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Charities: deadline signalled for tax exempt status

Changes in tax legislation for New Zealand charities are closer with the recent signalling of a key deadline.

The Charities Commission has indicated that charities wishing to retain their tax-exempt status will have to register with it by April 2007. Registration is just one of a number of changes affecting charities under the Charities Act 2005 (the **Charities Act**). In this newsletter we examine some of the tax implications and issues for charities to consider.

What role will Inland Revenue have to play in the registration process?

One of the requirements for exemption from income tax under the Income Tax Act 2004 (the **Tax Act**) is that a charity will have to register as a charity with the Charities Commission. Failure to register is fatal.

However, under the Tax Act, registration alone does not confer charitable status. The income tax exemption is available only if Inland Revenue accepts a charity is charitable at law.

We understand that Inland Revenue will be seconding staff to the Commission while the Commission gets up and running.

There are also indications that once the Commission approves any application it will be forwarded to Inland Revenue for approval of "donee status" under section KC 5 of the Tax Act.

However, preliminary draft registration forms prepared by the Commission do not mention donee status at all, let alone explicitly state that registration forms will be forwarded to Inland Revenue for donee status approval.

The Charities Commission's draft forms state that information provided on the organisation's charitable purposes is to "determine that its charitable purpose complies with the Charities Act 2005". No mention is made about compliance with the Tax Act.

Another issue is that neither of these two reviews (assuming they are done by the Charities Commission and Inland Revenue over donee status) appear to adequately take into account the additional requirements under sections of the Tax Act related to exemption for charitable non-business income and exemption for charitable business income.

These requirements basically relate to issues of private pecuniary profit, control and geographical limitations.

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The Commission draft forms require applicants to provide evidence that the organisation is not “for the private profit of any individual”. They also ask the applicant organisation to declare what percentage of New Zealand sourced funds the charity has spent, or expects to spend, overseas. These factors tend to suggest that registration with the Commission should automatically mean that a charity complies with the Tax Act.

However, as matters of income tax and exemptions from it are clearly an Inland Revenue issue, for charities with significant business income, reliance on tacit approval from Inland Revenue through the registration system may not be appropriate.

If you do not have a binding ruling from Inland Revenue, should you obtain one?

At the moment, Inland Revenue issues non-binding statements confirming that an entity is charitable for the purposes of the Tax Act. Many charities apply for, and rely on, these non-binding statements to prove that they are charitable and, therefore, exempt from paying income tax.

It is unclear whether Inland Revenue will continue to issue these statements once the registration system is in place. In the meantime, we recommend that charities at least continue to apply to Inland Revenue for non-binding approval of their charitable status.

For those earning significant income, obtaining a binding ruling on charitable status may still be the best approach. This gives certainty on the Tax Act issue and, under the Charities Act, is treated as meaning that the “essential requirements” for registration are satisfied. Provided that the other procedural requirements of the Charities Act are

complied with, a binding ruling will ensure registration occurs and mean that any income is exempt.

Where to now?

Until Inland Revenue provides some indication of its approach once the Charities Commission is up and running, charities are in an uncertain position.

If Inland Revenue indicates a policy of automatically accepting registration with the Charities Commission as indicating compliance with some or all the requirements of the Tax Act, there will be some comfort for the charity.

However, policy statements of Inland Revenue are not binding on Inland Revenue and, in circumstances where a significant amount of income is at issue, may not be of sufficient comfort for the charity involved.

To avoid all doubt, a binding tax ruling would be necessary.

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