

# Regulatory Impact Statement

## Tax treatment of community housing providers

### Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by Inland Revenue.

The question addressed in this statement is whether the current tax treatment of community housing providers (CHPs) which provide affordable home-ownership products aimed at very low-income households is appropriate and, if not, how this can be addressed.

In *Queenstown Lakes Community Housing Trust [2011] 3 NZLR 50*, the High Court found that the Queenstown Lakes Community Housing Trust (QLCHT), which offered an affordable home-ownership scheme to “low-to-moderate income families”, was not charitable in purpose. As a consequence, QLCHT was no longer eligible for the income tax exemption as a charity and donee organisation status. There is concern that other CHPs currently registered with Charities Services that are similar to QLCHT might also be affected.

The charitable status of CHPs offering social housing products (such as rental accommodation) where the housing benefit is directed to those who are poor, in need, aged or suffering genuine hardship, and provides actual relief, would seem to be relatively assured. At the other end of the spectrum, CHPs that are “for profit”, or accrue private, pecuniary profits for the owners are not charitable in purpose. However, the position of CHPs that offer affordable home-ownership products and that target households on low-incomes with alternative housing options is not certain.

The key objectives are to ensure that the tax treatment of CHPs that offer affordable housing products to low-income households:

- aligns with the current tax policy settings underlying the charities-related tax concessions;
- is consistent with the Government’s overall strategy for the tax system of having a broad base with low rates and few exemptions;
- is not a barrier to building a more diverse and sustainable social and affordable housing provider sector.

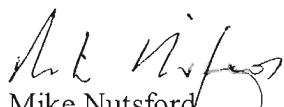
The class of taxpayers likely to be affected has been narrowly defined – namely, CHPs that provide affordable home-ownership products to low-income households “in poverty” as understood by charities law.

Targeted consultation has been undertaken with housing sector representatives, and their views have helped to inform the problem definition and the formulation of options. The Ministry of Business, Innovation and Employment; the Treasury; and the Department of Internal Affairs have been consulted on the policy discussed in this RIS.

The preferred option to preserve the status quo does not have a fiscal cost. All other options are expected to give rise to a fiscal cost of \$2.4 million, due to providing tax relief for the prospective tax costs for the affected CHPs and tax relief for donors who give cash donations to those CHPs. The fiscal cost is calculated based on the CHPs on the Charities Register which retain similar characteristics to those referenced in the QLCHT decision. We also note that it is a question of fact and degree as to whether a CHP meets the charities criteria in the Charities Act 2005 and each provider must be assessed on a case-by-case basis. We will not know which entities are in fact charitable in purpose until Charities Services has undertaken a thorough examination of each CHP.

A further constraint on the fiscal cost is that the underlying data is not tax data so it is, at best, a proxy. For example, income measures reported in the charities' annual returns could include non-taxable income such as grants, which would tend to overstate the implied tax (or fiscal gain) and understate the implied forgone tax (or fiscal cost).

There are no other significant constraints, caveats or uncertainties concerning the regulatory analysis undertaken. None of the policy options considered impair private property rights, restrict market competition, or override fundamental common law principles.



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23 October 2013

## STATUS QUO AND PROBLEM DEFINITION

### Social housing sector

1. At present, the community housing sector comprises a range of social and affordable housing providers offering rental accommodation and/or pathways to home-ownership products. Some are “for profit” while others are not-for-profit. Some are charitable in purpose while others are not. Some of these organisations also receive central or local government grants and/or receive public donations to carry out their housing assistance activities.

2. The Government’s Social Housing Reform Programme seeks to encourage a more diverse and contestable social housing market, and the Government’s Social Housing Fund aims to increase the supply of more social and affordable housing products for low-to-moderate income households. In particular, the Reform Programme seeks to significantly expand the proportion of social housing provided by the community housing sector over the long-term. The Government has set aside \$139 million for this programme.

3. Parliament is considering the Social Housing Reform (Housing Restructuring and Tenancy Matters Amendment) Bill. The bill provides a framework for the future provision of social housing that will promote contestability by increasing the number and diversity of community housing providers (CHPs) operating in the market, and increase the choices available for tenants and prospective tenants.

