

SOCIAL ENTERPRISE: SOME TAX POLICY CONSIDERATIONS

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ABSTRACT

Bright lines do not demarcate altruistic and entrepreneurial domains: many charities engage in trade and many companies perform some public benefit functions. The emergence of social enterprises, which employ features of business and charitable practices, has highlighted the desirability of revisiting simple policy and legal distinctions drawn between altruistic and for-profit firms. Since charitable firms are commonly thought to enjoy advantages over for-profit firms competing in the same market, and have come under increased scrutiny from revenue authorities, the social enterprise phenomenon makes the reformulation of tax policy a pressing concern. Using New Zealand as a jurisdictional focus, but drawing on overseas research and experience, this article discusses how tax policy might be reformulated in the face of the social enterprise phenomenon.

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I INTRODUCTION

New Zealand charities and related tax law is fundamentally derived from the Preamble to the *Charitable Uses Act 1601*¹ and its subsequent restatement in *Commissioner of Income Tax v Pemsel*.² Consequently a charity must, in short, have a charitable purpose (relieving poverty, advancing education, advancing religion or otherwise benefiting the community) and have a public benefit.³ Charities may engage in trade, provided such a business is 'not carried on for the private pecuniary profit of any individual'.⁴ Broadly, charities are exempt from income tax.⁵

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¹ 43 Eliz I c 4, also known as the *Statute of Charitable Uses* or the *Statute of Elizabeth*. For a reproduction of the Preamble, see *The Statute of Charitable Uses and the English Origins of American Philanthropy* Harvard Kennedy School <<http://www.hks.harvard.edu/fs/phall/01.%20Charitable%20uses.pdf>>; for a discussion of the role of the Preamble in the development of charities law, see 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, 2010) 297, 297-325.

² *Commissioner of Income Tax v Pemsel* [1891] AC 531 established that other charitable purposes could be accommodated if consistent with the Preamble's 'spirit and intendment'.

³ See LexisNexis, *Laws of New Zealand* (at 31 January 2013) Charities, '(2) Charitable Purpose' [12].

⁴ *Charities Act 2005* (NZ) s 13(1)(b). The Charities Board and the chief executive of the Department of Internal Affairs, which replaced the Charities Commission with effect from 1 July 2012, are responsible for oversight of New Zealand charities.

⁵ Charities registered in terms of the *Charities Act* do not pay income tax on their business income to the extent that such income is applied for charitable purposes within New Zealand: see *Income Tax Act 2007* (NZ) s CW 42.

Bright lines do not demarcate charitable and business operational domains. In New Zealand, for example, Sanitarium,⁶ the non-spiritual arm of the Seventh Day Adventist church, directly competes with multinational corporations, such as Kellogg's,⁷ and domestic firms, notably Hubbards,⁸ in the same breakfast cereals market.⁹ As a registered charity, Sanitarium is exempt from income tax; its competitors are not and yet also engage, to a degree, in activities that benefit the public through corporate social responsibility (CSR)¹⁰ and sustainable development programmes.¹¹ The principal

⁶ The Sanitarium brand is used in New Zealand by the New Zealand Health Association Ltd which is owned by The New Zealand Conference Association, itself part of the Seventh Day Adventist Church in New Zealand 1 group; all these organisations are registered charities. For convenience sake, in this article, we refer to Sanitarium as if it were a trading company.

⁷ Kellogg (New Zealand) Ltd is a wholly owned subsidiary of Kellogg (Aust.) Pty. Ltd and part of the United States-listed Kellogg's Company.

⁸ Hubbard Foods Ltd – trade mark 'Hubbards' – is a non-listed company based in Auckland which employs roughly 130 staff: see Jodyanne Kirkwood and Brendan Gray, 'From Entrepreneur to Mayor: Assessing the Impact of the Founder's Changing Reputation on Hubbard Foods Ltd' (2009) 17(2) *Australasian Marketing Journal* 115, 115-124.

⁹ The comparison between Sanitarium and Kellogg's is particularly apposite since both companies were founded by the Kellogg brothers. See Christopher Adams, 'Lifting the Lid on Sanitarium', *The New Zealand Herald* (online), 30 June 2012 <http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10816412>. For a less reliable, but more entertaining, account, see T C Boyle, *The Road to Wellville* (Viking, 1993).

¹⁰ Kellogg's bases its CSR programme on 'the four pillars' of 'Marketplace, Workplace, Environment and Community': see Kellogg's Company, *Corporate Responsibility Strategy* (2012) <<http://www.kelloggcorporateresponsibility.com/overview/corporate-responsibility-strategy>>.

¹¹ Hubbards pioneered triple bottom line reporting in New Zealand: see Hubbard Foods Ltd, *Hubbards Triple Bottom Line Report April 2000-March 2001* <<http://www.hubbards.co.nz/userDocuments/TBL01.pdf>>. (Triple bottom line is 'an accounting framework that incorporates three dimensions of performance: social, environmental and financial': see Timothy F Slaper and Tanya J Hall, 'The Triple Bottom Line: What Is It and How Does It Work?' (2011, Spring) *Indiana Business Review* 4, 4.) Hubbard's also engages in

grounds for preferential tax treatment of charities are:¹² their playing the role of a quasi-government agency;¹³ their advocating for the disempowered;¹⁴ the problems associated with assessing their taxable income;¹⁵ compensating them for their inability to raise capital;¹⁶ rewarding their responsiveness and effectiveness;¹⁷ and their role in correcting market failure.¹⁸ It is a moot point whether a charitable company, such as Sanitarium, meets all, or indeed, any of these criteria but the law does not engage with that question:

sustainable business practices: see Sustainable Business Council, *Sustainable Development Reporting Case Study: Hubbard Foods* <http://www.sbc.org.nz/_data/assets/pdf_file/0003/55587/Hubbards-SDR-Case-Study.pdf>.

¹² See Gino Dal Pont, *Charity Law in Australia and New Zealand* (Oxford University Press, 2000) 448 on the persuasiveness of these arguments when considered together.

¹³ 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. There is no evidence that Sanitarium acts as a proxy for government.

¹⁴ See Kerry O'Halloran, *Charity Law and Social Inclusion: An International Study* (Routledge, 2007) 35. Sanitarium does not play a noticeable advocacy role in New Zealand, other than for its own interests.

¹⁵ 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. As a registered company, Sanitarium is subject to normal financial reporting obligations under the *Financial Reporting Act 1993* (NZ) and presumably complies with New Zealand generally accepted accounting practice.

¹⁶ See Henry Hansmann, 'The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation' (1981) 91 *Yale Law Journal* 54, 72. Like Hubbards, Sanitarium may not be able to offer shares to the public but, unlike Hubbards or Kellogg's, can draw on congregation donations and tithes.

¹⁷ See Policy Advice Division, *Tax Incentives for Giving to Charities and Other Non-Profit Organisations: A Government Discussion Document* (Inland Revenue Department, 2006) 3.

