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**CHARITIES' TAX PRIVILEGES IN NEW ZEALAND:
A CRITICAL ANALYSIS**

JONATHAN BARRETT AND JOHN VEAL*

ABSTRACT

This article critically analyses the tax privileges extended to charities in New Zealand. The concept of a charity is established, and the grounds for tax privileges are considered. Without gainsaying the social value that many charities deliver, the authors ask whether certain historical privileges are justified when measured against contemporary needs and circumstances. They conclude that far greater transparency is needed in the sector. Such openness would enable a fully informed debate about the types of charitable organisations the tax system encourages, and whether the tax privileges currently extended to them are justified.

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I INTRODUCTION

The more than 25,000 charities registered in New Zealand enjoy various legal privileges,¹ which include the conferral of juristic personality,² trust law benefits,³ and restricted exemptions from consumer protection,⁴ employment,⁵ and human rights legislation.⁶ However, the most significant concessions granted to charities relate to tax, particularly income tax. Charities do not pay income tax on their exempt income,⁷ and provided they do not receive any non-exempt income,⁸ they are not required to file a tax return.⁹ Income earned by charities from trading operations and subsequently distributed in New Zealand, is, in short, tax free. Consequently, charitable firms may be able to amass capital and build a business much more quickly than a for-profit competitor.¹⁰ Furthermore, non-cash benefits provided by charities to their employees

¹ Charities Commission, *Annual Report 10/11* (Charities Commission, 2011) 7 records that 22 657 registered charities had published annual returns as at 30 September 2011. Publishing an annual report is a normal condition of continued registration: See *Charities Act 2005* (NZ) (*'Charities Act'*) ss 41 and 32 but also s 43 (on reporting exemption). The Charities Commission website includes a counter of registered charities. On 9 August 2012, 25 279 charities were recorded. See Charities Commission, *Registered Charities* (2012) <<http://www.charities.govt.nz/>>. In terms of *Charities Amendment Act (No 2) 2012* (NZ) s 9, the functions of the Charities Commission were taken over by Department of Internal Affairs with effect from 1 July 2012.

² Charities generally enjoy the legal privilege of legal personality and, if charitable trusts, have the status of corporation sole: *Charitable Trusts Act 1957* (NZ) s 7.

³ In contrast to the normal rule that trust capital must be distributed within 80 years (see *Perpetuities Act 1963* (NZ) s 6(1)), capital held by a charitable trust may be tied up in perpetuity: *Re Beckbessinger* (High Court, Christchurch, M 586/88, 28 September 1992, Tipping J).

⁴ Following *E v Australian Red Cross Society* (1991) 99 ALR 601, it seems likely that charities will generally not be considered to be in trade for the purposes of the *Fair Trading Act 1986* (NZ). While charity shops will normally be covered by the *Consumer Guarantees Act 1993* (NZ), s 41(2) of that Act excludes transactions that have the 'principal purpose of benefiting a person'.

⁵ Much charitable work is done by volunteers who are excluded from the definition of 'employee' under *Employment Relations Act 2000* (NZ) s 6(1)(c).

⁶ *Human Rights Act 1993* (NZ) s 28 permits certain otherwise outlawed forms of discrimination in a religious context.

⁷ *Income Tax Act 2007* (NZ) ss CW 41, CW 42, CW 43. Section CW 41 exempts the non-business income of charities. Section CW 42 exempts the business income of charities, but only to the extent that income is applied for charitable purposes within New Zealand. Section CW 43 exempts income derived by a deceased person's executor or administrator if the income is attributable to assets of the estate that have been left to a charity.

⁸ Income derived by the charity that is not covered by the exemptions in *Income Tax Act 2007* ss CW 41 to CW 43. For example, the portion of the business income derived by a charity that relates to charitable purposes not limited to New Zealand.

⁹ *Tax Administration Act 1994* (NZ) s 33. The Inland Revenue Department (IRD) may, however, request an annual tax return.

¹⁰ This proposition appears to be received wisdom in New Zealand: see, for example, *Taxation in New Zealand: Report of the Taxation Review Committee* (Government Printer, 1967) ('Ross Report') 308–313; Policy Advice Division, *Tax and Charities: A General Discussion Document on Taxation Issues relating to Charities and Non-Profit Bodies* (IRD, 2001) 43. However, for a contrary view, see Henry Hansmann, 'The Effect of Tax Exemption and Other Factors on the Market Share of Nonprofit versus For-Profit Firms' (1987) 60 *National Tax Journal* 71, 71–82.

are currently exempt from fringe benefit tax ('FBT') unless the employee is involved in a business activity outside the charity's registered purposes.¹¹

Charities also indirectly benefit from income tax concessions extended to donors.¹² Currently, subject to a minimum donation of NZ\$5, individuals may claim a tax credit of 33 $\frac{1}{3}$ per cent of their aggregate annual donations.¹³ Furthermore, a payroll giving scheme enables employees' donations to be deducted directly from their remuneration, with immediate tax credit being granted.¹⁴ Companies, excluding look-through companies,¹⁵ may deduct the value of all cash gifts to charities, not exceeding the company's net income.¹⁶

The New Zealand charitable sector was reformed in 2005, with tax exemption becoming contingent on registration with the Charities Commission and production of an annual report.¹⁷ However, the reforms were not intended to be radical.¹⁸ In contrast, a 2001 discussion paper issued by IRD's Policy Advice Division made far reaching income tax recommendations that were mostly not taken up.¹⁹ While the 2005 reforms may have contributed to transparency in the 'third sector',²⁰ and thereby reduced potential for abuse by rogue charities,²¹ the amended deduction rules may have presented novel opportunities for income tax avoidance and evasion.²²

This article considers the principal policy issues that arise from charities' and donors' tax privileges. First, an overview of charities is provided. This section sketches the

¹¹ *Income Tax Act 2007* s CX 25.

¹² *Income Tax Act 2007* s LD 3. Donations to qualifying donee organisations also qualify for tax concessions. See IRD, *Charitable Organisations and Donee Organisations (IR 255)* (IRD, 2011) 27 for an outline of donee organisation qualification.

¹³ *Income Tax Act 2007* ss LD 1–LD 3. The total gifts that qualify for the tax credit may not exceed the individual's taxable income: *Tax Administration Act 1994* (NZ) s 41A(3).

¹⁴ *Income Tax Act 2007* ss LD 4–LD 8. This scheme came into effect in January 2010. As at 12 March 2012, payroll giving was offered by 1 300 employers and over 100 000 employees had access to the scheme. See IRD, *New Website Offers Payroll Giving Help for Employers* (2012) <<http://taxpolicy.ird.govt.nz/news/2012-03-12-payroll-giving-website-launched>>. During the 12 months ended 31 January 2012, total donations through payroll giving totalled over NZ\$5 million. See *Payroll Giving Statistics to Date* <<http://www.ird.govt.nz/news-updates/like-to-know-payroll-giving-long-des.html>>.

¹⁵ *Income Tax Act 2007* s YA 1 definition of 'company' para (abb). Before 1 April 2008, deduction for corporate charitable donations was not available to defined 'close companies' unless their shares were publicly listed.

¹⁶ *Income Tax Act 2007* s DB 41.

¹⁷ See above n 1. Registration is voluntary but an unregistered charity may not describe itself as a 'registered charitable entity' and does not qualify for tax exemption. See Charities Commission, *Purpose of the Charities Register* <<http://www.charities.govt.nz/the-register/purpose/>>.

¹⁸ For example, the Explanatory Note, Charities Bill 2005 (1–108) indicated that it was not the intention of Parliament to change the definition of 'charitable purpose'.

¹⁹ Policy Advice Division, above n 10. Ross Report, above n 10, 308–313 appears to have been influential here.

