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SUBMISSION TO THE TAX WORKING GROUP

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[1]

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Introduction

This Submission is written in response to two specific issues concerning exemptions from income tax under the Income Tax Act 2007 (ITA 2007): Part 1, unrelated commercial activities undertaken by charities (s CW 42 *Charities: business income*), and Part 2, “vet clubs” (s CW 50 *Veterinary services bodies* and s CW 51 *Herd improvement bodies*). Further, such entities also qualify for the issuance of a Resident Withholding Tax certificate under s RE27 *RWT exemption certificates* of the ITA 2007 and s 32E *Applications for RWT exemption certificates* of the Tax Administration Act 1994 at s 32E(k) with respect to interest and dividends received.

Another section of the ITA 2007 that the author wishes to bring to the attention of the TWG which is deserving of further inquiry is s CW 46 *Bodies promoting amateur games and sports*, give that today there a number of entities claiming tax concessions under the ITA2007 yet it is evident that they are anything but in the business of promoting amateur games and sports. However this issue is not canvassed further in this submission.

Should the Tax Working Group (TWG) so wish, the author is able to provide further details on these issues as well as appearing before the TWG in person if that option is of assistance to the TWG. Alternatively, other forms of communication are acceptable to the author.

The author has no objections to his Submission being made available to the public.

What is the issue?

The author submits that there are two significant equity, or more correctly inequity issues, in the ITA 2007 concerning tax policy which no government has taken to the Select Committee stage to allow interested parties to put their cases before the Committee for Parliament to then make determinations on those issues. These are:

- Large scale commercial trading being undertaken by “charities” where that trading is unrelated to those charities charitable purposes;
- Trading being undertaken by “vet clubs,” an anachronistic post-WWII mechanism by which certain professional veterinary practices are acquiring “vet clubs” to take advantage of the “vet club” exemption from income tax.

Solutions to the issues

The Author respectfully recommends that:

- Charities which undertake commercial trading activities as limited liability companies that are unrelated to their charitable purposes be required to make charitable distributions which the current philanthropic regime allows as deductible items to the extent of their taxable net income under s DB 41 *Charitable or other public benefit gifts by company* to a separate registered charity or charities with income tax being paid on retained profits;
- Professional veterinary practices which claim income tax exempt status based on a concept developed in post-WWII New Zealand, that of “vet clubs,” be required to pay income tax on the basis that this exemption is anachronistic and no longer relevant;
- Amendments to the Income Tax Act 2007 be placed before the House to allow interested members of the public to make submissions at a Select Committee convened for the purpose in order that all sides can express their views on these two issues in a democratic way.

Part 1: Charities and taxation

Since the first substantive review of taxation in New Zealand in 1967, that of the Ross Committee and successive reviews, as outlined in **Appendix 1**, no government has proceeded by placing an amending section to the income tax legislation requiring charities that undertake commercial activities to pay income tax before a Select Committee in order that those with an interest in the issue might have their democratic say before Parliament deliberates on the matter. Not surprisingly, the history of charity taxation in New Zealand is bereft of such debate. Even at the time of the enactment of the first true income tax by William Pitt in 1799, which contained an income tax exemption clause regarding charitable purposes, no debate on that significant section was reported in reports of Parliamentary debates. However, the Author doubts that neither in Pitt’s time in 1799, nor in New Zealand in 1891 and 1892 when our first true income tax Acts were introduced, did either Parliament contemplate that commercial activities would claim charitable status, particularly to the extent evident in New Zealand today.

In 1892, rectifying an oversight on the introduction of the Land and Income Assessment Act 1891,¹ which exempted the land of “[p]ublic charitable institutions constituted under The Hospitals and Charitable Institutions Act 1885, and charitable institutions not carried on for gain or profit,”² an exemption from income tax regarding public charitable purposes was provided for in the Land and Income Assessment Act Amendment Act 1892.³

In 1940, during the debate on the Land and Income Tax Amendment Bill the Hon Mr Nash stated:⁴

... if [an] organization earns money that is spent overseas, then, if it is a trading organization, that trading profit become liable to taxation. The *portion* of the profit, however, that is spent charitably in the Dominion is not liable to taxation.

“Missions,” said Mr Nash, “are exempt, as they are not in business.”⁵ However, charitable businesses that operated solely in New Zealand were exempt from income tax with respect to “[i]ncome derived directly or indirectly from any business carried on by or on behalf of or for the benefit of trustees,” or the business of any society.⁶ In doing so, disregarding the developments in the UK in 1927, a tax inequity was created.

Today, under s DB 41 of the Income Tax Act 2007, companies can now donate to the extent their taxable income and claim a deduction for that amount. That, in effect, was what Mr Nash had said in 1940 with respect to charitable business that remitted funds overseas. However, companies with charitable status are not required to pay tax on retained funds that are not applied to charitable purposes, which the author argues is inconsistent with the recommendations of numerous tax reviews over the years. This is also inconsistent with the tax policies of the *fons et origio* of New Zealand’s charity law, England, concerning charities and primary trading.

In the 1920s the issue of trading by charities surfaced in the UK when, as the result of a case stated by the Commissioners for the Special Purposes of the Income Tax concerning the charging of fees by a public school, the [UK] Finance Act 1921 was amended in 1927 with

¹ 54 & 55 Vict. No. 18 (8 Sept. 1891)

² At s 16(1)(g).

³ 56 Vict. No 54 (11 October 1892) at s 3(4).

⁴ Hon Mr Nash, Land and Income Tax Amendment Bill” NZPD Vol 257 (18 July 1940) at 601 (author’s emphasis).

⁵ [Editorial], “Income Tax Amendment Bill” Auckland Star Vol 71 Iss 170 (19 July 1940) at 9.

⁶ Land and Income Tax Amendment Act 1940 No. 3 (19 July 1940) at s 5.

respect to income tax under Schedule D in respect of the profits of a trade carried on by any charity so that any such profits were exempt only where:⁷

- (i) the trade is exercised in the course of the actual carrying out of a primary purpose of the charity; or
- (ii) the work in connection with the trade is mainly carried on by beneficiaries of the charity.

Today, those comparable provisions can be found in the [UK] Income Tax Act 2007 C 3 ss524-525 with respect to charitable trusts, and in the [UK] Corporation Tax Act 2010 ss 478-479 with respect to charitable companies. For clarification, the guideline on trading published by the Charity Commission for England and Wales explains that “primary purpose trading” is “trading which contributes directly to one or more of the objects of a charity as set out in its governing document.”⁸ A report by a charity tax specialist in 2010 gave an example of a church with charitable status, its charitable purpose being the advancement of religion.⁹ The sale of religious books qualify as primary purpose, whereas the sale of non-religious books do not.

However, in the UK a pragmatic approach is taken whereby allowances are made for small scale non-charitable trading with respect to annual turnover, the limits of which are:¹⁰

- £5,000
- If the turnover is greater than £5,000, 25% of the charity’s total incoming resources, subject to an overall upper limit of £50,000.

The qualifying factor is that commercial activity which is unrelated to the charitable purposes of the entity is taxable for purposes of the income tax and corporation tax legislation. Hence, in the case of a public school in the UK, the charging of fees is permissible given that the advancement of education is a charitable purpose, in accordance with the principles laid down in *Pemsel* in 1891.¹¹ There is a direct relationship between fees charged by public schools and the provision of education, as is the case in New Zealand with respect to private schools.

⁷ Finance Act [17 & 18 Geo. V] C. 10 (1927) at s 24.

⁸ Charity Commission for England and Wales, “Trustees. Trading and tax: how charities may lawfully trade” (February 2016) at 3.6

⁹ Crowe Clark Whitehill, “The tax implications of charity trading” (2010) at 2.4.

¹⁰ See also Guidance, “Annex iv: trading and business activities – basic principles” at 15.

¹¹ *Commissioners for Special Purposes of the Income Tax v Pemsel* [1891] AC 531.

Unrelated commercial activity by registered charities in New Zealand

The extent of unrelated commercial activity undertaken by registered charities has become increasingly evident since the introduction of the Charities Act 2005 by which in order to be granted the privilege of fiscal benefits, in particular an exemption from income tax, such charities are required to register and to file annual returns and financial statements. The net equity of such entities now runs into the billions of dollars, yet successive governments appear reluctant to address what the author considers to be a failure of the most basic of tax policies, that of equity and fairness espoused by Adam Smith in 1776.¹² The author has frequently been contacted by people who find their businesses competing with income tax exempt entities and who consider this to be unfair, given the distinct fiscal advantage an income tax exempt entity has over a taxpaying business, in particular the ability to accumulate funds at a faster rate than an income tax paying entity. It is not only the charity sector where such an inequity can be seen, as this is also evident with respect to another anomaly in the Income Tax Act 2007, that of so-called “vet clubs” (see following discussion and at **Appendix 2**).

The Author does not consider that at this stage it is necessary to name names, on the basis that the members of the TWG will be aware of many of those charities from media commentaries and public debate over the years. However, an overview of the sectors of the economy where such commercial activity is being undertaken may be of assistance:

- Commercial property development
- Tourism
- Hotel accommodation
- Fisheries
- Electricity generation
- Geothermal energy
- Forestry
- Dairy farming
- Livestock
- Food manufacturing
- Commercial rental properties
- Seafood production and processing

¹² Adam Smith, “An Inquiry into the Nature and Causes of the Wealth of Nations” (London, Grant Richards, 1776) Vol 2 at 471.

- Vineyards/wineries
- Freight
- Public transport – land and air
- Quarrying
- Real estate
- Communications
- Recycling

A government (taxpayer-subsidised) subsidy

The Operational Statement (“OS”) published in December 2006 by Inland Revenue recognises that registered charities benefit from fiscal concessions both directly in the form of the income tax exemption and indirectly through donee status, as well as other tax concessions, such as an exemption from Resident Withholding Tax. This is clearly stated in the OS:¹³

The Government has acknowledged the enormous contribution that the charitable sector makes to New Zealand.

To aid in the funding of charitable organisations the Government provides a subsidy in the form of an exemption from income tax that allows such entities spending on charitable purposes to be made out of untaxed income.

Other tax benefits are also provided. Many charities and other organisations also receive an indirect subsidy through allowing donors to qualify for a rebate from their income tax.

The cost of the tax credits paid to donee organisations is able to be quantified, as can be seen in each year’s Tax Expenditure Statement (“TES”), the forecast for 2016/17 being \$247 million.¹⁴ The forecast for charitable or other public benefit gifts by way of a company deduction was \$21 million.¹⁵ The TES also details the various tax expenditures that are included in the Income Tax Act 2007, such as gifts by companies (s DB41), and exempt income, including charitable business exempt income (ss CW 41-43) to the extent that funds are applied

¹³ Inland Revenue, “OS 06/02 Interaction of tax and charities rules, covering tax exemption and donee status” (December 2006).

¹⁴ Treasury, “2017 Tax Expenditure Statement” (25 May 2017) Table 2 Quantified Tax Expenditure and Spending through the Tax System at 5.

¹⁵ Treasury, above n 14 at 5.

in New Zealand.¹⁶ However, no attempt is made to quantify the charitable business exempt income and related tax expenditures which are subsidised by the taxpaying public.

An anomaly rectified: Government trading

It is interesting that no recent government has taken the recommendations concerning the commercial activities of charities as reported in various tax reviews seriously (see **Appendix 1**), given that past governments recognised the unfairness of government commercial activities competing with tax-paying entities. In 1940, during the debate on the Land and Income Tax Amendment Bill, the Hon Mr Ward stated that he was “glad” that the Bill required State trading departments liable to income tax, “*because these departments are in competition with private business and it is only right that they should pay their income tax.*”¹⁷ It is curious that the government in 1940 introduced this as a tax policy to restore a level playing field yet in the same breath exempted businesses which claimed charitable status from income tax.

An example from the relatively recent past illustrates this – the Natural Gas Corporation. On being constituted under the Natural Gas Corporation Act 1967, the corporation was exempted from land and income tax.¹⁸ The Hon. T. P. Shand explained that the reason for exempting the corporation from taxation was that “the corporation will have to make sufficient profits during its lifetime of 25 years to repay the money it has borrowed,” and that taxing the corporation would make it more difficult to do repay the national development loans which had funded the venture.¹⁹ This is precisely the issue businesses face when they find that they are in competition with income tax exempt businesses being run by registered charities – there is a clear advantage in being exempt from income tax.

However, in 1976 the taxation exemption provision was repealed,²⁰ with the corporation being required to operate from “a more commercial aspect.”²¹ This implies working in competition with other energy providers and the requirement to pay income tax levels the playing field. Why should this not also apply to the charity sector?

¹⁶ Treasury, above n 14 Table 3 Tax Expenditures Included in the Income Tax Act 2007 at 8-9.

¹⁷ Hon Mr Ward, “Land and Income Tax Amendment Bill” NZPD Vol 257 (19 July 1940) at 648 (author’s emphasis).

¹⁸ Natural Gas Corporation Act 1967, No. 41, s 24.

¹⁹ Hon. T.P. Shand, “Natural Gas Corporation Bill” NZPD Vol 353 (4 October 1967) at 3479.

²⁰ Natural Gas Corporation Amendment Act 1976, No.141 at s 6.

²¹ Hon. E.S. Holland, “Natural Gas Corporation Amendment Bill” NZPD Vol 408 (24 November 1976) at 4249.

A new model emerging – Social enterprise

Internationally, a new model is emerging in the not-for-profit sector, that of social enterprise. While this is relatively new to New Zealand, Dr Tricia Fitzgerald, a researcher of social enterprise, states that in the UK there are “an estimated 80,000 social enterprises which together contribute £24 billion (NZ \$50 billion) to the UK economy.”²² Dr Fitzgerald is also reported as saying “[i]magine a world where ordinary commercial businesses have to compete with those that also deliver some environmental or social value – the potential for societal and business transformation is huge.”²³ That may be so, but what of tax equity implications? In the UK, the rules concerning trading and charities also applies to social enterprise activities when they have charitable status.²⁴ To quote a UK commentator: “[c]arrying on a ‘social enterprise’ does not confer any tax benefits on an organisation. A charity will be exempt from tax on trading as a social enterprise if this falls within its primary charitable purpose.”²⁵

In Canada “[t]he taxation of, or tax exemption of, social enterprises revolves around the provisions of the Income Tax Act and its interpretation by [the Canada Revenue Agency]... However, opinions differ ... and confusion reigns.”²⁶ One of the questions being asked in Canada in 2015 was, “[s]hould registered charities be allowed to carry on businesses that are not related to their approved charitable purposes to support themselves or should the charitable status of such charities be revoked as often is the case now?”²⁷ One suggestion was that Canada could adopt a UBIT regime – unrelated business income tax – as applied by the IRS in the USA.²⁸

With calls for the need of new legal forms,²⁹ whatever form of entity under which social enterprise is undertaken, unless New Zealand adopts an income tax exemption policy with respect to unrelated trading activities undertaken by charities as applied in the UK this country will find that the tax base continues to be insidiously eroded while at the same time international tax policy experts are engaged, on a larger scale, with the Base Erosion and Profit Shifting Project.³⁰

²² Tricia Fitzgerald, “From charity to social enterprise: when making money is good” University of Auckland (2 October 2017).