4. Among other things, the bill will enable the establishment of a Regulatory Authority to register CHPs, with associated objectives, functions, and powers to monitor and enforce compliance with regulatory standards. It will also enable the making of regulations that prescribe eligibility criteria and performance standards to be met by CHPs registered with the Regulatory Authority, and allow for the extension of income-related rent subsidies to those providers. The majority of the bill has a commencement date to be determined by Order in Council, although the expectation is commencement on 14 April 2014.

### Tax treatment of community housing providers

5. There are no specific tax rules for CHPs in the Income Tax Act 2007, other than the Housing New Zealand Corporation which is treated as a “state enterprise” subject to full taxation.

6. Entities registered with Charities Services as a charitable entity are entitled to the charities-related income tax exemption in the Income Tax Act 2007. This means that the income earned by registered charities is not subject to tax.

7. In addition, registered charities are recognised by Inland Revenue as meeting the requirements of donee organisation status<sup>1</sup>. Donors who give money to donee organisations are entitled to a tax credit (in the case of individuals) and a tax deduction (in the case of companies and Māori authorities). Although Inland Revenue approval is not required under current tax law, a practice has developed whereby organisations seek Inland Revenue’s confirmation of this status for certainty.

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<sup>1</sup> A “donee organisation” is any entity that is not carried on for the private pecuniary profit of an individual, and whose funds are applied wholly or mainly to charitable, benevolent, philanthropic or cultural purposes within New Zealand. A donee organisation also includes any entity that is listed in Schedule 32 of the Income Tax Act 2007.

8. Under current tax policy settings, registration with Charities Services is intended to act as a gateway to the charities-related income tax exemption and donee organisation status. In order to be registered with Charities Services, an entity must meet the legal tests of charity as set out in the Charities Act 2005 – that is, they need to have one of four “charitable purposes” and must be for the “public benefit”. A change to the legal test(s) in the Charities Act, and/or a change in the way the courts interpret those tests over time will affect how the Charities Registration Board applies the law. This will in turn affect a registered charity’s tax status.

### **Charitable status of Community Housing Providers**

9. In *Queenstown Lakes Community Housing Trust [2011] 3 NZLR 50*, the High Court found that the Queenstown Lakes Community Housing Trust (QLCHT) which offered an affordable home-ownership scheme to “low-to-moderate income” families was not charitable in purpose. This case highlighted the current uncertainty in charities law as it relates to providers that offer affordable home-ownership products including shared-ownership and rent to buy schemes.

10. The charitable status of providers offering social housing products (such as rental accommodation) where the housing benefit is directed to those who are “in poverty”, namely those who are poor, in need, aged or suffering genuine hardship and that provides actual relief, would seem to be relatively assured. These providers would be tax-exempt. At the other end of the spectrum, housing providers that are “for profit”, or accrue private, pecuniary profits for the owners, are not charitable, and are therefore taxable.

11. However, the position of CHPs involved in the provision of affordable home-ownership products and that target households on low-to-moderate incomes with alternative housing options is not certain. Providers that offer affordable home-ownership products tend to fall outside the Charities criteria – the ability to purchase a house is an indication a person is not “in poverty”. The QLCHT’s model of providing housing for “key workers” – whose income renders them unable to purchase a house in the region of their work due to local affordability factors – was deemed not to be charitable in purpose. Relevant factors in that case, which included the size of the deposit required (\$70,000) and the median income of buyers (140% of national median income), indicated that the workers were not “in poverty”.

12. Thus, given the range of social and affordable housing products which are or could be provided in the future by CHPs, and the fact that the intended recipients might not necessarily be considered “in poverty” (as understood by charities law), there is no clear “bright-line” test for determining who is charitable or not. It is a question of fact and degree as to whether a CHP meets the charities criteria and each provider must be assessed on a case-by-case basis either by Charities Services or the Courts.