²⁰ The term 'third sector' – government and business being the other sectors – was coined by the Commission on Private Philanthropy and Public Needs ('CPPPN'), *Giving in America, Toward a Stronger Voluntary Sector: Report of the Commission on Private Philanthropy and Public Needs* (CPPPN, 1975) (also known as the 'Filer Commission') 1, 11.

²¹ See Catherine Harris, 'Database to Reveal the Real Charities' *The Dominion Post* (Wellington), 29 December 2011, 4.

²² See below n 67.

origins of current law and the contemporary position of charities in New Zealand. Second, the tax privileges New Zealand charities enjoy are outlined. Third, the principal arguments for and against tax privileges are discussed in the specific New Zealand context. Finally, tentative recommendations are made and conclusions drawn.

II OVERVIEW OF CHARITIES

The legal concept of a charity in common law countries is derived from the Preamble to the *Charitable Uses Act 1601*.²³ In *Commissioner of Income Tax v Pemsel*,²⁴ Lord Macnaghten, following, but reducing the Preamble list to principles, held that a charity must be for the public benefit and have the purpose of relieving poverty,²⁵ advancing education, advancing religion, or benefiting the community.²⁶ Charitable purposes not contemplated in Elizabethan times could be accommodated, if consistent with the Preamble's 'spirit and intendment'. 'The law does not recognise all objects of public utility as charitable', for example political advocacy is, in theory, excluded.²⁷ Not all charitable purposes are equal. For example, their aims being presumed to be self-evident, charities for the relief of poverty, advancement of religion or education have traditionally not been required to specifically demonstrate public benefit.²⁸ However, the public benefit of private education has recently come under scrutiny in the United Kingdom.²⁹ Charities may conduct a business provided it is 'not carried on for the private pecuniary profit of any individual'.³⁰ Indeed, given the scale of religiously affiliated businesses, such as the Seventh Day Adventist Church's Sanitarium operations,

²³ 43 Eliz I c 4, also known as the *Statute of Charitable Uses* or the *Statute of Elizabeth*. Roman law, Judaeo-Christian theology, and the common law were influential, but, critically, the Tudor Reformation had disrupted the Church's traditional charitable function. Significantly, the *Charitable Uses Act* was companion legislation to the *Poor Law Act 1601* 43 Eliz I c 2. According to John Seymour, 'Parens Patriae and Wardship Powers: Their Nature and Origins' (1994) 14(2) *Oxford Journal of Legal Studies* 159, 159-188 the origins of State charity lie with the sovereign's obligations as *parens patriae* (father of the country).

²⁴ *Commissioner of Income Tax v Pemsel* [1891] AC 531.

²⁵ LexisNexis, *The Laws of New Zealand* (at 17 April 2012) 'Charities' [14] states: 'The word "relief" implies that the persons in question have a need attributable to their condition as aged, impotent, or poor persons which requires alleviating, and which those persons would find difficulty in alleviating themselves from their own resources.' The words 'relief' and 'benefit' are not synonymous: *Joseph Rowntree Memorial Trust Housing Association Ltd v Attorney-General* [1983] 1 All ER 288. Poverty is likely to be taken as relative to other members of the community, rather than absolute: see *Ballarat Trustees Executors and Agency Company Ltd v Attorney-General* (1950) 80 CLR 350.

²⁶ Reducing the purposes still further, Jan James and Peter Felstead, *Charitable Trusts and Entities* (Auckland District Law Society, 2002) 3 suggest that, to fall within the ambit of *Pemsel*, the pursuit of the purpose must benefit the public or an appreciable or sufficiently important section of the public ('public benefit test'); and the purpose must be charitable, being a purpose that falls within the 'spirit and intendment' of the Preamble.

²⁷ *The Laws of New Zealand*, above n 25, [3]. However, many charities do, in practice, engage in forms of advocacy that aim at changing attitudes, policy, and ultimately law.

²⁸ See, for example, *In re Hetherington* [1990] Ch 1. Giving alms to the poor is the original meaning of charity and still coincides with the everyday understanding of the term.

²⁹ See *The Independent Schools Council v The Charity Commission for England and Wales* [2011] UKUT 421 (14 October 2011). For an analysis of this decision from a New Zealand perspective, see Helen Dervan, 'Independent and Schools and Charitable Status' (2012) *New Zealand Law Journal* 51, 51-54.

³⁰ Charities Act s 13(3).

Max Wallace has described charities' participation in trade in Australasia as 'the Purple Economy'.³¹

Historical contingencies, including British settlement and a sparse population, have greatly shaped the charitable sector in New Zealand. Statutory definitions of 'charity' tend to be circular, and lead back to the common law,³² and, prompted by necessity, 'from an early stage the prevailing policy was to encourage charities, usually church-based community groups, to fill the gap and establish the health and social care facilities for the poor, ill or otherwise disadvantaged that government could not afford to provide'.³³ Since State-provided welfare was mostly absent from early New Zealand, 'self-help and family support were more important than government aid and formal charity in meeting welfare needs'.³⁴ The country's third sector remains characterised by a 'partnership ethos between government and community'.³⁵ Government in contemporary New Zealand has command over sufficient resources to deliver many of the services that charities currently perform — indeed, the greatest part of charities' income is derived directly from government³⁶ — and yet, it seems, the State prefers to pay and subsidise charities. This approach is consistent with neoliberal doctrines whereby government purchases services from various and competing agencies,³⁷ including traditional charities, rather than providing them directly.³⁸

III TAX PRIVILEGES

In this section, the history of tax concessions and current privileges in New Zealand are outlined.

³¹ Max Wallace, *The Purple Economy: Supernatural Charities, Tax and the State* (Australian National Secular Society, 2007).

³² See, for example, Charities Act s 5. Compare this with Australia (Royal National Agricultural and Industrial Association v Chester [1974] 48 ALJR 304) and Canada (Vancouver Society of Immigrant and Visible Minority Women v MNR (1999) 169 DLR (4th) 34 (SCC)).

³³ Kerry O'Halloran, *Charity Law and Social Inclusion: An International Study* (Routledge, 2007) 280.

³⁴ Gino Dal Pont, *Charity Law in Australia and New Zealand* (Oxford University Press, 2000) 78. It was not until the *Social Security Act 1938* (NZ) that 'income maintenance in the time of need' became 'a right of citizenship'. (Ibid).

³⁵ O'Halloran, above n 33, 281.

³⁶ Charities' income of approximately NZ\$15 billion in 2011 consisted of: government grants (NZ\$4.997 billion); donations (NZ\$1.040 billion); income from service provision (NZ\$5.667 billion); and other income, including investments (NZ\$3.214 billion). See Charities Commission, above n 1, 7.

³⁷ The Royal Plunkett Society, a prime example of a State-partner charity, had provided a child illness helpline for many years. In a competitive tender, it lost the right to provide this service. See 'Plunkett Loses Government Helpline Contract' *The New Zealand Herald* (online), 8 April 2006 <http://www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=10376607>.

³⁸ See, generally Margaret Tennant, Jackie Sanders, Michael O'Brien, and Charlotte Castle, *Defining the Nonprofit Sector: New Zealand* (Working Paper No 45, Johns Hopkins Comparative Nonprofit Sector Project, 2006).

