Tax Working Group
Te Awheawhe Tāke

Tax Working Group Public Submissions Information Release

Release Document

February 2019

taxworkingroup.govt.nz/key-documents

Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people;

[2] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [1] appearing where information has been withheld in a release document refers to section 9(2)(a).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

SUBMISSION TO THE TAX WORKING GROUP'S INTERIM REPORT

Author: Dr Michael Gousmett FGNZ PhD
[1]

30 October 2018

A SUBMISSION CONCERNING LIMITED LIABILITY COMPANIES AND THE CHARITABLE PURPOSES EXEMPTION FROM INCOME TAX

> Various sections of the Income Tax Act 2007 (ITA) define the taxation obligation of public authorities. [Certain] State enterprises and mixed-ownership enterprises are excluded from the public authorities exemption in the ITA. ... [T]his is because as commercial trading enterprises, which often compete with privately owned companies, the general principle is that they should be subject to tax on their income in the same way that private companies are, despite being owned by the Crown.
>
> *Hon Todd McClay*
> *Minister for Stated Owned Enterprises*
> *February 2016*

Introduction

Thank you for the opportunity to make a Submission in response to the Interim Report of 20 September 2018.[1]

I am making this further Submission as I believe that the Tax Working Group (TWG) has been mislead in its reliance on the Australian Henry Review concerning the charitable purposes exemption from income tax and commercial activities, and has failed to take into consideration the views of many tax experts in New Zealand, beginning with the Ross Committee in 1969, as well as English case law from the 1920s. A summary of the tax reviews is included at Appendix 1. Further, the specific issue is that of the unrelated trading by charities, one which was resolved in England in the 1920s, where a pragmatic approach is now taken based on the scale of

[1] Tax Working Group, "Future of Tax *Interim Report*" (Interim Report) (20 September 2018) at https://taxworkinggroup.govt.nz/resources/future-tax-interim-report.

commercial operations in order that small scale businesses operated by charities are not unduly disadvantaged, as described in the author's Submission of 30 April 2018 to the TWG.

The author's opinion on this issue can be summarised as follows:

- Previous tax reviews have argued for the taxation of commercial activities undertaken by charities (see Appendix 1);
- The issue, based on tax policies developed in England, concerns trading activities that are unrelated to the charitable purposes of the entity and are therefore liable to income tax;
- The ability to accumulate cash is a direct consequence of not having to pay income tax and provides an entity with a clear advantage over a competitor that is an income tax-payer;
- The underlying issue, which dates from Adam Smith is unchanged – that of equity and fairness in tax policy;
- The Income Tax Act 2007 already contains provisions that allows companies and Maori Authorities to claim donations to donee organisations, of which registered tax charities are a subset, to the extent of their taxable income as deductible items thereby reducing their income tax obligations. Requiring charity-related companies to conform does not create any additional compliance costs, and no more than any other company that already makes such donations, currently at a cost to the revenue currently forecast for the 2017/2018 year at $15 million.[2]
- This issue is one that needs to be addressed through the Select Committee process in order that those with an interest can exercise their democratic right to be heard.
- Had previous Governments taken the advice of tax experts since 1969 this situation would have been resolved long ago.
- It is only through the Charities Act 2005 that the public can now see the effect of this failure of tax policy given that in order to be exempt from income tax charities are required to file annual returns and financial statements which has exposed the extent of this failure to public and media scrutiny.

[2] Treasury, "2018 Tax Expenditure Statement" (17 May 2018) at 5 at https://treasury.govt.nz.

What is "unrelated trading?"

To explain what the author means by "unrelated trading," the sale in 2015 to a Chinese buyer, Kiwi Forests Investment Limited which is owned by Golden World International Limited, Hong Kong, of 2,366 ha of forestry blocks in the Waiararapa by the Schools Amalgamated Forest Trust (the Trust) for $17 million is a useful example.[3] We begin with the *Pemsel* classifications: relief of poverty, advancement of education, advancement of religion, and trusts for other purposes beneficial to the community.[4] As Christ's College was the majority holder in the Trust we will discuss this issue in relation to Christ's. Christ's College charitable purposes fall squarely under the advancement of education.