13. Charities Services can identify existing registered charities where the provision of accommodation and/or housing has been stated as the entity main purpose. Initial high level reviews indicate that a significant majority of these entities will continue to be registered as charities as they provide social housing products to people in identified charitable need. In this high-level review, a small percentage of charities have been identified as having similar activities and practices similar to those identified in the QLCHT decision. This has created risks regarding the on-going eligibility of an entity in this group to be registered as a charity.

A small number (ten) of these providers are currently pre-registered with the Social Housing Unit.

### **Tax consequences following loss of charitable status**

14. When an entity loses its charitable status, it can face a range of complex tax consequences that can be retrospective, transitional or prospective in nature. These consequences give rise to questions such as when the entity should start its life as a tax-paying entity, how the entity should treat its depreciable property or financial arrangements when it becomes a tax-paying entity, whether the entity continues to qualify as a donee organisation, and what tax provisions should apply to the entity going forward.

15. The nature and extent of these tax consequences ultimately depend on the underlying reason for deregistration. For example, if an entity was found never to have had a “charitable purpose” or ceased being charitable in purpose at some time in the past (through mission drift), it could face retrospective tax liabilities. Individuals who have donated to such entities could also be affected, as donation tax benefits might have to be reversed (as housing providers that do not qualify for registration as a charity also might not qualify as a donee organisation).

### **Problem definition**

16. The Minister of Housing and the Minister of Revenue understand that the majority of CHPs who provide social housing products are not at risk of losing their charitable status because they are engaged in the relief of poverty – that is, they direct their housing assistance to people “in poverty”. Consequently, their tax-exempt status and donee organisation status seem to be relatively assured. At the other end of the spectrum, Ministers understand that CHPs that are “for profit”, or accrue private, pecuniary profits for the owners are not charitable and therefore taxable.

17. However, Ministers are concerned about those CHPs which might possibly be at risk of being deregistered because they offer affordable home-ownership products to low-income households or people who are “in poverty”. They believe these providers should continue to be tax-exempt and be recognised as a donee organisation because they benefit people who “would never be able to afford a house”. The perceived problem therefore, which Ministers are seeking to address is to support CHPs that offer pathways to home ownership to low-income households but that might no longer be considered charitable in purpose.

18. The community housing sector has raised the following concerns with the loss of tax-exempt status and donee organisation status:

- the requirement to pay tax on the profits from the delivery of affordable home ownership products. There is a concern that to meet tax liabilities, particularly retrospective liabilities, there will be a need to sell existing housing units and prospectively, some may reconsider whether they will continue to remain affordable home-ownership providers;
- it removes money from providers that would otherwise be reinvested into additional affordable housing;

- the compliance costs associated with meeting taxpayer obligations, adding another layer of complexity to their activities, especially the tax rules on land, financial arrangements and Government grants; and
- reduced public donations.

19. The community housing sector also believes that the change in tax status for CHPs might also put at risk the Government's social housing policy as it relates to building a more diverse and sustainable housing provider sector.

20. There are two related areas to consider: the tax liability incurred in the past resulting from the charities deregistration process, and the tax status of the providers in the future.

21. Inland Revenue, the Treasury and the Ministry of Business, Innovation and Employment agree that retrospective tax liabilities arising from deregistration is a problem and should be addressed. The proposed new rules for deregistered charities may provide relief to CHPs that have been compliant with their constitutions since registration. The proposed new rules are discussed in the RIS *New tax rules for deregistered charities*.

22. The Ministry of Business Innovation and Employment and the Treasury do not consider that current tax and charitable status arrangements for CHPs engaged in the provision of rental housing for those in need present a significant risk to the Government's social housing policy in the future. This is because from 14 April 2014, CHPs offering rental housing and registered with the Regulatory Authority will be eligible to receive market rents through the income related rent subsidies.<sup>2</sup> The Ministry and the Treasury's view is that the status quo would be sustainable from 14 April 2014.