²³ Fitzgerald, above n 22.

²⁴ Buzzacott, “Social enterprise – From a tax perspective” (October 2009).

²⁵ Horwath Clark Whitehill, “The tax implications of charity trading” (March 2010) at 137.

²⁶ Drache Aptowitzer LLP, “Hope for clarity in all things social enterprise” (12 November 2015).

²⁷ Drache, above n 26.

²⁸ Drache, above n 26.

²⁹ Amanada Cropp, “Social enterprises mull tax-break push” Press (28 September 2017) at A10.

³⁰ See BERP at www.oecd.org.

Part 2: Veterinary clubs and taxation

Veterinary clubs, societies or associations, and similar organisations which carry on trading activities should be subject to income tax in respect of the profits derived from such activities.

Ross Committee (October 1967)

The main advantage [of the exemption from income tax] lies with the ability of these bodies to effectively re-invest their total profits in the provision of necessary infrastructure ... The concession is effectively one of allowing these activities to grow at a faster speed ... Over time, these exemptions are likely to be withdrawn.

OECD Working Party on Agricultural Policies and Markets (2005)

The following commentary are extracts from a detailed report submitted to the National Government (Hon Todd McClay) and Inland Revenue in 2015 by the author.³¹ The full report is provided at **Appendix 2** of this Submission.

Since 1951 veterinary services bodies, that is veterinary clubs and the Veterinary Services Council, have benefited from a concession which exempts them from income tax. This concession followed the creation of such bodies in 1946 following the introduction of the Veterinary Services Act in post-WWII New Zealand. The rationale for the concession was that the functions of veterinary clubs, as well as herd improvement associations which were also granted an exemption from income tax, were “of national importance and they should be exempt from tax accordingly.” Times have moved on and while the rationale was applicable at that time, New Zealand’s economic situation is now quite different from that of sixty years ago. However, there are certain entities that describe themselves as “vet clubs” which are anything but, and use the income tax exemption to gain a distinct competitive advantage over their for-profit competitors. This competitive advantage through the ability to accumulate funds at faster rate than that of their for-profit entities is due not only to the exemption from income tax, but also to the exemption from resident withholding tax which was introduced in 1989. In 2001 a submission to the Tax Review described the income tax concession as an anachronism. Further, even the OECD had concerns in 2005 about such a concession, as well as tax experts in New Zealand since 1967.

³¹ M.J. Gousmett, “‘Vet Clubs’ Veterinary Services Bodies and their Fiscal Privileges” (15 November 2015).

While the Veterinary Services Council was created by statute in 1946 under a Labour government (Peter Fraser), with one of its functions being the establishment of so-called “vets’ clubs,” it was not until 1955 that the VSC and its siblings were granted an exemption from income tax by the National government (Sidney Holland) when the Land and Income Tax Amendment Bill provided, at clause 8, “an exemption from income tax and from social security charge on the income derived by the Veterinary Services Council, and also veterinary clubs and herd improvement associations.”³² In moving the Second Reading of the Bill on 26 October 1955, the Hon Mr Watts, Minister of Finance, stated that:³³

[c]lause 8 confers exemption from income tax, and, therefore, also from social security charge, [on] the income derived by the Veterinary Services Council, and also all veterinary clubs, and herd improvement associations. ***Their functions are of national importance and they should be exempt from tax accordingly.*** One condition of the exemption will be that *no individual member will be able to derive private pecuniary profit from the clubs or associations.* It is necessary to provide for the exemption to be made retrospective to 1951, to regularize the exemption which has already been granted, on the assumption – now found to be erroneous – that the present law was sufficient to grant the exemption.

What then, was that “present law” that was “now found to be erroneous?” The principal income tax legislation in force in 1951 was the Land and Income Tax Act 1923³⁴ until the legislation was consolidated and amended in 1954 in the form of the Land and Income Tax Act 1954.³⁵ There is no evidence of any amendments to the 1923 Act between 1923 and 1951 regarding veterinary services bodies, and it was not until 1955 that a specific exemption from income tax for the VSC, veterinary clubs, and herd improvement associations, was provided in the amendment to s 86 of the principal (1954) Act in the Land and Income Tax Amendment Act 1955 at s 8 (1)(oo).³⁶

Income derived by the Veterinary Service Council established under the Veterinary Services Act 1946; and income derived by any veterinary club, society, or association, whether incorporated or not, which is, in the opinion of the Commissioner, established substantially or primarily for the purpose of promoting efficient veterinary services in New Zealand, if no part of the income or other funds of the club, society, or association is used or available to be used for the private pecuniary profit of any proprietor, member, or shareholder thereof:

Income derived by any herd improvement society or association ...

³² Land and Income Tax Act Amendment Bill, NZPD (19 October 1955) vol 307 at 3196.

³³ Land and Income Tax Amendment Bill, NZPD (26 October 1955) vol 307 at 3381.

³⁴ Land and Income Tax Act 1923 [28 August 1923] No 21.

³⁵ Land and Income Tax Act 1954 [30 September 1954] No 67.

³⁶ Land and Income Tax Amendment Act 1955 [27 October 1955] No 91 s 8 (1).

Section 8(2) provided that the section was to apply “with respect to the tax for the year of assessment that commenced on the first day of April, nineteen hundred and fifty-one, and for every subsequent year.”³⁷

Today, the format and wording of the relevant section in the Income Tax Act 2007 that provides an exemption from income tax to veterinary associations, clubs and societies differs from that of 1955, as seen in s CW 50 Veterinary services bodies:³⁸

Exempt income: veterinary clubs

- (1) An amount of income derived by a veterinary association, club, or society is exempt income if –
 - (a) the association, club, or society was established mainly to promote efficient veterinary services in New Zealand; and
 - (b) none of its funds is used or available to be used for the private pecuniary profit of a member, proprietor, shareholder, or associate of any of them.

Exempt income: Veterinary Council

An amount of income derived by the Veterinary Council of New Zealand is exempt income.

The intent of s CW 50(1)(b) was broadened as part of the rewriting of the Income Tax Act 1994, which was finally completed on the passing of the Income Tax Act 2007 on 1 November 2007, by adding the term “associate” into the existing section CB 4(1)(f) on the basis that “the policy underlying [the wording ‘proprietor, member or shareholder’] is defeated if any person, not just a proprietor, member, or shareholder, is able to obtain a pecuniary profit.”³⁹

The exemption from income tax for herd improvement bodies now resides in s CW 51 Herd improvement bodies of the Income Tax Act 2007:

An amount of income derived by a herd improvement association or society is exempt income if –

- (a) the association or society was established mainly to promote the improvement of the standard of dairy cattle in New Zealand; and
- (b) none of its funds is used or available to be used for the private pecuniary profit of a member, proprietor, shareholder, or associate of any of them.

³⁷ Land and Income Tax Amendment Act, above n 36 s 8(2).

³⁸ Income Tax Act 2007 [1 November 2007] No 97 (reprinted as at 1 April 2015).

³⁹ Rewriting the Income Tax Act 1994 – Exposure Draft Part C: Income, CW Exempt Income at 220 (available at <http://taxpolicy.ird.govt.nz>). Note that neither of the two issues papers that were written by the Policy Advice Division of Inland Revenue, their purpose being “to promote discussion of minor policy issues relating to policy intent or clarification of legislation that arise from the rewrite, and to seek comment from interested parties,” discussed the veterinary services exemptions. See Policy Advice Division, Inland Revenue, “Rewriting the Income Tax Act [1994]: Parts C, D, and E” (March 1998) Issues Paper 1; (June 1998) Issues Paper 2.

In 1967 the Report of the Taxation Review Committee, chaired by L.N. Ross, (the Ross Committee,) in commenting on the veterinary clubs under s 86 (1)(00) of the Land and Income Tax Act 1954, noted that:⁴⁰

[m]any of these veterinary clubs carry on quite extensive business activities in the supply of stock medicines and veterinary services to members and others. They thus compete both in buying and selling markets with other forms of enterprise whose profits are subject to taxation. ***It is in keeping with our recommendations regarding the taxation of business profits of other exempt organisations [ie trading charities] that veterinary and other similar clubs and societies or associations should be subject to tax on the profits derived from trading activities.***

Accordingly, the Ross Committee recommended that “[v]eterinary clubs, societies or associations, and similar organisations which carry on trading activities should be subject to income tax in respect of such activities.”⁴¹

However, a review of the New Zealand Parliamentary Debates following the tabling of the report in the House from 1967 through to 1970 suggests that this recommendation was not even debated, let alone implemented as a budgetary measure.

According to the OECD, the income tax exemptions provided to veterinary clubs and herd improvement societies have had their day:⁴²

185. Tax revenue from the agriculture sector [in New Zealand] is an important component of government revenue. ...

...

189. *Exempt income of veterinary clubs and herd improvement societies [s CB 4(f)-(g)].* These exemptions are historical. In the farming context they are not of any significance. ***The main advantage lies with the ability of these bodies to effectively re-invest their total profits in the provision of necessary infrastructure*** (buildings, equipment, vehicles, etc). Interest on borrowings for such infrastructure, and associate costs of depreciation and repair/maintenance are not tax deductible. ***The concession is effectively one of allowing these activities to grow at a faster speed (due to the ability to reinvest all net profits earned rather than net profits after tax).*** There is no distortion in investments decisions as a

⁴⁰ The Taxation Review Committee, “Taxation in New Zealand Report of the Taxation Review Committee” (Ross Committee) (October 1967) Wellington, R.E. Owen, Government Printer at §783.

⁴¹ Ross Committee, above n 43 at p. 323. The Ross Committee also recommended at p. 313 that “[p]rofits from trading derived directly or indirectly by charitable organisations and dividends derived from any company substantially owned by such organisations are assessable for income tax at normal rates.”

⁴² OECD Directorate for Food, Agriculture and Fisheries Committee for Agriculture, Working Party on Agricultural Policies and Markets, “Non-sectoral Policies for the Agriculture and Agri-food Sectors: Taxation and Social Security” (4 August 2005) AGR/CA/APM (2004) 13/Final (available at www.oecd.org).

result of this measure, as the exemption applies to all income earned from the club or society. *Over time, these exemptions are likely to be withdrawn.*

While the income tax exemption granted to veterinary services bodies in 1955 was done so with a particular economic policy in mind, sixty years later the concession is being used in a manner that would not have been contemplated by Parliament in that the concession is being applied to commercial trading activities by veterinary services bodies thereby providing them with a distinct competitive advantage over their for-profit competitors through the retention of funds that allows a faster rate of growth that would otherwise be possible if those funds were applied to income tax liabilities. As a author to the 2001 Tax Review Committee stated, the concession is indeed an anachronism that should be removed from New Zealand's income tax legislation. In 2005 the OECD also noted its inappropriateness and that in due course it was likely that it would be removed, yet ten years later the concession remains.

The Author respectfully recommends that the government revisit the fiscal concession with a view to amending the Income Tax Act 2007 such that only bona-fide non-profit veterinary services bodies be able to apply the concession to their benefit and that the commercial trading activities now undertaken by veterinary services bodies be liable to income tax in order to level the playing field in terms of tax equity. Neither is it acceptable that because a shareholder, being a veterinary services body, has income tax exempt status therefore the concession can also be applied to the commercial activities of the related company.

Appendix 1

Taxation Reviews

Report of the Taxation Review Committee (Ross Committee) (1967)

Report of the Taxation Review Committee.⁴³

It is in keeping with our recommendations regarding the taxation of business profits of other exempt organisations [ie trading charities] that veterinary and other similar clubs and societies or associations should be subject to tax on the profits derived from trading activities.

Report of the Task Force on Tax Reform (McCaw Report) (1982)

The Report of the Tax Force on Tax Reform,⁴⁴ chaired by P.M. McCaw (McCaw Report), whose Terms of Reference required the Task Force amongst other requirements “[t]o undertake a thorough and systematic review of all aspects of central government.”⁴⁵ However, at Chapter 12 the Task Force gave consideration to life insurance and superannuation, building societies, co-operatives, and charitable organisations.⁴⁶ The Task Force recognised that “[b]ased on information made available [to the Task Force], the cost of business incentives in revenue forgone is in the vicinity of \$470 million per annum,” with a “strong” recommendation that those incentives “be subject to a rigorous assessment of costs and effectiveness on a regular basis.”⁴⁷ The Task Force “further recommend[ed] a more explicit accounting of all concessions and incentives to improve government management procedures in this area.”⁴⁸ In this regard, the Task Force also discussed the concept of tax expenditure budgeting, noting that in order “[t]o meet the fundamental objectives of government accountability and [to achieve] efficient and effective management, requires, as a first step, more explicit accounting of the cost of tax expenditures and their allocation (where possible) to the government’s economic and social programmes.”⁴⁹ Of significance is the observation by the Task Force that “[b]ecause they

⁴³ The Taxation Review Committee, “Taxation in New Zealand Report of the Taxation Review Committee” (October 1967) Wellington, R.E. Owen, Government Printer at §783.

⁴⁴ Task Force on Tax Reform, “Report of the Task Force on Tax Reform” (7 April 1982) 265 pp. The McCaw Report was the third official Report on Tax Reform post-WWII the first being the Report of the Taxation Committee in 1951, chaired by T.N. Gibbs, which dealt only with the reform of income tax, and the second, the Ross Committee in 1967. See B.M. Niculescu, “The McCaw Report on Tax Reform” (1982) 16 *New Zealand Economic Papers* 28 – 40 at 31.

⁴⁵ Task Force on Tax Reform, above n 44 (a) at (i).

⁴⁶ Task Force on Tax Reform, above n 44 Ch 12 Special Cases at 242.

⁴⁷ Task Force on Tax Reform, above n 44 at 7.

⁴⁸ Task Force on Tax Reform, above n 44 at 7.

⁴⁹ Task Force on Tax Reform, above n 44, 4.7 at 62. The term “tax expenditure” is a concept created by former United States Assistant Secretary of the Treasury for Tax Policy, Stanley Surrey, which The Budget Reform Act

*escape effective government control, tax expenditures seem to be more difficult to terminate.*⁵⁰ Further, the Task Force also considered that “concessions intended to act as incentives ... [that are] provided through the tax system [are] inefficient.”⁵¹

Regarding the income tax exemption of commercial activities undertaken by charities within the same sector as income tax liable for-profit entities, the Task Force recommended that while charitable organisations should be permitted to undertake their traditional fundraising activities, at the same time *the government should “minimise” the scope for avoidance and reduce the advantages which accrue to income-tax exempt charities which operate in competition with taxable businesses.*⁵²

It must not be overlooked that “both the Ross Committee [1967] and the McCaw Report [1982] suffered from the same major disability: “the lack of relevant data,” with the McCaw committee being “both surprised and frustrated by the lack of reasonably up-to-date statistical information which could be made available to [the committee].”⁵³

Government Economic Statement (1987)

In 1987 the Minister of Finance, Roger Douglas, released his alternative economic statement⁵⁴ in which he proposed a raft of controversial measures, including the taxation of charities.⁵⁵ Amongst other measures, Douglas proposed the removal of personal tax rebates and deductions,⁵⁶ alternative funding support for charitable activities,⁵⁷ a reduction in the company tax rate,⁵⁸ the taxation of superannuation funds, life offices and related organisations,⁵⁹ measures to eliminate tax avoidance and to broaden the tax base by introducing a tougher international tax regime, taxing exempt organisations at normal rates and a new petroleum mining tax regime.⁶⁰ Douglas specifically targeted charities and sporting bodies, mutual associations, primary producer co-operative companies, primary producer and marketing

of 1974 defined as “[t]hose revenue losses attributable to the provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide special credit, a preferential rate of tax, or a deferral of tax liability” Stanley S. Surrey, “The Tax Expenditure Concept and the Budget Reform Act of 1974” (1976) 17 *Boston College Law Review* 679 - 736 at 683.