Schools Amalgamated Forest Trust		
Christ's College	70.00%	11,900,000
Samuel Marsden Collegiate School Trust Board	15.00%	2,550,000
Wellington Diocesan School for Girls (Nga Tawa) Marton Board of Trustees	4.50%	765,000
St Marks Parish Property Trust	3.90%	663,000
St Hilda's Collegiate Endowment Trust Board	2.70%	459,000
Huntly School Endowment Trust Board	2.10%	357,000
St Margaret's College Trust Board	1.50%	255,000
Waihi School Association Incorporated	0.30%	51,000
Consideration: Kiwi Forests Investments Limited	**100.00%**	**$ 17,000,000**

If, as part of the College's curriculum, young men were taught about silviculture (the growing and cultivation of trees), both in the classroom and in the forest (albeit that the forest is in the North Island), that is clearly the advancement of education and therefore is a related purpose. On the other hand, if the sole purpose of the forest was to grow high-grade *pinus radiata* for commercial profit, in competition with other forestry operations, that is not a related purpose of which the net profits should ultimately be liable to income tax. To mitigate that income tax liability the trading entity can choose the extent to which it wishes to make donations to the College and other members of the Trust, thus making a commercial decision about what funds to retain for the ongoing viability of the forest without jeopardising the business activity.

[3] LINZ, "Case 201420053 – Kiwi Forests Investment Limited" at www.linz.govt.nz. See also Alan Wood, "Christ's College sells forest stake to Chinese" 1 May 2015) at www.stuff.co.nz.
[4] *The Commissioners for Special Purpsoes of the Income Tax v John Frederick Pemsel* [1891] AC 531 at 583.

Further investigation into the Schools Amalgamated Forest Trust (the Trust) reveals that the Trust was incorporated as a board under the Charitable Trusts Act 1957 on 3 August 2012,[5] and was registered as a tax charity on 22 August 2012.[6] On 2 March 2016 the Trust was deregistered as a tax charity at its request with the assets being "transferred ... to another [unidentified charity or charities] for charitable purposes."[7] Only two sets of financial statements were filed by the Trust with Charities Services, for 2013 and 2014, and these report that the initial cost of the land on amalgamation was $6.4 million,[8] which was then sold in 2015 for $17 million. This situation suggests two questions. Was this land purchased with the intention of resale, thus triggering a tax liability? What has happened to the 310 ha of land that was not sold to Kiwi Forests Investments Limited which, based on the rate per hectare for the land that was sold, would have been worth $2.2 million? The financial statements for the Trust clearly demonstrate that this was a commercial undertaking for profit and had nothing whatsoever to do with advancing education.

Concerns regarding the Interim Report

Passive investments

The opinion of the Interim Report about passive income is interesting. As at 5 October, data from Charities Services reported cash and bank balances of $6 billion, and investments of $14 billion, in round figures $20 billion. By way of example, one national charity holds in excess of $60 million, yet spends an average of $2.5 million annually on its main charitable purpose of medical research while each year continuing to generate significant net surpluses from its donors and at the same time increasing its investment holdings. While those funds are understandably invested, income from its New Zealand investments, as with all charities, benefit from an exemption from Resident Withholding Tax (RWT).

Further, where a separate charitable trust has been established solely for the purpose of investing funds why should those funds not be liable to income tax given that such an activity is clearly not consistent with the *Pemsel* concepts? The author is aware that some charities set up a second trust solely for the purpose of investing donations and bequests received, then drip-feeding funds to the operating arm of the charity. However, people donate in the expectation

[5] Schools Amalgamated Forest Trust, 256321 at www.societies.govt.nz.
[6] Schools Amalgamated Forest Trust CC48330 at www.charities.govt.nz.
[7] Schools Amalgamated Forest Trust, above n 6.
[8] Schools Amalgamated Forest Trust, above n 6, Statement of Financial Position as at 30 June 2014.

that their contributions will be applied to charitable purposes, not invested in perpetuity, unless they explicitly make such a provision as a condition of the gift.