23. This RIS is concerned solely with the future tax treatment of CHPs.

## **OBJECTIVES**

24. The key objectives are to ensure that the tax treatment of CHPs that offer affordable home-ownership products to low-income households:

- a) aligns with the current tax policy settings underlying the charities-related tax concessions;
- b) is consistent with the Government's overall strategy for the tax system of having a broad base with low rates and few exemptions; and
- c) is not a barrier to building a more diverse and sustainable social and affordable housing provider sector.

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<sup>2</sup> The income related rent subsidy is a government subsidy which helps people on low incomes with the cost of housing. The government pays the difference between the rent paid by tenants and the current market rent for the area and type of property. Currently, this subsidy is only available to HNZC, but under the Social Housing Reform (Housing Restructuring and Tenancy Matters) Amendment Bill this will be extended to include registered CHPs.

25. We note that there may need to be a trade-off between the objective of ensuring a broad base, low-rate tax system with few exemptions and the objective of building a more diverse housing provider sector, depending on the option that is adopted.

26. A time constraint exists in relation to the legislative vehicle for any of the options requiring legislative amendments. It is preferable that any legislative amendments be included in the tax bill scheduled for introduction in November 2013 so that Ministers can signal to affected CHPs that they are considering the tax issues facing them at the same time as the Social Housing Reform bill is ushering in the new housing sector reforms.

## REGULATORY IMPACT ANALYSIS

27. Three broad options and the status quo (option 4) have been considered for addressing the problems and achieving the stated objectives. These options are:

- **Option one:** direct funding for eligible CHPs and conferring donee organisation status
- **Option two:** specific income tax exemption for eligible CHPs and conferring donee organisation status
- **Option three:** confer charitable status on eligible CHPs

28. Options one and three can be achieved in two ways. A detailed description of each option (and its variations) is set out below.

### Eligible CHPs

29. “Eligible CHPs” in options one, two and three would be those that meet the following criteria:

- CHPs must be registered with the proposed Regulatory Authority under the Social Housing Reform Bill
- the affordable home-ownership products offered by these CHPs must be aimed at low-income households. Two options were considered for determining that is a “low income household” namely; explicit income thresholds set by reference to regional household income and asset testing; and an “in poverty” test (which does not have an income threshold)
- CHPs must ensure that no part of their funds is used or is available to be used for the private pecuniary profit of a member, proprietor, shareholder, or associate of any of those classes of people
- CHPs must ensure that no person (or their associate) is able to direct or divert amounts from the business to their own benefit or advantage
- the affordable home-ownership product must be aimed at increasing the supply of affordable housing

- CHPs must re-invest all surpluses back into its affordable home-ownership activities
- on winding up, the assets of the provider must be distributed to another CHP registered with the Regulatory Authority.

30. The criteria above ensure certainty about the scope of the options and consistency between those options.

31. Two options were considered for setting the criterion for determining whether the recipient of housing assistance is a low-income household:

- an “in poverty” test
- an income and assets threshold test

### ***“In poverty”***

32. Under the first criterion, the recipient must be “in poverty” as understood by charities law.

33. We accept that there is no single, fixed criterion of what constitutes “in poverty” for the purposes of charities law. The High Court in the QLCHT case observed there cannot be a single, fixed criterion, and the case law does not support a “bright-line” test for poverty.<sup>3</sup> However, charities case law provides some guidance in this area.

34. In particular, poverty includes being unable to meet all that is necessary, not only for a bare existence, but for a modest standard of living. People who are in need, aged, or who are suffering genuine financial hardship from a temporary or long-term change in their circumstances are likely to qualify for assistance. However, alleviating poverty does not mean that a person should be supplied with all that one should have for one’s own good. Relieving poverty has the connotation of relieving financial needs, but financial disadvantage is not the same as being poor.

35. In the QLCHT case, the Court recognised that assisting the poor to buy housing through shared ownership or other direct financial aid can be charitable but held that the QLCHT’s scheme was open to individuals who were not impoverished in the relevant sense. Participation in the scheme was open to individuals with incomes over the New Zealand median income; and, in point of fact, QLCHT was assisting beneficiaries who could have met their housing needs, by renting or purchasing in an alternative location.