⁵⁰ Task Force on Tax Reform, above n 44 4.8 at 63 (emphasis added).

⁵¹ Task Force on Tax Reform, above n 44 4.11 at 63.

⁵² Task Force on Tax Reform, above n 44 12.57 at 254 (emphasis added).

⁵³ Niculescu, above n 44 at 39.

⁵⁴ Roger Douglas, “Government Economic Statement” (17 December 1987) Government Printer 68pp.

⁵⁵ See MJ Gousmett, “1987: Roger Douglas’ failed attempt to tax charities” (December 2013) 19:4 *New Zealand Journal of Taxation Law and Policy* 279-287.

⁵⁶ Douglas, above n 54 at 7.

⁵⁷ Douglas, above n 54 at 7.

⁵⁸ Douglas, above n 54 at 8.

⁵⁹ Douglas, above n 54 at 8.

⁶⁰ Douglas, above n 54 at 8.

boards, and milk treatment companies.⁶¹ Douglas intended to withdraw tax exemptions that “were intended to assist the farming sector,” such as “special tax concessions for primary producer co-operatives,” which he considered provided “opportunities for tax avoidance [as well as] distorting investment patterns.”⁶²

Report of the Committee of Experts on Tax Compliance (1998)

The issue of the exemption from income tax provided to certain organisations was also raised in the Report of the Committee of Experts on Tax Compliance in 1998.⁶³ The report noted that (emphasis added):⁶⁴

[b]usiness income derived by charities is exempt from tax under section CB 4(1)(e). However, some charities may engage in business activities unrelated to the charitable purpose for which they are provided a tax exemption. ***This exemption gives charities a competitive advantage over taxpaying business competitors.***

The report recommended that (emphasis added):⁶⁵

the government should review the tax treatment of charities and other tax-exempt entities that engage in commercial activities unrelated to their purposes. ***No reason exists in principle why business income, unrelated to the core purpose, should not be taxed.***

The committee made reference to the unrelated business income tax (UBIT) regime applied in the United States and suggested that “[t]he government may wish to refer to the relevant United States legislation in designing rules for New Zealand.”⁶⁶

Tax Review 2001 (McLeod Report)

The report in October 2001⁶⁷

In its submission, the New Zealand Business Roundtable of the report noted that.⁶⁸

[i]n particular, the pattern of domestic investment is distorted by significant differences in the effective marginal tax rates applying to income from alternative investments. Those differences in effective marginal tax rates arise from:

- differences in the tax treatment of different forms of income
- ...

⁶¹ Douglas, above n 54 Annex 5 at 33-37.

⁶² Douglas, above n 54 at 33.

⁶³ Rt Hon Sir Ian McKay, Tony Molloy, John Prebble, and John Waugh, “Tax Compliance A Report to the Treasurer and Minister of Revenue by a Committee of Experts on Tax Compliance” (December 1998).

⁶⁴ McKay, above n 63 at §4.16.

⁶⁵ McKay, above n 63 at §4.17.

⁶⁶ McKay, above n 63 at §4.19.

⁶⁷ Rob McLeod (Chair), David Patterson, Shirley Jones, Srikanta Chatterjee, and Edward Sieper, “Tax Review 2001” (available at www.treasury.govt.nz).

⁶⁸ New Zealand Business Roundtable, “Submission on the Tax Review 2001” (March 2001) at 49 at <http://nzinitiative.org.nz>.

- Differences in the income tax treatment of different entities (e.g. Maori Authorities, qualifying companies, mutual associations and cooperatives, and charities) ...

Further, the authors noted that:⁶⁹

[s]ome of these differences are due to practical problems associated with the assessment and collection of tax on certain types of activities ... *other differences are due to explicit decisions made by past governments to use the tax system as a means of encouraging certain 'desirable' activities and discouraging certain 'undesirable' activities.* Unfortunately, it is not clear to what extent the concessional tax treatment of certain activities is due to the practical difficulties associated with taxing those activities as opposed to a deliberate decision by the government to assist or deter certain activities. ... We believe the Review has an important role to play in affirming the view that the tax system should, as far as feasible, tax all activities and classes of entities on a neutral basis. ***It should also identify those activities that are currently subject to concessional tax treatment and determine the extent to which those concessions arise from either explicit government policies aimed at subsidising particular activities or entities, or practical income measurement problems.***

Tax and Charities (2001)

The 2001 report “Tax and Charities” focussed specifically on the non-profit sector, making some interesting comments made concerning the income tax exemption, trading by charities, and tax policy.⁷⁰ While the issue of competitive advantage was raised, the final price of products was competitive with for-profits, therefore pricing was not the issue.⁷¹ The issue, it was suggested, was the competitive advantage a charity could gain ***through the ability to accumulate tax-free profits thus enabling “a faster accumulation of funds [which would allow it] to expand more rapidly than its competitors.”***⁷² This was ***“the real competitive advantage that trading activities owned by charities have over their competitors.”***⁷³ On that basis the Discussion Paper proposed that ***“[t]rading operations owned by charities would be subject to tax in the same way as other businesses,*** but with an unlimited deduction for distributions made to relevant charitable purposes.”⁷⁴ Ultimately it was not until 2007 when the new concessions for charitable giving by donors, companies and Maori Authorities were

⁶⁹ New Zealand Business Roundtable, above n 68 at 49.

⁷⁰ Policy Advice Division, Inland Revenue Department. “Tax and Charities – A government discussion document on taxation issues relating to charities and non-profit bodies” (June 2001) at www.ird.govt.nz.

⁷¹ Tax and Charities, above n 70 at §9.2 – §9.5.

⁷² Tax and Charities, above n 70 at §9.6.

⁷³ Tax and Charities, above n 70 at §9.6.

⁷⁴ Tax and Charities, above n 70 at §9.7.

adopted by the removal of the caps on donations and deductions.⁷⁵ However, the issue of taxing the trading activities of charities was not pursued further by the government.

⁷⁵ See Taxation (Business Taxation and Remedial Matters) Act 2007 (19 December 2007) No 109.

Appendix 2

**“VET CLUBS”
VETERINARY SERVICES BODIES
AND THEIR FISCAL PRIVILEGES**

**A REPORT
TO THE DIRECTORS,
[REDACTED]**

Dr Michael Gousmett FCIS PhD

15 November 2015

Veterinary clubs, societies or associations, and similar organisations which carry on trading activities should be subject to income tax in respect of the profits derived from such activities.

Ross Committee (October 1967)

The main advantage [of the exemption from income tax] lies with the ability of these bodies to effectively re-invest their total profits in the provision of necessary infrastructure ... The concession is effectively one of allowing these activities to grow at a faster speed ... Over time, these exemptions are likely to be withdrawn.

OECD Working Party on Agricultural Policies and Markets (2005)

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Executive Summary

Since 1951 veterinary services bodies, that is veterinary clubs and the Veterinary Services Council, have benefited from a concession which exempts them from income tax. This concession followed the creation of such bodies in 1946 following the introduction of the Veterinary Services Act in post-WWII New Zealand. The rationale for the concession was that the functions of veterinary clubs, as well as herd improvement associations which were also granted an exemption from income tax, were “of national importance and they should be exempt from tax accordingly.” Times have moved on and while the rationale was applicable at that time, New Zealand’s economic situation is now quite different from that of sixty years ago. However, there are certain entities that describe themselves as “vet clubs” which are anything but, and use the income tax exemption to gain a distinct competitive advantage over their for-profit competitors. This competitive advantage through the ability to accumulate funds at faster rate than that of their for-profit entities is due not only to the exemption from income tax, but also to the exemption from resident withholding tax which was introduced in 1989. In 2001 a submission to the Tax Review described the income tax concession as an anachronism. Further, even the OECD had concerns in 2005 about such a concession, as well as tax experts in New Zealand since 1967.

This research paper explores the history of the income tax concession for veterinary services bodies, as well as that of RWT, and provides a number of case studies to demonstrate how these concessions are being used in a manner that was unlikely to have been contemplated by Parliament on their introduction. Finally, the paper concludes that the Income Tax Act 2007 requires amendment to ensure that such concessions are applicable only to bona-fide non-profit veterinary services bodies as intended by Parliament in 1955.

Part A The Income Tax Concession

Part A of this research paper explores the history of the veterinary services bodies and their income tax concession, and discusses the findings of various tax experts on the issue, including the classification of the concession as a tax expenditure.

Introduction

Following discussions in 2014 and further communications in 2015 to the Hon Todd McClay, the Minister of Revenue, the author was approached with a request for a report on the income tax exemption granted to veterinary services in 1955 which, in the 21st century, is now considered by some commercial veterinary practices (“the group”) as a matter of tax policy to be wholly unnecessary and unfair. In 2014 the Minister wrote to [REDACTED], the representative of the group, noting that:⁷⁶

- New Zealand has a broad base low rate system;
- Officials had reviewed the latest financial statements filed with the Companies Office by 12 qualifying veterinary clubs;
- The annual net profit of those clubs was about \$2.3 million;
- Income tax forgone on that amount was about \$600,000;
- The clubs are required to have commercial arrangements between themselves and their members which should limit any excesses;
- As non-profit bodies the clubs are prohibited from distributing profits or gains back to their members;
- Officials have been asked to further consider this issue when the tax policy work programme is next renewed later in the current year.

On 16 February 2015 [REDACTED] wrote to the Minister observing:⁷⁷

- The benefits that the forgone income tax would provide to the revenue base, noting the broad base law rate system used in New Zealand;
- That substantial assets may be being created without proper consultation with the members of veterinary clubs and that the excesses may not be limited;
- That there is evidence of abuse of the tax system through the payment of bonuses to veterinarians to reduce profits and rebates being allocated in the following financial year;

⁷⁶ Letter from the Minister of Revenue, Hon Todd McClay, to [REDACTED], 22 April 2014.

⁷⁷ Letter to Hon Todd McClay from [REDACTED], 16 February 2015.

- According to *The Daily Post*, the Rotorua Veterinary Club spent \$1 million to provide high end facilities that intentionally benefit non-members as well as subsidising associated services.⁷⁸ However, in 2014 NZ AgriVet reported that the cost of the refurbishment was \$1.5 million.⁷⁹

The Origin of Veterinary Clubs

In 1985, as a project for the Kellogg's Rural Leadership Course, Alan Grant of Lincoln University wrote an excellent study on the history of the veterinary club movement in New Zealand.⁸⁰ Grant considered that at that time the history of the development of veterinary services in New Zealand could be divided into three phases:⁸¹

1. Pre 1946 – as farming developed in New Zealand post WWII the need for an adequate veterinary service was identified;
2. 1946 to 1970 – the Veterinary Services Council (VSC) was created by the Veterinary Services Act 1946 with the role of the VSC to be the establishment and maintenance of a veterinary service for farmers and the eventual graduation of students from the new veterinary faculty at Massey University;
3. Dissatisfaction with the level of funding required by the VSC from producer boards.

The establishment of the VSC followed the work of a ministerial committee in 1943 and 1944 which was tasked with investigating and making recommendations on veterinary services in New Zealand, with the recommendations becoming the basis of the Veterinary Services Act 1946 ("VSA")⁸²: "to make provision for the establishment and maintenance of veterinary services for farmers, and for that purpose to constitute a Veterinary Services Council and define its functions and powers."⁸³

⁷⁸ Julie Taylor, "Animal care staff delighted after \$1m makeover," (24 May 2010) *The Daily Post* at p. 8.

⁷⁹ Vet Profile, "Pursuing excellence in the provinces – high end care, without the high price" (2014) NZ AgriVet November/December 14 – 16 at 15.

⁸⁰ Alan Grant, "The Veterinary Club Movement in New Zealand" [A] Project for the 1985 Kellogg's Rural Leadership Course 41 pp. See also: H.G. Pearce, "Development of the club practice in New Zealand and some thoughts on its future" *Canadian Veterinary Journal* 5:6 (June 1964) 128-134; Edgar Burns, "Difficult times ... between veterinarians and farmers; Occupational control in the New Zealand veterinary club system, 1930s-1960s" *Journal of Historical Sociology* 20:4 (December 2007) 579-604; Edgar Burns, "Urged for more than fifty years: Veterinary education in New Zealand c 1900-1964" *History of Education Review* 38:1 (2009) 63-77 for a detailed discussion of the farmers vet clubs as well as vet clubs generally. Neither of these papers discuss the issue of the exemption from income tax. For an interesting historical perspective on training as a veterinary surgeon in England in the nineteenth century see Roger M. Ridley-Smith, "The apprenticeship model in [England in] 1842" *Journal of the New Zealand Medical Association* 124:1332 (15 April 2011) 3pp.

⁸¹ Grant, above n 80 at 2.

⁸² Veterinary Services Act 1946 [9 October 1946] No 26.

⁸³ Grant, above n 80 at 3.

Section 12 (1) of the VSA described the functions of the VSC as follows:⁸⁴

[t]he functions of the Council shall be to promote and encourage the provision of efficient veterinary services for owners of livestock in New Zealand; with a view to the maintenance and improvement of the health and general condition of livestock and the quality of produce derived from any livestock, and the increased production of such produce; and for those purposes to promote the training of a sufficient number of persons in veterinary science and their employment, when qualified, as veterinary surgeons.

Grant noted that “in practical terms, these functions were classified into (a) training and employment; (b) formation of a policy statement to cover the formation of veterinary clubs, and (c) the organisation of veterinary services.”⁸⁵ In particular, with respect to veterinary clubs, Grant noted that (emphasis added):⁸⁶

[t]he aim of this policy was to co-ordinate the formation of veterinary clubs throughout New Zealand and *to protect the interests of existing private veterinary practices* where they adequately covered the needs of the area they served. The policy statement provided for contracts between the new clubs and the stockowners involved, and the club and the vet or vets employed. It also provided for a salary scale to make the remuneration of club veterinarians consistent throughout the country. The Veterinary Services Council would approve the areas serviced by each new club *to ensure the economic viability [of the club]* and define the boundaries of these areas to prevent overlapping of services. The policy statement also outlined the basis and level of subsidies to veterinary clubs and to private practitioners who either serviced areas not covered by a vet club, or who were in practice in an area before the Veterinary Services Act 1946 came into force. The aim of these subsidies was obviously to encourage the formation of clubs and to a lesser degree private practices in areas not yet serviced by a club, ***and at the same time not to give the veterinary clubs an unfair trading advantage over existing private practitioners.***

The first task of the VSC was “to produce a policy statement to cover the formation of the vet clubs.”⁸⁷ By 1951 56 veterinary clubs (“vet clubs”) had been formed and, by 1955, there were 63 vet clubs employing 150 veterinary surgeons (“vets”) which, by 1985, were employing 234 vets.⁸⁸

Then, in 1955 (emphasis added):⁸⁹

⁸⁴ Veterinary Services Act, above n 82 at s 12(1); see also Grant, above n 80 at 3.