Reserves policies

The author notes and agrees with the view of the TWG "that some charities may have good reasons to accumulate funds."[9] The failure this time is not in tax legislation, but of the Charities Act 2005 which, unlike its counterpart in the UK, does not require trustees to provide a written publicly available document that explains the trustees –not the chief executive - reserves policies in detail. For example, the charity mentioned above has no publicly available document that explains why its $60 million of investments have accumulated year-on-year for many years, yet expenditure on medical research has remained virtually constant, while at the same time still expecting donors to continue making contributions – which may also qualify for tax credits. This raises another issue in that tax credits are a direct cost to the revenue –currently $258 million[10] – so the taxpayer has subsidised donations that have been banked, not applied to the purposes for which the charity solicited the funds in the first place. Charities do not, as far as the author is aware, solicit funds purely on the basis to build up investments for a rainy day in the future, which may or may not eventuate.

The failure to provide Charities Services with its current reserves policy every year regarding accumulated funds should render a charity liable to income tax on the income from the invested funds on the grounds that the funds, having already been subsidised by other taxpayers through refundable tax credits and RWT exemptions, have not been applied to charitable purposes.

Competitive neutrality

To conflate the taxation of passive income with income from unrelated commercial trading income, on the basis that if passive income is income tax exempt therefore so should trading income also be exempt, is wrong.[11] Charities have a choice – opportunity cost – invest, trade, or apply funds to their charitable purposes. That choice should be influenced by tax policy, not the other way round: either apply the funds to charitable purposes and be exempt from income tax, or be liable to income tax on income from unrelated investment or trading activities.

[9] Interim Report, above n 1, cl 17 at 121.
[10] Treasury, above n 2 at 5.
[11] Interim Report, above n 1, cl. 14 at 120.

Commercial trading activities

The author argues that the Henry Review was in error in stating that "[income] tax concessions do not confer a competitive advantage."[12] In recent years, the author has been contacted by a number of businesses, large and small, who claim that their very survival is being affected by the unfair advantage conferred on their income tax exempt competitors. One prominent business operator wrote to the National government about the impact on their long-established family business by an income tax exempt competitor, only to be rebuffed. The author is not at liberty to identify those businesses and individuals publicly because of their fear of repercussions, the most serious and disappointing one being racist accusations of Maori bashing. It is a sad day in New Zealand when a tax policy cannot be openly discussed because of such accusations.

Note in particular the opinion of the 1998 Report of the Committee of Experts on Tax compliance in 1998.[13] The report noted that (emphasis added):[14]

> [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):[15]

> 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.***

This Report, echoing the philosophy of English tax law, states explicitly that "[n]o reason exists in principle why business income, unrelated to the core purpose, should not be taxed." The opinions in the Henry Review were not based "in principle," no doubt having been influenced by charity businesses that would have been disadvantaged if required to pay income tax, which is not based in tax policy, of which the underlying concept is one of equity and fairness. The author suspects, that many of those businesses are operated by faith-based charities which have

[12] Interim Report, above n 1, cl. 13 at 120.
[13] 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).
[14] McKay, above n 50 at §4.16.
[15] McKay, above n 50 at §4.17.

significant influence over politicians. The Catholic Church allegedly holds in excess of $30 billion across Australia, and benefits from "exemptions from almost all forms of taxation [with] minimal public accountability."[16] This also explains why faith-based charities are exempt from filing with the Australian charities regulator, the Australian Commission for Nonprofits and Charities (ACNC): "[i]n terms of accountability, main churches were able to get a concession from the government when it enacted the [ACNC] Act so that it's subject to much less reporting, if the entity qualifies as a basic religious charity."[17]

The author notes and agrees with the opinion of the TWG that "[o]n the other hand, a charitable business that does not distribute its income will be able to accumulate capital faster than an equivalent tax-paying business."[18] The author also agrees with the TWG "that the accumulated assets and income of all charitable businesses and charitable organisations should be used for charitable purposes in order to qualify for the [income] tax exemption."[19] The key word that is missing from that statement is "related' – ie "related charitable purposes."

Further, it should not be accepted as an intention that at some time in the distant future that a company will be wound up and its proceeds distributed to charitable purposes in order to qualify for an income tax exemption today.