36. It may be difficult for a person to assess whether they are “in poverty”, and so this criterion could provide less certainty than an income and assets threshold test, which can be assessed more readily. However, this uncertainty can be alleviated by Inland Revenue providing guidelines on the interpretation of what is meant by “in poverty”.

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<sup>3</sup> *Queenstown Lakes Community Housing Trust* [2011] 3 NZLR 50 at [40].



### *Income and assets tests*

37. Under the second criterion the recipient must meet both an income test and an assets test. The income test prescribes an income threshold aligned to the lower quartile of household income – which is currently about \$35,700 per annum. The main benefit of using an income threshold is that it is objective and can easily be applied in a self-assessment environment. It can also be set by reference to household composition and by geographical region.

38. However, there is a risk with using an income threshold alone, as it may include people who are not “in poverty”, such as cash-poor, asset-rich individuals. To address this concern, we feel that if this option is chosen, an asset test should form part of the exemption. An assets test could be designed to be similar to the transitional assistance support<sup>4</sup>.

39. Even with an asset test, there are concerns with this approach. These include:

- The test requires comprehensive definitions of “income” and “assets”, which could be quite complex;
- There is potential for people who are not “in poverty” to be included, as their low level of income and assets is only temporary;
- The test may exclude current registered charities who offer affordable home-ownership products;
- The approach may set an unintended benchmark for what the Government regards as a “low-income household”;
- There are issues relating to future-proofing the thresholds such as indexing the thresholds to ensure that they are inflation-adjusted or pressure on the Government to increase the thresholds in the future;
- The test creates a “cliff”. The income and asset thresholds do not provide any flexibility for either safe-harboured people who are close to the thresholds and inadvertently cross the thresholds, or for dealing with people who structure their affairs to maintain their eligibility.

### **Option one**

40. Under this option, the eligible CHPs would be subject to tax but they would be compensated for their future tax costs by:

- additional Government grants. It would be very difficult to make additional Government grants to providers to accurately reflect the amount of their tax liability; or

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<sup>4</sup> A temporary grant to support people when their basic expenses exceed their income, administered by Work and Income.

- a tax indemnity provided by the Minister of Finance under section 65ZD of the Public Finance Act. A tax indemnity involves CHPs quantifying their tax liability, and the Government compensating them for this amount.

41. The Government may choose to issue tax indemnities until the proposed housing reforms have bedded in and then move to additional direct grant funding. Alternatively, the Government could offer direct grant funding from the outset.

42. In addition, this option would include a legislative amendment to the Tax Acts to preserve the donee organisation status of the affected CHPs (see paragraphs 49 to 50).

### **Option two – specific income tax exemption**

43. A specific income tax exemption would apply to eligible CHPs that offer affordable home-ownership products to low-income households or people “in poverty”.

44. The exemption would be administered by Inland Revenue on a self-assessment basis, which is consistent with how tax law applies to all entities. In general, the criteria contain objective tests which should enable CHPs to self-assess if the exemption applies or not, and Inland Revenue would provide guidance on how the exemption applies. If absolute certainty is required, CHPs can apply for a binding ruling to confirm their status at a cost to them. Further, the proposed Regulatory Authority and Inland Revenue would consider how the exemption could be administered, once the Authority is established and housing guidelines are determined.

45. In addition, this option would include a legislative amendment to the Tax Acts to preserve the donee organisation status of eligible CHPs (see paragraphs 49 to 50).

### **Option three – confer charitable status on eligible CHPs**

46. Under this option charitable status would be conferred on eligible CHPs by amending the definition of “charitable purpose” in the Charities Act 2005 to:

- deem CHPs to be charities; or
- recognise that the provision of affordable home ownership does not automatically disqualify CHPs from having a charitable purpose, provided that all the other requirements of “charitable purpose” are met.

