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Response submission

Taxation and the not-for-profit sector
(February 2025 – Official’s Issues Paper)

Submission made by (on behalf of Presbyterian Support Northern):
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To: policy.webmaster@ird.govt.nz

“Taxation and the not-for-profit sector”

Background

Presbyterian Support Northern has been helping vulnerable New Zealanders for 140 years, and is one of New Zealand's largest Social Services, Disability Support and Aged Care not-for-profits.

The IRD Tax paper requests submissions in response to the proposals being made to change the tax exemptions as they apply to charities and not-for-profit organizations. PSN has relied on investment returns to prop up loss making government contracts. Without the income from other sources, we would not be able to continue to contract with government to deliver services to the community. As a charity we make no distributions of our profits, and reuse our profits to support our sustainability. Any potential to tax revenues from any source, will reduce our available funding, and jeopardise our ability to maintain the level of services we provide.

The reasons to remove tax exemptions and increase costs to charities, must meet the IRD objectives of "simplifying tax rules, reducing compliance costs, and addressing integrity issues", and these proposals fail to deliver on these objectives.

In the introduction the issues paper states at 1.4

"Every tax concession has a "cost", that is, it reduces government revenue and therefore shifts the tax burden to other taxpayers".

By definition, a PBE is a public benefit entity, and as charities, there are benefits that we provide at no cost to the government, or below cost to the government, which are a Net Benefit to the government, even after accounting for the foregone revenue that IRD may have collected on the income or FBT account. i.e on the cost vs benefit analysis, charities are funded at a level below cost (underfunded), to deliver the work on behalf of government, and costs exceed their revenues, so a tax relief needs to be assessed in comparison to the burden that charities relieve government to support vulnerable New Zealanders.

Per 1.5

"The review will consider a range of integrity measures as well as what improvements and simplifications can be made to some of the existing rules."

As a very large charity in New Zealand, we can confirm that the level of financial income from the government contracts does not keep up with the annual increase in the direct costs of running these contracts, and we have seen a consistent year on year reduction in government funding in real terms, and each year, this reduction in support decreases the level of services we can undertake for our clients.

Any proposal to further reduce government support through changes to tax incentives, will further reduce the level client support we can deliver. It is inconsistent, with this long history of reductions in real contract values, to propose a change in the tax system to reduce incentives, will be made good by increases from other government agencies to increase contract values. Government has consistently demonstrated policy to reduce costs year on year. We already lose money running government contracts, which we supplement with passive income, adding a new tax burden to charity run operations will worsen this loss.

Response to questions per the IRD issues paper numbering

Chapter 2: Charities business income tax exemption

Q1. What are the most compelling reasons to tax, or not to tax, charity business income? Do the factors described in 2.13 and 2.14 warrant taxing charity business income?

Response

- Tax exemptions recognise the positive contribution charities make to the community. Charities provide cost effective services to vulnerable New Zealanders that if not provided could fall on the Government to provide. Typically, when provided by the Government these services are at a much higher price point. Charities need to be innovative in how they accumulate sufficient resources to deliver their services. The use of "business" income is one of the ways this is achieved. Removing tax exemptions from this income will ultimately reduce the effort that charities can deliver, thus putting more demand on Government.
 - These proposals fail to deliver on the IRD objectives of "simplifying tax rules, reducing compliance costs, and addressing integrity issues" Removing tax exemptions results in increased compliance costs to charities, without improving integrity.
 - The operating capacity of charities will reduce, and government departments who have to fill the gap, will pay more to deliver the same services, as they have higher operating costs.
e.g. PSN operates Lifeline, with over 400,000 phone and txt responses a year, at a salary cost 50% lower than the government funded helpline 1737. If we discontinue this service due to increased tax and compliance costs, the government will have to pay to pick up this service at a higher cost.
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Q2. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be the most significant practical implications?

Response

- How will "Business Income unrelated to the charitable purpose" be objectively defined. It would be impractical and costly for 29,000 charities to seek legal advice on the interpretation of "business income that is unrelated to charitable purposes". The resulting subjectivity and high levels of inconsistency, along with the high level of compliance costs.
 - The proposed changes will not prevent bad actors to continue to game the system. If there is a need to crack down on institutions using a charitable status to avoid taxes, then more measures should be taken to enforce compliance, rather than adding significant compliance costs to the sector to resolve an issue, that is not
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throwing a blanket over the entire charity sector with changes to tax exemptions just to solve a compliance issue.

- Removing tax exemptions for Income tax and FBT, will increase the cost and lower the available funding for PSN to undertake the work we do for the vulnerable. The impact of removing exemptions will result in us needing to reduce our services to the vulnerable.
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Q3. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what criteria should be used to define an unrelated business?

