



SocialLink – Tūhono Pāpori is the umbrella peak body for the social and community sector and represents over 1500 organisations and individuals working in the Western Bay of Plenty (WBOP).

SocialLink walks alongside social service providers, community and Māori organisations to build their capability as they deliver services to their communities, as well as advocates for the sector's interests, social justice and equity of opportunity for all people living in the WBOP.

www.sociallink.org.nz

Response to the Inland Revenue's Officials' Issues Paper "Taxation and the not-for-profit sector"

March 2025

SocialLink is focusing mostly on Chapter 2 Charity business income tax exemption. (Q1 – Q6) and Chapter 4 – Integrity and Simplification.

Our position is that the ability of charities to generate income and use it for their charitable purposes should be supported and enhanced rather than made harder. This is particularly pertinent given the current restrained funding environment and subsequent difficulties of securing funding from other sources.

We are worried that efforts to identify taxable income from the business/commercial efforts of a few large charitable entities¹ perceived to have an unfair advantage over commercial entities, will have a potential detrimental roll-on effect for all charities. If there are a very small number of charities exploiting the tax exemption, we recommend that Charities Service utilise its regulatory functions to investigate rather than apply a blanket removal of tax exemptions to all charities.

We are not sure if it is a coincidence or just somewhat ironic that the Government are currently considering reducing the corporate tax rate at the same time that they are consulting on introducing tax on charities that generate unrelated business income. If a decrease in the corporate tax rate comes to pass, businesses will accrue increased profits, and less revenue will be available for public services. If it also comes to pass that charities are taxed on their unrelated business income, it will

¹ Eg Sanitarium is one charity often mentioned as having an unfair advantage.

reduce services to the community, increase compliance costs for charities that will further reduce services, and the tax take is very unlikely to make up for the loss of the corporate tax revenue. Businesses are critical to the economy but should not be prioritised over much needed services to communities, many of which are already at risk due to the changes in the funding landscape.

In our experience, working alongside a considerable range of social, health and community sector charities over the past thirteen years, the vast majority need all the support possible to retain and grow income, including from tax policy settings and from Inland Revenue regulations.

A local charity summed up the potential impact of losing tax exemptions:

“The most significant practical implication of removing a tax exemption would be the loss of income to support our overall charitable purpose. This would mean a reduction in the scope of services provided and increasing strain on already tight budgets. Coming on the back of a reduction in and increasing competition for contestable funding sources to support operations, such a policy change has the potential to tip us over the edge. Trying to recoup the loss through other means for example, increasing user charges will only serve to perpetuate growing inequality of access to the services we provide.”

Lastly, we are very concerned that no consideration has been given to the impacts the proposed changes will have on iwi or Māori organisations in line with the Crown's responsibility as a partner to Te Tiriti o Waitangi to ensure the proposal do not disadvantage Māori communities.

Recommendation: SocialLink opposes charging charities tax on unrelatable business income.

The reasons for our opposition are stated below:

Income for charitable sector is precarious amid rising need and costs.

- Income for many charities in the social and community sectors is precarious. They often do not have a guarantee of income year to year and have little control over their income sources such as donations, philanthropic grants, fundraising activities, government or similar contracts, investments and business operations.
- Organisations report drops in income but rising costs, need and demand in recent sector surveys in the WBOP and nationally. For example, the national State of the Sector Survey in 2024 reported 45% of organisations using reserves, up from 37% in 2022 and 33% in 2020.²
- SocialLink's own survey of the western Bay of Plenty sector found income had dropped or stayed the same for most, including from government contracts but demand for services had increased (the survey was also used by other peak bodies in the Waikato region and nationally with similar findings).³ A West Auckland survey found that out of over a hundred

² Horan, J (2024) State of the Sector Survey – Community and Voluntary Sector report. Community Networks Aotearoa.

³ SocialLink Survey Report (2024): Social and community service providers on funding and service demand – western Bay of Plenty region. Community Waikato report (2024) Report of survey for social and community service providers on 'What's happening for your organisation regarding funding and service demand?' Community Network Aotearoa (2024) Report on

community organisations, most were operating with 20% less income in 2024 and there had been an over \$3million loss of funding from 24 organisations in the past year.