¹⁸ See John D Colombo, 'The Role of Access in Charitable Tax Exemption' (2004) 82(2) *Washington University Law Review* 343, 345. The provision of healthy breakfast food appears to have been the motive for both the Kellogg brothers. Once Kellogg's established itself as a purveyor of similar foods to Sanitarium, it is arguable that no market failure existed to be corrected.

the simple but critical consideration that fundamentally distinguishes a charity from any other firm is whether the firm is constitutionally prohibited from distributing its surpluses to individuals.¹⁹

In contrast with what might be characterised as a long-term shift towards trade on the part of traditional charities,²⁰ more recently, social enterprises have emerged that seek to achieve public benefits through corporate structures and entrepreneurial behaviours.²¹ Overseas legislatures have recognised the increasing hybridisation of altruism and enterprise to establish vehicles that ‘blur the line between non-profits and for-profits by allowing for some profit, although directed at a charitable or altruistic purpose’.²²

The pivotal public/individual benefit distinction drawn by the law to distinguish charitable from for-profit firms fails to reflect the practice of convergence of altruism and entrepreneurship.²³ Different treatment of firms, which appear to be similarly situated, may be considered inequitable and, furthermore, may cause the potential efficiency advantages of entrepreneurial delivery of public benefits to be lost. Despite hard and fast legal and tax categorisation, in practice, a continuum runs from pure charity to Friedmanite, shareholder value-maximising firm.²⁴ Points between these poles include: charities that engage in ancillary trade;²⁵ charities that employ corporate

¹⁹ See Anup Malani and Eric A Posner, “The Case for For-Profit Charities” (2007) 93 *Virginia Law Review* 2017, 2020; see also *Charities Act* s 13(1)(b).

²⁰ ‘Of the total income for non-profit institutions, 61 percent came from the sale of goods and services’: see Statistics New Zealand, *Non-profit Institutions Satellite Account: 2004* (2007) <<http://www.stats.govt.nz>>.

²¹ See, generally, Nic Frances, *The End of Charity: Time for Social Enterprise* (Allen & Unwin, 2008).

²² *Not-for-Profit Project, Taxing Not-For-Profits: A Literature Review* (Melbourne Law School, 2011) 37.

²³ As Malani and Posner, above n 19, 2020 observe, under the traditional ‘all or nothing’ approach, any distribution of surplus to stakeholders negates all charitable tax concessions.

²⁴ See Milton Friedman, “The Social Responsibility of Business is to Increase its Profits”, *The New York Times Magazine* (New York), 13 September 1970, 32, 32-33.

²⁵ See, for example, the Salvation Army’s ‘Family Stores’.

disciplines;²⁶ charities that are businesses;²⁷ hybrids that have surplus distribution caps and specific community interests;²⁸ and for-profit firms that have some social or environmental goals.²⁹ Since charitable firms are commonly thought to enjoy significant advantages over for-profit firms,³⁰ notwithstanding plausible arguments to the contrary,³¹ the different manifestations of the social enterprise phenomenon make the formulation of tax policy for the third sector more problematic and worthy of revisiting.³²

²⁶ Skylight, for example, which is registered as The Children's Grief Centre Charitable Trust CC27206, describes itself as operating 'as a social enterprise, balancing our social mission with the need to generate income to ensure we contribute to our own sustainability': see Skylight, *Skylight's Beginnings* <<http://www.skylight.org.nz/About+Skylight%27s+Beginnings>>. We are grateful to Nazir Awan for discussing his research into Skylight's ethos and practices with us.

²⁷ Mark von Dadelszen, *Law of Societies in New Zealand: Unincorporated, Incorporated and Charitable* (Butterworths, 2000) [13.2.7] n 79 cites examples of a drapery, furnishing and warehouse business; a construction business; and an automobile and engineering parts business.

²⁸ Hybrid social enterprise companies are sketched at III B below.

²⁹ See, nn 10 and 11 above, on CSR and sustainable business practices.

³⁰ See, for example, *Taxation in New Zealand: Report of the Taxation Review Committee* (Government Printer, 1967) 308-313; Policy Advice Division, *Tax and Charities: A General Discussion Document on Taxation Issues relating to Charities and Non-Profit Bodies* (Inland Revenue Department, 2001) 43.

³¹ 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; 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; Colombo, above n 18, 345.

³² The first sector is government, the second sector business and third sector public benefit, non-profit organisation: see 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, Washington (DC), 1975) 1, 11. In this article, we do not follow Thomas Kelley's proposal that emerging forms of social enterprise should be identified as the 'fourth sector': see Thomas Kelley, 'Law

Using New Zealand as a jurisdictional focus but drawing on overseas research, in this article we discuss tax policy regarding traditional charitable firms in the light of emerging social enterprises. In particular, we consider the radical proposition that tax policy in relation to public benefit might be informed by institutional function rather than institutional status, which is derived from constitutional structure. First, we discuss specific issues that arise from New Zealand's current tax treatment of charitable trade. Second, to demonstrate the convergence of altruism and enterprise, we sketch the phenomenon of social enterprise and the different forms of hybrid corporate structures that are permitted overseas for jointly pursuing profit and public benefit. Third, we discuss the potential for neutral tax treatment of entities that pursue socially beneficial goals, and draw conclusions.

II SPECIFIC ISSUES

In this part of the article, we identify specific issues that arise from New Zealand's current treatment of charitable trade: these issues relate to the scope of public benefit and the position of charitable companies.

A The Scope of Public Benefit

A full discussion of public benefit lies beyond the scope of this article but certain issues raised by two recently decided High Court cases are particularly pertinent and illustrative:³³ first, financial activities may enjoy charitable status provided the participants believe these activities advance their particular religious beliefs, and, second, certain activities which, in a lay view, appear to be eminently for public benefit, may be excluded because of the *Pemsel* test. In short, the decisions demonstrate that the

and Choice of Entity on the Social Enterprise Frontier' (3 April 2009) Social Sciences Research Network <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1372313>.

³³ For a discussion of public benefit, see Debra Morris, 'Public Benefit: the Long and Winding Road to Reforming the Public Benefit Test for Charity: A Worthwhile Trip or 'Is Your Journey Really Necessary'?' in Myles McGregor-Lowndes and Kerry O'Halloran (eds), *Modernising Charity Law: Recent Developments and Future Directions* (Edward Elgar Publishing, 2010) 103, 103-127.

concept of public benefit is overly inclusive in certain regards and, conversely, unduly exclusive in other regards.