A Income Tax

1 Charities' Exemptions

John Avery Jones traces English charities' tax privileges directly to land tax exemptions promulgated in 1671 and 1688, and indirectly to sixteenth century subsidies.³⁹ The proto-income tax introduced by William Pitt the Younger in 1799 exempted the income of any 'corporation, fraternity or society of persons established for charitable purposes only'.⁴⁰ The broad charitable exemption from taxes has persisted in British Commonwealth countries.⁴¹ In New Zealand, the first land and income tax, introduced in 1891, exempted all income derived or received by, among others, 'all public bodies and societies not carrying on any business'.⁴² The following year, an exemption was introduced in respect of 'mortgages held, and all income received or derived, by or on behalf of any public charitable institution ... not for any gain or profit'.⁴³ This formulation of exemption based on the dual criteria of charitable status and a not-for-profit motive was continued in subsequent legislation.⁴⁴ While the expression of the exemption became more prolix,⁴⁵ the exemption formulation has remained essentially the same. Following the *Pemsel* formulation,⁴⁶ the current income tax legislation defines 'charitable purpose' as including 'every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community'.⁴⁷

2 Taxpayer Concessions

Historically, income tax concessions were not available in respect of taxpayers' charitable donations.⁴⁸ In 1962, an innovative provision introduced a deduction (by way of special exemption) from the assessable income of individuals making donations to charities: the deduction was limited to £25. When income tax legislation was consolidated in 1976, the maximum deduction was NZ\$200.⁴⁹ This deduction was replaced in 1978 by a rebate for charitable deductions by individuals, calculated at the rate of 31 per cent of qualifying donations, but limited to NZ\$200.⁵⁰ In 1990, the rate at which the rebate was calculated became the current rate of 33 $\frac{1}{3}$ per cent but subject to a

³⁹ John F Avery Jones, 'The Special Commissioners from Trafalgar to Waterloo' in John Tiley (ed), *Studies in the History of Tax Law* (Hart Publishing, 2007) 3, 14.

⁴⁰ *Income Tax Act 1799*, 39 Geo III c13, s 5, cited by Fiona Martin, 'The History of the Taxation of Charities: How the Common Law Development of a Legal Definition of 'Charity' Has Affected the Taxation of Charities' in John Tiley (ed), *Studies in the History of Tax Law 4* (Hart Publishing Ltd, 2010) 297, 309.

⁴¹ Martin, *ibid*, notes that, once income tax was reintroduced in 1842, charitable tax privileges were retained.

⁴² See *Land and Income Assessment Act 1891* (NZ) s 16(2).

⁴³ See *Land and Income Assessment Act Amendment Act 1892* (NZ) s 3.

⁴⁴ See *Land and Income Assessment Act 1900* (NZ) s 16(1); *Land and Income Assessment Act 1908* (NZ) s 14(1); *Land and Income Tax Act 1954* (NZ) s 86(1).

⁴⁵ See *Income Tax Act 1976* (NZ) s 61.

⁴⁶ See *Molloy v Commissioner of Inland Revenue* [1981] 1 NZLR 688.

⁴⁷ *Income Tax Act 2007* s YA 1 definition 'charitable purpose'.

⁴⁸ *Land and Income Tax Act 1954* (NZ) s 84B came into effect on 1 April 1962.

⁴⁹ *Income Tax Act 1976* (NZ) s 58.

⁵⁰ *Income Tax Act 1976* (NZ) s 56A.

maximum of NZ\$500.⁵¹ The maximum rebate increased to NZ\$630 in 2002.⁵² With effect from 1 April 2008, and the introduction of the current *Income Tax Act 2007*, the term 'rebate' was replaced by 'tax credit', and the then applicable maximum of NZ\$630 was removed. To reiterate, the current amount of the personal tax credit is limited only to the extent that it may not exceed an individual's taxable income.⁵³ In the 2010 tax year, 376,500 claims for donations were made and IRD rebated a total of NZ\$195 million.⁵⁴

B Other Taxes

1 Taxes on Capital Transfers

An exemption from estate duty for charitable bequests was instituted soon after the introduction of the duty in 1881.⁵⁵ Under the estate and gift duties system, charitable donations and legacies continued to attract favourable tax treatment.⁵⁶ New Zealand no longer levies any form of tax on capital transfers.⁵⁷

2 Local Property Rates

Rates levied on real property are the principal source of local authority revenue in New Zealand.⁵⁸ Local authorities have wide discretion in the mix of the rating instruments they can employ,⁵⁹ but certain exclusions from the ratings base are peremptory and not open to local variation or preference. In particular, places of worship, which commonly have significant land and capital values,⁶⁰ and various types of charitable institution, are exempt from local authority rates.⁶¹

⁵¹ There was some variation in the rate and maximum allowance between 1978 and 1990.

⁵² Policy Advice Division (above n 10, 10) recommended that the amount of the maximum deduction should increase with the rate of inflation.

⁵³ See above nn 7–14 for the relevant statutory provisions, and above nn 15 and 16 on companies' deductions.

⁵⁴ IRD, *Donation Rebates, 2001 to 2010* (2011) <<http://www.ird.govt.nz/aboutir/external-stats/revenue-refunds/donations-rebates/revenue-refunds-donation-rebates.html>>.

⁵⁵ *Charitable Gifts Duties Exemption Act 1883* (NZ) s 3 exempted charitable devises and bequests from the *Deceased Persons' Estates Duties Act 1881* (NZ) 'or any other Act of a like character'.

⁵⁶ See *Estate and Gift Duties Act 1968* (NZ) ss 5(c), 73(1).

⁵⁷ Estate duty was abolished in 1992 and gift duty in 2010.

⁵⁸ Graham Bush, 'Local Government' in Raymond Miller (ed), *New Zealand Government and Politics* (Oxford University Press, 2003) 161, 164 reports that in 2001 an average of 57 per cent of local authority revenue was contributed by rates (excluding user charges). K A Palmer, *Local Government Law in New Zealand*, (2nd ed, Law Book Co, 1993) 362 defines rating as 'a levy on land holdings, assessed against the legal occupier, for the purpose of raising revenue for one or more local authorities'.

⁵⁹ See *Local Government Rating Act 2002* (NZ) ss 13–19.

⁶⁰ Figures are not readily available in New Zealand on the benefits that excluded property brings to its owners. However, a 2000 investigation indicated that, if the exempt property of religious organisations were included in the rating base, Melbourne's rates could be reduced by 10 per cent. See Sally Blundell, 'The God Dividend' *New Zealand Listener* (New Zealand), 2 February 2008, 26, 28.

⁶¹ *Local Government Rating Act* s 8 and sch 1. See Michael Gousmett, 'The Fiscal Privileges of Charities' [2012] *New Zealand Law Journal* 55, 55–59 for a critical analysis of charities' exemption from the ratings base.

3 Goods and Services Tax

In general,⁶² charities must register for goods and services tax ('GST'), and account for GST, if they make taxable supplies in excess of NZ\$60,000 per annum. However, various GST concessions apply to non-profit bodies,⁶³ including charities. A non-profit body may treat each of its branches or divisions as separate entities for GST purposes, with the result that each branch or division is only required to register for GST if its annual taxable supplies exceed NZ\$60,000.⁶⁴ Non-profit bodies are not required to account for GST on unconditional gifts they receive.⁶⁵ Furthermore, sales of donated goods and services by a non-profit body are exempt from GST.⁶⁶ These concessions may facilitate avoidance.⁶⁷

IV SHOULD CHARITIES ENJOY PREFERENTIAL TAX TREATMENT?

Having outlined charitable tax concessions in New Zealand, in this section, major arguments for and against preferential tax treatment of charities are considered.⁶⁸

A General Arguments

1 Role as a Quasi-Government Agency

The third sector seeks to bridge the gap between the public services citizens in general expect to be able to access and those the State and the market actually provide. Consequently, numerous charities deliver public services that the State might otherwise provide. This is not an ideological judgment about the extent of government reach; New Zealand is treaty-bound to satisfy its citizens' economic, social and cultural rights.⁶⁹ In terms of subsidy theory, granting tax-free status to charities, which act as quasi-government agencies, is justified as it constitutes a means of indirect State funding of

⁶² See Graeme S Cooper and Richard J Vann, 'Implementing the Goods and Services Tax' (1999) 21 *Sydney Law Review* 337, 354 for a discussion of the principal problems that arise from charities and GST.