- Increasing costs included rent, power, vehicle costs, insurance and meeting social worker pay equity requirements. Organisations were cutting back services, letting staff go, using reserves (if they had them) and considering other ways of delivering services. Some were looking at possible closure or had closed.
- These findings echo other findings in jurisdictions such as Australia, where many charities are operating with a thin or no margin, have limited reserves and feel vulnerable.⁴ This is not because of mismanagement but because they have been pushed into 'running lean' by various forces for many years, meaning they risk a reduced ability to adjust to economic shocks.⁵

Impact of proposals on delivery of services to communities

- Running a businesses is an important source of income, especially due to the constrained funding environment and the underfunding of the sector over many years. Charities are entitled to operate businesses which do not have to be connected to their overall purpose, so long as the profits are used to advance that purpose and work, according to Charities Services.⁶
- The consultation paper noted in countries where unrelated business income is taxed, certain unrelated commercial activities remain tax exempt, including certain fundraising activities, volunteer run business and those selling donated goods or services such as charity op shops (pg 9). However, changes to 'unrelated' business settings means the devil will be in the detail of what is considered 'unrelated' and will be administratively complex to interpret and follow, which in turn will drive up compliance costs.
- To tax fund-raising business income will limit the revenue from this source, meaning either a cut in services, more reliance on other precarious income sources or on government funding with many charities reporting decreases in government funding already.
- This leaves the options of government delivering services in the place of for-purpose organisations who know their communities and who can deliver services far more efficiently and cost effectively than government, or not addressing the increased needs in communities. The latter option is likely to result in public pressure for the government to respond to a growing demand for services.

Several structural factors contribute to income shortfalls which is why changes to taxation settings is likely to cause further hardship for charities

survey for social and community service providers on 'What's happening for your organisation regarding funding and service demand?'

⁴ Social Ventures Australia and the Centre for Social Impact (2022) *Paying what it takes: funding indirect cost to create long-term impact*. Social Ventures Australia.

⁵ Social Ventures Australia and the Centre for Social Impact (2022) *Paying what it takes: funding indirect cost to create long-term impact*. Social Ventures Australia.pg 9

⁶ Charities Services Myth busting: when charities can run businesses. 24 February 2021

<https://www.charities.govt.nz/news-and-events/blog/myth-busting-when-charities-can-run-businesses/>

- Charitable organisations have been underfunded for many years by government agencies contracting them to deliver services, according to inquiries by the Productivity Commission and economic consultants Martin Jenkins ⁷. The latter report estimated social services were funded for less than two thirds of the actual costs of delivering services.
- Insufficient funding of 'indirect costs' has been found to be a key driver of not for profits' financial vulnerability.⁸⁹
- Indirect costs make up a much larger percentage of total costs than is widely understood. In one study the average indirect costs of the not-for-profits analysed was 33% of their total costs, with significant variation between 26% and 47%. However, funding agreements often only included indirect capped costs of between 10% and 20% of overall costs. Not for profits said they underreported indirect costs believing funders were unwilling to fund more than 20%. This situation contributes to what has been termed a 'starvation cycle', where funder expectations lead to not for profits feeling pressure to both underinvest in their indirect costs and underreport their true costs to funders, thereby perpetuating the cycle. The sector is starved of the necessary core funding required to create resilient entities delivering long term impact.¹⁰¹¹
- Furthermore, a lot of not for profits in New Zealand do not receive consumer price indexation on funding which would support them to cover indirect costs. Instead, over time the funding they receive gradually declines in value. For example, a \$75,000 government contract in 2020 would be worth \$60,000 in 2024 due to the high inflationary environment we have been experiencing, yet organisations are expected to deliver the same level of output with the funding that is eroding in value. This was cited as a significant issue for many for-purpose organisations according to the sector surveys mentioned above.
- The lack of indexation contrasts with government policy in the state of Victoria in Australia for example, where from June 2024 services funded by several government departments (eg housing related, family violence) are costed out and indexed year by year. For example, the current indexation is between 2.5 and 3.55%.¹²
- Another factor is that reductions in revenue growth compound over time. A recent review of hospice funding for five hospices reported a 1% reduction in revenue growth means about \$2million less in revenue in the early years but more in the next 20 years.¹³.

⁷ The Productivity Commission (2015) More effective social services. Summary version, September. Wellington. Martin Jenkins (2019) The Social Servicer System: The Funding Gap and How to Bridge It

⁸ Eckhart-Queenan, Etzel, M and Prasad, S (2016) 'Pay what it takes' Philanthropy, Stanford Social Innovation Review.

⁹ These have been found to fall into four general areas regardless of purpose or mission: administrative expenses(eg costs related to leadership, finance, human resources, technology, legal, bids and proposals); network and field costs (maintaining operations in the field and in branches); physical assets (costs associated with facilities, projects, equipment) and knowledge management (costs for building and maintaining subject and programme expertise and internal knowledge, including data development, staff training and development.

