serious Road Trip Charitable Trust
- Valehead Community Health Centre Trust
- Nelson Mandela Trust (New Zealand)
- African Enterprise (New Zealand) Aid and Development Fund
- New Zealand Viet Nam Health Trust
- Mission Without Borders (NZ), Humanitarian Aid Account
- Bangladesh Flood Appeal Trust
- Karunai Illam Trust
- Cry for the World Foundation New Zealand Humanitarian Aid Fund
- Akha Rescue Ministry Charitable Trust
- Register of Engineers for Disaster Relief New Zealand
- The Hillary Himalayan Foundation
- Together for Uganda
- Open Home Foundation International Trust
- Books for Africa
- Bright Hope International Trust
- Help a Child Foundation New Zealand
- Greater Mekong Subregion Tertiary Education Consortium Trust
- The Sir Edmund Hillary Trust
- Cheboche Area Trust Inc
- Sampoerna Foundation Limited
- Surf Aid International Incorporated
- Plan New Zealand
- St Stanislas Charitable Trust of New Zealand
- Medicine Mondiale
- New Zealand Jesuits in India Trust
- Operation Vanuatu Charitable
- Habitat for Humanity New Zealand Limited

ANNEX B

Registration requirements for charities

An organisation can register as a charitable entity if:¹⁹

- it is established and maintained for charitable purposes;
- it is not for the private profit of any individual or group;
- it has a name that complies with the Charities Act 2005; and
- all the officers of the charitable organisation are qualified to be officers.

The Charities Commission will use the well-established common law test for charitable purposes. The test requires a charitable organisation to have a purpose that either:

- advances education;
- advances religion;
- relieves poverty; or
- is otherwise beneficial to the community.

Furthermore, the organisation's object must be of benefit to the public (public benefit test).

To register, organisations will have to complete the prescribed application form and:

- submit a copy of their rules, constitution, trust document or similar;
- provide information about their current and proposed charitable activities; and
- register the officers of the organisation.

Once registered, organisations will need to:

- file an annual return within six months of their nominated balance date; and
- notify the Charities Commission within three months if certain information about their organisation changes.

¹⁹ A guide to the Charities Act is available on the website of the Charities Commission at <http://www.charities.govt.nz/news/updates/electronic-guide.htm>