1 Inclusion

*Liberty Trust v Charities Commission*³⁴ concerned the charitable status of the Liberty Trust, a mortgage lending scheme principally funded by donations, which makes interest-free loans to donors and others. The trust argued that the lending scheme advances religion by teaching, through action, financial principles derived from the Bible. The Charities Commission decided that, although the scheme might be conducive to religion, it does not advance religion and its main purpose is to provide private benefits to members.³⁵ However, ordering reinstatement to the Charities Register, the High Court held that the purpose of the trust was to advance religion, which purpose it pursued by teaching biblical financial principles as understood by the trustees and participants. Because the trust's founding purpose was the advancement of religion, its public benefit could be rebuttably presumed. Justice Mallon observed:³⁶

As a trust which has as its purpose the advancement of religion, the starting assumption is that it has a public benefit ... It is not for the Court to impose its own views as to the religious beliefs that are advanced through the scheme.

From this decision, it may be concluded that: first, the advancement of a religious doctrine, however eccentric it might appear to the general public,³⁷ is presumptively for the public benefit and therefore worthy of legal and tax privileges; and, second, ostensible openness equates to 'public' even though it may be inferred that the participants, in practice, would be a select group of co-religionists.

³⁴ *Liberty Trust v Charities Commission* [2011] 3 NZLR 68.

³⁵ See *Charities Act* ss 5(1) and 13(1).

³⁶ *Liberty Trust* [2011] 3 NZLR 68, [125]. Mallon J also observed that anyone could join the scheme and the money donated was 'recycled' for the benefit of others.

³⁷ The religious freedom guarantee affirmed by the *New Zealand Bill of Rights Act 1990* (NZ) s 13 is, of course, designed to protect unorthodox beliefs.

2 Exclusion

In contrast with the church considered in *Liberty Trust*, an organisation which has a seemingly obvious public benefit but whose activities do not exclusively meet the *Pemsel* test are denied tax free status. Thus in *Canterbury Development Corporation v Charities Commission*,³⁸ despite having been treated as a charity by the Inland Revenue Department for more than 20 years, the Canterbury Development Corporation, whose principal aim is to 'drive economic growth for the benefit of the community',³⁹ was denied registration as a charity, and thereby lost its tax privileges.

Susan Barker expresses the view that many are likely to hold when she argues that the Canterbury Development Corporation 'is precisely the type of entity the government would wish to support, particularly in the current economic times'.⁴⁰ Michael Gousmett concurs and argues more broadly:⁴¹

the problem for the charity sector lies in the failure of the courts to look beyond charity law to other disciplines for inspiration, concerning the contribution entities such as [Canterbury Development Corporation] make to the economy, society, and commerce, in New Zealand ... Yet the courts insist on testing concepts that were not known in the 17th century against legislation that was relevant to those times, but not to the 21st century. It is time to move forward in our thinking about the relationship between charity and economic development.

³⁸ *Canterbury Development Corporation v Charities Commission* [2010] 2 NZLR 707.

³⁹ Canterbury Development Corporation, *About CDC* <<http://www.cdc.org.nz/about-cdc/>>.

⁴⁰ Susan Barker, 'Canterbury Development Case' [2010] *New Zealand Law Journal* 248, 256. The decision was made before the disastrous Canterbury earthquakes, but, in terms of the law, those events should have had made no difference to the court's decision, notwithstanding the corporation's enhanced public role in the earthquakes' aftermath.

⁴¹ Michael Gousmett, 'Charity and Economic Development' [2011] *New Zealand Law Journal* 63, 63.

These decisions indicate why the *Pemsel* test is an anachronism: on the one hand, it may be considered discriminatory in a greatly secular New Zealand,⁴² and, on the other hand, it may be ineffective in capturing real public benefit in the contemporary socio-economic context.

B Charitable Companies

In the previous section, we highlighted anomalies arising from the inclusive/exclusive conception of public benefit. The cases discussed in this section demonstrate that, even when firms manifest a similar public benefit, the constitutional structure of the firm further determines charitable status. The decisions also indicate policy disinterest in the way charitable firms raise funds to finance their public benefits.

1 Controller Benefits

In *Commissioner of Inland Revenue v Dick*,⁴³ a trust set up to hold gaming licences and operate gaming machines, and later to invest in commercial property, was held by the High Court to be a charitable trust. However, the Court further held that the trust's business income was not exempt from income tax because the trustees were able to influence the receipt of benefits from the trust's business income: Justice Salmon

⁴² Only 15 per cent of New Zealanders attend Christian churches every week: see Stephen Opie, *Bible Engagement in New Zealand: Survey of Attitudes and Behaviour* (2008) 11 <<http://biblesociety.org.nz/mediafiles/bible-society-research-2008.pdf>>.

With regard to unfair discrimination, the State accords ethical atheist belief a lesser value than religious belief because advancement of religion is presumed to be of public benefit: see Kerry O'Halloran, *Charity Law & Social Policy: National and International Perspectives on the Functions of the Law* (Springer, 2008) 299. Compare with the equality principle enshrined in *New Zealand Bill of Rights Act* s 19(1) and *Human Rights Act 1993* (NZ) s 21. The crime of blasphemous libel (*Crimes Act 1961* (NZ) s 123(1)), which applies only to offence against Christian sensibilities, may also be noted: see LexisNexis, *Laws of New Zealand* (at 31 January 2013) Criminal Law, '(20) Offences against the Person' [217].

⁴³ *Commissioner of Inland Revenue v Dick* [2003] 1 NZLR 741.

critically observed, '[t]he legislation is directed at the ability to influence benefits rather than the actual payment of them'.⁴⁴ In short, the law is not concerned with whether the activity which funds a charity is, in itself, socially beneficial; rather concern lies with the constitutional structure of the 'feeder' entity.⁴⁵

2 Retention of Surplus

In *Calder Construction Co Ltd v Commissioner of Inland Revenue*,⁴⁶ a company's memorandum of association empowered the directors to set aside out of the profits such reserves as they deemed necessary for the needs and development of the company's operations. The company was found to be entitled to the income tax exemption because the resulting assets ultimately had to be applied for charitable purposes; it was irrelevant that profits were retained in the company. The *Calder Construction* decision may be contrasted with *MK Hunt Foundation Ltd v Commissioner of Inland Revenue*,⁴⁷ a conveyance duty case.

Here the court found that MK Hunt Foundation was neither a charitable trust, nor had it acquired the land in question to hold it on a charitable trust; the transfer of the land was therefore dutiable. In *Calder Construction*, Justice Wilson distinguished his decision from *MK Hunt Foundation* on the grounds that, despite similarities in their construction, the memoranda of association of the two companies were not identical.⁴⁸ Justice Hardie

⁴⁴ Ibid [82].

⁴⁵ The best known example of an income feeder company is C F Mueller Company, then the United States' largest manufacturer of macaroni, which was bought by alumni of the New York University Law School to fund their alma mater: see Michael A Knoll, 'The UBIT: Leveling an Uneven Playing Field or Tilting a Level One' (2007) 76(2) *Fordham Law Review* 857, 862.

⁴⁶ *Calder Construction Co Ltd v Commissioner of Inland Revenue* [1963] NZLR 921.