⁶³ There are some 97,000 not-for-profit organisations in New Zealand. See Statistics New Zealand, *Non-Profit Institutions Satellite Account: 2004* <http://www.stats.govt.nz/browse_for_stats/industry_sectors/non-profit-institutions-satellite-account-2004.aspx>.

⁶⁴ *Goods and Services Tax Act 1985* (NZ) ('GST Act') s 51(5).

⁶⁵ See the definitions of 'consideration' and 'unconditional gift' in *GST Act* s 2(1).

⁶⁶ *GST Act* s 14(1)(b).

⁶⁷ IRD has identified the following avoidance scheme: fundraising is done on behalf of a charity. Donations are passed to an intermediary closely related to the charity, who is expected to 'donate' these funds to the charity. The charity will not account for GST on the fundraising. Furthermore, the intermediary will claim a donations tax credit, which may be donated to the charity. See IRD, *Revenue Alert RA 11/01* (2011) <<http://www.ird.govt.nz/technical-tax/revenue-alerts/revenue-alert-ra1101.html>>. See also Michael Gousmett, 'Charities and Business Activities' (2009) *New Zealand Law Journal* 57, 57-60 on charitable abuse of the 'corporate veil' and tax avoidance.

⁶⁸ For a comprehensive literature review of taxation of charities, see Not-for-Profit Project, *Taxing Not-For-Profits: A Literature Review* (Melbourne Law School, 2011).

⁶⁹ See, in particular, the *International Covenant on Economic, Social and Cultural Rights ICESCR*, GA Res 2200A (XXI), 21 UN GAOR Supp (No 16), at 49, UN Doc A/6316 (1966), 993 UNTS 3.

essential services.⁷⁰ This is a particularly strong argument in New Zealand, where government has traditionally refrained from providing certain popularly expected public services.⁷¹ Furthermore, since the neoliberal ascendancy in the mid-1980s, governments have relied on charities as they retreat from the role of the 'welfare state as the reliable provider of benefit'.⁷² Charities are, then, increasingly contracted to give effect to governments' mandates. However, there are important distinctions between direct government provision of welfare and government supported welfare through charitable agencies. First, the greater the size of the third sector providing the welfare services the State would otherwise provide, the less citizens have actionable rights claims.⁷³ Second, unlike government agencies, charities are not subject to direct Ministerial oversight, judicial review or investigation by important watchdog institutions of modern governance, such as an Ombudsman or Auditor-General.⁷⁴

Beyond specific contractual mandate, charities and other non-profit organisations may help government to further the broad objective of social inclusion. Increasing support to disadvantaged members of society, for example, may foster a more caring and cohesive political community.⁷⁵ A flourishing third sector may contribute to a fair society: all citizens may gain psychic benefits from living in a society in which everyone enjoys a basic minimum standard of living and care. In a pluralist society, it may be politically problematic for government to focus on the diverse social needs of different minority groups.⁷⁶ Charitable provision of public utilities helps 'to acknowledge the diversity of social need, broadens the range of utilities available and thereby enhances the capacity of a society to act in a more inclusive manner'.⁷⁷ Generally, the public interest is likely to be served by facilitating charities' altruistic activities.⁷⁸

⁷⁰ For an analysis of subsidy theory, see John Simon, Harvey Dale and Lisa Chisholm, 'The Federal Tax Treatment of Charitable Organizations' in Walter W Powell and Richard Steinberg (eds), *The Nonprofit Sector: A Research Handbook* (2nd ed, Yale University Press, 2006) 267, 274–275.

⁷¹ It is noteworthy that New Zealand government neither provides nor significantly funds certain services that citizens need and expect, such as rescue helicopters. See 'The Air Ambulance Rescue Trusts', *Independent Financial Review* (New Zealand), 10 September 2009, 7 for an analysis of the sources of funding of the country's air ambulance trusts.

⁷² Dal Pont, above n 34, 3. During the 2011 financial year, charities received NZ\$5.5 billion for service provision and NZ\$4.8 billion in government grants. See Charities Commission, *A Snapshot of New Zealand's Charitable Sector: A Profile of Registered Charities as at 28 February 2011* (2011) <<http://www.charities.govt.nz/assets/docs/key-statistics/2011/sector.pdf>>.

⁷³ Furthermore, as Colin Crouch, *Post-Democracy* (Polity Press, 2004) 19 observes, the less the State directly provides for the needs of ordinary people, the more apathetic those people will become about democracy.

⁷⁴ As noted, with effect from 1 July 2012, a Board was established to take over the functions of the Charities Commission. The members of the Board are appointed by the Minister of Internal Affairs, and many functions will be delegated to the Department of Internal Affairs: see *Charities Act* s 8.

⁷⁵ Policy Advice Division, *Tax Incentives for Giving to Charities and Other Non-Profit Organisations: A Government Discussion Document* (IRD, 2006) 3.

⁷⁶ Dal Pont, above n 34, 3.

⁷⁷ O'Halloran, above n 33, 36.

⁷⁸ *Ibid*, 20.

When directly implementing government's social requirements, charities are contractually answerable to their principal.⁷⁹ However, in relation to more nebulous outcomes, such as contributing to a fairer society, charities have no statutorily-imposed focus of accountability;⁸⁰ indeed, they 'face multiple and competing accountability demands'.⁸¹ Since 'the primary source of accountability in nonprofit organizations is in the external environment',⁸² unlike directors of companies, whose duties to the company are, in effect, owed to the body of shareholders,⁸³ managers of charities may lack the internal performance pressures that can be expected in the private sector.⁸⁴ One consequence of this potential independence from stakeholder oversight is that charities may amass wealth, rather than distribute it.⁸⁵ Whereas accumulating capital to, say, build a night shelter for the homeless is unquestionably legitimate, it is a moot point whether a cycle of wealth accumulation and capital investment for the benefit of a particular religious denomination warrants tax privilege.⁸⁶

Since all charities qualify for tax concessions, not only those providing services that would otherwise be government's direct responsibility, such tax privilege is 'an imprecise policy instrument and an inefficient way of providing analysis'.⁸⁷ Some social services may be more effectively provided by the third sector, but surely not all charities provide services that might otherwise be provided by government? This question is particularly relevant to religious proselytising, which obviously would not be provided by a secular State. The role of religion in society lies beyond the scope of this article, nevertheless it is pertinent to note the observation of Wendy Cadge and Robert Wuthnow that religion has proved to be an ally of the progressive governments 'in such wide-ranging social causes as education, healthcare reform, overcoming racial discrimination, and protecting the environment'.⁸⁸

⁷⁹ See Shirley Sagawa and Eli Segal, *Common Interest, Common Good: Creating Value through Business and Social Sector Partnerships* (Harvard Business School Press, 1999) 156, on social enterprises that commonly seek independence from the grants of both government and large foundations so as not be compromised by the principal's mandate.

⁸⁰ According to the Charities Commission, charities should have a strong board and be accountable and transparent, but this is a matter of the Commission's 'vision', rather than a statutory requirement. See Charities Commission, *The Qualities of an Effective Charity* (2009) <<http://www.charities.govt.nz/assets/docs/information-sheets/qualities-of-an-effective-charity.pdf>>.

⁸¹ Alnoor Ebrahim, 'The Many Faces of Nonprofit Accountability' (Working Paper 10-1069, Harvard Business School, 2010) 1, 26.

⁸² Kevin P Kearns, 'The Strategic Management of Accountability in Nonprofit Organizations: An Analytical Framework' (1994) 54(2) *Public Administration Review* 185, 191.

