

Tax Working Group Public Submissions Information Release

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Tax Working Group Submission - the future of tax

Monday 30 April 2018

Submitted by email: submissions@taxworkinggroup.govt.nz

Introduction

My name is Steven Moe and I work at Parry Field Lawyers in Christchurch. I appreciate the opportunity to give recommendations to the Tax Working Group on the future of tax. I would be happy to discuss this submission if that would be of assistance by phone.

We act for a number of different clients wishing to form, or running a social enterprise. We see time and time again the issues that arise out having to choose between following a charitable trust structure, or a company structure. This submission argues that a different type of tax should be imposed on social enterprises to encourage the growth of that sector.

Tax change proposed for Social Enterprises

Summary: We argue that social enterprises are a new way of doing business and often do work which traditionally has been done by registered charities (which are tax exempt). We argue that a new legal entity form is needed and that part of that would involve some tax concessions for such entities.

Longer explanation: In the classic children's story by Hans Christian Andersen, an emperor is given new clothes which are invisible to those who are unfit to see them. So no-one dares tell him he isn't wearing anything at all. That's a bit like the current legal structures available for someone who has an idea to start a new venture which incorporates purpose beyond making profit - they are faced with a difficult choice. Do they become a company, which carries assumptions that it is for profit, with less focus on social good? Or a charity, which carries assumptions that it is not-for-profit, focusing on helping others.

Neither really fit a "social enterprise" the term used to describe businesses that act for both profit and purpose. Social enterprises combine entrepreneurial spirit with a strong dose of 'heart' as they work to make a real difference in our world. And it is not just part of a temporary trend. The 1,600 people who assembled last year in Christchurch at the Social Enterprise World Forum demonstrate that. But how should social enterprises set themselves up? Would a legal structure created for these ventures help?

Let's walk for a minute down each of the usual roads taken to map out that answer. Choosing a company structure has advantages because it is well known, and provides a return of profit to the founder through dividends or selling shares. Investors are easier to attract, although they probably won't understand a business that exists for more than profit. And, in fact, directors may feel a legal obligation to maximise shareholder returns. While the purpose-driven company may solve a critical social or environmental problem, otherwise addressed by expensive government programmes, it will be hard to access any funding from that source as they will not be a charity, which is usually required.

Down the other fork in the road, a charity may offer the ability to access grant funding, although the danger is that it may come or go. People assume a charity is doing good, and an advantage that flows from such an assumption (if it meets strict charitable purposes) is that donations are tax deductible. However, despite years of a founder's blood, sweat and tears -

which every new venture requires - the founder will not be able to have private gain, apart from a market rate salary.

Neither option truly suits our social entrepreneur, a conclusion explored in detail in the recent Ākina Foundation paper about the inadequacy of current legal structures.

What would help is a “Social Enterprise Company”, a new legal structure which takes the best of both roads described above, as well as a dash of learning from Scotland, Canada and the USA where these structures already exist. Increased legitimacy would result as the purpose is baked into the DNA through clear statements in the constitution, reporting on how it is travelling (to prevent abuse), and the ability to return capped dividends to shareholders so profits go back into the purpose.

What’s the pitch to you in Government on the case for change and in particular the tax aspects? We will end up with tax paying companies, that are also uniquely positioned to give back to their communities in ways that improve the environment, or care for disadvantaged social groups as they combine both making profit and acting with purpose. However, what if the social enterprise companies were given some tax concessions for that part of their business which would otherwise be “charitable” and tax exempt? That would be world leading and really promote social enterprise as an option. This new legal structure would ensure that when that light bulb moment happens, social entrepreneurs don’t need to reach for the number 8 wire in order to adapt, and then make do with the ill-fitting legal forms that currently exist. Social enterprises need ‘new clothes’ that fit better than the current legal structures we have.

All of us want to lead lives of purpose and meaning, and more businesses are seeking to position themselves in that direction as the old paradigms are tossed off the throne that profit and private wealth creation is king. New Zealand has the chance to be a true world leader through a new social enterprise legal structure that other countries would look to as an example, and which the next generations that follow us demand.

Recommendations

The comments above outline the reasoning for our recommendation that a different form of tax should be imposed on social enterprises.

Currently there is no legal structure that fits a social enterprise (which is both for profit and for purpose). Social entrepreneurs are forced to make the decision between forming a charitable trust or a company. If they choose to form a charitable trust, it carries the assumption that they are not-for-profit. If they choose to form a company, tax will be imposed as it normally is regardless of the fact that they are giving back to the community.

If a different form of tax was imposed on social enterprises, this would be a world-leading step for New Zealand. It would work to allow social enterprises to act for both purpose and profit as they are not tied down by the reporting obligations that come with a charitable trust or the tax obligations that come with a company not acting for the good of the community. The more social enterprises that are properly equipped to give back to the community while still making a profit, the better.

Conclusion

In conclusion, the current legal structures and consequently tax systems do not adequately fit social enterprises. The imposition of a different form of tax would be a step in the right direction to making the running of social enterprises more practical.