An omission from the Interim Report

It is interesting that while the Interim Report refers to the Henry Review,[20] no mention is made in the Interim Report of the 2008 case, *Word Investments*, which confirmed the income tax exemption of trading by Australian charities, with the Henry Review noting that "[t]he High Court of Australia's decision in the *Word Investments* case has significantly increased the scope for NFP organisations to undertake commercial activities."[21] This was an issue that Henry Review considered that the establishment of a national charities commission would address by monitoring, regulating and providing advice to the sector.[22] After referring to "Samuelson's

[16] Royce Millar, Ben Schneiders and Chris Vedalago, "Catholic Church's massive wealth revealed" (12 February 2018) at www.smh.com.au.
[17] Emily Boruke, "Catholic Church national wealth estimated to be $30 billion, investigation funds" (12 February 2018) at www.abc.net.au.
[18] Interim Report, above n 1, cl. 14 at 120.
[19] Interim Report, above n 1, cl. 16 at 121.
[20] Ken Henry et al, "Australia's Future Tax System *Report to the Treasurer*" (Henry Review) (December 2009) at http://taxreview.treasury.gov.au.
[21] Henry Review, above note 20 at B3 Tax concessions for not-for-profit organisations.
[22] Henry review, above n 21 at B3.

invariant valuations theorem," a textbook theory which few people other than economists have probably ever heard of, the Henry Review found that "NFP income tax concessions do not generally violate the principle of competitive neutrality where NFP organisations operate in commercial markets."[23] This is where the author considers the Henry Review to be flawed. Tax policy is not about "competitive neutrality." It is solely about equity and fairness. As noted by Kirby J. (dissenting) in *Word Investments*: "[i]f the economic transfer costs of the exemption for 'charitable' and 'religious institutions' have divided the Parliament and official inquiries in the past, it is little wonder that courts, including this Court, have also been divided in such cases."[24]

The author also disagrees with the judgment in *Word Investments* in which it is notable that the one dissenting decision of Kirby J explains why such trading should be liable to income tax. A summary of the key points made by Kirby J is provided at Appendix 2, but notably (emphasis added):

- "First, there is the need to avoid an **abuse of claims** to be a 'charitable institution' and the potential misuse of such claims for the purposes of **tax avoidance**. Secondly, there is **a legitimate concern of competitors** operating in the same market as the actual business operations of Word. By linking the business operations of Word with the 'charitable purposes' of Wycliffe or Wycliffe International, Word is allegedly afforded **an unfair economic advantage that its competitors … do not enjoy**." [170]
- "[T[he real *discrimen* for the characterisation of an entity propounded as a 'charitable institution' is **what that entity actually does and what purposes it actually pursues**." [174]
- " …. **It is obvious to me that Word's own activities were not themselves charitable.** What was charitable was the **ultimate proposed destination** of the profits that Word derived from its investment and commercial funeral business activities." [177]
- " … the **unrelatedness** of a revenue-raising activity, for 'charitable purposes,' will deprive the entity of characterisation as a 'charitable institution'." [180].

To rephrase Gonthier J in a Canadian case cited by Kirby J: Is the pursuit of purposes still a means to the fulfilment of the organization's primary purposes, or have they become an end in itself?[25] The author suggests that in most cases in New Zealand, they are an end in themselves.

---

[23] Henry Review, above n 20, B3-2 Existing NFP tax concesions and regulatory arrangements are complex.
[24] M.J. Gousmett, "Charities and business activities" NZLJ (March 2009) 57 – 60 at 58.
[25] Kirby J at [186] citing Gonthier J in *Vancouver Society of Immigrant and Visible Minority Women v Minister of National Revenue* [1999] 1 SCR 10 at 44-45.

Even past governments in New Zealand from many years ago have recognised the unfairness in operating commercial activity in competition with the private sector. More recently, as stated in a letter from the Hon Todd McClay to the author:[26]

> [v]arious sections of the Income Tax Act 2007 (ITA) define the taxation obligation of public authorities. [Certain] State enterprises and mixed-ownership enterprises are **excluded** from the public authorities exemption in the ITA. ... **[T]his is because as commercial trading enterprises, which often compete with privately owned companies, the general principle is that they should be subject to tax on their income in the same way that private companies are, despite being owned by the Crown.**

If this is the case then should this principle not also apply to commercial activities that are unrelated to charitable purposes? Alternatively, why should the rules being stated by the TWG not apply to those government-owned enterprises by also exempting them from income tax? Why should there be two sets of rules concerning the taxation of commercial entities being operated by government on the one hand and the charity sector on the other?