⁴⁷ *MK Hunt Foundation Ltd v Commissioner of Inland Revenue* [1961] NZLR 405.

⁴⁸ *Calder Construction* [1963] NZLR 921, 924. A more plausible distinction perhaps lies with the particular legislative provisions: the stamp duty law exempted from conveyance duty, a 'conveyance of property to be held on a charitable trust in New Zealand' (*Stamp Duties Act 1954* (NZ) s 69(f)), whereas the income tax statute exempted income 'derived directly or indirectly from any business carried on by or on behalf of or

Boys found that MK Hunt Foundation's memorandum merely indicated the destination for profits; it did not establish a charitable trust.

These and the other reported cases on charitable trade were decided before the reform of company law in 1993.⁴⁹ A company now has 'capacity to carry on or undertake any business or activity',⁵⁰ unless restricted by its constitution. Previously, the critical consideration was, as Mark von Dadelszen observes, that, provided 'the income and capital of the entity itself [were] destined for charitable purposes it [could] trade if empowered to do so by its constitution'.⁵¹ Today, from an income tax perspective, the critical consideration is that the company's constitution restricts 'distributions of income to charitable purposes'.⁵²

New Zealand's current position on charitable enterprise is in line with the High Court of Australia's majority decision in *Word Investments*,⁵³ which 'unequivocally confirms that there is no strict dichotomy between a charitable purpose and the carrying out of 'commercial' activities; or potentially, between a charitable purpose and other activities that indirectly aid that charitable purpose'.⁵⁴ This fudging of purposes means, for example, that certain wealthy *iwi* (tribes), whose extensive business interests are housed in charitable structures, may appear to pay no tax on their business profits.⁵⁵

for the benefit of any society or institution established exclusively for such purposes and not carried on for the private pecuniary profit of any individual' (*Income Tax Act 1954* (NZ) s 86(1)(o)).

⁴⁹ See also *Commissioner of Inland Revenue v Carey's (Petone and Miramar) Ltd* [1963] NZLR 450;

Commissioner of Inland Revenue v NTN Bearing-Saeco (NZ) Ltd (1986) 8 NZTC 5,039.

⁵⁰ *Companies Act 1993* (NZ) s 16.

⁵¹ Von Dadelszen, above n 27, [13.2.7].

⁵² Ibid. See also *Companies Act* s 16(2) on the permissibility of such a constitutional restriction.

⁵³ *Commissioner of Taxation of the Commonwealth of Australia v Word Investments Ltd* [2008] HCA 55.

⁵⁴ Ian Murray, 'Charity Means Business – *Commissioner of Taxation v Word Investments Ltd*' (2009) 31 *Sydney Law Review* 309, 328.

Income Tax Act s CX 25(1) distinguishes between charitable and business operations with regards to fringe benefits tax but this is a minor provision that does not change basic principles.

⁵⁵ See Daniel Adams, 'Super-Rich Tribes Pay No Tax', *The Waikato Times* (Hamilton), 11 June 2011, 3 on central North Island *iwi*; on Ngai Tahu charitable companies operating in the South Island, see Michael

III SOCIAL ENTERPRISE

In the preceding part, we identified the specific issues of disputable public benefit and the constitutions of feeder businesses. In this part we consider a more recent issue – the emergence of social enterprise – and the ways in which this development problematises simple legal distinctions drawn between charity and business.

A What Is Social Enterprise?

In recent decades, almost all industrialised countries have experienced a phenomenal growth in ‘socio-economic initiatives that belong neither to the traditional private for-profit sector nor to the public sector’.⁵⁶ This broad concept of social enterprise is notoriously difficult to categorically define,⁵⁷ particularly given the many variations in form and goals of the different entities operating in the field,⁵⁸ and the diverse contexts in which the term is used across jurisdictions.⁵⁹ The Department of Internal Affairs identifies three characteristics of a social enterprise in New Zealand: public benefit purpose, proportionately substantial income from trade and constitutional restriction on profit distribution.⁶⁰ The last criterion is not in line with international definitions,

Gousmett, *Tax-Payer Subsidised Charities and Their Business Activities – Time for Change* New Zealand Centre for Political Research (2013) <<http://www.nzcpr.com/guest331.htm>>.

⁵⁶ Jacques Defourny, ‘Introduction: From Third Sector to Social Enterprise’ in Carlo Borzaga and Jacques Defourny (eds), *The Emergence of Social Enterprise* (Routledge, 2001) 1, 1.

⁵⁷ On the numerous definitions in play, see François Brouard and Sophie Larivet, ‘Essay of Clarification and Definitions of the Related Concepts of Social Enterprise, Social Entrepreneur and Social Enterprise’ in Alain Fayolle and Harry Matlay (eds), *Handbook of Research on Social Entrepreneurship* (Edward Elgar Publishing, 2011) 29, 33-39.

⁵⁸ For graphics illustrating different conceptions of social enterprise, see Matthew F Doeringer, ‘Fostering Social Enterprise: A Historical and International Analysis’ (2010) 20 *Duke Journal of Comparative and International Law* 291, 325-329

⁵⁹ See Rory Ridley-Duff and Mike Bull, *Understanding Social Enterprise: Theory and Practice* (Sage, 2011) 12.

⁶⁰ See Department of Internal Affairs, *Mapping Social Enterprises in New Zealand: Results of a 2012 Survey* (2013)

which typically disregard ‘ownership or legal structure’.⁶¹ For current purposes, then, it may be noted that: first, social enterprise is not synonymous with a particular institutional form – traditional charities, whose constitutions prohibit any surplus distribution to individuals, firms that constitutionally permit some distribution of surplus and fully for-profit firms may each claim to be social enterprises; second, social enterprises have public benefit goals which may or may not fall within the spirit and intendment of the Preamble.

B Hybrid Entities

In response to the emergence of the social enterprise phenomenon, among other jurisdictions, the United Kingdom has introduced a community interest company (CIC) regime.⁶² Likewise, many of the United States⁶³ have legislated for low-profit limited liability companies (L3Cs) or benefit corporations.⁶⁴ The common feature of these

<[http://www.dia.govt.nz/Pubforms.nsf/URL/SocialEnterpriseSurvey.pdf/\\$file/SocialEnterpriseSurvey.pdf](http://www.dia.govt.nz/Pubforms.nsf/URL/SocialEnterpriseSurvey.pdf/$file/SocialEnterpriseSurvey.pdf)>.

⁶¹ See François Brouard and Sophie Larivet, ‘Essay of Clarifications and Definitions of the Related Concepts of Social Enterprise, Social Entrepreneur and Social Entrepreneurship’ in Alain Fayolle and Harry Matlay (eds), *Handbook of Research on Social Entrepreneurship* (Edward Elgar Publishing, 2011) 29, 39. Brouard and Larivet considered some 30 definitions of social enterprise.

⁶² See *Companies (Audit, Investigations and Community Enterprise) Act 2004* (UK) and Community Interest Company Regulations, 2005, SI 2005/1788.

