



WEEKLY COMMENT: FRIDAY 15 AUGUST 2014

1. In *Weekly Comment* 9 August 2013 I looked at *Clarifying the tax consequences for deregistered charities – An officials’ issues paper* (“the Charities Deregistration IP”) released in July 2013. Included in *Weekly Comment* 9 August 2013 is a useful introduction to the requirements for charities to be registered and the charities-related tax concessions.
2. The Charities Deregistration IP contained various proposals to amend the tax laws as they apply to deregistered charities. The proposals have been enacted in the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014* (“the Employee Allowances Tax Amendment Act 2014 ”), which received the Royal assent on 30 June 2014. The new rules are explained in *Tax Information Bulletin* Vol. 26 No. 7 (August 2014), pages 65-69 (“the TIB Item”).
3. It is stated in the *Commentary* to the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* (“the *Commentary*”) that two major policy changes arose from consultation which led to the suggested solution in the Charities Deregistration IP being modified:
 - (a) The first change extinguishes any retrospective tax costs for deregistered charities (and their donors) that have acted in good faith and have been compliant.
 - (b) The second change imposes an additional tax cost on deregistered charities that have not divested themselves of their assets or income that they had accumulated as a charity, within 12 months of the deregistration date.
4. This week I look at the timing of when the tax rules will commence to apply to a deregistered charity. Next week I will look at how the tax rules will apply to a deregistered charity.

Application of the new rules

5. The new rules apply to “non-exempt charities” (i.e. charities that are no longer exempt from income tax). The term ‘non-exempt charity’ is used to acknowledge that some entities which are deregistered continue to operate as charities, albeit no longer as tax exempt charities. The new rules:
 - (a) Clarify how the general tax rules (including the income tax, fringe benefit tax and donations tax relief regimes) apply to deregistered charities;
 - (b) Establish the opening values of assets or consideration for any financial arrangements held by a deregistered charity when it becomes a tax-paying entity;
 - (c) Prescribe specific timing rules for the application of the taxing provisions; and

- (d) Outline new requirements for the treatment of the accumulated assets of deregistered charities.
6. It is noted in the *Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill* ("the Officials' Report") that the new rules for deregistered charities apply to a "person". Officials consider that the term "person" is more appropriate than "entity". The term "person" as used in the *Income Tax Act 2007* encompasses a wider range of entity types than "entity" as defined in the *Charities Act 2005* does. For example, an unincorporated body of people is a person, but would not necessarily be an entity.
7. The following points in the Officials' Report and the TIB Item are also worth noting:
- (a) The new rules include entities which voluntarily request to be removed from the charities register.
 - (b) The new rules do not concern the tax consequences for charities that have been declined registration, as opposed to deregistered. Officials stated that further work is required to investigate the policy implications of extending the rules to declined registrations, which will be undertaken as part of the Government's tax policy work programme.
 - (c) The new rules apply to entities which are removed from the charities register. If an entity's non-compliance with its constitution or rules does not lead to it being removed from the register, these rules will not apply to that entity.
 - (d) The new rules do not apply to periods before 1 July 2008. The rules set out the grace-period for compliant deregistered charities, during which an entity is not exposed to tax on a retrospective basis where the entity has effectively relied upon the decision of Charities Services. Before 1 July 2008, there was no registration system for charities, which were required to self-assess their eligibility for charities-related tax exemptions.
 - (e) If an entity that is deregistered is subsequently re-registered, the rules will apply for the period of deregistration. Officials acknowledged that an entity may choose to apply for registration after deregistration instead of disputing deregistration. However, whether an entity will be re-registered cannot be known with certainty at the time of deregistration.
8. The amendments generally apply from 14 April 2014. There is one exception to this, which relates to the new requirement for accumulated assets of deregistered charities to be discussed next week, for which there is a split application date. This rule will apply from:
- (a) 14 April 2014 for entities which choose to voluntarily deregister; and
 - (b) 1 April 2015 for entities which are deregistered by Charities Services.