⁸³ See, for example, Peter Watts, *Directors' Power and Duties* (LexisNexis, 2009) 142.

⁸⁴ The social enterprise movement seeks to incorporate the disciplines of the corporation into charitable organisations. See, for example, Nic Frances, *The End of Charity: Time for Social Enterprise* (Allen & Unwin, 2008).

⁸⁵ In the United States, in terms of 26 USC § 4942, private foundations are subject to minimum distribution rules.

⁸⁶ See Wendy Cadge and Robert Wuthnow, 'Religion and the Nonprofit Sector' in Walter W Powell and Richard Steinberg (eds), *The Nonprofit Sector: A Research Handbook* (2nd ed, Yale University Press, 2006) 485, 485-505 for a discussion of the merits of religious organisations qualifying for charitable privileges.

⁸⁷ Dal Pont, above n 34, 450.

⁸⁸ Cadge and Wuthnow, above n 86, 500.

2 *Advocacy for the Disempowered*

Kerry O'Halloran notes that:⁸⁹

the trust and specialist knowledge that charities build up in the processes of mediating between giver and recipient places them in a crucially important strategic position between State and citizens, as broker on behalf of the socially disadvantaged and vests them with the responsibility to work with both to further social inclusion.

Having the 'stamp of virtue', charities can mollify the effects of a market economy and link back to traditions of caring.⁹⁰ They 'are then often the only acceptable agency positioned to advocate on behalf of and empower those who would otherwise be left to become alienated'.⁹¹ This socially invaluable role is not, however, performed by all registered charities; perhaps by relatively few of the more than 25,000 charities registered in New Zealand. Furthermore, without a clear statutory mandate and status,⁹² advocacy for the disempowered can have undesirable consequences for charitable organisations.⁹³ Rather than subsidising such a vague function through tax concessions, a dedicated office, perhaps a Commissioner for the Disempowered analogous to the Commissioner for the Environment, might be established.

3 *Problem of Income Measurement*

Charities' income may be difficult to measure because donations are generally excluded from the tax system,⁹⁴ but, whereas measurement of charities' taxable income may be problematic, it is not technically impossible.⁹⁵ Furthermore, technical barriers in assessing income do not justify other concessions, such as exemption from local property rates.

⁸⁹ O'Halloran, above n 33, 12.

⁹⁰ See, for example, Social Policy and Parliamentary Unit, *The Growing Divide: A State of the Nation Report from the Salvation Army 2012* (Salvation Army New Zealand, Fiji and Tonga Territory, 2012).

⁹¹ O'Halloran, above n 33, 35.

⁹² Cf the role of 'critic and conscience of society' established for universities under the *Education Act 1989* (NZ) s 162(4)(a)(v).

⁹³ On 19 September 1979, CORSO lost its tax exempt status and an annual NZ\$40,000 government grant after it released a film criticising the government and drawing attention to New Zealand's role in labour exploitation in Hong Kong, and poverty amongst Māori. See David Sutton, Caroline Cordery and Rachel Baskerville, *Paying the Price of the Failure to Retain Legitimacy in a National Charity: the CORSO Story* (Working Paper No 47, Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, 2007).

⁹⁴ See Boris I Bittker and George K Rahdert, 'The Exemption of Non-Profit Organizations from Federal Income Tax' (1976) 85 *Yale Law Journal* 299, 305. Based on Charities Commission, above n 1, approximately NZ\$9 billion of New Zealand charities' income comes from eminently measurable government grants and income from service provision.

⁹⁵ Miranda Perry Fleischer, 'Theorizing the Charitable Tax Subsidies: The Role of Distributive Justice' (Illinois Law & Economic Research Papers Series Research Paper No LE 09-006, University of Illinois College of Law, 2009) 10 <papers.ssrn.com/sol3/papers.cfm?abstract_id=1348772>.

4 *Compensation for Inability to Raise Capital*

Henry Hansmann observes that ‘in raising capital, nonprofits are limited to three sources: debt, donation, and retained earnings. These three sources may, in many cases, prove inadequate to provide a nonprofit with all the capital it needs’.⁹⁶ Consequently, while noting that ‘an exemption from income taxation is a crude mechanism for subsidizing capital formation in the nonprofit sector’,⁹⁷ Hansmann argues that ‘the need for capital subsidies provides some justification for exempting nonprofits from corporate income taxation in those industries in which, owing to contract failure, nonprofits have important efficiency advantages over for-profit firms’.⁹⁸ Certain charities, notably churches, may already possess substantial real property holdings, which themselves attract generous rating concessions. Government might consider charities’ limited access to capital markets a matter worthy of intervention, particularly where the nonprofit sector is more efficient at delivering services than for-profit firms, but it needs to be asked whether the blunt instrument of tax privilege is an appropriate means of solving the problem.

5 *Responsiveness and Effectiveness*

Charities — and their donors — may respond more quickly to developing social needs than government.⁹⁹ This argument is particularly plausible with regard to identifying ‘the emerging needs of isolated groups in society’, notably newly arrived minorities.¹⁰⁰ Consistent with public choice theory,¹⁰¹ the donations people choose to make may effectively indicate the extra public goods and services needed in society. Furthermore, because charities typically use donated goods and volunteer labour they may represent a financially more efficient way of providing social assistance than government programmes.¹⁰² Conversely, unlike government agencies that are funded by compulsory taxes, to remain viable in a highly competitive donations marketplace, charities are increasingly reliant on professional managers, expensive marketing campaigns and ubiquitous paid ‘chuggers’.¹⁰³ Without access to compulsory contributions, they may be subject to a donations ‘feast or famine’. In a recession, when crises have ‘vacuumed up’ donors’ disposable dollars, or when ‘donor fatigue’ has set in, charities become

⁹⁶ Henry Hansmann, ‘The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation’ (1981) 91 *Yale Law Journal* 54, 72. Conversely, charities are not subject to the onerous capital subscription rules that apply to for-profit organisations when raising funds from the public: see generally the *Securities Act 1978* (NZ).

⁹⁷ *Ibid.*

⁹⁸ *Ibid.*, 75. For a critique of Hansmann’s capital formation theory, see Ira Ellman, ‘Another Theory of Nonprofit Corporations’ (1982) 80 *Michigan Law Review* 999, 999–1018.

⁹⁹ Policy Advice Division, above n 75, 3.

¹⁰⁰ Dal Pont, above n 34, 3.

¹⁰¹ John Meadowcroft, *Major Conservative and Libertarian Thinkers: James M Buchanan* (Continuum International Publishing Group, 2011) 1, identifies public choice as the application of ‘economic theory and analysis to public decisions in the political realm’.

¹⁰² Policy Advice Division, above n 75, 3.

¹⁰³ The social mischief caused by third party fund raisers is considered sufficiently serious for specific legislation to have been introduced. See *Fair Trading (Soliciting on Behalf of Charities) Act 2012* (NZ).

vulnerable and their effectiveness can be challenged. Conversely, in the face of a catastrophe, charities may be simply incapable of handling inflows of donations.¹⁰⁴ There is no way of ensuring that the public donates to the 'right' charity in the time of a crisis. Even under normal conditions, the emotional aspect of charity is likely to ensure that donations are not made in a way that rationally ensures the long-term public good. For example, many people may prefer to give a portion of their scarce resources to a charity that researches an obscure childhood disease, rather than one that helps prevent prisoner recidivism.