⁸⁵ Grant, above n 80 at 4.

⁸⁶ Grant, above n 80 at 4.

⁸⁷ Grant, above n 80 at 4.

⁸⁸ Grant, above n 80 at 8.

⁸⁹ Grant, above n 80 at 9.

[t]he government played its part by enacting the Land and Income Tax Amendment Act which exempted from taxation the Veterinary Services Council and veterinary clubs provided that they met certain criteria on disposal of assets should [a] club stop practicing[,] and if they provided a predominantly veterinary service. This has played a very important part in the improvement of veterinary services *by allowing all of the profits to be re-invested in better facilities or higher standards of service to farmers. It is not surprising that the advantages conferred by this [income] tax exemption are regarded as unfair by those in private practice who do not receive such an exemption.*

The VSC itself was also able to benefit from the income tax exemption as, according to Grant:⁹⁰

the VSC gave substantial financial assistance to fledging clubs in the form of direct subsid[ies] and grants, and was also expending large amounts on the training of New Zealanders at universities overseas and the bringing into New Zealand of suitably qualified foreign vets. However, it was also able to accumulate quite large sums of money in its reserve fund and accumulated fund into which any excess income from the year's operations was paid.

This gave the VSC the ability to fund its operations in later years when, in the 1970s, the VSC was “forced” to draw on its reserve and accumulated funds.⁹¹

Grant concluded his study with his view of the future of the vet clubs (emphasis added):⁹²

I see for the future the vet club movement playing an equally important part in a farmer co-operative role *providing an effective competition to the other forms of practice.* By providing sound business management and *utilising their inherent advantages of exemption from [income] taxation and generally larger scale of operation,* the farmer executive members of veterinary clubs have the very real opportunity to greatly influence the form and efficiency of the veterinary service and the cost of that service – they must not underestimate or neglect this opportunity.

And of the VSC itself? Grant saw a limited role for the VSC “as an organisation purely to act on behalf of the veterinary clubs and without its other functions, or to be handing full

⁹⁰ Grant, above n 80 at 11.

⁹¹ Grant, above n 80 at 12.

⁹² Grant, above n 80 at 33.

responsibility to the New Zealand Federation of Veterinary Clubs.”⁹³ The Federation was formed in 1976 following dissatisfaction with the VSC that many considered “was becoming too autocratic and not truly reflecting the views of the farmer executive members throughout the country.”⁹⁴

The VSC was ultimately replaced in 1994 by the Veterinary Council of New Zealand, which also took over the functions of the Veterinary Services Board which until that time had been responsible for registering and regulating vets.⁹⁵ The VSC itself had previously taken over the roles of the Dominion Federation of Farmer Veterinary Services, and the Veterinary Services Committee⁹⁶ with the Veterinary Services Committee having been formed by the New Zealand Veterinary Association in 1943; the Association was incorporated on 4 April 1924.⁹⁷

Types of Veterinary Clubs

Veterinary clubs were funded through a variety of means: grants from the Veterinary Services Council, debentures from farmers, and loans from banks and dairy companies.⁹⁸ There were three types of veterinary club:⁹⁹

- Dairy-factory clubs, which had compulsory membership of all farmers who supplied a particular factory;
- Clubs set up in association with dairy factories, but with voluntary membership;
- Clubs in dairying or meat and wool farming areas, with voluntary membership and no dairy factory involvement.

The Formation of the Veterinary Services Council

The Veterinary Services Bill was introduced into the House of Representatives on 4 October 1946 for its First Reading,¹⁰⁰ followed by its Second Reading on 7 October 1946.¹⁰¹ The Third Reading took place on 9 October 1946,¹⁰² and was given Royal Assent on that same date as the Veterinary Services Act 1946.¹⁰³

Nothing further was heard about the VSC in the House until 1950, when a question was asked concerning subsidies to veterinary clubs payable by the VSC being withheld due to issues

⁹³ Grant, above n 80 at 33.

⁹⁴ Grant, above n 80 at 21.

⁹⁵ Hamish Mavor and Bob Gumbrell, “Later developments” in *Veterinary Services* (available at www.teara.govt.nz).

⁹⁶ Mavor and Gumbrell, “Veterinary Services Council” above n 95, at [2].

⁹⁷ Mavor and Gumbrell, “New Zealand Veterinary Association” above n 95 at [2]; New Zealand Veterinary Association, No. 219096 at www.societies.govt.nz.

⁹⁸ Mavor and Gumbrell, “Types of vet clubs” above n 95 at [3].

⁹⁹ Mavor and Gumbrell, “Types of vet clubs” above n 98 at [3].

¹⁰⁰ First Readings, New Zealand Parliamentary Debates (NZPD) (4 October 1946) vol 275 at 418.

¹⁰¹ Veterinary Services Bill, NZPD (7 October 1946) vol 275 at 504.

¹⁰² Veterinary Services Bill, NZPD (9 October 1946) vol 275 at 574.

¹⁰³ Veterinary Services Act, above n 82.

over the signing of standard contracts with veterinarians.¹⁰⁴ Then, in 1952, the Veterinary Services Council Annual Report for the year ended 31 March 1952 was “referred to the Government for consideration,” but no further action was taken.¹⁰⁵

The Income Tax Acts 1946-2007

While the Veterinary Services Council was created by statute in 1946 under a Labour government (Peter Fraser), with one of its functions being the establishment of so-called “vets’ clubs,” it was not until 1955 that the VSC and its siblings were granted an exemption from income tax by the National government (Sidney Holland) when the Land and Income Tax Amendment Bill provided, at clause 8, “an exemption from income tax and from social security charge on the income derived by the Veterinary Services Council, and also veterinary clubs and herd improvement associations.”¹⁰⁶ In moving the Second Reading of the Bill on 26 October 1955, the Hon Mr Watts, Minister of Finance, stated that:¹⁰⁷

[c]lause 8 confers exemption from income tax, and, therefore, also from social security charge, [on] the income derived by the Veterinary Services Council, and also all veterinary clubs, and herd improvement associations. ***Their functions are of national importance and they should be exempt from tax accordingly.*** One condition of the exemption will be that *no individual member will be able to derive private pecuniary profit from the clubs or associations.* It is necessary to provide for the exemption to be made retrospective to 1951, to regularize the exemption which has already been granted, on the assumption – now found to be erroneous – that the present law was sufficient to grant the exemption.

What then, was that “present law” that was “now found to be erroneous?” The principal income tax legislation in force in 1951 was the Land and Income Tax Act 1923¹⁰⁸ until the legislation was consolidated and amended in 1954 in the form of the Land and Income Tax Act 1954.¹⁰⁹ There is no evidence of any amendments to the 1923 Act between 1923 and 1951 regarding veterinary services bodies, and it was not until 1955 that a specific exemption from income tax for the VSC, veterinary clubs, and herd improvement associations, was provided in the amendment to s 86 of the principal (1954) Act in the Land and Income Tax Amendment Act 1955 at s 8 (1)(oo):¹¹⁰

Income derived by the Veterinary Service Council established under the Veterinary Services Act 1946; and income derived by any veterinary club, society, or association, whether incorporated or not, which is, in the opinion of the Commissioner, established substantially or primarily for the purpose of promoting efficient veterinary services in New Zealand, if no part of the income or other

¹⁰⁴ Subsidies to Veterinary Clubs, NZPD (11 October 1950) vol 292 at 3199.

¹⁰⁵ Veterinary Services Council Annual Report, NZPD (18 July 1952) vol 297 at 410.

¹⁰⁶ Land and Income Tax Act Amendment Bill, NZPD (19 October 1955) vol 307 at 3196.

¹⁰⁷ Land and Income Tax Amendment Bill, NZPD (26 October 1955) vol 307 at 3381.

¹⁰⁸ Land and Income Tax Act 1923 [28 August 1923] No 21.

¹⁰⁹ Land and Income Tax Act 1954 [30 September 1954] No 67.

¹¹⁰ Land and Income Tax Amendment Act 1955 [27 October 1955] No 91 s 8 (1).

funds of the club, society, or association is used or available to be used for the private pecuniary profit of any proprietor, member, or shareholder thereof:

Income derived by any herd improvement society or association ...

Section 8(2) provided that the section was to apply “with respect to the tax for the year of assessment that commenced on the first day of April, nineteen hundred and fifty-one, and for every subsequent year.”¹¹¹

The proposal regarding the exemption from income tax prompted some interesting and rare debate in Parliament on the concept. In the author’s experience, little attention has been given by parliaments in common law countries to rationale for exemptions from income tax, with the exception of personal income tax concessions, particularly with respect to charities,¹¹² so to find at least some debate is significant in itself in understanding how such exemptions come to be. For that reason, the author has transcribed the debate in full because of its relevance both to this project and to tax history in particular.¹¹³

The Right Hon Mr Nash (Leader of the Opposition). - Sir, there is only one point on which the Minister might give us a little more information. He has already given the major information I required. Representations have been made in regard to the exemption of veterinary clubs from income tax. *I am not concerned about that if they are not profit making organizations, but if they carry on trade to make profit the profit so made would be taxable*, if my memory serves me rightly. The representations I have had are that a club itself is completely exempt from tax. I would have thought that the portions of the club’s income that came from ordinary activities would be all right, provided the income was non-profit income. That is probably defined as income, but in the general run of things, you can have non-profit income, and that should be free from

tax. I do not know if the representations which were made to me were also made to the Minister.

The Hon Mr Watts (Minister of Finance). - I did not get those representations, although I think they have reached the Prime Minister. A Member of the Opposition also showed me a copy of a letter.

The Right Hon. Mr Nash. – If the Minister knows about it he can answer the question. I would be glad to get the information so that I can clear my mind. *I should like to know whether anyone engaged in trading and making a profit can be exempt from tax*. Even co-operative companies are subject to tax in the ordinary way if they make a profit on their trading activities.

¹¹¹ Land and Income Tax Amendment Act, above n 36 s 8(2).

¹¹² See MJ Gousmett, “The Charitable Purposes Exemption from Income Tax: Pitt to Pemsel 1798-1891” (2009) Unpublished Doctoral Thesis, University of Canterbury at <http://hdl.handle.net/10092/3448>.

¹¹³ Land and Income Tax Amendment Bill, NZPD (26 October 1955) vol 307 3383 - 3384.

The Hon Mr Watts. – Sir, the Member for Dunedin Central showed me a copy of a letter which had been written to the Prime Minister, but which has not yet come to me in the course of business.¹¹⁴ The letter contained representations from a private veterinarian, who said *that the provisions of this Bill would make the position of veterinary clubs more favourable than that of private veterinarians.* On the face of it I cannot see that. This veterinarian went on to say that the veterinary clubs went in for a fair amount of trading; they sold drugs, vaccines, treatments, and so on, and in that way they engaged in trading. *As they did not pay tax, they put the private veterinarians at a disadvantage.*

The Hon Mr Skinner. – A private veterinarian does that sort of trading.

The Hon Mr Watts. – Yes, but he has to pay tax on the profit he makes on the sale of vaccines and so on. First of all, the Bill provides that no shareholder or member of or a private person connected with a veterinary club shall make any profit out of the dealings of that club. If he does, then it would be taxable. Secondly, *the inquiries that we have made so far lead us to believe that there is very little trading by veterinary clubs. It is so small that it is not worth doing anything about at this stage.* They are not in the same position as dairy companies, which do a lot of trading. The veterinary clubs might carry some

vaccines or drugs for the convenience of their members, but they sell them at cost or a little above cost. There is nothing involved in this, but between now and the next session I shall get the Department of Agriculture to make some further inquiries so that I can see whether there is anything in the representations that have been made, *not so much from the point of view of protecting the private veterinarians, because I think they are rare and are in such great demand that they need no protection, but from the point of view of protecting the revenue against a growth of private trading which I do not think would be particularly desirable.* We would then have a look to see *whether the trading of veterinary clubs should be taxed.* That is the position as I have found it.

The Right Hon. Mr Nash. – If the veterinary clubs do not make a profit, even though they sell goods –

The Hon. Mr Watts. – They would not be taxed.

The Right Hon. Mr Nash. – They could not be. If they engage in trading on a non-profit basis they would not be subject to tax because there would be no profit to tax.

The Hon. Mr Watts. – That is right.

Bill read a second and a third time.

¹¹⁴ The Member for Dunedin Central was the Hon George Connolly (1899-1970). The author has not

been able to locate the Member's private papers, which may have contained a copy of the letter.

A search of the New Zealand Parliamentary Debates (NZPD) in the following Parliamentary session failed to locate any material that suggested that the question of trading by vets clubs, and whether they should be taxed, was followed up by either political party. However, the author did find a reference to the VSC (as discussed above) in that in October 1965 the Controller and Auditor-General, Mr A.D. Burns, drew the attention of the Public Expenditure Committee (PEC) to a number of matters in his report, one of those being concerns about the VSC's financial position.¹¹⁵ Burns had suggested in his report “[t]hat the Council had permitted its accumulated funds and reserves to increase steadily over the years and that there should be greater utilisation of reserves before further assistance was given.”¹¹⁶ However, the PEC found:¹¹⁷

[t]hat in fact the accumulated funds and reserves had not increased over the past 10 years and that since 1962 the [VSC] had been using reserves to supplement current revenue ... [which] comes jointly from funds of the producer boards and Government and it is clear that the [VSC] is adopting a responsible attitude towards budgeting and its use of these funds. ... There appears to be no case for criticism on the grounds used in the report of the Controller and Auditor-General and the Audit Department was unable to substantiate its criticism under examination.

There are two points to note about this exchange. The first is that the ten year period referred to followed the introduction of the exemption from income tax granted to veterinary services bodies in 1955, with the second point being that no mention was made of the impact of the exemption on the funds of the VSC, even when Treasury discussed the matter of the VSC reserves with the Department of Agriculture which advised Treasury that “because of the Veterinary Services Act 1946 [neither the Department nor Treasury] had any control over the finances of the VSC.”¹¹⁸

Reports of the Veterinary Services Council

The author had expected to find reports submitted annually by the VSC to Parliament, having found a reference to such a report in the NZPD of 18 July 1952.¹¹⁹ In moving that the report “be referred to the government for consideration,” the Hon Mr Skinner considered the report to be “not only of great interest, but ... also of the greatest importance to the Dominion,

¹¹⁵ Public Expenditure Committee (PEC), “Part II – Miscellaneous matters and matters arising out of the Controller and Auditor-General’s Report” (1966) Appendix to the Journals of the House of Representatives vol III Reports of Select Committees I12 at p. 14.