Response

- It could be subjective whether a business is for charitable purpose or not, and will mainly depend on the interpretation of accountants and advisors, some of whom will not have deep understanding of the question.
 - The level of ambiguity is more likely to work for current charities that are the target of these changes – who are gaming the system, and hurt honest charities who are not.
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Q4. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what would be an appropriate threshold to continue to provide an exemption for small-scale business activities?

Responses

- Use of Charities already existing structure size, ie. Tier 3 and 4 should be exempt as they could not bear the burden of the compliance costs should they be captured.
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Q5. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, do you agree that charity business income distributed for charitable purposes should remain tax exempt? If so, what is the most effective way to achieve this? If not, why not?

Response

- Agree the business income distribution should remain exempt, but the reality is that in order to achieve this through a new entity (trading company or subsidiary charity) will add unnecessary compliance costs.
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Q6. If the tax exemption is removed for charity business income that is unrelated to charitable purposes, what policy settings or issues not already mentioned in this paper do you think should be considered?

Responses

- The operating capacity of charities will reduce, and government departments who have to fill the gap, will pay more to deliver the
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same services, as they have higher operating costs.

- Policy needs to consider that Revenues collected by IRD will be offset by costs incurred in other government departments, who incur a high operating cost compared to charities.
 - Charities are obliged to be more transparent in reporting (eg. Through Charities Services annual reporting) that is not the same with non-listed commercial enterprises.
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Chapter 3: Donor-controlled charities

Q7. Should New Zealand make a distinction between donor-controlled charities and other charitable organisations for tax purposes? If so, what criteria should define a donor-controlled charity? If not, why not?

Response

No comment

Q8. Should investment restrictions be introduced for donor-controlled charities for tax purposes, to address the risk of tax abuse? If so, what restrictions would be appropriate? If not, why not?

Responses

No comment

Q9. Should donor-controlled charities be required to make a minimum distribution each year? If so, what should the minimum distribution rate be and what exceptions, if any, should there be for the annual minimum distribution? If not, why not?

Responses

No comment

Chapter 4: Integrity and simplification

Q10. What policy changes, if any, should be considered to reduce the impact of the Commissioner's updated view on NFPs, particularly smaller NFPs? For example:

- increasing and/or redesigning the current \$1,000 deduction to remove small scale NFPs from the tax system,
- modifying the income tax return filing requirements for NFPs, and
- modifying the resident withholding tax exemption rules for NFPs.

Responses

- To achieve the IRD stated objectives, exemption levels should be set high enough (eg Tier 3 and Tier 4 Charities) to ensure compliance and filing costs do not exceed Tax revenues.
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Q11. What are the implications of removing the current tax concessions for friendly societies and credit unions?

Responses

No comment

Income tax exemptions

Q12. What are the likely implications if the following exemptions are removed or significantly reduced:

- local and regional promotional body income tax exemption,
- herd improvement bodies income tax exemption,
- veterinary service body income tax exemption,
- bodies promoting scientific or industrial research income tax exemption, and
- non-resident charity tax exemption?

Responses

- In the case of New Zealand bodies, it is normally a requirement that they are not able to distribute surplus funds to their members, and only raise the minimum membership fees and levies to undertake their work. Changing existing tax rules to deal with a non-existent problem, is likely to increase compliance costs without generating revenue, and reduces the available funds for the bodies to undertake their work.
 - If a non-resident charity is gaming the system then remove their tax-exempt status, but do not change exemption rules for charities to fix non-compliance by a minority of charities.
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FBT exemption

Q13. If the compliance costs are reduced following the current review of FBT settings, what are the likely implications of removing or reducing the exemption for charities?

Responses

- To remove tax exemptions for FBT, will require FBT filing and this will incur compliance costs (tax accountants and filing returns), in addition levying FBT will reduce available funds from our charity to complete our work with the community, and this work will fall back to government to undertake at a higher cost.
 - Government agencies, including MoH, MSD & Oranga Tamariki, pay their staff 15%-25% higher salaries, than provided for under PSN funding contracts. FBT exemption partially reduces the gap to overcome this market distortion. This exemption currently ensures that we are not priced out of the market by our own Funders.
 - We disagree the stated IRD objectives of "simplifying tax rules, reducing compliance costs, and addressing integrity issues", will be achieved. The proposal will increase complexity, increase compliance costs and increase costs to charities.
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Tax simplification

Q14. What are your views on extending the FENZ simplification as an option for all

NFPs? Do you have any other suggestions on how to reduce tax compliance costs for volunteers?

Responses

No comment

Q15. What are your views on the DTC regulatory stewardship review findings and policy initiatives proposed? Do you have any other suggestions on how to improve the current donation tax concession rules?

Responses

- If donors are not claiming credits, from the government as DTC's, then any simplifications in the system to refund donation tax concessions is a positive move, as it encourages higher giving.
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