47. Deeming CHPs to be charities is intended to provide absolute certainty CHPs will not be subject to tax. The effect on CHP’s costs if the Charities Services Board is required to register them as charities is uncertain because CHPs may incur compliance costs under more than one piece of legislation. Simply amending the definition of “charitable purpose” in the Charities Act 2005 would not provide absolute certainty for affordable home-ownership providers because an application to register as a charity would remain subject to a case by case consideration by the Charities Registration Board (or the courts).

**Option 4 – Status quo**

48. If the status quo is maintained, the current tax policy settings for CHPs continue to apply. If a CHP is registered with Charities Services it is eligible for the charities-related income tax exemption and is recognised as a donee organisation. Deregistered CHPs are subject to tax.

**Donee organisation status**

49. The eligibility criteria could also be used as the basis for establishing criteria for donee status specifically for CHPs. CHPs meeting the criteria would automatically qualify for donee status. In practice, it is likely that CHPs would confirm this status with Inland Revenue.

50. A specific provision conferring donee status could be included in options one and two. Option three confers donee status on CHPs by virtue of it conferring charitable status, but that status would remain subject to confirmation of registration by the Charities Registration Board. Thus, all options would preserve the donee status that existed for CHPs before the High Court decision in the QLCHT case. There is a fiscal cost associated with preserving donee status for the eligible CHPs, this is tentatively estimated at \$0.1 million.

**Impact analysis of the options**

51. The impacts of options one to three and the status quo option, and whether they meet the objectives in paragraph 24, are summarised in the table below.

52. Summary of impacts of options one, two and three and the status quo.

<b>Option</b>	<b>Meets objectives a, b, or c?</b>	<b>Impacts</b>				<b>Net impact</b>
		<b>Fiscal/economic impact</b>	<b>Administrative and compliance impacts</b>	<b>Risks</b>		
<b>One</b> <i>Direct funding for eligible CHPs and donee status</i>	b, c	Tax system	Fiscal cost of \$2.4 million pa	Additional administrative costs associated with administering the direct funding mechanism No additional compliance costs, as CHPs will still need to determine their tax liabilities	May create a precedent for direct funding of a broader range of CHPs' tax liabilities in the future	Addresses the problem definition as identified by Ministers and most of the objectives
		CHPs	Transparent about fiscal cost Extinguishes future tax costs for eligible CHPs			
<b>Two</b> <i>Specific tax exemption for eligible CHPs and donee status</i>	c	Tax system	Fiscal cost of \$2.4 million pa but the true cost may never be known because it is not clear who will actually be deregistered Creates a tax preference for home ownership over other forms of housing	Administrative savings from not having to assess future tax liabilities but there is a cost associated with administering the exemption	May create a precedent for tax exemptions for a broader range of CHPs in the future	Addresses the problem definition but does not meet two objectives
		CHPs	Extinguishes future tax costs for eligible CHPs			

<b>Option</b>	<b>Meets objectives a, b, or c?</b>	<b>Impacts</b>			<b>Net impact</b>
		<b>Fiscal/economic impact</b>	<b>Administrative and compliance impacts</b>	<b>Risks</b>	
<b>Three</b> <i>Conferring charitable status on CHPs</i>	c	Tax system	Same as option two	Additional administration required by Charities Services Administrative cost savings for IRD as there is no need to assess the tax liabilities of eligible CHPs	Addresses the problem definition but does not meet two objectives
		CHPs	Extinguishes future tax costs for CHPs	Same as option two Potential additional compliance costs for eligible CHPs under more than one piece of legislation	
<b>Four</b> <i>Status quo</i>	a, b, and c	Tax system	No fiscal cost Does not create a tax preference for home ownership over other forms of housing	Potential additional administrative costs as some previously charitable CHPs enter the tax base	Achieves all objectives but does not address the problem definition identified by Ministers
		CHPs	Future tax costs for CHPs	Tax and compliance costs for previously-charitable CHPs	

### *Fiscal cost*

53. Options one, two and three have a fiscal cost which has been estimated at \$2.4 million per annum. The fiscal cost of relieving the prospective tax costs for eligible CHPs is calculated based on the CHPs on the Charities Register, which retain similar characteristics to those referenced in the QLCHT decision. The fiscal cost will ultimately depend on how rapidly the affordable housing market grows. The fiscal cost of donee status is based on reported public donations received by eligible CHPs. We also note that the fiscal cost is based on reported financial information that is not tax data so it is, at best, a proxy. For example, income measures reported in the charities' annual returns could include non-taxable income such as grants, which would tend to overstate the implied tax (or fiscal gain) and understate the implied forgone tax (or fiscal cost).