¹¹⁶ PEC, above n 115 at p. 14

¹¹⁷ PEC, above n 115 at p. 14

¹¹⁸ Report of the Controller and Auditor-General, “Veterinary Services Council” (1965) Appendix to the Journal of the House of Representatives vol I B.1 Part II at p. 40

¹¹⁹ NZPD, “Veterinary Services Council Annual Report” (18 July 1952) vol 297 at 410.

because we depend so much on the production of live-stock for a huge proportion of our national income.”¹²⁰

However, a thorough search of the Journals to the House of Representatives for 18 July 1952 and of the volumes of the Appendix to the Journals of the House of Representatives from 1946 to 1972 failed to locate any such reports. The only item that was found (as discussed above) was the reference to a matter arising out of a report by the Controller and Auditor-General to the Public Expenditure Committee concerning the utilisation by the VSC of its accumulated funds and reserves which the Council “had permitted ... to increase steadily over the years and that there should be greater utilisation of reserves before further assistance was given.”¹²¹ The Committee was of the opinion that there was “no case for criticism [of the VSC] ... and the Audit Department was unable to substantiate its criticism under examination [having failed to undertake] an adequate in-depth investigation.”¹²²

The New Zealand Veterinary Association

On 25 January 1952 the New Zealand Veterinary Association decided, at its Annual General Meeting, to publish its own official journal, the New Zealand Veterinary Journal (NZVJ) to provide a service to the Association’s 179 members.¹²³ In his Presidential Address to the Association on 12 February 1954, the President, Mr A.D.M. Laing, M.R.C.V.S., referred to the role of the Farmers’ Veterinary Clubs, describing the function of the veterinary clubs as the development “[of] veterinary services for farmers by veterinary surgeons.”¹²⁴ In a later letter published in the NZVJ to explain a point that Laing had made in his address concerning subsidies, Laing stated that the funding of £100,000 provided from “public and semi-public money received by the Veterinary Services Council is to be directly or indirectly used to support the veterinary club system.”¹²⁵ Laing also stated that:¹²⁶

[t]here is room in New Zealand for both types of clinical veterinary service, individual private practice, and farmer-controlled veterinary clubs, and for reasonable competition between them. *But such competition must not be unfair through the one-sided use of public funds* controlled by a body such as the Veterinary Services Council.

¹²⁰ NZPD, above n 119 at 410.

¹²¹ Public Expenditure Committee (PEC), “Part II Miscellaneous matters arising out of Controller and Auditor-General’s Report – Veterinary Services Council” (1966) Appendix to the Journals of the House of Representatives vol III I Reports of Select Committees I. 12 at p. 14.

¹²² PEC, above n 121 at p. 15.

¹²³ J.M. Filmer, “Foreword” *The New Zealand Veterinary Journal (NZVJ)*, (1952-1953) vol 1 at 1. The New Zealand Veterinary Association was founded in 1923 – see *NZVJ* (1954) vol 2 at 62.

¹²⁴ A.D.M.G. Laing, “The History and Development of the Veterinary Profession in New Zealand” *NZVJ* (1954) vol 2 iss 3 61 - 68 at 67.

¹²⁵ A.D.M.G. Laing, “Correspondence” *NZVJ* vol 2 at 141.

¹²⁶ Laing, above n 125

This statement predated the introduction of the exemption from income tax for veterinary services bodies in 1955. The question is, was the introduction of the concession in 1955 seen by private veterinary practices as giving an unfair advantage to the veterinary clubs? Writing in the same edition of the NZVJ in which Laing's letter was published, a letter from a private veterinary surgeon suggests that there were such concerns in 1954, as the author of a letter, A.E.N. Egan B.V.Sc., was of the opinion that the achievements of the VSC were "made possible by sub-cost fees, levies and government subsidies." Significantly, however, Egan stated that (emphasis added):¹²⁷

[r]ecently, *comment was made on the taxing of the profits of these subsidized clubs* and at the same time it was considered desirable that the Veterinary Services Council be empowered to increase its expenditure in continuation of its subsidies. The aspect which is most prone to criticism is the fact that the Veterinary Services Council has so exceeded its aims in the promotion of veterinary services in an unresponsive community that, in some areas, it is now *subsidizing what appears to be a lucrative business*; a business controlled by and for lay persons and which, in some cases, is *in competition with private practice*. The latter is an extremely objectionable feature and is certainly not permissible ethically.

Another veterinary surgeon noted in his letter in 1955 that the VSC was "[a] body which subsidizes clubs which are *a burden on taxation* [yet] refuses to extend subsidies to those farmers who prefer to support private practice (emphasis added)."¹²⁸

A review of the NZVJ through to 1965 revealed little on the issue of the income tax exemption for veterinary services. In fact, the only comment was that in a letter by R. Jackson B.V.Sc, of the Lower Maitāwhiri Farmers' Veterinary Club, in which he wrote that:¹²⁹

[t]he *tax free* [sic] profits from drug sales are used by some clubs to help keep visit fees at a ridiculously low level, in one case as low as 5s. A fee of 7s 6d for a bovine Caesarean section has been, and probably still is, charged by some clubs. Is it any wonder that a farmer would consider 2s 6d per animal too high a fee for tuberculin testing?

Of interest, however, was the observation by M.B. Buddle B.V.Sc, D.Sc, President of the New Zealand Veterinary Association, in his Presidential Address in 1964, that:¹³⁰

¹²⁷ A.N. Egan, "Correspondence" *NZVJ* (1954) vol 2 141 – 142 at 142.

¹²⁸ Y.H. Leewenburg, "Correspondence" *NZVJ* (1955) vol 3 82 – 83 at 83.

¹²⁹ R. Jackson, "Drug sales and the veterinarian" *The New Zealand Veterinary Journal* (1961) 9:4 at 81.

¹³⁰ M. V. Buddle, "Presidential Address" *The New Zealand Veterinary Journal* (1964) 12:3 43 - 48 at 46.

[o]ur association is vitally interested in the current considerations of the future responsibilities of the Veterinary Services Council, particularly as to its role as the co-ordinating body for the veterinary club system with which more than half of our members are directly associated.

Herd Improvement Associations

What also of the herd improvement associations to which the exemption from income tax also applied? A review of the Societies Register reveals that of the ten herd improvement associations registered, only three are currently registered, with one of those being of the same name as an entity previously struck off, The Normal Herd Improvement Society Limited.¹³¹ Interestingly, of the ten entities, five were incorporated under the Incorporated Societies Act 1908 and five under the Industrial and Provident Societies Act 1908. Only one of the three currently registered entities had ever filed its financial statements, those of The Umawera Herd Improvement Society.¹³² It was with some surprise to read that the Society, in its notes to the financial statements declared that the Society, which was incorporated under the Incorporated Societies Act 1908 on 14 May 2002, “meets the test for an income tax exemption as its net assessable taxable surplus is less than \$1,000 per annum,”¹³³ especially as the Income Statement reported a net surplus of \$90,654 for the year ended 31 May 2014 (2013: net deficit \$43,884.)¹³⁴ The Note continued: “[a]s such, the [Society] is not subject to income tax under the Income Tax Act 2007.”¹³⁵ It would appear that the Society had applied the concession for non-profit organisations at s DV 8 of the Income Tax Act 2007 of \$1,000 rather than the exemption from income tax provided under the Income Tax Act 2007 at s CW 51 that is available to it as a herd improvement society. What was even more intriguing to read in the Society’s rules as one of its objects was the ability to apply for a licence under the Sale of Liquor Act 1962. However, the Society did not report a bar trading account in its audited financial statements, nor did it report any associated stock on hand ...

Of more concern, however, was to read the objects and then to attempt to relate the objects to the financial activities of the Society, as the objects make no mention of trading in livestock, yet that is precisely what the Society does to the exclusion of anything else in its objects, such as:¹³⁶

- Train, promote, develop, research, implement and practice farming techniques ... ;
- Provide facilities for, promote, organise, regulate, hold and conduct ... research events ... ;
- Promote, encourage and assist participation in training and research ... by its members ... ;
- Be a member, affiliate or be associated in any other way with any other organisations with similar and/or compatible objects ... ;
- Recognise, promote and support Federated Farmers of New Zealand ... ;

¹³¹ The Normal Herd Improvement Society Limited, No. 2220730 at www.societies.govt.nz.

¹³² The Umawera Herd Improvement Society, No. 1212035 at www.societies.govt.nz.

¹³³ The Umawera Herd Improvement Society, above n 132 Notes to and forming part of the Financial Statements Note 1(d) at p. 10.

¹³⁴ The Umawera Herd Improvement Society, above n 132 Income Statement for the year ended 31 May 2014 at p. 6.

¹³⁵ The Umawera Herd Improvement Society, above n 132 at p. 6.

¹³⁶ The Umawera Herd Improvement Society, above n 132, Rules, Objects at Clause 3.1.

- Promote, encourage and assist members and supporters in the research, development, education, maintenance transportation, storage, use (or otherwise howsoever) of research projects ... ;
- Establish (when appropriate), maintain and conduct Society rooms facilities and generally afford to its members and invitees the accommodation, advantages, privileges and conveniences of a Society, and to conduct such social activities ... ;
- To apply for obtain and from time to time renew a Society Licence pursuant to the provisions of the Sale of Liquor Act 1962 ... ;
- Generally to service the needs and requirements of members, affiliates, supporters and sponsors of Dairy Herd Improvement;
- Act in good faith and loyalty to ensure the maintenance and enhancement of Dairy Herd Improvement ... ;
- At all times to operate and co-operate with, and promote, mutual trust and confidence between Dairy Herd Improvement, its members, affiliates, supporters and sponsors in pursuit of these objects;
- At all times to act on behalf of and in the interests of, its members, affiliates, supporters and research.

While it might seem unfair to single out this Society, this does raise the issue of what the intention was behind the exemption from income tax when it was introduced, and how it is being applied in practice, at least by this particular entity. Given that the Society's financial activities are purely trading, with no evidence of any expenditure on the items listed as the Society's objects, is it fair, in terms of tax policy, that the income tax exemption at s CW 51 should continue to be available to the Society?

Of the two remaining registered herd improvement bodies, The New Zealand Herd Improvement Society Incorporated appears to have been in financial difficulties with no financial statements filed since being incorporated on 18 May 2007, with three Property Law Notices filed by Rabobank New Zealand Limited attached to the Society's file on the Societies Register.¹³⁷ The other, The Normal Herd Improvement Society Limited, an Industrial and Provident Society incorporated on 24 June 2014, has yet to file any financial statements.¹³⁸ An organization with an identical name was incorporated on 17 March 2009 but struck off on 17 March 2014 without any financial statements having been filed.

A final comment – of the ten herd improvement entities listed on the Societies Register, the earliest date of incorporation was The Waikato Herd Improvement Society on 13 June 2001, but the Society was struck off on 17 June 2004.

Given that the exemption for herd improvement societies was first granted in 1955, why were so few such bodies registered and, given the importance of the dairy industry to the New

¹³⁷ The New Zealand Herd Improvement Society, No. 1944907 at www.societies.govt.nz.

¹³⁸ The Normal Herd Improvement Society, No. 2607863 at www.societies.govt.nz.

Zealand economy, why are there so few today, with only one that appears to be financially viable but with questions concerning its activities?

The Income Tax Act 2007

Today, the format and wording of the relevant section in the Income Tax Act 2007 that provides an exemption from income tax to veterinary associations, clubs and societies differs from that of 1955, as seen in s CW 50 Veterinary services bodies:¹³⁹

Exempt income: veterinary clubs

- (2) An amount of income derived by a veterinary association, club, or society is exempt income if –
- (c) the association, club, or society was established mainly to promote efficient veterinary services in New Zealand; and
 - (d) none of its funds is used or available to be used for the private pecuniary profit of a member, proprietor, shareholder, or associate of any of them.

Exempt income: Veterinary Council

An amount of income derived by the Veterinary Council of New Zealand is exempt income.

The intent of s CW 50(1)(b) was broadened as part of the rewriting of the Income Tax Act 1994, which was finally completed on the passing of the Income Tax Act 2007 on 1 November 2007, by adding the term “associate” into the existing section CB 4(1)(f) on the basis that “the policy underlying [the wording ‘proprietor, member or shareholder’] is defeated if any person, not just a proprietor, member, or shareholder, is able to obtain a pecuniary profit.”¹⁴⁰

The exemption from income tax for herd improvement bodies now resides in s CW 51 Herd improvement bodies of the Income Tax Act 2007:

An amount of income derived by a herd improvement association or society is exempt income if –

- (c) the association or society was established mainly to promote the improvement of the standard of dairy cattle in New Zealand; and

¹³⁹ Income Tax Act 2007 [1 November 2007] No 97 (reprinted as at 1 April 2015).

¹⁴⁰ Rewriting the Income Tax Act 1994 – Exposure Draft Part C: Income, CW Exempt Income at 220 (available at <http://taxpolicy.ird.govt.nz>). Note that neither of the two issues papers that were written by the Policy Advice Division of Inland Revenue, their purpose being “to promote discussion of minor policy issues relating to policy intent or clarification of legislation that arise from the rewrite, and to seek comment from interested parties,” discussed the veterinary services exemptions. See Policy Advice Division, Inland Revenue, “Rewriting the Income Tax Act [1994]: Parts C, D, and E” (March 1998) Issues Paper 1; (June 1998) Issues Paper 2.

- (d) none of its funds is used or available to be used for the private pecuniary profit of a member, proprietor, shareholder, or associate of any of them.

Taxation Reviews

Report of the Royal Commission on Land and Income Taxation (1924)

The 1924 Report of the Royal Commission on Land and Income Taxation provides a precursor to the creation in 1946 of the Veterinary Services Council over two decades later.¹⁴¹ In his submission, Mr P.J. Small, President of the Dairy-farmers' Union Incorporated (Wellington Branch), stated that:¹⁴²

[e]ach dairy farmer today has to be a practical veterinary surgeon to be able to live at all. He starts the beginning of the season with a good herd of cows. I know a man who paid £80 an acre for some of the richest land in New Zealand. He paid a high price for high-grade Jerseys, and his neighbour was envious of him. His neighbours thought that that was the proper way to go about dairy-farming. But at the end of the season there was only one cow left. (How is that man to pay his land tax?)

Report of the Taxation Committee (Gibbs Report) (1951)

While the Report of the Taxation Committee of 1951, chaired by Mr T.N. Gibbs (Gibbs Report, predated the exemption from income tax granted to veterinary service bodies in 1955, the report is enlightening from the fact of what was not discussed as much as what was.¹⁴³ While farming production was a matter that was discussed in the Gibbs Report, no reference was made to support services such as veterinary surgeons. Yet in presenting the Financial Statement for 1952 and proposed tax revisions, the value of the primary sector to the economy was acknowledged by the Prime Minister, the Hon. Mr Holland, who stated that in the previous financial year, the sector had “exported £237 million worth of goods ... It is vital to the expansion of our primary industries that they should prosper and thrive, and that the number of successful farmers on the land should increase in proportion as the total population grows.”¹⁴⁴

¹⁴¹ Report of the Royal Commission on Land and Income Taxation, (1924) Appendix to the Journals of the House of Representatives at B5.

¹⁴² Report, above n 141 at p. 254.

¹⁴³ Report of the Taxation Committee, (1951) Appendix to the Journals of the House of Representatives B. Finance at B8.

¹⁴⁴ Financial Statement, (7 August 1952) NZPD vol 297 at 795.

