



12 October 2018

Ref: DOIA 1819-0335

Redacted -
Privacy

Dear Redacted -

Thank you for your email of 31 August 2018 to the Ministry of Business, Innovation and Employment (the Ministry) requesting, under the Official Information Act 1982 (the Act), the following information:

I was just reading the 10 August Regional Economic Development Weekly Report which has been placed on the MBIE website:

<https://www.mbie.govt.nz/info-services/open-government-official-information/weekly-reports-to-ministers/regional-economic-development/regional-economic-development-weekly-report-week-ending-10-august-2018.pdf>

It mentions a report on the "Charitable Status for EDAs" which has been prepared for USEC Tabuteau. Tracker Number 0505 18-19 signed out by AJ Millward and with a delivery date of 14 August.

It would be great if you can provide us with a copy of the report – and/or any further update on progress.

Please find attached the documentation which falls within the scope of your request. Some information is withheld under the following section of the Act:

9(2)(a) to protect the privacy of natural persons, including that of deceased natural persons

You have the right to seek an investigation and review by the Ombudsman of our response to your request. Information about how to make a complaint is available at: www.ombudsman.parliament.nz or freephone: 0800 802 602.

Yours sincerely



Mark Jacobs
Manager, Regional Investment
Provincial Development Unit, MBIE

PROACTIVELY RELEASED CONSISTENT WITH THE OIA



AIDE MEMOIRE

Update on the Charitable Status of Economic Development Agencies

Date:	15 August 2018	Priority:	Medium
Security classification:	In Confidence	Tracking number:	0565 18-19

Information for Minister(s)
Fletcher Tabuteau Parliamentary Under-Secretary to the Minister for Regional Economic Development

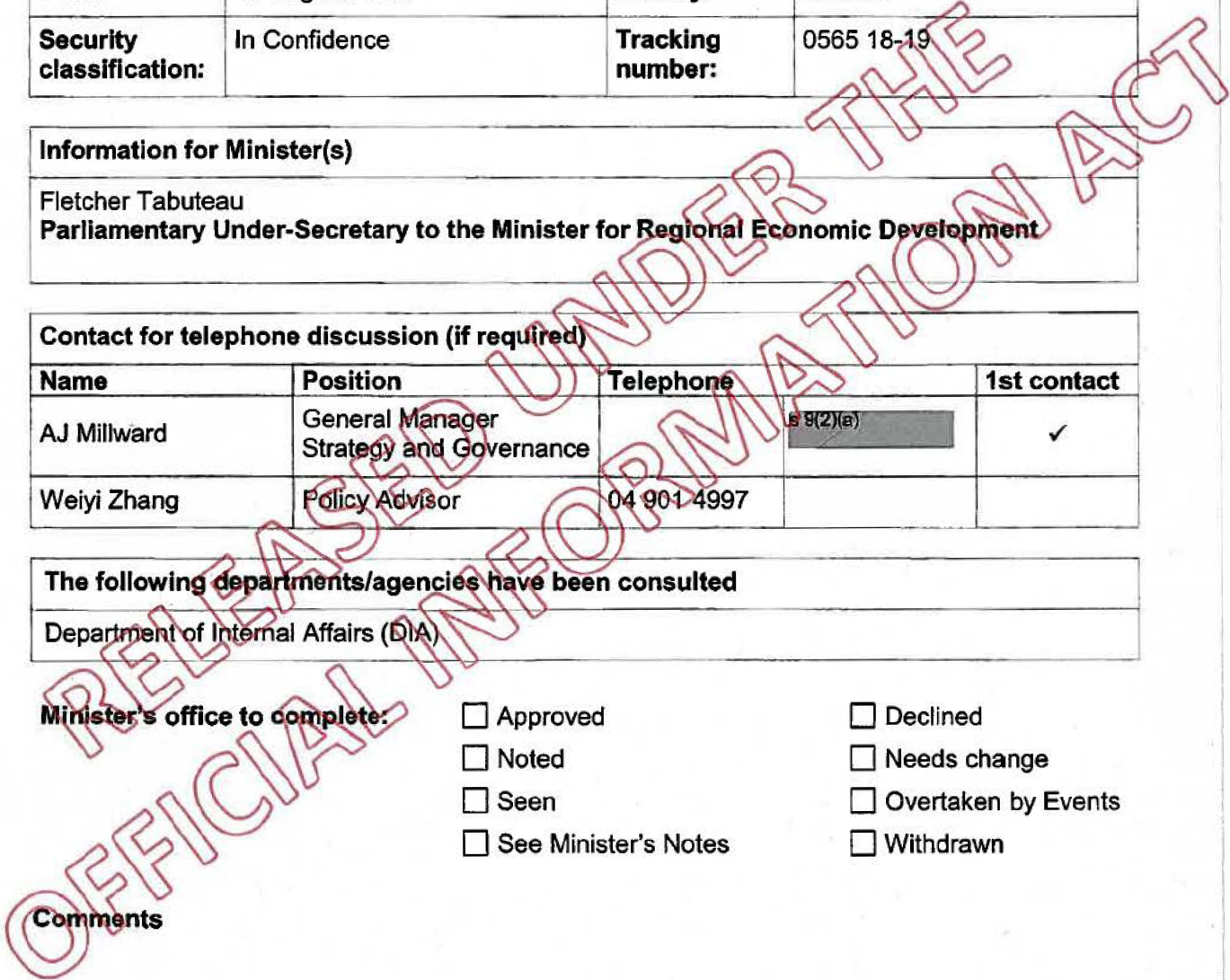
Contact for telephone discussion (if required)			
Name	Position	Telephone	1st contact
AJ Millward	General Manager Strategy and Governance	s 9(2)(a)	✓
Weiyi Zhang	Policy Advisor	04 901 4997	