B Donors' Tax Privileges

The discussion so far could be reduced to the binary oppositions: charities are good/bad and therefore should/should not receive tax privileges. These arguments largely apply to concessions directly extended to charities but also to donors' tax deductions or credits. Further specific considerations apply to donor concessions.¹⁰⁵

1 Incentives

The Laws of New Zealand sums up the two basic considerations that inform taxpayer concessions for charitable donations in the following terms:¹⁰⁶

The object of the Legislature in relieving charitable gifts from [tax] is to encourage such gifts. Taxation is remitted from such gifts because the public receives a benefit from that remittance, as the burden of maintaining the objects of the gift and the burden upon finances are lessened by the remittance. On the other hand, an exemption to a taxing statute adds to the burdens of the public.

In short, those who can afford to donate should be encouraged to do so,¹⁰⁷ but all taxpayers share the burden of a donor's generosity.¹⁰⁸ Assuming that charities provide the types of public services taxpayers actually want and use — although, that is far from certain — spreading costs across all taxpayers prevents free riding.¹⁰⁹ However, in practice, there is no proven connection between the services a charitable organisation chooses to provide and potentially free riding taxpayers.

¹⁰⁴ See Robert A Katz, 'A Pig in a Python: How the Charitable Response to September 11 Overwhelmed the Law of Disaster Relief' (2003) 35 *Indiana Law Review* 251, 251-333 on the inability of American charities to deal with the massive inflow of donations following the 11 September 2001 terrorist attacks.

¹⁰⁵ Strictly speaking, in the New Zealand context, these questions should be distinguished between whether donations to charities by (a) companies (especially closely held companies) should qualify for a deduction; or (b) individuals should qualify for a tax credit. While recognising that companies do not directly experience utility or disutility, the two queries are conflated for convenience.

¹⁰⁶ *The Laws of New Zealand*, above n 25, [287].

¹⁰⁷ Dal Pont, above n 34, 448. For a full discussion of the potential role of theorising charitable tax privileges, see Fleischer, above n 95, 19-47.

¹⁰⁸ It is typically argued that it is unfair that taxpayers with the highest marginal tax rates should benefit the most: see, for example, Dal Pont, above n 34, 450. However, this argument is not valid in New Zealand because individuals qualify for a tax credit, rather than a tax deduction. Consequently, all taxpayers obtain the same amount of tax credit for the same amount donated.

¹⁰⁹ Boris I Bittker, 'Charitable Contributions: Tax Deductions or Matching Grants' (1978) 28 *Tax Law Review* 37, 37-63.

2 *Donation as Consumption*

The dominant Haig-Simons model of income includes accretions in wealth and consumption between points in time.¹¹⁰ On this logic, if a donation does not constitute consumption, it is not income and should, therefore, be excluded or deductible from income tax. It may be argued that a donor forgoes the economic power to consume the value of a donation, and therefore the donation should not be taxed as income.¹¹¹ Furthermore, a donor, such as the philanthropist who endows an art gallery, may be said to share with others any benefit she receives from her donation.¹¹² However, as Miranda Fleischer observes, the more common view is that an individual's charitable donations do indeed constitute consumption and should, therefore, be taxable under the Haig-Simons model.¹¹³ According to James Andreoni, 'warm glow' or 'impure altruism' theory indicates that '[w]hen people make donations to privately provided public goods, they may not only gain utility from increasing its total supply, but they may also gain utility from the act of giving'.¹¹⁴ Not only may donors gain utility from giving, they may also enjoy the further psychic benefits of community esteem, and even recognisable rewards, such as degrees conferred *honoris causa* or public honours.

3 *Administrative Efficiency*

Donor concessions effectively divert revenue, which would otherwise go to the treasury, directly from taxpayers to charities. Such indirect funding by government may be administratively efficient,¹¹⁵ but lacks transparency.¹¹⁶ Furthermore, when deductions or tax credits are not subject to a maximum sum, government may be less able to anticipate tax yield.¹¹⁷ Generous taxpayer concessions may also encourage avoidance schemes, evasion and fraud. IRD has already identified certain generic schemes that are financially neutral between the parties involved but would not be transacted unless the enhanced donations deductions were available.¹¹⁸ This is not, in itself, an argument

¹¹⁰Robert Murray Haig, 'The Concept of Income' in Robert Murray Haig, Thomas Sewall Adams and Thomas Reed Powell (eds), *The Federal Income Tax* (first published 1921, BiblioBazaar, 2009) 7 defines income as the 'money value of the net accretion to one's economic power between two points of time'. Henry C Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (University of Chicago Press, 1938) 50 defines personal income as 'the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question'.

¹¹¹Dal Pont, above n 34, 448.

¹¹²William D Andrews, 'Personal Deductions in an Ideal Income Tax' (1972) 86 *Harvard Law Review* 309, 344-375.

¹¹³Fleischer, above n 95, 10. As Simon et al, above n 70, 274 note, '[i]t is hard to see why a gift to a stranger, poor or rich, is consumption, whereas a gift to charity is not'.

¹¹⁴James Andreoni, 'Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving' (1990) 100 *Economic Journal* 464, 473.

¹¹⁵See, for example, Industry Commission, *Charitable Organisations in Australia* Report 45 (Australian Government Publishing Services, 1995) 271.

¹¹⁶Dal Pont, above n 34, 450.

¹¹⁷Ibid. While this does not appear to be a plausible concern in New Zealand at present, charitable deductions may distort democratically negotiated spending patterns: insufficient tax revenue may be available for government projects, while donations are funnelled to the pet causes of the wealthy.

¹¹⁸One scheme involves a creditor of the charity, which cannot repay the debt. The creditor makes an additional payment to the charity to allow it to repay the original debt. This transaction only takes place

Footnote continues over page

against taxpayer concessions, but, because the administrative costs of policing fraud and evasion should be taken into account, it needs to be asked whether the public benefits gained by the concessions could be achieved in other ways that do not facilitate avoidance, such as direct grants to charities drawn from contestable funds.

4 *Policy Justification*

Currently, insufficient policy analysis exists to justify or deny charitable tax privileges.¹¹⁹ In particular, it is difficult not to infer a degree of political expediency to the 2008 expansion of donation tax concessions by the Labour-led government at the behest of the ideologically elusive United Future party. Peter Dunne, the sole Member of Parliament for United Future, and Minister of Revenue, described the amending Bill¹²⁰ as 'a particular consequence of the confidence and supply agreement between United Future and Labour';¹²¹ he did not, however, plausibly explain the Bill's underpinning policy.

C Preliminary Conclusions and Recommendations

Gino Dal Pont concludes that, although no one particular theory or argument 'is conclusive in itself, they do combine to form a considerable arsenal against taxing charitable bodies'.¹²² However, it is implausible that all of the 25,000 and more registered charities in New Zealand perform universally admired humanitarian functions that deserve public respect and fiscal reward. Indeed, even unimpeachable charities often conflate their uncontroversial charitable work with religious proselytising that is anathema to a secular understanding of charity.¹²³ Conversely, arguments against tax privileges do not apply to all charities, but do indicate that a more focused approach is needed to establish qualification for tax privileges.

The current system for regulating and taxing the third sector in New Zealand may be optimal. However, it is not possible to know whether charities are, in fact, performing

because of the ability to claim the tax deduction/credit for the donation. The second scheme relates to the situation where a person intends to donate goods to a charity. Rather than donate the goods, the person donates cash. The charity then purchases the goods that would originally have been donated. See IRD, above n 67. With regard to the second identified scheme, the problem may lie with the law. Analogous to fringe benefits, the value of gifts in kind might be made deductible in the same way as monetary donations.

¹¹⁹ Dal Pont, above n 34, 450. It is submitted that IRD's 2006 analysis (Policy Advice Division, above n 75), was insufficiently robust in its analysis of arguments against extending tax credits and deductions relative to its 2001 analysis (Policy Advice Division, above n 10.)

¹²⁰ Taxation (Business Taxation and Remedial Matters) Bill 2007 (7-109).