Report of the Taxation Review Committee (Ross Committee) (1967)

In 1967 the Report of the Taxation Review Committee, chaired by L.N. Ross, (the Ross Committee,) in commenting on the veterinary clubs under s 86 (1)(00) of the Land and Income Tax Act 1954, noted that:¹⁴⁵

[m]any of these veterinary clubs carry on quite extensive business activities in the supply of stock medicines and veterinary services to members and others. They thus compete both in buying and selling markets with other forms of enterprise whose profits are subject to taxation. *It is in keeping with our recommendations regarding the taxation of business profits of other exempt organisations [ie trading charities] that veterinary and other similar clubs and societies or associations should be subject to tax on the profits derived from trading activities.*

Accordingly, the Ross Committee recommended that “[v]eterinary clubs, societies or associations, and similar organisations which carry on trading activities should be subject to income tax in respect of such activities.”¹⁴⁶

However, a review of the New Zealand Parliamentary Debates following the tabling of the report in the House from 1967 through to 1970 suggests that this recommendation was not even debated, let alone implemented as a budgetary measure.

Report of the Task Force on Tax Reform (McCaw Report) (1982)

The Report of the Tax Force on Tax Reform,¹⁴⁷ chaired by P.M. McCaw (McCaw Report), whose Terms of Reference required the Task Force amongst other requirements “[t]o undertake a thorough and systematic review of all aspects of central government,”¹⁴⁸ made no mention of the exemption from income tax granted to veterinary clubs. However, the Task Force did consider tax issues concerning life insurance and superannuation, building societies, co-operatives, and charitable organisations.¹⁴⁹ An explanation for not considering veterinary clubs may be because “[a] consideration of the policy objectives giving rise to concessions and incentives was not a part of [the Task Forces’] terms of reference.”¹⁵⁰ However, the Task

¹⁴⁵ The Taxation Review Committee, “Taxation in New Zealand Report of the Taxation Review Committee” (Ross Committee) (October 1967) Wellington, R.E. Owen, Government Printer at §783.

¹⁴⁶ Ross Committee, above n 43 at p. 323. The Ross Committee also recommended at p. 313 that “[p]rofits from trading derived directly or indirectly by charitable organisations and dividends derived from any company substantially owned by such organisations are assessable for income tax at normal rates.”

¹⁴⁷ Task Force on Tax Reform, “Report of the Task Force on Tax Reform” (7 April 1982) 265 pp. The McCaw Report was the third official Report on Tax Reform post-WWII, the first being the Report of the Taxation Committee in 1951, chaired by T.N. Gibbs, which dealt only with the reform of income tax, and the second, the Ross Committee in 1967. See B.M. Niculescu, “The McCaw Report on Tax Reform” (1982) 16 *New Zealand Economic Papers* 28 – 40 at 31.

¹⁴⁸ Task Force on Tax Reform, above n 44 (a) at (i).

¹⁴⁹ Task Force on Tax Reform, above n 44 Ch 12 Special Cases at 242.

¹⁵⁰ Task Force on Tax Reform, above n 44 at 7.

Force recognised that “[b]ased on information made available [to the Task Force], the cost of business incentives in revenue forgone is in the vicinity of \$470 million per annum,” with a “strong” recommendation that those incentives “be subject to a rigorous assessment of costs and effectiveness on a regular basis,”¹⁵¹ thus foreshadowing the debate on the concept of tax expenditures as seen in its recommendation of “a more explicit accounting of all concessions and incentives to improve government management procedures in this area.”¹⁵² It was in this regard that the Task Force discussed the concept of tax expenditure budgeting, (see following discussion at “Income Tax Concessions as Tax Expenditures”) noting that in order “[t]o meet the fundamental objectives of government accountability and [to achieve] efficient and effective management, requires, as a first step, more explicit accounting of the cost of tax expenditures and their allocation (where possible) to the government’s economic and social programmes.”¹⁵³ Of significance is the observation by the Task Force that “[b]ecause they escape effective government control, **tax expenditures seem to be more difficult to terminate.**”¹⁵⁴ Further, the Task Force also considered that “concessions intended to act as incentives ... [that are] provided through the tax system [are] inefficient.”¹⁵⁵

However, in addition to those categories mentioned above, the Task Force considered that wealth taxes and trusts were also areas where there “appears to be a clear need for reform of some kind.”¹⁵⁶ The driver for such reforms were concerns by the Task Force “**where the fairness of the system is most in question** and ... the source of erosion of the acceptability of the system in the absence of reform.”¹⁵⁷

Finally, regarding an issue which parallels the subject of this report, i.e. the income tax exemption of commercial trading activities undertaken by charities within the same sector as income tax liable for-profit entities, the Task Force recommended that while charitable organisations should be permitted “to undertake their traditional fundraising activities, at the same time [**the government**] **should minimise the scope for avoidance and reduce the advantages accruing to [income-tax exempt] charities which operate in competition with taxable businesses.**”¹⁵⁸ The same argument could clearly also have been made for veterinary clubs. The question is: did for-profit veterinary practices see this as a threat in 1982, or has the issue only become more prominent in recent years? One hundred submissions were made to the Task Force, but the only farmer-focused groups to do so were the Ministry of

¹⁵¹ Task Force on Tax Reform, above n 44 at 7.

¹⁵² Task Force on Tax Reform, above n 44 at 7.

¹⁵³ Task Force on Tax Reform, above n 44, 4.7 at 62. The creation of the term “tax expenditure” is a concept largely credited to former United States Assistant Secretary of the Treasury for Tax Policy, Stanley Surrey, which the [US] Budget Reform Act of 1974 defined as “[t]hose revenue losses attributable to the provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide special credit, a preferential rate of tax, or a deferral of tax liability” Stanley S. Surrey, “The Tax Expenditure Concept and the Budget Reform Act of 1974” (1976) 17 *Boston College Law Review* 679 - 736 at 683.

¹⁵⁴ Task Force on Tax Reform, above n 44 4.8 at 63 (emphasis added).

¹⁵⁵ Task Force on Tax Reform, above n 44 4.11 at 63.

¹⁵⁶ Task Force on Tax Reform, above n 44 1.12 at 7.

¹⁵⁷ Task Force on Tax Reform, above n 44 1.11 at 7.

¹⁵⁸ Task Force on Tax Reform, above n 44 12.57 at 254 (emphasis added).

Agriculture and Fisheries, and Federated Farmers of New Zealand.¹⁵⁹ However, it must not be overlooked that “both the Ross Committee [1967] and the McCaw Report [1982] suffered from the same major disability: “the lack of relevant data,” with the McCaw committee being “both surprised and frustrated by the lack of reasonably up-to-date statistical information which could be made available to [the committee].”¹⁶⁰

Government Economic Statement (1987)

In 1987 the Minister of Finance, Roger Douglas, released his alternative economic statement¹⁶¹ in which he proposed a raft of controversial measures, including the taxation of charities.¹⁶² Amongst other measures, Douglas proposed the removal of personal tax rebates and deductions,¹⁶³ alternative funding support for charitable activities,¹⁶⁴ a reduction in the company tax rate,¹⁶⁵ the taxation of superannuation funds, life offices and related organisations,¹⁶⁶ measures to eliminate tax avoidance and to broaden the tax base by introducing a tougher international tax regime, taxing exempt organisations at normal rates and a new petroleum mining tax regime.¹⁶⁷ Douglas specifically targeted charities and sporting bodies, mutual associations, primary producer co-operative companies, primary producer and marketing boards, and milk treatment companies.¹⁶⁸ Douglas also intended to withdraw tax exemptions that “were intended to assist the farming sector,” such as “special tax concessions for primary producer co-operatives,” which he considered provided “opportunities for tax avoidance [as well as] distorting investment patterns.”¹⁶⁹ However, Douglas made no specific mention of the exemption provided to the VSC and veterinary clubs as provided at s 61 (28) nor of herd improvement societies or associations at s 61 (29) of the Income Tax Act 1976.¹⁷⁰

Report of the Committee of Experts on Tax Compliance (1998)

The issue of the exemption from income tax provided to certain organisations was also raised in the Report of the Committee of Experts on Tax Compliance in 1998.¹⁷¹ The report noted that (emphasis added):¹⁷²

¹⁵⁹ Task Force on Tax Reform, above n 44 Appendix A at 261-264.

¹⁶⁰ Niculescu, above n 44 at 39.

¹⁶¹ Roger Douglas, “Government Economic Statement” (17 December 1987) Government Printer 68pp.

¹⁶² See MJ Gousmett, “1987: Roger Douglas’ failed attempt to tax charities” (December 2013) 19:4 *New Zealand Journal of Taxation Law and Policy* 279-287.

¹⁶³ Douglas, above n 54 at 7.

¹⁶⁴ Douglas, above n 54 at 7.

¹⁶⁵ Douglas, above n 54 at 8.

¹⁶⁶ Douglas, above n 54 at 8.

¹⁶⁷ Douglas, above n 54 at 8.

¹⁶⁸ Douglas, above n 54 Annex 5 at 33-37.

¹⁶⁹ Douglas, above n 54 at 33.

¹⁷⁰ Income Tax Act 1976 [9 December 1976] No 65.

¹⁷¹ Rt Hon Sir Ian McKay, Tony Molloy, John Prebble, and John Waugh, “Tax Compliance A Report to the Treasurer and Minister of Revenue by a Committee of Experts on Tax Compliance” (December 1998).

¹⁷² McKay, above n 63 at §4.16.

[b]usiness income derived by charities is exempt from tax under section CB 4(1)(e). However, some charities may engage in business activities unrelated to the charitable purpose for which they are provided a tax exemption. *This exemption gives charities a competitive advantage over taxpaying business competitors.*

Significantly, while the committee did not specifically mention veterinary clubs, the report goes on to say that (emphasis added):¹⁷³

The committee **recommends** [sic] that the government should review the tax treatment of charities *and other tax-exempt entities that engage in commercial activities unrelated to their purposes. No reason exists in principle why business income, unrelated to the core purpose, should not be taxed.*

The committee made reference to the unrelated business income tax (UBIT) regime in the United States which is applied to trading activities undertaken by exempt organisations such as charities under § 501 (c)(3) of the Internal Revenue code, and suggested that “[t]he government may wish to refer to the relevant United States legislation in designing rules for New Zealand”¹⁷⁴ regarding unrelated trading activities. This did not happen.

However, the author considers that as well as the UBIT issue, the fact that veterinary clubs are mutual associations for the benefit of their members, if the clubs are trading with non-members, whether or not they are “commercial farmers,” is another tax policy issue that needs to be considered by the current government.

Tax Review 2001 (McLeod Report)

The report in October 2001 by the Tax Review Committee did not specifically discuss the issue of the taxation of veterinary clubs,¹⁷⁵ in spite of submissions to the contrary being raised in the June 2001 issues paper which reported that amongst “some of the other issues raised” was the taxation of “vet clubs.”¹⁷⁶ However, in its submission, the New Zealand Business Roundtable of the report noted that:¹⁷⁷

¹⁷³ McKay, above n 63 at §4.17.

¹⁷⁴ McKay, above n 63 at §4.19.

¹⁷⁵ Rob McLeod (Chair), David Patterson, Shirley Jones, Srikanta Chatterjee, and Edward Sieper, “Tax Review 2001” (available at www.treasury.govt.nz).

¹⁷⁶ Treasury, “Tax Review 2001 – Issues Paper” (20 June 2001) at Annex F Summary of Submissions F. 24 (available at www.treasury.govt.nz).

¹⁷⁷ New Zealand Business Roundtable, “Submission on the Tax Review 2001” (March 2001) at 49 at <http://nzinitiative.org.nz>.

[i]n particular, the pattern of domestic investment is distorted by significant differences in the effective marginal tax rates applying to income from alternative investments. Those differences in effective marginal tax rates arise from:

- differences in the tax treatment of different forms of income
- ...
- Differences in the income tax treatment of different entities (e.g. Maori Authorities, qualifying companies, mutual associations and cooperatives, and charities) ...

Further, the authors noted that:¹⁷⁸

[s]ome of these differences are due to practical problems associated with the assessment and collection of tax on certain types of activities ... *other differences are due to explicit decisions made by past governments to use the tax system as a means of encouraging certain 'desirable' activities and discouraging certain 'undesirable' activities.* Unfortunately, it is not clear to what extent the concessional tax treatment of certain activities is due to the practical difficulties associated with taxing those activities as opposed to a deliberate decision by the government to assist or deter certain activities. ... We believe the Review has an important role to play in affirming the view that the tax system should, as far as feasible, tax all activities and classes of entities on a neutral basis. ***It should also identify those activities that are currently subject to concessional tax treatment and determine the extent to which those concessions arise from either explicit government policies aimed at subsidising particular activities or entities, or practical income measurement problems.***

As the author has found, it was an explicit government policy that the income of veterinary clubs should be exempt from income tax, on the basis that the work of the VSC, veterinary clubs and herd improvement associations, were of “national importance.”¹⁷⁹ However, while the farming sector continues to be of national importance, the historical basis for the tax concession to encourage the development of veterinary services has long since passed.

Submission to Tax Review Committee

Noting that the McLeod Tax Review Committee had recorded a reference to the issue of the income tax exemption of veterinary services bodies, the author submitted an Official Information ACT (OIA) request to Treasury for copies of submissions made to the committee.¹⁸⁰ This request was duly fulfilled and the author found that there was one submission with which he was provided that was directly related to the concession, a copy of which is appended to this report as a separate document. The submitter, whose name has been withheld by Treasury, in noting that “[o]ver many years numerous vets (sic) have written

¹⁷⁸ New Zealand Business Roundtable, above n 68 at 49.

¹⁷⁹ See above n 33.

¹⁸⁰ The author wishes to record with appreciation the assistance accorded to him by Treasury officials in responding to his request for copies of submissions made to the McLeod tax review committee.

on this matter to MPs, Ministers of Revenue and the Inland Revenue Department without success,” also made a number of pertinent observations.¹⁸¹ In particular, the submitter stated that:¹⁸²

- The original reasons for establishing a subsidised veterinary service have long since disappeared;
- The farming industry has adapted to the removal of subsidies in a competitive economic environment [s]o why should the business of providing veterinary services by vet clubs be exempt from income tax under any circumstances in 2001?
- This tax exemption is an anachronism and an inequity that should be removed from the tax legislation;
- Some [vet] club practices have accumulated enormous assets, have turnovers of many millions of dollars and have become monopolies;
- Their existence ... provides an unfair tax advantage;
- Vet clubs have an obvious commercial advantage over private practices;
- There is no logical reason for [vet clubs] to be exempt [from income tax].

Tax and Charities (2001)

While the 2001 report “Tax and Charities” focussed specifically on the non-profit sector (although it could be argued that vet clubs are also “non-profit,” at least in theory), nevertheless there were some interesting comments made concerning the income tax exemption, trading by charities, and tax policy.¹⁸³ While the issue of competitive advantage was raised, the final price of products was competitive with for-profits, therefore pricing was not the issue.¹⁸⁴ The issue, it was suggested, was the competitive advantage a charity could gain *through the ability to accumulate tax-free profits thus enabling “a faster accumulation of funds [which would allow it] to expand more rapidly than its competitors.”*¹⁸⁵ This was *“the real competitive advantage that trading activities owned by charities have over their competitors.”*¹⁸⁶ On that basis the Discussion Paper proposed that *“[t]rading operations owned by charities would be subject to tax in the same way as other businesses,* but with an

¹⁸¹ [Anonymous], “Submission on income tax exemptions [S]ection 61 (28),” Private submission to the Tax Review Committee, 21 February 2001 provided to the author. On 26 October 2015 the author wrote to the Minister of Revenue and the Commissioner of Inland Revenue requesting copies of such correspondence, and also any subsequent correspondence on this matter as well as replies to the correspondence received. At the time of completing this report shortly afterwards, no response had been received by the author.