Case Study: Ngai Tahu Charitable Group

In the author's previous Submission to the TWG he chose not to name charities, but in order to further explain his thinking it is now necessary to do so through using Ngai Tahu Charitable Group by way of a case study. The author begins by acknowledging the impressive commercial successes achieved by Ngai Tahu following its Treaty of Waitangi settlement and acknowledge that this ongoing success is beneficial to its 61,000 registered members.[27] This is not a case of "Maori-bashing," as Ngai Tahu have suggested in the media in the past, but is one of a failure of tax policy given that at the time that the charitable purposes exemption from income tax was introduced into law, the scale of such operations was likely unforeseen by Parliament.

Recently the Press reported on Ngai Tahu's announcements of its financial performance for the year ended 30 June 2018.[28] However, in the past Ngai Tahu have not filed their results until December each year, therefore the author does not have access to that information and can only rely on the Press report for the purposes of this Submission.

---

[26] Hon Todd McClay, Private correspondence concerning SOE's to the author, (29 February 2016).
[27] Chris Hutching, "Ngai Tahu posts $150m profit, grows cautious" *Press* (26 October) at 21.
[28] Hutching, above n 27

Rather confusingly, the Press reported two different profit figures, one of $150 million and a second of $273.2 million, which includes the recent $190 million Treaty settlement top-up. The Press also reported that a "dividend" of $61 million had been returned to the 61,000 registered Ngai Tahu members – an average of only $1,000 per member. Using that information, had Ngai Tahu's companies paid that sum as a deductible donation to the Ngai Tahu Charitable Trust, Ngai Tahu would have contributed between $6 million and $24.9 million to the government's revenue base while still retaining sufficient funds for the further development of its business empire (see below). However, that is not the case, and Ngai Tahu have instead benefited to an even greater extent from the full income tax exemption of between $23 million and $42 million. Profits retained, due to being exempt from income tax and after "providing a dividend of $61 million for cultural, social and economic programmes for the 61,000 registered members," [29](an average of $1,000 per member), will be between $21.2 million and $89 million. The Press ran another story about Ngai Tahu's successes only a few days later, about Ngai Tahu Farming's many activities throughout the South Island. This makes for impressive reading and person who was not familiar with Ngai Tahu would have no idea that Ngai Tahu Farming is one of the iwi's 39 tax charities which are registered with Charities Services with a collective net worth of in excess of $1 billion as at 30 June 2017. Ngai Tahu Farming Limited is wholly owned by Ngai Tahu Corporation Limited which in turn is owned by Ngai Tahu Charitable Trust, the sole trustee being TRONT – Te Runanga o Ngai Tahu – as corporate trustee.

[29] Chris Hutching, above n 27.

Ngai Tahu as reported in Press 26 October 2018

Dividend	61,000,000	
Registered members	61,000	
Average per member	1,000	

Tax effect if Ngai Tahu's companies claimed donations as deductible item

Net profit	150,000,000	
Donations to NTCT	61,000,000	Donations claimed as deductible items
Profit before tax	89,000,000	
Tax at 28%	**24,920,000**	**Contribution to society**
Retained profits	**64,080,000**	

Profit after tax	273,200,000	Australia/Maori Authority tax
Less top-up	190,000,000	
	83,200,000	
Less Donation to NTCT	61,000,000	Donations claimed as deductible items
Profit before tax	**22,200,000**	
Tax at 28%	**6,216,000**	**Contribution to society**
Retained profits	**15,984,000**	

Loss to IR under the present regime

Net profit	150,000,000	
Donations to NTCT	0	No donations claimed as deductions
Profit before tax	**150,000,000**	
Tax at 28%	**42,000,000**	**Income tax forgone - subsidised by society**
Retained profits	**108,000,000**	

Profit after tax	273,200,000	Australia/Maori Authority tax
Less top-up	190,000,000	
	83,200,000	
Less Donation to NTCT	0	No donations claimed as deductions
Profit before tax	**83,200,000**	
Tax at 28%	**23,296,000**	**Income tax forgone - subsidised by society**
Retained profits	**59,904,000**	

Appendix 1

Taxation Reviews

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

Report of the Taxation Review Committee.[30]

> ***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,[31] 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."[32] However, at Chapter 12 the Task Force gave consideration to life insurance and superannuation, building societies, co-operatives, and charitable organisations.[33] 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."[34] The Task Force "further recommend[ed] a more explicit accounting of all concessions and incentives to improve government management procedures in this area."[35] 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."[36] Of significance is the observation by the Task Force that *"[b]ecause they*

---

[30] The Taxation Review Committee, "Taxation in New Zealand Report of the Taxation Review Committee" (October 1967) Wellington, R.E. Owen, Government Printer at §783.