⁶³ For an analysis of state-level enactments, see Carter G Bishop, ‘Fifty State Series: L3C & B Corporation Legislation Table’ (Legal Studies Research Paper Series Research Paper 10-11, 2012, Suffolk University Law School) <<http://ssrn.com/abstract=1561783>>.

⁶⁴ On the distinctions between L3Cs and benefit corporations, see Dana Brakman Reiser, ‘Benefit Corporations – A Sustainable Form of Organization’ (2011) 46 *Wake Forest Law Review* 591, 606. Distinct from benefit corporations, ‘B Corps’ are, according to their promoter, ‘certified by the non-profit B Lab to meet rigorous standards of social and environmental performance, accountability and transparency’: see B Lab, *What Are B Corps?* (2012) <<http://www.bcorporation.net/what-are-b-corps>>.

hybrid bodies corporate is that they have an explicit purpose of public benefit, and distribution of surpluses to investors is limited. Charities seeking ways to reduce their reliance on donations and philanthropic grants are increasingly developing programmes that resemble businesses; the hybrid structure allows them to stress their social mission, continue to attract philanthropic grants but also to access capital markets.⁶⁵

1 *Taxation of CICs*

Unlike charities,⁶⁶ CICs do not attract special tax benefits and are taxed in the same way as ordinary limited liability companies.⁶⁷ However, CICs may be used to harness specific tax concessions. Thus Community Investment Tax Relief (CITR) extends tax benefits to investors who back businesses in less advantaged areas through Community Development Finance Institutions (CDFIs); accredited CDFIs may invest in qualifying CICs.⁶⁸

2 *Taxation of L3Cs*

⁶⁵ Stephanie Strom, 'A Quest for Hybrid Companies That Profit, but Can Tap Charity' *The New York Times* (online), 13 October 2011 <<http://www.nytimes.com/2011/10/13/business/a-quest-for-hybrid-companies-part-money-maker-part-nonprofit.html?pagewanted=all>>.

⁶⁶ In the United Kingdom, a charity is exempt from income tax to the extent that its trading activities are part of its main charitable objective: see *Corporation Tax Act 2010* (UK) s 478 in relation to charitable companies and *Income Tax Act* (UK) 2007 s 524 in relation to charitable trusts.

⁶⁷ See HM Customs & Revenue, *CTM40145 – Particular Bodies: Clubs: Community Interest Companies* <<http://www.hmrc.gov.uk/manuals/ctmanual/ctm40145.htm>>.

⁶⁸ See Regulator of Community Interest Companies, *Frequently Asked Questions – Community Interest Companies* (2008) 9
<<http://webarchive.nationalarchives.gov.uk/+http://www.cicregulator.gov.uk/CICleaflets/FAQ%20-%20October%202009%20V7.00%20Final.pdf>>.

Although L3Cs themselves are taxed in the same way as for-profit firms,⁶⁹ L3Cs may enable private foundations to meet their program-related investment (PRI) distribution requirements.⁷⁰ They do therefore have an ostensible tax planning element but ordinary limited liability companies (LLCs) may equally perform that PRI function.⁷¹ Nevertheless, Stephanie Strom reports on ‘a quiet push to get preferential tax treatment for’ hybrids.⁷² The most likely concession would be for automatic PRI approval for registered L3Cs or benefit corporations, since decisions are currently made on a case by case basis.⁷³

An assessment of hybrids lies beyond the scope of this article.⁷⁴ The pertinent point is to recognise the convergence both in institutional forms and organisational functions and

⁶⁹ An L3C does not qualify for tax-exempt entity status under IRC § 501(c)(iii).

⁷⁰ Broadly, private foundations must distribute five per cent of their capital annually to maintain charitable status: see 26 USC § 4942. Investment in an L3C will normally meet that requirement: see Thomas H Moody, ‘The Promise of the L3C’ (2008, September) *Trusts & Estates* 16, 18. See also Steve Davis and Sue Woodrow, ‘The L³C [sic]: A New Business Model for Socially Responsible Investing’ *Community Dividend* (2009, November) <http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=4305>.

⁷¹ See Daniel S Kleinberger, ‘A Myth Deconstructed: The “Emperor’s New Clothes” on the Low Profit Limited Liability Company’ (William Mitchell College of Law Legal Studies Research Paper Working Paper No. 2010-03, 2010) <<http://ssrn.com/abstract=1554045>>.

⁷² Strom, above n 65.

⁷³ See William Callison, ‘L3Cs: Useless Gadgets?’ (2009) 19(2) *Business Law Today* <<http://apps.americanbar.org/buslaw/blt/2009-11-12/nonbindingopinions.shtml>>.

Daniel Kleinberger and William Callison note the failure of L3C lobbyists to convince the federal government to view L3C investments as automatically qualifying as PRIs and conclude that L3Cs are no better placed to receive PRI treatment than the ordinary LLC: see Daniel Kleinberger and J William Callison, ‘When the Law is Understood-L3C No’ *Community Dividend* (2009, November) <http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=4490>

⁷⁴ For a critique of L3Cs, see Carter G Bishop, ‘The Low-Profit LLC (L3C): Program Related Investment by Proxy or Perversion?’ (2010) 63(2) *Arkansas Law Review* 243, 243-267. It is notable that certain

goals. We submit that this sectoral crossover indicates the need for a reassessment of charities' tax privileges even in New Zealand where new forms of hybrid bodies corporate have not been legislated.

IV POLICY OPTIONS

The discussion so far leads us to conclude that, on the one hand, tax treatment of charitable companies, including income feeder entities, is not optimal, and, on the other hand, the practical convergence of altruism and enterprise manifest in social enterprises may not attract appropriate legal and tax recognition. In this part, we consider those ideas further and consider solutions to make taxation fairer and arguably more efficient in relation to social enterprise.

A Ad Hoc Options

Before considering more radical policy options, ad hoc options are outlined.

1 *Feeders and Retained Surplus*

The issue of feeder companies having income that is unrelated to the charitable purpose of the organisation they fund is met in the United States by an unrelated business income tax (UBIT).⁷⁵ Following the *Word Investments* decision,⁷⁶ Australia has introduced an unrelated commercial activities tax (UCAT).⁷⁷ Whereas the UCAT will only

regulators also oppose hybrids: see, for example, David Edward Spenard, 'Panacea or Problem: A State Regulator's Perspective on the L3C Model' (2010) 65(2) *Exempt Organization Tax Review* 36, 36-41.

⁷⁵ The UBIT (IRC § 511 (1982)) essentially taxes a not-for-profit corporation's income which is not related to the principal purpose for which it was formed. For a discussion, see Henry B Hansmann, 'Unfair Competition and the Unrelated Business Income Tax' (1989) 75(3) *Virginia Law Review* 605, 605-635.

⁷⁶ *Word Investments* [2008] HCA 55.