¹⁸² [Anonymous], above n 181.

¹⁸³ Policy Advice Division, Inland Revenue Department. “Tax and Charities – A government discussion document on taxation issues relating to charities and non-profit bodies” (June 2001) at www.ird.govt.nz.

¹⁸⁴ Tax and Charities, above n 70 at §9.2 – §9.5.

¹⁸⁵ Tax and Charities, above n 70 at §9.6.

¹⁸⁶ Tax and Charities, above n 70 at §9.6.

unlimited deduction for distributions made to relevant charitable purposes.”¹⁸⁷ Ultimately it was not until 2007 when the new concessions for charitable giving by donors, companies and Maori Authorities were adopted by the removal of the caps on donations and deductions.¹⁸⁸ However, the issue of taxing the trading activities of charities was not pursued further by the government.

OECD Working Party on Agricultural Policies and Markets (2005)

According to the OECD, the income tax exemptions provided to veterinary clubs and herd improvement societies have had their day:¹⁸⁹

185. Tax revenue from the agriculture sector [in New Zealand] is an important component of government revenue. ...

...

189. *Exempt income of veterinary clubs and herd improvement societies [s CB 4(f)-(g)].* These exemptions are historical. In the farming context they are not of any significance. ***The main advantage lies with the ability of these bodies to effectively re-invest their total profits in the provision of necessary infrastructure*** (buildings, equipment, vehicles, etc). Interest on borrowings for such infrastructure, and associate costs of depreciation and repair/maintenance are not tax deductible. ***The concession is effectively one of allowing these activities to grow at a faster speed (due to the ability to reinvest all net profits earned rather than net profits after tax).*** There is no distortion in investments decisions as a result of this measure, as the exemption applies to all income earned from the club or society. ***Over time, these exemptions are likely to be withdrawn.***

It is interesting to note also the recent report by the OECD on the taxation of small and medium-sized enterprises (SME) with one of the key findings being that “[t]he heterogeneity of the SME population means careful targeting is required to ensure that any government interventions, including tax preferences, achieve their stated policy objectives,” with careful targeting required to ensure that distortions are reduced.¹⁹⁰ The OECD also noted that “[e]xemptions may be temporary in nature, designed to ease the burden of the tax system in the first year of existence.”¹⁹¹

¹⁸⁷ Tax and Charities, above n 70 at §9.7.

¹⁸⁸ See Taxation (Business Taxation and Remedial Matters) Act 2007 (19 December 2007) No 109.

¹⁸⁹ OECD Directorate for Food, Agriculture and Fisheries Committee for Agriculture, Working Party on Agricultural Policies and Markets, “Non-sectoral Policies for the Agriculture and Agri-food Sectors: Taxation and Social Security” (4 August 2005) AGR/CA/APM (2004) 13/Final (available at www.oecd.org).

¹⁹⁰ OECD, “Taxation of SMEs in OECD and G20 Countries,” (2015) OECD Tax Policy Studies, No 23, OECD Publishing (Paris), at 14.

¹⁹¹ OECD, above n 190, at 73.

Non-profit Institutions Satellite Account: 2004

In 2007 Statistics New Zealand released the first in-depth study of the non-profit sector in New Zealand, “Non-profit Institutions Satellite Account.”¹⁹² This study was inspired by a series of similar international studies led by the Centre for Civil Society Studies, Johns Hopkins University, in Baltimore. The purpose of a satellite account is to “[rearrange] existing information in the national accounts so that an area of particular economic or social importance ... can be analysed more closely.”¹⁹³ What is of interest is to find that “veterinary clubs” were classified as a community-based organisations, alongside A & P societies, as being “in scope” for the purposes of the study while licensing trusts, also classed as community organisations, were not in scope;¹⁹⁴ “veterinary services” were classified under the subgroup “animal protection.”¹⁹⁵

Apart from a statement that “[i]t is important to note that the environment group is financially dominated by the Animal Health Board and farmers’ veterinary cooperatives,” and that “[m]uch of the contribution to GDP comes from the large employing [environment] non-profit institutions, including national and international environmental institutions, the Animal Health Board, and farmers’ veterinary cooperatives,” with “[t]he primary source of income [being] the sale of goods and services [at \$125 million or 78% of environment total income], such as veterinary services to farmers,” there is nothing specifically in the report about the contribution of veterinary clubs per se.¹⁹⁶

The different language that was used in the Statistics New Zealand report, such as veterinary club, veterinary cooperatives, veterinary services, and in another report associated with the study, veterinary associations,¹⁹⁷ suggests some confusion about the activities of these entities, given that they are not mutually inclusive. With the NFP study due to be replicated in New Zealand in the near future, this point should be made when reviewing which institutions are to be in scope for the purposes of the study, particularly when some veterinary clubs are clearly based on the for-profit model.

Income Tax Concessions as Tax Expenditures

Each year at Budget time, the government issues a Tax Expenditure Statement, the purpose of the statement being “to provide additional transparency around policy-motivated ‘expenditures’ made through the tax system.”¹⁹⁸ The first such statement was produced in 1984 and included the exemption from income tax provided to veterinary clubs and herd

¹⁹² Statistics New Zealand, “Non-profit Institutions Satellite Account: 2004” (2007) Statistics New Zealand, Wellington.

¹⁹³ Statistics New Zealand, above n 192 at 1.

¹⁹⁴ Statistics New Zealand, above n 192 at 7.

¹⁹⁵ Statistics New Zealand, above n 192 at 111.

¹⁹⁶ Statistics New Zealand, above n 192 at 59.

¹⁹⁷ Margaret Tennant, Jackie Sanders, Michael O’Brien and Charlotte Castle, “Defining the Nonprofit Sector: New Zealand” (2006) *Working Papers of The Johns Hopkins Comparative Nonprofit Sector Project* at 22 (available at www.philanthropy.org.nz.)

¹⁹⁸ Treasury, “2015 Tax Expenditure Statement” (21 May 2015) at www.treasury.govt.nz.

improvement societies, with the general objective being “[t]o encourage these organisations,” but it was not possible to provide an estimate of the cost due to there being “[i]nsufficient information available on which to base an estimate.”¹⁹⁹ The 2015 Tax Expenditure Statement was the sixth successive release of tax expenditure data, with 2010 being the first time that New Zealand had released tax expenditure data since 1984.²⁰⁰ Treasury defines tax expenditures as “[taking] the form of an exemption, allowance, preferential tax rate, deferral or offset that reduce a tax obligation to achieve a specific policy objective.”²⁰¹ The basis for disclosing tax expenditures is because they are tax provisions that are “significantly motivated” by “non-revenue policy objective[s].”²⁰² Some, such as deductions and tax credits for charitable or other public benefit gifts, are quantifiable. For example, the forecast value of the tax expenditure for 2014/2015 for donations claimed as deductions by companies is \$14 million, and for tax credits for private donations, \$236 million.²⁰³ Not all tax expenditures are reported in this way, as while the Tax Expenditure Statement lists the tax expenditures that are included in the Income Tax Act 2007, not all are quantifiable.²⁰⁴ This list includes Veterinary Services Bodies exempt income (s CW 50), as an uncoded “permanent” “business” expenditure,²⁰⁵ as well as Herd Improvement Bodies exempt income (s CW 51), also as a “permanent” “business” expenditure.²⁰⁶

Resident Withholding Tax (RWT)

Certain entities are eligible for an exemption from income tax on interest earned on bank deposits and dividend income under section 32E of the Tax Administration Act 1994,²⁰⁷ including Veterinary Services Bodies and Herd Improvement Bodies.²⁰⁸ Note that this is not a certificate for the exemption from income tax on net surpluses, as in this case the certificate only applies to interest on bank funds and dividend income. At a rate of 28% this exemption alone provides eligible organisations with a further cash advantage in addition to the exemption from income tax on net surpluses and on dividend income. The RWT was introduced in 1989 in order to “counter the substantial evasion and deferral of tax on interest and dividends that have been reported for several years, notably in the report of the McCaw task force on tax reform The Bill . . . is consistent with our objective of closing tax loopholes and of attacking tax fraud.”²⁰⁹

¹⁹⁹ Hon R.O. Douglas, “1984 Budget Part II Tables” (8 November 1984) Table 17: Income Tax Expenditures at 21.

²⁰⁰ Treasury, “2014 Tax Expenditure Statement” (15 May 2014) at www.treasury.govt.nz.

²⁰¹ Treasury, above n 200 at 1. This definition was not provided in the 2015 Tax Expenditure Statement.

²⁰² Treasury, above n 198 at 3.

²⁰³ Treasury, above n 198 Table 2 at 5.

²⁰⁴ Treasury, above n 198 Table 3 at 7.

²⁰⁵ Treasury, above n 198 Table 3 at 10.

²⁰⁶ Treasury, above n 198 Table 3 at 8.

²⁰⁷ S 32E Applications for RWT exemption certificates, *Tax Administration Act 1994* (20 December 1994) No 166.

²⁰⁸ S 32E (k), *Tax Administration Act 1994*, above n 207 which provides for “an amount that is exempt income under sections CW 38(2), CW 39(2), CW 40 to CW 52, and CW 63 of the Income Tax Act 2007 in relation to their activities in the capacity in which they derive income.”

²⁰⁹ New Zealand Parliamentary Debates, *Income Tax Amendment Bill (No 8)* (Thursday 13 April 1989).

IRD Rulings

The author was unable to locate any IRD rulings of significance with respect to the subject matter of this report.

Case Law

There is no case law of significance to the subject matter of this report. The only case directly related to a veterinary club that the author was able to identify was *Ashburton Veterinary Club (Inc.) v Hopkins* in Christchurch in 1960.²¹⁰ This case concerned a dispute over a contract between the veterinary club and a veterinarian employed by the club, the issue of the “assigned area” in which he was required to work and a restraint of trade clause should he resign. Further, as an incorporated society, the Court held that the society “was not precluded from making gains unless the gains are distributed among members. It may, therefore, as the proprietor of any ordinary business may do, protect itself against unreasonable competition on the part of a former employee,” and an injunction was issued to restrain the defendant from practicing as a veterinary surgeon for a period of one year from 10 September 1959.

There is, however, an interesting parallel with the subject matter of this report, concerning unfair competition through the effects of the exemption from income tax on private veterinary practices which would be interesting to explore in a tax court setting. It is this issue to which this report now turns by way of a financial analysis of five veterinary clubs.

²¹⁰ *Ashburton Veterinary Club (Inc.) v Hopkins* [1960] NZLR 564.

Part B Case Studies

Part B of the research paper discusses a number of case studies to illustrate how the income tax exemption is being applied contrary to Parliaments intent in 1955, and the resulting benefit of the income tax exemption to commercialised veterinary clubs.

Te Awamutu Veterinary Association Incorporated

The Te Awamutu Veterinary Association Incorporated (the Association) was incorporated on 9 March 1943 as a registered incorporated society.²¹¹ The original rules by which the Association was incorporated are no longer available on the Societies Register, with the latest set being filed on 16 April 2008.²¹² The Rules describe the objects of the Association as being to:²¹³

- 4.1 provide for members, and at the discretion of the Board and on such terms and conditions as the Board from time to time determines for non-members, a cost effective veterinary service,
- 4.2 employ qualified veterinary surgeons and other necessary staff to provide that veterinary service,
- 4.3 purchase, prepare, dispense and sell livestock remedies, medicines and supplies,
- 4.4 promote by the dissemination of information, holding of seminars or otherwise the instruction of members in livestock management, diseases, treatment, breeding, care and improvement,
- 4.5 purchase, exchange, take on lease or let real or personal property for the purposes of the Association and to borrow or raise money for any of the purposes of the Association and charge or mortgage any of its assets, and
- 4.6 apply the income of the Association solely towards the promotion and furtherance of these objects but so that except as provided at Rule 17 no portion of the Association's funds is to be paid directly or indirectly by way of bonus, dividend or otherwise to any member.

²¹¹ Te Awamutu Veterinary Association, Number 214303 at www.societies.govt.nz.

²¹² Rules of the Te Awamutu Veterinary Association (16 April 2008). Note that the Rules were sworn at Te Awamutu on 5 November 2003.

²¹³ Rules, above n 212 at Clause 4 Objects.

Further, the Rules provided that membership was available “to bona fide farmers conducting commercial farming operations,”²¹⁴ with a provision for associate members who “may receive such benefits or services as the Board from time to time authorises and may be present and speak at General Meetings but may not vote or stand for office.”²¹⁵

As an incorporated society is only required to file financial information with the Societies Registrar, and not an annual report on the activities undertaken by the society, it is difficult to ascertain whether a society is complying with its constitution based on the financial information that is filed. With respect to the Te Awamutu Veterinary Association, the financial information that has to date been filed clearly provides details of trading activities in accordance with clauses 4.1 to 4.3 above, but there is no evidence on the record of activities undertaken with respect to Clause 4.4 above. However, what is of interest from a ten year analysis from 2004 to 2013 of the financial information are increases in:²¹⁶

- rebates to sales from \$6.6 million (2.93%) to \$13.5 million (5.39%);
- gross profit to gross income from \$1.5 million (23.3%) to \$4 million (29.9%);
- net profit to total income from \$120,780 (3.9%) to \$369,095 (5.0%).
- net assets from \$2.7 million to \$6.7 million.

Of particular interest is the effect on the Association’s funds through the income tax concession, as the benefit derived by the Association from that concession from 2004 to 2013 alone, when the de facto income tax is calculated, equates to \$1.2 million with \$0.8 million of that amount having accrued since 2009.

Rotorua District Veterinary Club Incorporated

The Rotorua District Veterinary Club Incorporated was incorporated under the Incorporated Societies Act 1908 on 22 August 1944.²¹⁷ The latest version of the Constitution of the Club, dated 29 November 2005, states that “[t]he primary object of the Society [sic] is to provide efficient *large animal* veterinary services to members” (emphasis added).²¹⁸ The Constitution also states that “[t]he further objects of the Society are”:²¹⁹

- 3.2.1 To provide efficient veterinary service for non-members provided that the provision of such a service is not detrimental to the interest of members.

²¹⁴ Rules, above n 212 at Clause 5 Membership and Admission, Sub-clause 5.1.

²¹⁵ Rules, above n 212 at Clause 5 Membership and Admission, Sub-clause 5.6.

²¹⁶ Te Awamutu Veterinary Association, Financial Statements, above n 211.

²¹⁷ Rotorua District Veterinary Club Incorporated, Number 214317 at www.societies.govt.nz.

²¹⁸ Rotorua District Veterinary Club Incorporated, above n 217 at Clause 3.1.