[31] 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.

[32] Task Force on Tax Reform, above n 31 (a) at (i).

[33] Task Force on Tax Reform, above n 31 Ch 12 Special Cases at 242.

[34] Task Force on Tax Reform, above n 31 at 7.

[35] Task Force on Tax Reform, above n 31 at 7.

[36] Task Force on Tax Reform, above n 31, 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 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

escape effective government control, ***tax expenditures seem to be more difficult to terminate***."[37] Further, the Task Force also considered that "concessions intended to act as incentives … [that are] provided through the tax system [are] inefficient."[38]

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.***[39]

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]."[40]

Government Economic Statement (1987)

In 1987, the Minister of Finance, Roger Douglas, released his alternative economic statement[41] in which he proposed a raft of controversial measures, including the taxation of charities.[42] Amongst other measures, Douglas proposed the removal of personal tax rebates and deductions,[43] alternative funding support for charitable activities,[44] a reduction in the company tax rate,[45] the taxation of superannuation funds, life offices and related organisations,[46] 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.[47] Douglas specifically targeted charities and sporting bodies, mutual associations, primary producer co-operative companies, primary producer and marketing

---

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.

[37] Task Force on Tax Reform, above n 31 4.8 at 63 (emphasis added).

[38] Task Force on Tax Reform, above n 31 4.11 at 63.

[39] Task Force on Tax Reform, above n 31 12.57 at 254 (emphasis added).

[40] Niculescu, above n 31 at 39.

[41] Roger Douglas, "Government Economic Statement" (17 December 1987) Government Printer 68pp.

[42] 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.

[43] Douglas, above n 41 at 7.

[44] Douglas, above n 41 at 7.

[45] Douglas, above n 41 at 8.

[46] Douglas, above n 41 at 8.

[47]. Douglas, above n 41 at 8.

boards, and milk treatment companies.[48] 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."[49]

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.[50] The report noted that (emphasis added):[51]

> [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):[52]

> 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."[53]

Tax Review 2001 (McLeod Report)

The report in October 2001[54]

In its submission, the New Zealand Business Roundtable of the report noted that:[55]

> [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
> - …

---

[48] Douglas, above n 41 Annex 5 at 33-37.
[49] Douglas, above n 41 at 33.
[50] 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).
[51] McKay, above n 50 at §4.16.
[52] McKay, above n 50 at §4.17.
[53] McKay, above n 50 at §4.19.
[54] Rob McLeod (Chair), David Patterson, Shirley Jones, Srikanta Chatterjee, and Edward Sieper, "Tax Review 2001" (available at www.treasury.govt.nz).
[55] 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:[56]

> [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.[57] While the issue of competitive advantage was raised, the final price of products was competitive with for-profits, therefore pricing was not the issue.[58] 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."***[59] This was "***the real competitive advantage that trading activities owned by charities have over their competitors***."[60] 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."[61] Ultimately, it was not until 2007 when the new concessions for charitable giving by donors, companies and Maori Authorities were

[56] New Zealand Business Roundtable, above n 55 at 49.
[57] 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.
[58] Tax and Charities, above n 57 at §9.2 – §9.5.
[59] Tax and Charities, above n 57 at §9.6.
[60] Tax and Charities, above n 57 at §9.6.
[61] Tax and Charities, above n 57 at §9.7.

adopted by the removal of the caps on donations and deductions.[62] However, the issue of taxing the trading activities of charities was not pursued further by the government.

[62] See Taxation (Business Taxation and Remedial Matters) Act 2007 (19 December 2007) No 109.