¹²¹ New Zealand, *Parliamentary Debates*, House of Representatives, 11 December 2007, 13767 (Peter Dunne).

¹²² Dal Pont, above n 34, 448.

¹²³ For a discussion of non-religious taxpayers subsidising religious organisations as tax-exempt charitable organisations, see Blundell, above n 60, 26-29. Generally, following Wallace, above n 31, Blundell argues that charitable firms enjoy an unfair advantage over for-profit firms, and should at least have their books opened up to public scrutiny: *ibid*, 29. Hansmann (above n 10, 79) also concludes that 'tax exemption - or at least exemption from sales, and, particularly, corporate income taxes - offers nonprofit firms a significant advantage in establishing market share vis-à-vis for-profit firms offering similar services'.

the activities that benefit the general public, and which contemporary society wishes to subsidise, because of the opacity that obfuscates analysis of the sector. It is submitted that, particularly at a local level,¹²⁴ there needs to be greater citizen participation in decisions about charities' tax privileges,¹²⁵ but before an informed debate can commence, full transparency about which organisations benefit from tax concessions is necessary. In short, sufficient reliable information is not currently available to inform relevant policy.¹²⁶ Despite this lack of information, it is submitted that the following recommendations deserve further consideration:

1 *Statutory Definition of 'Charity'*

O'Halloran observes that 'the fact that four centuries of charity law has left poverty firmly entrenched in the common law nations raises some basic questions'.¹²⁷ So: does the Preamble-derived definition of 'charity' meet contemporary needs or should it be superseded by a statutory definition? Ken Lord and David McLay argue that the lack of a positive statutory definition 'is probably a good thing, even if based on the simple but powerful argument that proscription may unwittingly result in the exclusion of charities which benefit society immensely'.¹²⁸ A non-exhaustive definition that may accommodate unforeseen purposes seems uncontroversial, but whether such flexibility should be delivered by the common law or legislation is debatable.

While the Preamble was not a *tabula rasa*,¹²⁹ since its enactment, the common law has developed from a particular statute, enacted for particular historical purposes. Thus Fiona Martin observes:¹³⁰

The history of the legal definition of 'charity' shows that this development must be viewed in the context of the economic situation of the seventeenth and eighteenth centuries. Commencing with the Preamble in 1601, it was drafted with the state's agenda for

¹²⁴ Local Government Rates Inquiry Panel, *Funding Local Government: Report of the Local Government Rates Inquiry* (Local Government Rates Inquiry, 2007) 227 noted: 'Almost universally, local government supports removing statutory exemptions and having the power to determine what land should continue to be exempt. Local government would exercise this power through its rates remission policies.'

¹²⁵ The 'tyranny of the majority' could result in minority-oriented charities being disfavoured, but New Zealand has robust anti-discrimination legislation, procedures, and culture to render this a minor consideration. Besides, government can also make good the gaps in charitable delivery.

¹²⁶ The making available of charities' annual reports by the Charities Commission is a significant step towards transparency, but both government and the charities themselves need to do more in showing how they benefit from tax revenue and how they promote public benefit. Dervan above n 29, 54 notes that leading independent schools in the United Kingdom voluntarily (and prudently) publish on their websites how they meet the public benefit criterion, and argues that since 'such schools receive fiscal benefits, there is no reason why this information should not be public'.

¹²⁷ O'Halloran, above n 33, 17.

¹²⁸ Ken Lord and David McLay, *Charities Act 2005: The New Deal* (New Zealand Law Society, 2006) 4. However, the common law framework has operated to obstruct philanthropic activity on behalf of the socially disadvantaged Māori. See Policy Advice Division, *Government Discussion Document No 2 of the Tax Simplification Series: Taxation of Māori Organisations* (IRD, 2001).

¹²⁹ According to W K Jordan, *Philanthropy in England 1480-1660: A Study of the Changing Pattern of English Social Aspirations* (Russell Sage Foundation, 1959) 112, the Preamble was notable because it codified 'a body of law badly wanting classical statement'.

¹³⁰ Martin, above n 40, 324 (footnotes omitted).

charitable giving in mind, rather than contemplating a list of altruistic purposes that were considered worthy of charitable relief. When drafting the Preamble, the government did not consider from a public policy perspective which areas were important for the benefit of its citizens, but, rather, listed Elizabethan political, economic and social programmes with government hoping that the wealthy would be encouraged to implement and fund these particular areas in order to relieve them from this necessity.

A serious challenge was made to charities' tax privileges by William Gladstone, who, as Chancellor of the Exchequer in 1863, sought to limit the exemption to the relief of hospitals, colleges and almshouses.¹³¹ Significantly, his rationale was 'that the original exemption had been warranted at a time when the state made no provision for education or for the poor and that the situation in 1863 was very different, and therefore the exemption was no longer needed'.¹³² If broad tax concessions could be considered out of date in the mid-nineteenth century, it seems they might appear positively obsolete in a contemporary context. Indeed, in the heyday of the welfare state in the forty year period following the Second World War, the idea of a third sector in New Zealand making good the gaps in the provision of public goods and services may have seemed archaic. However, with the retreat, albeit not withdrawal, of the State from direct welfare provision since the mid-1980s, the role of the third sector has been re-emphasised.

The common law may be sufficiently flexible to allow some expansion of the scope of charitable purposes so as to meet the social values and attitudes prevalent in a particular society,¹³³ but adherence to the common law in New Zealand has left charitable law 'largely unchanged in terms of its capacity to address contemporary social inclusion issues'.¹³⁴ Furthermore, it is not obvious that the common law is capable of removing antiquated charitable purposes — religious proselytising being the most archaic purpose from a secular perspective.

The common law is complex and, not being codified, difficult to access without specialist knowledge. Consequently, 'charitable' in the legal sense does not correspond with the popular understanding of 'eleemosynary' (alms giving).¹³⁵ 'The current meaning of charity and charitable purpose is largely defined at common law, which has developed over 400 years. As a result the law can often be confusing and unclear'.¹³⁶ Indeed, Lord Simonds, contemplating the common law on charities, observed in *Oppenheim v Tobacco Securities Trust Ltd* '[n]o one who has been versed for many years in this difficult and very artificial branch of the law can be unaware of its illogicality'.¹³⁷

¹³¹ Ibid, 309.

¹³² Ibid.

¹³³ *Centre Point Community Trust v CIR* [1985] 1 NZLR 673, 679.

¹³⁴ O'Halloran, above n 33, 309.

¹³⁵ Dal Pont, above n 34, 8.

¹³⁶ Australian Treasury, *A Definition of Charity: Consultation Paper* (2011) http://www.treasury.gov.au/documents/2161/PDF/definition_v6.pdf (no longer operative). This document has since been archived: see http://archive.treasury.gov.au/documents/2161/PDF/definition_v6.pdf.

¹³⁷ *Oppenheim v Tobacco Securities Trust Ltd* [1951] AC 297, at 307.

Adoption by the early colony of the English common law and equity,¹³⁸ albeit 'so far as applicable to the circumstances' of the country,¹³⁹ impacts on the contemporary formulation, operation and strategies of New Zealand charities. And so, while New Zealand continues to develop as a distinctive common law patois,¹⁴⁰ English law 'is generally considered to set out the principles of charity law in New Zealand'.¹⁴¹ Furthermore, despite recent reforms, the 'Charities Act 2005, on the face of it, has left charity law in New Zealand anchored to its common law legacy'.¹⁴² In *Commissioner of Inland Revenue v Medical Council of New Zealand*, Justice Thomas held that the 'spirit and intendment' rule should be used with more attention to contemporary circumstances than to case precedent.¹⁴³ This relaxation of the public benefit test to accommodate 'other purposes beneficial to the community' indicates the flexibility of the common law in the hands of a progressive jurist.¹⁴⁴ However, a contemporary legislative definition of 'charity' informed by current needs and aspirations, and public consensus, seems desirable. In response to the difficulties arising from adherence to a common law conception of charity, the Australian Treasury argues:¹⁴⁵

A statutory definition of charity will allow Parliament to more easily alter the definition over time to ensure that it remains appropriate and reflects modern society and community needs, rather than having the common law being developed only by the courts as an ad hoc, costly and time consuming process.