Date from when the general tax rules will apply to a deregistered charity

9. Under current law, tax consequences on deregistration could involve retrospective tax liabilities if a deregistered charity is found never to have had a "charitable purpose" or ceased being charitable in purpose at some time in the past. This was seen to be unfair if an entity has been acting in accordance with its constitution, but, for example, there has been a slight change in jurisprudential interpretation of what is "charitable" and what is not, causing the entity to cease being charitable.
10. Under new s. CW 41(1)(aa), effective generally from the 2014-15 income year onwards, an amount of income derived by a person who is removed from the register of charitable entities (the **register**) under the *Charities Act 2005*, is exempt income if it is derived in the

period starting with the day they are registered on the register and ending with the earlier of the following days:

(a) The day on which the person *does not comply with the person's rules contained in the register*; or

(b) The *day of final decision*. (emphasis added)

11. Under the new definition in s. YA 1 inserted by s. 144(8) of the Employee Allowances Tax Amendment Act 2014, the **day of final decision** means the later of:

(a) The day the relevant person is removed from the register of charitable entities under the *Charities Act 2005*; or

(b) The day on which all reasonably contemplated administrative appeals and Court proceedings, including appeal rights, are finalised or exhausted in relation to the person's charitable status.

12. This effectively provides a “grace-period” for **compliant entities** starting from the date of registration with Charities Services to the **later** of two dates: namely, the day the entity is removed from the charities register or the day on which that entity exhausts all disputes and appeals to determine its charitable status. The Officials’ Report states: “this is a significant departure from the current rules, which assess whether a charity is deriving income for charitable purposes”. Note that the exemption will not apply if the entity has ceased to comply with its rules contained in the register.

13. In order to qualify for the “grace period”, the exemption as initially framed, in the Bill introducing the new rules, required charities to have acted in accordance with their constitution or other information supplied to Charities Services at the time of applying for charitable status. However, following submissions, this was changed to the requirement to comply with rules contained in the register. It is noted in the Officials’ Report that:

“The constitution or rules of a registered charity are required to be filed on the charities register and any changes to the constitution or rules of the entity are required to be notified and reviewed by Charities Services. The constitution or rules of the entity as they appear on the charities register are current. Therefore, we believe it is sufficient to refer to the entity’s rules as they appear on the charities register.”

14. As explained in *Weekly Comment* 9 August 2013, to be eligible for the income tax exemption, a charity must be a “tax charity”. Consistent with the new exemption, new s. CW 41(5)(c), effective generally from the 2014-15 income year onwards, provides that a person continues to be a **tax charity** for the purposes of ss. CW 42 and CW 43 despite removal from the register, in the period starting with the day they are registered on the register and ending with the earlier of the following days:

(a) The day on which the person does not comply with the person's rules contained in the register; or

(b) The day of final decision.

15. Under s. 30(4)(b) of the Employee Allowances Tax Amendment Act 2014, these rules can apply for an income year before the 2014–15 income year, but only for the first income year and subsequent income years for which the person files a return of income on the basis that these rules apply for the relevant income year.

16. Note that the charities exemption in s. CW 41 does not apply to income derived from a business carried on by, or for, or for the benefit of a charitable trust or institution. Section CW 42 provides a tax exemption for business income of a tax charity if the charitable purposes are carried out in New Zealand and no person with control over the business is able to divert income to their own advantage.

Date from when the FBT rules will apply to a deregistered charity

17. As explained in *Weekly Comment* 9 August 2013, the FBT exemption in s. CX 25 applies to a “charitable organisation”. The definition of **charitable organisation** in s. YA 1 includes a new paragraph (ab) so that it:

(ab) Includes a person who has been removed from the register of charitable entities (the **register**) under the *Charities Act 2005*, but only for the period starting on the day the person is registered on the register and ending on the **earlier of** the last day of the following periods:

- (i) The quarter, or income year (if the “close company option” in s. RD 60 applies), in which the person does not comply with their rules contained in the register; or
- (ii) The quarter, (or income year if s. RD 60 applies), in which the day of final decision falls.

18. As noted in the *Commentary*, this FBT amendment mirrors the income tax amendment to s. CW 41, so that a deregistered charity can remain a “charitable organisation” for a specified period, from the date of registration to the earlier of the two dates referred to in paragraph 17 above.

19. It is noted in the Officials’ Report that a deregistered charity might still apply its funds wholly or mainly to charitable, benevolent, philanthropic or cultural purposes within New Zealand and therefore qualify for the FBT concession (and also continue to meet the requirements to be a donee organisation, as discussed next week).



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