Appendix 2

Summary of key points by Kirby J in *Word Investments*

- Wycliffe Bible Translators (Australia) was endorsed by the ATO from 1 July 2000 as an income tax exempt charity under subdiv 50-B of the *Income Tax Assessment Act* 1997 (Cth) [12].
- Word Investments Limited was founded by members closely associated with Wycliffe who wanted to use Word to raise money in Australia and give it to Wycliffe for the carrying out of its purposes, which, at least to some degree, are fulfilled overseas. [2].
- Word gives it profits (less sums retained by it) to Wycliffe and other similar Christian organisations [for their charitable purposes]. [3].
- Word was incorporated under the *Companies Act* 1961 (Vic) on 8 August 1975 as a company limited by guarantee. [3].
- From about 1986, Word began to accept deposits from members of the public. Depositors received little or no interest, but Word invested the money at commercial rates of interest.
- Between 1996 and 2002, Word operated a business of conducting funerals, not all of Christians, for profit. [5].
- Word's profits generated from its investment business and the funeral business were sued to support Christina activities in the form of Bible translation and missionary work largely carried out by Wycliffe and other bodies to whom the non-retained profits were given. [5]
- On 2 May 2001, the Commissioner declined Word's application for endorsement as exempt from income tax on the basis that "[c]ommercial enterprise charities are not considered to be charities. This is the case irrespective of whether charitable consequences flow from the entity's activities." [7].
- During the hearing, the Commissioner argued that "there was no nexus between the profit and the effectuation of a charitable purpose." [36].
- Kirby J. (dissenting 4:1): It was "agreed that, generally, the taxation legislation in issue here was written against the background of the Statute of Elizabeth [1601] and *Pemsel* [1891]. [78].
- Kirby J: "Ultimately, the question is whether Word, performing what are undoubtedly commercial business activities, could itself qualify as a 'charitable institution' with religious purposes and thus be exempt from paying income tax." [91]
- Kirby J: "However, it remains the fact that Word is attempting to secure for itself a special privilege provided by a statutory exemption of charitable and religious institutions from the general liability to pay income tax." [107]
- Kirby J (citing Lord Simonds in *Oppenheim v Tobacco Securities Trust Co Ltd* [1951 AC 297 at 307: "[i]t must not, I think, be forgotten that charitable institutions enjoy rare

and increasing privileges, and that the claim to come within that privileged class should be clearly established." [111]

- Kirby J (citing the Australia[n] Industry Commission, *Charitable Organizations In Australia* Report No 45 (June 1995) at K 5 [Table K.1]: "The report contrasted the international treatment in comparable countries of commercial activities of non-profit organisations – [Australia, Belgium, Israel, Spain, Thailand, the United Kingdom, the United States and West Germany]. It found that the law in most of those countries subjected non-profit organisations, including charitable and religious institutions, to taxation in respect of income derived from their commercial activities." [118]

- Kirby J: It follows that, arguably, if the expansion of the exemption to a company such as Word is to be sanctioned by law, it should be done *by express legislation enacted for that purpose by the Parliament after a full debate about the issues of principle and policy that are raised*. [126]

- Kirby J: "[Word's] claim for exemption as a 'charitable institution' from income tax liability should be rejected." [169]

- Kirby J: "First, there is the need to avoid an abuse of claims to be a 'charitable institution' and the potential misuse of such claims for the purposes of tax avoidance. Secondly, there is a legitimate concern of competitors operating in the same market as the actual business operations of Word. By linking the business operations of Word with the 'charitable purposes' of Wycliffe or Wycliffe International, Word is allegedly afforded an unfair economic advantage that is competitors … do not enjoy." [170]

- Kirby J: "[T[he real *discrimen* for the characterisation of an entity propounded as a 'charitable institution' is what that entity actually does and what purposes it actually pursues." [174]

- Kirby J (citing Scott J in *Attorney-General v Ross* [1985] 3 All ER 334 at 343): "The activities of an organisation after its formation may serve to indicate that the power to carry on non-charitable activities was in truth not incidental or supplementary at all but was the main purpose for which the organisations was formed. In such a case the organisation could not be regarded as charitable." [175].

- Kirby J: " …. It is obvious to me that Word's own activities were not themselves charitable. What was charitable was the ultimate proposed destination of the profits that Word derived from its investment and commercial funeral business activities." [177]

- Kirby J: "Unless the ultimate destination of the designated profits to other independent corporate entities applies retrospectively to colour the characterisation of Word by reason of its subventions, the 1997 Act [Div 50 of Pt 2-15] demands that Word itself be characterised as a business for profit. The ultimate destination of that profit or part of it cannot alter that conclusion." [178]

- Kirby J: " … the ***unrelatedness*** of a revenue-raising activity, for 'charitable purposes,' will deprive the entity of characterisation as a 'charitable institution'." [180].