This argument appears plausible,¹⁴⁶ provided that the legislative process is not subject to undue lobbying and the influence of special interest groups.

2 Filing

Since charities are not required to file income tax returns if all their income is exempt,¹⁴⁷ the total amount of income which is not subject to tax cannot be established. While this concession simplifies compliance and minimises administration costs, it also ensures an

¹³⁸ As Justice Denniston observed in *Re Dilworth (Deceased)* (1896) 14 NZLR 729, 735: 'It would be absurd to contend that, apart from any legislation in New Zealand, a bequest for charitable purpose by a testator in New Zealand would be interpreted by any other standard than that of the measure of the same words in English law.'

¹³⁹ See consolidation by *English Laws Act 1908* (NZ) s 3. *Imperial Laws Application Act 1988* (NZ) s 5 perpetuates the application of the common law and equity (to charities). The most obvious accommodation of local circumstances in New Zealand charity law lies in the acceptance that Māori charities often benefit blood relations; charity may be said to start on the *marae* (community meeting place). See, in particular, *Income Tax Act 2007* s YA 1 definition 'charitable purpose' para (b).

¹⁴⁰ See, for example, Michael Taggart, 'The New Zealandness of New Zealand Public Law' (2004) 15 *Public Law Review* 81, 81-86.

¹⁴¹ Lord and McLay, above n 128, 4.

¹⁴² O'Halloran, above n 33, 309.

¹⁴³ *Commissioner of Inland Revenue v Medical Council of New Zealand* [1997] 2 NZLR 297.

¹⁴⁴ O'Halloran, above n 33, 288

¹⁴⁵ Australian Treasury, above n 136.

¹⁴⁶ A statutory definition of 'charity' was included in the *Charities Act 2006* (UK). Despite this innovation, in the view of Garry Runciman, '[c]harity law is a mess.' See W G Runciman, 'The Charity Mess' (2012) 34(14) *London Review of Books* 20, 20.

¹⁴⁷ See above n 9.

unacceptable degree of opacity. Filing should be an obligation.¹⁴⁸ Regular monitoring should also be conducted to ensure that the charitable objects for which their tax exemptions were granted are, in fact, being pursued.¹⁴⁹

3 *Neutrality*

It is widely believed that, by virtue of tax concessions, charities gain an unfair advantage when they operate in the same markets as commercial entities.¹⁵⁰ There can be little doubt that the rating exemption enjoyed by many charities 'because it reduces input costs, assists a non-profit in a contest with taxable competitors'.¹⁵¹ The principle of neutrality implies that tax advantages for charities should be denied when they compete in the same field of enterprise as profit-seeking firms;¹⁵² conversely, the latter might attract the same tax advantages when performing similar functions to charities.¹⁵³ Certainly, FBT concessions, which might attract employees to charities from profit-seeking firms, should be phased out.¹⁵⁴ Trading operations of charities could be subject to income tax in the normal way, and like any other company, they could claim unlimited deduction of charitable donations.¹⁵⁵ At first face, then, firms affiliated to charities should be treated in precisely the same way as ordinary companies.¹⁵⁶ However, Eleanor Brown and Al Slivinski argue that charitable firms typically do not have a pure profit motive; they do not behave in the same way as profit-seeking firms; in short, '[n]onprofit firms are not, in general, for-profits in disguise'.¹⁵⁷ Furthermore, John Colombo argues:¹⁵⁸

the criterion that can and should be used to judge exempt status in these cases of "commercial similarity" is whether the organization provides access to services for previously-underserved populations or provides specific services to the majority population that otherwise are not provided by the private sector.

¹⁴⁸ Policy Advice Division, above n 10, 9 contemplated that tax returns would be 'possibly' filed.

¹⁴⁹ Ibid, 10.

¹⁵⁰ Dal Pont, above n 34, 448.

¹⁵¹ Simon et al, above n 70, 288.

¹⁵² See, Ross Report, above n 10, 312-313.

¹⁵³ For a discussion, see Anyp Malani and Eric A Posner, 'The Case for For-Profit Charities' (John M Olin Law & Economic Working Paper No 304, University of Chicago Law School, 2006) <http://ssrn.com/abstract_id=928976>.

¹⁵⁴ Policy Advice Division, above n 10, 10. As noted, this did not happen. Policy Advice Division, *Recognising Salary Trade-offs as Income* (IRD, 2012) 17 recommended bringing salary trade-offs and voucher schemes into the FBT net for employees of charities. On phasing out FBT concessions for charities in Australia, see Productivity Commission, *Contribution of the Not-for-Profit Sector* (2010) <<http://www.pc.gov.au/projects/study/not-for-profit/report>> 211-218.

¹⁵⁵ cf Policy Advice Division, n 10 above, 43.

¹⁵⁶ In 1987, the neoliberal Labour government announced radical plans, including a flat income tax and for charities to be taxed in the same way as companies. Neither proposal was enacted.

¹⁵⁷ Eleanor Brown and Al Slivinski, 'Nonprofit Organizations and the Market' in Walter W Powell and Richard Steinberg (eds), *The Nonprofit Sector: A Research Handbook* (2nd ed, Yale University Press, 2006) 140, 154.

¹⁵⁸ John D Colombo, 'The Role of Access in Charitable Tax Exemption' (2004) 82(2) *Washington University Law Review* 343, 345.

In short, the principle of neutrality is not controversial; what is problematic is demonstrating that for-profits and charitable firms are equally situated, and therefore warrant equal treatment.

Neutrality between charities and the government agencies with which they may compete in providing social services should also be considered. On the one hand, their apparently equal situation may support arguments for tax-free status for charities, but arguably the more pertinent neutrality consideration raised here relates to citizen rights and accountability. If charities compete with government agencies, they should be subject to similar accountability disciplines as the public sector.

V CONCLUSION

Contemplating the American third sector, but expressing a sentiment relevant to New Zealand, Roger Colinvaux argues that the time is ripe 'to begin developing a clearer idea of the type of organisation that should be supported by the tax system, and, critically, to what extent'.¹⁵⁹ This article has outlined the development of the common law conception of charity and charitable tax concessions in New Zealand. Without gainsaying the socially invaluable work performed by many charities, charitable tax policy is not well informed.¹⁶⁰ Efficiency and neutrality, two of the pillars of good tax policy, remain mostly unexamined in relation to charitable concessions. In the wake of the global financial crisis and increasing socio-economic inequality, government must, on the one hand, ensure there is no unjustifiable leakage from the treasury, but on the other hand, avoid exacerbating the plight of those worst off in society, who are typically the beneficiaries of charities' endeavours. It is politically implausible to think that government might remove tax privileges from all charities, indeed, tax concessions once enacted tend to become entrenched. However, while these substantial benefits merit reconsideration, such a review is not possible without the transparency that is currently lacking in the New Zealand third sector.

¹⁵⁹ Roger Colinvaux, 'Charity in the 21st Century: Trending Toward Decay' (2011) 11(1) *Florida Tax Review* 1, 70.

¹⁶⁰ 'In every jurisdiction except the United States, there has been **remarkably little substantive literature on the taxation concession.**' See Not-for-Profit Project, above n 69, 3 (emphasis in original).