¹⁰ Eckhart-Queenan, Etzel, M and Prasad, S (2016) 'Pay what it takes' Philanthropy, Stanford Social Innovation Review.

¹¹ Social Ventures Australia and the Centre for Social Impact (2022) *Paying what it takes: funding indirect cost to create long-term impact*. Social Ventures Australia.

¹² See Victoria State Government's Funded Agency Channel's information on indexation for the Department of Families, Fairness and Housing (DFFH) and Department of Health (DH) at

<https://fac.dffh.vic.gov.au/dffh-and-dh-approved-yearly-indexation-rates-and-unit-prices>

¹³ Martin Jenkins (2024) Sustainable funding for hospice services. Final Report Accessed https://www.hospice.org.nz/hospices_under_significant_cost_pressure_a_landmark_report_shows_the_real_value_of_hospices_to_health_system

Accumulated funds needed to further charitable purposes

The tenuous income and operating situation for many charities may contrast with a public perception that there is ‘\$2 billion unused income in the sector for 2023/24’ as reported by Charities Services and covered in media.¹⁴ The implication is that money is therefore not available to the people the charity is established to serve.

This is misleading as there are often many reasons for accumulated funds. Charities require reserves to continue to operate into the future under obligations as good employers and to meet service and development needs. Some charities are highly asset-driven like community housing. A random review of some charities in the local area for example, identified considerable revenue in the millions being held for new housing developments for people with long term health needs while consent processes were completed, or in another example, for purchase of more homes and maintenance of existing homes to benefit low-income individuals and families.

Taxation settings need to be supportive of charities’ capacity to fund services and be simple to administer and comply with

- If the policy goal is to enable charities to provide publicly available services for the public good in its broadest sense¹⁵ reducing the administrative and financial costs for charities is important.
- We are concerned that introducing a more administratively complex regime of deciding what business activities are exempt and what are not will impose compliance burdens on charities.
- Making the system more complex will inevitably mean more resources and time spent by charities, Department of Internal Affairs and Inland Revenue to administer it, not least because of variable interpretations and appeals on decisions.
- The OECD report on philanthropy and taxation ¹⁶recommended countries should look to reduce the complexity and improve their oversight of concessionary regimes for philanthropic entities and philanthropic giving. We think the regulatory arms of Charities Services and Inland Revenue are the appropriate place for following up on concerns with any charities competing with businesses or abusing charity or taxation regulations.
- New Zealand has put considerable effort in having a trustworthy and transparent register of charities, including performance and detailed financial reporting. More regulatory capacity and person power would enable Charities Services and Inland Revenue to audit and follow up on concerns, although cuts to public service staff are likely to be limiting this.
- We also note charities providing social services through government contracts are also required to be accredited through Te Kāhui Kāhu.¹⁷ This means they must have strong and

¹⁴ Susan Edmunds ‘Charities’ \$2billion in untaxed profits’. Radio New Zealand, 4 December 2024

¹⁵ Often providing services on behalf of the government or which are recognised as being better provided by community-based entities

¹⁶ OECD (2020), *Taxation and Philanthropy*, OECD Tax Policy Studies, No. 27, OECD Publishing, Paris, <https://doi.org/10.1787/df434a77-en>.

¹⁷ Te Kāhui Kāhu provides Social Services Accreditation for agencies such as Department of Corrections, Ministry of Justice, Ministry of Housing and Urban Development, Ministry of Social Development and Oranga Tamariki.

safe business practices and deliver quality services. This is a further and appropriate regulatory regime and includes standards on financial management and systems.

De Minimis for small-scale trading activities

We would favour a de minimis exemption threshold and that Tier 3 and Tier 4 charities be exempt (as the briefing paper notes this would limit the impact of a policy change to less than 1,300 charities reporting annual expenses above \$5 million per annum).

Chapter 4 - Integrity and simplification

Fringe Benefit Tax

We don't see anything in the current review of FBT that appears to reduce compliance costs therefore the issue of saving compliance costs still needs to be given consideration. Based on our experience, charities that have vehicles are generally providing front line service delivery and need the vehicles to go out into the community. There are already high costs associated with this including fuel, repairs and maintenance, insurance. Adding FBT would be another cost burden to charities and also increase compliance in accounting for any fringe benefits that may still be provided.

Volunteers

We would be concerned that the FENZ approach would add a burden to the organisation to process the payments as wages / salaries. In our experience many organisations don't pay honoraria and the ones that do don't generally have staff and are quite small or volunteer reliant so adding payroll to what they need to do would be an additional burden to the organisations.

Donation Tax Concessions

We support introducing a delinking of donation concessions from income tax to allow for more real-time payments and other measures suggested.