²¹⁹ Rotorua District Veterinary Club Incorporated, above n 217 at Clause 3.2.

- 3.2.2 To employ the services of qualified veterinarians.
- 3.2.3 To retail to members and non-members, stock remedies, stock medicines, drugs, veterinary equipment and associated materials and any other classes of goods approved by the Board from time to time.
- 3.2.4 To promote and hold lectures, field days and demonstrations, and similar functions and activities for the purposes of instructing members and others in the treatment and care of their animals and in the utilisation of land for that purpose.
- 3.2.5 To establish and maintain clinics and animal hospitals in the district for use by the Society.
- 3.2.6 To provide scholarships, grants or other benefits for the purposes of encouraging and assisting persons in the pursuit of careers in large animal veterinary medicine.

The Notes to the financial statements declare that “[t]he Club [sic] is exempt from income tax by virtue of section CW 50 of the Income Tax Act 2007.”²²⁰

There is nothing in the financial statements for the years 2009 to 2014 that suggest that anything other than commercial activities are undertaken by the Society, or Club. For example, the chairman reported in 2011 (emphasis added):²²¹

The Club was very aware of the recessionary climate last year and [the CEO] has made the most of the upgrade of the Animal Hospital in Rotorua and Fonterra’s record payout. This, *along with an increase in market share*, has delivered a positive result and allowed the Club to further invest in the delivery of service to you, the members. ... The 2011 result is a tribute to all the veterinary teams (*large and small animals*) vet nurses

The CEO also made an interesting comment in his report, stating that “[h]owever, it is our diversification in servicing all animal species, employment of a motivated enthusiastic team of veterinary staff *plus attention to being price competitive* and minimising costs which have all contributed to our positive year end result.”²²² The CEO also noted the “Club’s achievement in growing market share in the rural dairy sector. ... Remaining cost effective without compromising service is the priority for The Vet Club team.”²²³

²²⁰ Rotorua District Veterinary Club Incorporated, above n 217, Financial Statements for the year ended 31 May 2009, Statement of Accounting Policies.

²²¹ Rotorua District Veterinary Club Incorporated, above n 217, Report of the Chairman 2011 at 2.

²²² Rotorua District Veterinary Club Incorporated, above n 217, Report of the CEO 2011 at 3.

²²³ Rotorua District Veterinary Club Incorporated, above n 217, Report of the CEO 2011 at 3.

The CEO also stated in his report that during the year he had “presented the 4th year veterinary students at Massey University *the advantages of working for vet clubs over private clinical practice* which was very well received. *Vet clubs remain unique as profit is not the main driver for the business.*”²²⁴

Apart from a passing reference to “continued education,” the financial statements for 2011 do not report any expenditure on its objects with respect to field days, lectures, and other means of instruction delivered to its members, as the financial statements report only on the Society’s trading and administrative functions. Director’s fees for 2011 were \$43,992 (2010: \$35,415),²²⁵ but no information is provided regarding “Other Expenses” of \$606,836.²²⁶

The financial statements for 2012 and 2013 are equally as uninformative on the non-trading activities of the Society. However, what can be extracted from the financial statements for the five years from 2009 to 2013 is that the de facto income tax on the Society’s net surpluses would amount to \$437,667, an average before de facto tax return of 11.1% and an after de facto tax of 7.9% with peaks of 18.4%:12.9% in 2010 and 17.6%:12.7% in 2013. The author argues that this concession provides a significant fiscal advantage to the Society in that the income tax forgone by the government is an indirect subsidy of the activities of the commercial trading activities of the Society, with the concession allowing the accumulation of funds towards the \$1.5 million refurbishment of the Society’s Rotorua clinic.²²⁷ A comment by the chair also demonstrates how far the Society has moved from its founding constitution in that:²²⁸

because the Club constitution allows only those with a number of production animals to be members and obtain member benefits, *the majority of its small animal clients have missed out on these benefits*. By providing NZVZ Best Practice Hospital facilities at small town pricing, all our clients will benefit.

These comments by the chair of a veterinary club are a clear indication that the rationale behind the creation of the veterinary clubs in the first place, that is, to support the development of New Zealand’s economy in the post WWII years, and of the rationale for the exemption from income tax as being in the national interest, have been forgotten by both the commercialised vet clubs and the government resulting in an unfair competitive advantage to those commercialised vet clubs in the 21st century. Further, as a society, there is an income tax concession under the Income Tax Act 2007 in section DV 8 which provides for “a deduction for the lesser of \$1,000 and the amount that would have been the organisations net income in the absence of this section.”²²⁹ However, on the basis of the mutuality principle, “trading within the circle of membership” is a non-taxable activity (with the exception of the

²²⁴ Rotorua District Veterinary Club Incorporated, above n 217, Report of the CEO at 5.

²²⁵ Rotorua District Veterinary Club Incorporated, above n 217, Notes to the Accounts 2011 at Note 4.

²²⁶ Rotorua District Veterinary Club Incorporated, above n 217, Statement of Financial Performance 2011 at 9.

²²⁷ Vet Profile, above n 79 at 15.

²²⁸ Vet Profile, above n 79 at 15.

²²⁹ Income Tax Act 2007, s DV8 Non-profit organisations at s DV8 (2).

sale of trading stock or the provision of services) with the requirement that trading by a society with non-members that can be readily accounted for is a taxable activity. It seems that these provisions are being over-riden by the income tax exemption for veterinary services as provided in section CW 50 of the Income Tax Act 2007.

Private veterinary practices have been seen as a potential threat to the financial viability of the veterinary clubs for some time, as can be seen on The Vet Club Rotorua's website where the timeline for 1957 recorded that "[t]wo enquiries have been made by private practices to open their own businesses. The Vet Club may have to stay open on Saturday mornings to stay profitable."²³⁰

Anexa FVC

Anexa FVC is a merger between Anexa Animal Health and Farmers' Vet Club (FVC Veterinary Services,) with the intention of the Board of the new entity being "to ensure [that] strong competition remains in the market ... as a farmer-led veterinary practice ... adding value to their member's farming enterprises."²³¹ The Farmers' Vet Club, trading as FVC Veterinary Services Incorporated, was established in Ngatea in 1923²³² and the Morrinsville Vet Club which, according to Anexa, was founded in 1939.²³³ FVC Veterinary Services was placed into liquidation on 20 May 2015.²³⁴

While the author has been unable to find any record of the Morrinsville Veterinary Club on the Societies Register, an article in the *New Zealand Herald* throws some light on the club.²³⁵ The Morrinsville Veterinary Club was formed in December 1938 with the following recommendations made by the committee (emphasis added):²³⁶

The veterinary officer to confine his services *to club members*;

The annual subscription to be on the basis of £2 10s for 50 cows per shed, and £3 10s for over 50 cows;

That 400 members be the minimum for the club;

That information be obtained as to the amount being spent in New Zealand in combating disease in stock and a comparison made with the amount spent on similar work in other countries.

²³⁰ The Vet Club Rotorua, "Timeline" at www.thevetclub.co.nz.

²³¹ Anexa Animal Health, "Vet Club Merger Confirmed" (2 June 2015) at www.anexa.co.nz.

²³² Companies Office, FVC Veterinary Services Incorporated, 214117 at www.societies.govt.nz.

²³³ Anexa Animal Health, above n 231. The author has not been able to identify the Morrinsville Veterinary Club on the Societies Register.

²³⁴ Companies Office, above n 232.

²³⁵ Correspondent, "Veterinary Club Morrinsville activity[:] Campaign for membership" *New Zealand Herald* (11 January 1939) at 18. The club also advertised itself as: Morrinsville District Veterinary Club (Inc.) (*New Zealand Herald* 14 April 1945 at 12); and Morrinsville District Veterinary Association (Inc.) (*New Zealand Herald* 7 March 1942 at 2).

²³⁶ Correspondent, above n 235.

Rangiora Vet Centre Limited

The Rangiora Vet Centre Limited²³⁷ is wholly owned by Vetlife Limited which was originally incorporated under the Companies Act 1995 as South Canterbury Veterinary Services Limited.²³⁸ The relationship of Vetlife to the veterinary club movement is explained on Vetlife's website: "[a]lthough Vetlife is now one of the largest veterinary organisations[s] in the South Island [with 16 clinics], it essentially is the combination of three vet clubs and a private practice, with a forward looking vision."²³⁹ Vetlife explains that the "underlying entity is the South Canterbury Vet Club which was established in the early 1950s."²⁴⁰ There is no such entity on the Societies Register, but a closer examination of the records of the South & Mid Canterbury Veterinary Club, which was incorporated as a society in 1950,²⁴¹ reveals that the financial statements for the society in 2013 were under the name South Canterbury Veterinary Club (Inc.), but in 2014 the financial statements were headed South & Mid Canterbury Veterinary Club (Inc.), with the Notes to the Financial Statements explaining that "[t]hese financial statements are of South & Mid Canterbury Veterinary Club (Inc.). [The society] is engaged in the business of property rental."²⁴² According to a notification filed with the Registrar of Societies in 2006, the name of the society was changed from "South Canterbury Veterinary Club" to "South & Mid Canterbury Veterinary Club Incorporated."²⁴³ With rental income in 2014 of \$92,950 and no income tax paid, and unsecured advances of \$1,159,308 to Veterinary Properties Limited, of which the South & Mid Canterbury Veterinary Club Incorporated is the sole shareholder,²⁴⁴ what is the nature of the income tax exempt entity to Vetlife? Do these companies argue that because the shareholder has income tax exempt status that also colour those companies commercial activities with that fiscal privilege, as in the charity sector in New Zealand?

Vetlife Ashburton²⁴⁵ was originally the Ashburton Veterinary Club Incorporated, which was incorporated as a society in 1950.²⁴⁶ The last set of financial statements filed by the society was in 1999 but the financial statements have been archived and are no longer available to the public, with the society having been struck off in 2001.²⁴⁷ Presumably the income tax exemption for the society also died at that point.

²³⁷ Companies Office, Rangiora Vet Centre Limited, Registered No. 1925207 at www.business.govt.nz.

²³⁸ Companies Office, Vetlife Limited, Registered No. 133282 at www.business.govt.nz.

²³⁹ Vetlife, "Who we are," at <http://vetlife.co.nz>.

²⁴⁰ Vetlife, above n 239.

²⁴¹ South & Mid Canterbury Veterinary Club, Registration No. 219583 at www.societies.govt.nz.

²⁴² South & Mid Canterbury Veterinary Club Inc., Notes to the Financial Statements for the year ended 28 February 2014 at Note 1.

²⁴³ South & Mid Canterbury Veterinary Club, above n 241.

²⁴⁴ Veterinary Properties Limited, Registration No. 1902013 at www.business.govt.nz.

²⁴⁵ Vetlife, above n 239.

²⁴⁶ Ashburton Veterinary Club Incorporated, No. 219568 at www.societies.govt.nz.

²⁴⁷ Ashburton Veterinary Club Incorporated, above n 246.

The Banks Peninsula Farmers' Veterinary Club Incorporated

A recent edition of *The Akaroa Mail* carried an advertisement for the forthcoming AGM of the Banks Peninsula Farmers' Vet Club,²⁴⁸ which was incorporated in 1950.²⁴⁹ The 2014 financial statements of the club state that "the nature of the society's business is leasing plant and buildings to VetLife Ltd (previously known as South & Mid Canterbury Vet Service Ltd) to continue on [sic] providing veterinary services in the Banks Peninsula District."²⁵⁰ The club's income for 2014 of \$18,747 consisted of membership fees of \$2,580, interested received of \$9,167 and rent of \$7,000. Administration expenses of \$7,616 included insurance of \$1,794, rates of \$2,289 and building repairs and maintenance of \$1,063.

The gross rent received of \$7,000 indicates a return of 4.2% on the carrying value of land and buildings of \$168,493. However, after taking rates, insurance and depreciation on the land and buildings into account at a total \$10,601, the club made a loss of \$3,600 which suggests that the income tax exemption enjoyed by the club allows it to rent its property to VetLife at a discount to the market.

There is no evidence of any direct veterinary activity by the club at all. This suggests that the club is today a landlord, which is able to offer reduced rents to a commercial operator as a consequence of the club's exemption from income tax, yet the primary object of the club as stated in its Rules of 1950 is "[t]o provide a veterinary service in that part of Banks Peninsula East of the Rabbit Fence for members of the Society and for that purpose to retain the services of a duly qualified veterinary surgeon or surgeons."²⁵¹ There is no evidence of the performance of other objects as described in the club's Rules, such as trading in medicines, drugs, or veterinary equipment,²⁵² holding lectures, field-days or demonstrations,²⁵³ or establishing and maintaining a laboratory.²⁵⁴ The question then is, to what extent is this occurring throughout New Zealand by other vet clubs, unnoticed by IRD and the Government?

²⁴⁸ [Classified Advertisements,] *The Akaroa Mail* (11 September 2015) at 19.

²⁴⁹ The Banks Peninsula Farmers' Veterinary Club, No. 219587 at www.societies.govt.nz.

²⁵⁰ The Banks Peninsula Farmers' Veterinary Club, above n 249, Notes to the Financial Statements for the year ended 31 March 2014, Note 2.

²⁵¹ The Banks Peninsula Farmers' Veterinary Club, above n 249, Rules, Objects at Clause 2(a).

²⁵² The Banks Peninsula Farmers' Veterinary Club, above n 249, Rules, Objects at Clause 2(c).

²⁵³ The Banks Peninsula Farmers' Veterinary Club, above n 249, Rules, Objects at Clause 2(d).

²⁵⁴ The Banks Peninsula Farmers' Veterinary Club, above n 249, Rules, Objects at Clause 2(e).

Part C Conclusions and Recommendations

While the income tax exemption granted to veterinary services bodies in 1955 was done so with a particular economic policy in mind, sixty years later the concession is being used in a manner that would not have been contemplated by Parliament in that the concession is being applied to commercial trading activities by veterinary services bodies thereby providing them with a distinct competitive advantage over their for-profit competitors through the retention of funds that allows a faster rate of growth that would otherwise be possible if those funds were applied to income tax liabilities. As a submitter to the 2001 Tax Review Committee stated, the concession is indeed an anachronism that should be removed from New Zealand's income tax legislation. In 2005 the OECD also noted its inappropriateness and that in due course it was likely that it would be removed, yet ten years later the concession remains.

The author respectfully recommends that the government revisit the fiscal concession with a view to amending the Income Tax Act 2007 such that only bona-fide non-profit veterinary services bodies be able to apply the concession to their benefit and that the commercial trading activities now undertaken by veterinary services bodies be liable to income tax in order to level the playing field in terms of tax equity. Neither is it acceptable that because a shareholder, being a veterinary services body, has income tax exempt status therefore the concession can also be applied to the commercial activities of the related company.

Further, the issue of the use of the RWT concession that is also available to veterinary services bodies which are engaged in commercial trading activities also needs to be addressed by the government.

In order that all affected parties may exercise their democratic right to be heard, this amendment to the Income Tax Act 2007 should be considered through the Select Committee process. If adopted by the House, provision should also be made to allow affected entities an opportunity to reorganise their financial positions to accommodate their new income tax liabilities. It is not recommended that such an amendment should be back-dated.