54. This fiscal cost would be counted against the tax policy work programme scorecard.

### *Social, environment or cultural impacts of all options*

55. Providing support to affordable home-ownership providers could have the following social benefits:

- reduces pressure on the rental market;
- households achieve more permanent housing solutions – households that are assisted may have been very transient in their quest to find suitable rental accommodation options. Increased stability through home ownership could mean households are more inclined to become active members of their community, have more permanent access to education and employment options; and
- depending on eligibility requirements of the CHP, it supports households who are able to sustain a mortgage long-term but are unable to save enough for a deposit.

56. There are no environmental or cultural impacts associated with the options considered above.

### *Net impact of all options*

57. The preferred option of the status quo (option four) does not address the specific problem raised by Ministers but it does achieve all of the stated objectives: aligning with the current tax policy settings, consistency with the Government's strategy for the tax system and not creating a barrier to building a more diverse and sustainable housing provider sector. At present it is not absolutely clear that the current law would not address the problem definition as articulated by Ministers, but until Charities Services has reviewed each eligible CHP involved in an affordable home-ownership provision, it is not possible to provide Ministers with the requisite level of certainty about who is affected.

58. The net impact of option one ensures that the specific problem definition is addressed, aligns with current tax policy settings, and is consistent with the Government's overall tax strategy for the tax system.

59. Options two and three address the problem definition and do not present a barrier to building a more diverse and sustainable social and affordable housing provider sector.

## CONSULTATION

60. Inland Revenue has had several discussions with QLCHT and the Community Housing Association of Aotearoa to understand the impact of the loss of tax-exempt status on CHPs. In addition, the Community Housing Association of Aotearoa (a representative body in the community housing sector) provided a submission on the July 2013 officials' issues paper on *Clarifying the tax consequences for deregistered* charities, in which it outlined its views on the tax issues facing CHPs. The Association suggested that CHPs should be recognised as charitable in purpose and therefore eligible for tax exemption and donee organisation status (option 3).

61. Inland Revenue also conducted in-depth discussions with officials from the Ministry of Business, Innovation and Employment; the Treasury and the Department of Internal Affairs.

### Ministry of Business, Innovation and Employment's view

62. The Ministry supports option four – the status quo because it meets the stated objectives and is consistent with the Government's longer term goal of creating a level playing field for social rental housing providers. From this perspective, it is appropriate that a consistent tax approach should apply to all classes of social rental housing providers (Government and non-Government; for-profit and not-for-profit). Within this general approach, providers that consider their purpose to be charitable should be free to apply for charitable status (as at present).

63. If the Government wishes to provide support to a tightly-defined group of eligible CHPs, the Ministry supports option one – direct funding, on the basis that it is fiscally more transparent than options two and three. They do not see any significant risk to the future social rental housing market if the support is limited to providers of home-ownership products to low-income families, as proposed.

### The Treasury's view

64. The Treasury supports and endorses the views of the Ministry of Business Innovation and Employment. Like the Ministry, the Treasury supports option four – status quo with a second preference of option one. The Treasury does not support a tax exemption for the reasons outlined by Inland Revenue below. However, if a tax exemption becomes the preferred option, the Treasury's preference is for a tax exemption with objective income thresholds rather than one based on the more uncertain concept of "in poverty".

### **Department of Internal Affairs' view**

65. The Department of Internal Affairs (Charities Services) does not support option three, which undermines the Charities Registration Board's statutory independence from ministerial direction. A loss of public confidence in the integrity of the charities registration process could have unintended consequences for charities that currently meet all registration requirements, and which are heavily reliant on donations. Option three does not offer any advantages over option two in terms of the objectives achieved, but it is likely to have a number of additional negative impacts. In the Department's view, option three raises similar issues to Option two in terms of what criteria would be used to "qualify" a CHP as a "deemed charity".