⁷⁷ For an analysis of the provisions, which are due to come into effect on 1 July 2014, see Matthew Dwight Turnour and Myles McGregor-Lowndes, 'Taxing Charities: Reform without Reason?' (2012) 47(2) *Taxation in Australia* 74, 74-77, noting, in particular, arguments against the need for a UCAT.

apply to retained unrelated profits, the UBIT applies to all unrelated profits.⁷⁸ Following, in particular, revelations that Sanitarium has been using retained profits to invest offshore, some discussion has ensued in New Zealand about a possible UBIT.⁷⁹ However, since the mischief to be remedied, if any such mischief exists, relates to retained profits, a UCAT-type tax would be more appropriate. That noted, the possibility of changes to the taxation of charities, without a comprehensive first principles review, seems remote.⁸⁰ Besides, the likely effectiveness of a UCAT is not obvious: first, presuming that Sanitarium would be the principal target, since Seventh Day Adventist teachings promote health and wellbeing, Sanitarium products may be seen as a natural extension of the church's doctrine;⁸¹ second, a company's donations to registered charities are fully deductible.⁸² Consequently, any potential liability for tax on retained profits could be eliminated by donating the surplus.⁸³

2 Definition of Public Benefit

⁷⁸ See Micah Burch, 'Australia's Proposed Unrelated Commercial Activities Tax: Lessons from the U.S. UBIT' (2012) 7(1) *Journal of the Australasian Tax Teachers Association* 21, 25

⁷⁹ See Rob O'Neill, 'Unfair Tax Rules Go against the Grain' *Sunday Star-Times* (New Zealand), 31 July 2011, D12.

⁸⁰ A first principles review of the charities regime has been ruled out on the grounds that there may be fiscal implications of such a review: see Jo Goodhew (Community and Voluntary Sector Minister), 'No Review of the Charities Act at This Time' (media release), 16 November 2012.

⁸¹ Not all commercial activities, it will be noted, are as easily distinguished as macaroni production is from the teaching of law.

⁸² *Income Tax Act* s DB 41.

⁸³ Compare with the United Kingdom where a common arrangement is for charities to house their non-primary purpose trading activities in a separate private company. The company then donates its profits to the charity, thereby effectively eliminating the feeder company's corporation tax liability: see *Corporation Tax Act* s 189.

Statutory intervention has ensured that Māori charities are included within the ambit of public benefit, despite apparent inconsistency with *Pemsel*.⁸⁴ It is plausible, then, that regional development organisations, such as the Canterbury Development Corporation, which already enjoy special concessions under securities laws,⁸⁵ could be specifically included in the public benefit provisions of the *Charities Act*. However, such an ad hoc response appears undesirable from a policy perspective, particularly since other special cause lobbying might ensue. Conversely, as noted,⁸⁶ government has retreated from a first principles review of not-for profits.

3 Public Benefit Disclosure

Seen in securities and consumer protection legislation,⁸⁷ and, indeed, charities law,⁸⁸ New Zealand policymakers demonstrate a strong confidence in the policing power of transparency, that sunlight is the best disinfectant.⁸⁹ Following United Kingdom precedent,⁹⁰ Gousmett argues that New Zealand should require charities to report annually and publicly on how they have advanced public benefit,⁹¹ thereby ensuring that

⁸⁴ For a general analysis of the taxation of Māori charities, see Audrey Sharp, 'The Taxation Treatment of Charities in New Zealand with Specific Reference to Maori Authorities including Marae' (2010) 16 *New Zealand Journal of Taxation Law and Policy* 177, 177-216.

⁸⁵ See Securities Act (Venture Capital Schemes) Exemption Notice 2008 (SR 2008/218).

⁸⁶ See, above n 80.

⁸⁷ For example, rather than prohibiting usurious interest rates, the *Credit Contracts and Consumer Finance Act 2003* (NZ) presumes that disclosure by usurious lenders will protect vulnerable borrowers.

⁸⁸ Publication of their annual reports, policymakers presume, will effectively police charities: see *Charities Act* s 22.

⁸⁹ Louis D Brandeis, *Other People's Money: and How the Bankers Use It* (F A Stokes, 1914) 92 said: 'Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.' Highlighting an egregious example of charitable opacity, Ole Holsti, 'Letters', *The Economist* (United Kingdom), 30 June 2012, 20 claims that the Mormon Church has not released financial statements since 1959.

⁹⁰ See *Charities (Accounts and Reports) Regulations 2008* (UK) reg 40.

⁹¹ See Gousmett, above n 55.

charities really do perform a public benefit. However, the success of this initiative in the United Kingdom has been so far variable, indeed unimpressive. Thus Gareth Morgan and Neil Fletcher report that 26 per cent of charities above the audit threshold (annual income of more than £500 000), 10 per cent of those in the £100 000 – £500 000 income band and only two per cent in the £25 000 – £100 000 income band fully and properly complied with the regulations.⁹²

4 Mandatory Controls

Various directive measures could be adopted. These might include: mandatory distribution of capital in the way of PRIs in the United States or caps on officers' remuneration. But such measures would be inconsistent with New Zealand's broadly laissez faire approach to charitable regulation.

We submit that more radical policy options deserve consideration in the face of these traditional issues and the more recent emergence of social enterprise; these possibilities call for certain taxation fundamentals to be revisited.

B Why Distinguish between Taxpayers?

The main arguments for charitable tax concessions have been noted,⁹³ but why distinguish between taxpayers in the first place?

In accordance with basic principles of distributive justice that inform income taxation, similarly situated taxpayers should be taxed similarly (horizontal equity), whereas differently situated taxpayers may be treated differently (vertical equity).⁹⁴ However, since no two taxpayers are similarly situated in all ways, social judgment determines

⁹² Gareth G Morgan and Neil J Fletcher, *Public Benefit Reporting by Charities: Report of a Study Undertaken by Sheffield Hallam University on behalf of the Charity Commission for England and Wales* (2011) 7 <http://www.charitycommission.gov.uk/.../public_benefit_reporting_shu.pdf>.

⁹³ See above, nn 13-18.

⁹⁴ See Carl S Shoup, *Public Finance* (Weidenfeld and Nicolson, 1969) 23.

both similarity and difference.⁹⁵ Thus the profits of a cigarette manufacturer and those of a maker of lung cancer treatments are taxable in the same way because they are similarly engaged in trade, notwithstanding the differences in harm/benefit their trading operation bring to society.⁹⁶ In contrast, two drug manufacturers may be taxed differently because one is owned by a charity, notwithstanding their similar benefit to society. Income tax policymakers may be generally disinterested in the nature of a firm's business activities, but, from a moral perspective, it may seem odd, if not simply wrong, that the profits of a cigarette manufacturer should be taxed in the same way as those of the drug manufacturer.

This moral disinterest manifest in income tax policy extends to the business of charities. While some may argue that religion is, in itself, socially harmful,⁹⁷ those arguments lie beyond the scope of this article.⁹⁸ We are interested here in feeder business activities that have no special public benefit or, indeed, may be socially undesirable. In an egregious example, Benedictine monks at Buckfast Abbey (a registered charity) in Devon, England produce a tonic wine which has been linked to a disproportionate level of intoxicated violence in urban Scotland.⁹⁹ More widespread but similarly pernicious is

⁹⁵ See Bernard P Herber, *Modern Public Finance* (Irwin, 5th ed, 1983) 119.

⁹⁶ Indeed, the proceeds of crime are taxable in New Zealand: see *Income Tax Act* s CB 32.

⁹⁷ See, generally: Sam Harris, *The End of Faith: Religion, Terror, and the Future of Reason* (W W Norton & Co, 2004); Richard Dawkins, *The God Delusion* (Houghton Mifflin Co, 2006); Daniel C Dennett, *Breaking the Spell: Religion as a Natural Phenomenon* (Allen Lane, 2006); Christopher Hitchens, *God Is Not Great: How Religion Poisons Everything* (Warner, 2007).

⁹⁸ On religion as a head of charity, see: Brian Lucas and Anne Robinson, 'Religion as a Head of Charity' in Myles McGregor-Lowndes and Kerry O'Halloran (eds), *Modernising Charity Law: Recent Developments and Future Directions* (Edward Elgar Publishing, 2010) 187, 187-203.

⁹⁹ See BBC, *Buckfast Crime Link Revealed* (2010) <http://news.bbc.co.uk/2/hi/uk_news/scotland/8465957.stm>. An emerging trend in the United States is the charity pub concept, which Patrick Rooney, the associate dean at Indiana University's School of Philanthropy, somewhat uncritically describes as 'a clever idea and certainly a noble ambition': see Kirk Johnson, 'In New Pubs, Good Cheer and Good Works' *The New York Times* (online), 20 January 2013, <http://www.nytimes.com/2013/01/21/us/new-pubs-send-profits-to-charity.html?_r=0>.

charitable involvement with gambling.¹⁰⁰ Robert Nozick observes that '[p]eople want their society to be and to look just'.¹⁰¹ Are these policies just or do they look just?

Tax policy does not manifest a wholly amoral approach to trade; for example, society's disapproval of cigarettes is, in part, reflected in the imposition of swingeing excise duties on tobacco. Furthermore, the differential treatment of merit and demerit goods under value added tax (GST) systems shows that moral considerations can be accommodated.¹⁰² And, of course, the income tax privileges extended to charities under tax laws represent what is essentially a moral preference. In short, non-neutral treatment of different forms of income is both plausible and practicable. The pertinent question is this: should the constitutional structure of a firm determine its privileged tax status or should the real public benefits of its activities be determinative? If charities, hybrids and public benefit entrepreneurs are competing in the same market, it may be considered fundamentally unfair to tax them differently.¹⁰³

C Neutrality on Efficiency Grounds

¹⁰⁰ See Problem Gambling Foundation of New Zealand, *Facts and Figures – Auckland City* <http://www.pgfnz.org.nz/Uploads/PDFDocs/Auckland_City-Facts_and_Figures.pdf>.

¹⁰¹ Robert Nozick, *Anarchy, State, and Utopia* (Blackwell, 1984) 158.

¹⁰² The *Goods and Services Tax Act 1985* (NZ) does not distinguish between merit and demerit goods but compare with *A New Tax System (Goods And Services Tax) Act 1999* (Cth) sub-div 38-A-P.

¹⁰³ See Evelyn Brody, 'Agents without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms' (1996) 40 *New York Law School Law Review* 457, 535-536; David A Hyman and William M Sage, 'Subsidizing Health Care Providers through the Tax Code: Status or Conduct?' (2006) 25 *Health Affairs* W312. In their comprehensive literature review of non-profits, Melbourne Law School scholars compare Malani and Posner, above n 19 with James Hines Jr, Jill Horwitz and Austin Nichols, 'The Attack on Nonprofit Status: A Charitable Assessment' (2010) 108 *Michigan Law Review* 1179 but do not consider the equity issues of differential treatment raised by Brody: see above n 22, 37.

Having considered and dismissed to their satisfaction the major economic arguments for coupling tax concessions with the particular charitable organisational form,¹⁰⁴ Anup Malani and Eric Posner conclude that current law leads to two principal inefficiencies:¹⁰⁵ first, such coupling ‘encourages inefficient production by rewarding nonaltruistic entrepreneurs who take non-profit status’;¹⁰⁶ second, ‘current non-profit law discourages talented altruists from establishing charitable enterprises, causing them at the margin to throw in their lot with commercial firms’.¹⁰⁷ Generally, the authors argue that ‘nonprofit firms are less efficient than for-profit firms and that, if the law permitted for-profit firms to compete in charitable markets, charitable activity would become more efficient’.¹⁰⁸ They conclude:¹⁰⁹

The relevant consideration for the law is not whether the entrepreneur is altruistic but whether the effect of the entrepreneur’s action is socially beneficial. If it is socially beneficial, and if ordinary market forces do not provide sufficient incentive for people to engage in that action, then a subsidy may be appropriate. Because the effect of the entrepreneur’s behaviour is unrelated to her incentives to choose between the non-profit or for-profit form, the choice of form does not provide grounds for a tax subsidy.

James Hines and his co-authors note, by way of analogy, that consumers place very specific orders for the goods and services they require and do not hand over their money to a retailer and wait to see what the retailer might provide; they then ask:¹¹⁰

Why shouldn’t the government behave this way when it buys charitable goods? Decide it wants something specific – buy it, evaluate it, and repeat. Rather, the government

¹⁰⁴ These are: public good theory, agency theory, altruism theory, a theory of imperfect consumers and administration overload: see Malani and Posner, above n 19, 2029-53.

¹⁰⁵ Ibid, 2054.

¹⁰⁶ Ibid.

¹⁰⁷ Ibid, 2055.

¹⁰⁸ Ibid.

¹⁰⁹ Ibid, 2067.

¹¹⁰ Hines et al, above n 103, 1218.

throws tax exemptions at something akin to a charity store and hopes it gets what it needs. Many observers find this approach puzzling, and – at least on the surface – it is.

Hines et al argue that Malani and Posner’s arguments ‘are founded on an economic analysis that is too limited’ but do not prove that the analysis is wrong.¹¹¹ Nevertheless, for Hines et al, the most important argument against neutral treatment is that it ‘would create new avenues for tax avoidance’.¹¹² This may be so, but only craven policymaking rejects measures that would promote fairness and, possibly, efficiencies for the tax system because some risk of abuse exists. They conclude:¹¹³

Properly encouraging and rewarding charitable activity does not entail making explicit tax benefits available to everyone, but instead involves identifying cases in which recipients of donated funds pursue clearly identified charitable ends without the potential conflict for interest that inevitably accompanies the profit motive.