66. The Department does not support an alternative to an amendment to the definition of "charitable purpose" in the Charities Act 2005 that would require the Charities Registration Board to assess a CHP's eligibility for registration against criteria (including "deemed charitable status") specified in the Tax Acts.

67. Option three is inconsistent with Cabinet's November 2012 decision not to review the Charities Act 2005. At the same time, Cabinet decided it was not appropriate to conduct a separate review of the definition of "charitable purpose" [SOC Min (12) 24/3].

### **CONCLUSIONS AND RECOMMENDATIONS**

68. Inland Revenue's preferred option is option four – the status quo because it best achieves the stated objectives. We consider that current tax policy settings underlying the charities-related tax concessions are appropriate. Linking eligibility to the tax concessions for charities to charities registration ensures that the tax concessions are appropriately targeted and policy intentions are met. Although we accept that eligible CHPs can face difficulties in readily determining whether they meet the legal tests for charitable status, this problem is temporary as Charities Services will eventually provide the requisite certainty when it carries out a thorough examination of each eligible CHP.

69. If the Government does wish to intervene to provide support to eligible CHPs, we support option one – direct funding on the basis that it is fiscally more transparent than options two and three. Options two and three are not supported as they are inconsistent with the Government's overall strategy for the tax system of having a broad base with low rates and few exemptions. Exemptions create boundaries between taxable and tax-exempt activities or entities, which creates complexity and compliance costs as people transition from one to another. Also, an exemption may give CHPs an incentive to focus on providing home-ownership products over other forms of housing products. Exemptions also present a risk to maintaining the revenue base, as other groups will seek to lobby the Government for similar treatment.

70. Inland Revenue supports the use of an "in poverty" test to define eligible CHPs for the reasons outlined in paragraph 39 and because the test would provide more flexibility to determine who should be a tax-exempt provider.



## IMPLEMENTATION

71. The status quo and option one do not require legislation to implement. Option two would require changes to the Tax Acts and option three would require changes to the Charities Act 2005. Conferring specific donee status on CHPs would require a change to the Tax Acts.

72. The amendments to the Tax Acts could be included in the tax bill scheduled for introduction in November 2013. Amendments to the Charities Act 2005 would not be within the scope of the tax bill or the Social Housing Reform bill and so they will have needed to be included in a Charities Amendment bill. Ideally, any legislative amendments should apply from 14 April 2014, the date on which most of the proposals in the Social Housing Reform bill take effect.

73. Inland Revenue will communicate any legislative tax changes to CHPs and their advisors through its existing channels, such as the *Tax Information Bulletin* and by updating its guides.

74. Inland Revenue, Charities Services and the Ministry of Business, Innovation and Employment could work together to provide general guidance on charities law, tax law and housing to help CHPs transition to the new housing regime.

75. There are no significant implementation risks arising from the preferred option. Inland Revenue will assess any tax liabilities of CHPs as part of its business as usual.

## MONITORING, EVALUATION AND REVIEW

76. There are no specific plans to monitor, evaluate and review the changes to the Tax Acts to give effect to the specific tax exemption or the donee organisation change (if adopted). If any detailed concerns are raised in relation to these changes, Inland Revenue will determine whether there are substantive grounds for review under the Generic Tax Policy Process (GTPP).

77. In general, Inland Revenue's monitoring, evaluating and reviewing of new legislation takes place under the GTPP. The GTPP is a multi-stage tax policy process that has been used to design tax policy in New Zealand since 1995. The final stage in the GTPP is the implementation and review stage, which involves post-implementation review of the legislation, and the identification of any remedial issues. Opportunities for external consultation are also built into this stage. In practice, any changes identified as necessary for the new legislation to have its intended effect would generally be added to the Tax Policy Work Programme, and proposals would go through the GTPP.