We agree that tax concessions should not be available to *everyone* and yet the current system extends tax concessions to *any* entity that qualifies as a charity notwithstanding the true benefit their activities bring to contemporary society.

Compelling arguments against putting charities on an equal footing with other firms operating in the same public benefit market can be raised but they do not relate to administrative challenges, such as countering tax avoidance; rather they arise from the arguably unique nature of charities as an inherent public good.¹¹⁴ Nozick observes that people do not merely care about outcomes; they also tend to care about how those

¹¹¹ Ibid, 1219. In our view, horizontal equity grounds, together with an outcomes orientation (discussed in the following section), are sufficient to prompt a reconsideration of differential treatment of firms operating in the same market. Consequently any inadequacy in the scope of Malani and Posner’s study is not fatal for neutral treatment arguments.

¹¹² Ibid.

¹¹³ Ibid, 1219-20.

¹¹⁴ See Policy Advice Division, above n 30, 3.

outcomes are attained.¹¹⁵ The general public may consider it intuitively wrong to extend the tax concessions traditionally reserved for charities, given their virtuousness, to partially or fully for-profit firms. But contemporary charities have already evolved into hybrid organisations that follow entrepreneurial practices, such as active marketing campaigns, and engage professional managers, as well as volunteers.

D Outcomes Orientation

The *Statute of Elizabeth* sought to solve particular social problems that England experienced in the early seventeenth century. Contemporary New Zealand faces different problems.¹¹⁶ However, the generalising ratio of *Pemsel*, to a great extent, decoupled charitable tax privilege from its direct historical contingency but also obfuscated the idea of public benefit and left it to judges to ultimately set important elements of charities policy.¹¹⁷ We submit that the Preamble, rather than *Pemsel*, was the better policy approach.¹¹⁸ Elizabethan lawmakers could have had no expectation of

¹¹⁵ See Robert Nozick, 'Moral Constraints and Distributive Justice' in Michael J Sandel (ed), *Liberalism and Its Critics* (Blackwell, 1984) 100, 110.

¹¹⁶ Indeed, as Martin, above n 1, 309 notes, some one hundred and fifty years ago, William Gladstone recognised the folly of granting tax concessions based on the anachronistic Preamble.

¹¹⁷ See, for example, *Re Greenpeace New Zealand Inc* [2012] NZCA 533. An unusual feature of that decision was the court's setting out five tests for the Chief Executive of the Department of Internal Affairs and the Charities Board to take into account when considering revocation of Greenpeace's charitable status (at [43]). The court's refusal to hold that engagement in illegal activity is fundamentally incompatible with charitable status is likely to encourage a certain level of law breaking: for example, Greenpeace's anti-oil drilling campaign received significant publicity with the trespass prosecution, but lenient punishment, of actress and activist Lucy Lawless: see 'Lawless Proud after Drillship Sentencing', *The Dominion Post* (Wellington), 8 February 2013, A3.

¹¹⁸ If the court in *Pemsel* had found that the charitable motive did not accord with the Preamble, it may be inferred that Parliament would have needed to reconsider the Preamble. Had it done so, it is likely that tax privileges would have been restricted to poverty relief: see 'Sweet Charity', *The Economist* (online), 9 June 2012, <<http://www.economist.com/node/21556570>>.

prescribing which activities ought to be considered charitable several hundred years into the future; their interest lay in identifying and privileging activities that might solve the temporally and spatially specific problems of their particular society.¹¹⁹ Society today might fruitfully follow the Elizabethan precedent in looking to here and now social needs and legislating accordingly.¹²⁰ Instead, reliance continues to be placed on a ‘spirit and intendment’ test implied by a court centuries after the Preamble was enacted.¹²¹ Provision of affordable housing might, for example, replace the Preamble’s seawall building, but the critical point is that whatever might be decided would be one of a limited number of democratically determined goals to meet the temporally and spatially specific needs of contemporary New Zealand. Such a reformulation seems imperative, whether or not neutral tax treatment of firms competing in the same public benefit market is accorded similar importance.

V CONCLUSION

To attract charitable tax privileges, a firm must meet two basic requirements: first, its purpose must be reconcilable with those set down in the Preamble and, second, its constitution must prohibit distribution of surpluses to interest holders. We have argued that the social goals recorded in the Preamble were specific to a particular time and place. Notwithstanding the principles approach established in *Pemsel*, reliance on a 400 year old statute is egregiously anachronistic – each generation might usefully deliberate and construct its own version of the Preamble, setting out its particular social goals.¹²²

¹¹⁹ The long title to the Act, which was ‘An Acte to redresse the Misemployment of Landes Goodes and Stockes of Money heretofore given to Charitable Uses’, reflects the specific mischiefs sought to be remedied: see Harvard Kennedy School, above n 1.

¹²⁰ See Barker, above n 40 and Gousmett, above n 41 on the exclusion from charitable status of the Canterbury Development Corporation.

¹²¹ But see Hines et al, above n 103, 1219, who argue that ‘the reasons for *not* adhering to this 400-year-old tradition are not compelling’ (emphasis added).

¹²² Updating William Beveridge’s ‘Five Great Social Evils’ of the mid-twentieth century, David Utting (ed), *Contemporary Social Evils* (Policy Press, 2009) examines the types of social evils whose elimination might

Tax privileges would then be awarded in order to promote achievement of the desired outcomes.¹²³ It is likely that the work of many charities, such as in relieving poverty, would always feature in such a list. It would also be open to government to provide direct grants to unpopular causes and, of course, no one would be prevented from donating to any cause but they would not necessarily gain tax privileges from doing so. In a greatly secular New Zealand,¹²⁴ it is moot whether the promotion of religious belief in itself would make today's Preamble of social goals. Once more, this does not mean that the socially valuable activities of many church-affiliated organisations would not be tax-privileged; rather, that altruistic work would need to be separated from proselytising activity.

Using the example of for-profit and not-for-profit firms competing in the same market, we have indicated the ostensible unfairness of one of those firms enjoying special tax privileges simply because of the charitable nature of its shareholder. The emergence of different forms of social enterprise, including new corporate vehicles, has accentuated the irrationality of a simple altruism/enterprise distinction in law and taxation. In short, we propose that an outcomes-oriented approach to tax concessions should be adopted so that pursuit of socially agreed goals – not institutional form or conformity with historically contingent norms – would determine qualification.

be pursued in contemporary society; any firm that seeks to counter these social evils might attract tax privileges.

¹²³ Compare with the Jeffersonian proposal of Roberto Mangabeira Unger, *The Critical Studies Movement* (Harvard University Press, 1986) 35 for a rotating capital fund that would change hands every twenty years.

¹²⁴ See, for example, Ben Heather, 'Are We Now So Godless that Christmas Is Irrelevant', *The Dominion Post* (Wellington) 11 December 2013, A3.