The following departments/agencies have been consulted
Department of Internal Affairs (DIA)

Minister's office to complete:

- | | |
|---|--|
| <input type="checkbox"/> Approved | <input type="checkbox"/> Declined |
| <input type="checkbox"/> Noted | <input type="checkbox"/> Needs change |
| <input type="checkbox"/> Seen | <input type="checkbox"/> Overtaken by Events |
| <input type="checkbox"/> See Minister's Notes | <input type="checkbox"/> Withdrawn |

Comments





AIDE MEMOIRE

Update on the Charitable Status of Economic Development Agencies

Date:	15 August 2018	Priority:	Medium
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Purpose

Earlier this year, Venture Taranaki discussed with you on how the Charities Act 2005 (the Act) has affected the tax obligations of certain Economic Development Agencies (EDAs).

This aide memoire follows up previous advice provided by officials on this matter [briefing 3233 17-18 refers], and provides you with an update on:

- The terms of reference and timeline for the review of the Act;
- How the Department of Internal Affairs assess entities and determine their charitable status; and
- Initial scoping work done around the potential for EDAs, or their controlling entities, on establishing Special Purpose Vehicles (SPVs).

AJ Millward
General Manager, Strategy and Governance
Provincial Development Unit

15/08/18

Background

1. Earlier this year, Venture Taranaki discussed with you on how the Charities Act 2005 (the Act) has affected the tax obligations of Economic Development Agencies (EDAs).
2. Prior to the Act, some EDAs, including Venture Taranaki, paid no income tax on surplus income because as charitable trusts, they qualified as charities and were exempt from income taxes.¹
3. When the Act came into force in 2005, some EDAs lost their charitable status and consequently tax exemptions as their purpose was deemed to not be charitable, according to the Act. Instead, the EDAs were deemed to have advanced private benefits for for-profit businesses.
4. You asked officials to prepare initial advice on this matter. Key points were:
 - Many EDAs (with exceptions such as Development West Coast²) are not considered charitable as most of their activities are not deemed to be advancing charitable purposes.
 - A review of the Act is currently underway. However, officials do not view that EDAs should change or limit their activities to meet the purposes of the Act because activities that do not advance a charitable purpose are nonetheless important to an EDA's operations. Neither do officials believe that the Act is not fit for purpose for the broader charities sector.
 - Changing the Act or re-interpreting the Act so that all EDAs are deemed charitable organisations could create precedents and perversely incentivise organisations to avoid paying tax.
 - However, EDAs, or their controlling organisations, could set up Special Purpose Vehicles (SPVs) that advance charitable purposes separate of the EDAs' businesses that are non-charitable.
 - SPVs are subsidiary entities with a separate debt, asset, and legal status to the parent organisation. SPVs are usually set up as limited liability companies, but could also be established as charitable trusts or limited partnerships.

How DIA assesses EDAs and their charitable status

5. When the Act first came into force, the Charities Commission assessed EDAs on what percentage of their activities met the definition of charitable purpose; 85 to 90 per cent of an EDA's activities needed to meet the charitable purpose test for the EDA to obtain charitable

¹ At the time, an entity's charitable status was often self-declared, and would not usually involve detailed assessment of whether activities advanced charitable purposes.

² The activities of Development West Coast were deemed as charitable as its purpose states that it is "a trust for charitable purposes for the benefit of the community of the present and future inhabitants of the West Coast region".

status. In the case of Venture Taranaki, the Charities Commission advised that only 55 per cent of Venture Taranaki's activities met the definition of charitable purpose, and as a result Venture Taranaki lost its charitable status.

6. That position has since changed. The Department of Internal Affairs (DIA) now assesses the activities and purposes of the entities holistically, based on subsequent case law. Assessment is being done on a case by case basis, taking in account not only percentage of expenditure, but also other factors such as volunteer and paid staff time allocation, strategic plans, and quantitative results achieved.
7. As a general rule, DIA advised that if an entity is spending over 15 per cent of its expenditure on advancing non charitable purposes (e.g. giving grants to businesses in an area that is not in need), the entity would likely not qualify for charitable status.

Update on the review of the Charities Act 2005

8. The Minister for the Community and Voluntary Sector announced a review of the Act on 24 May 2018. Led by DIA, the purpose of the review is to ensure that the Act is effective and fit for purpose. The indicative timeline is as follows:

Phase	Indicative Timing	Key activities
Pre-consultation	May - October 2018	Establish Core Reference Group Identify issues and possible solutions, develop discussion document
Consultation	October - December 2018	Launch discussion document Public consultation
Policy	Early-mid 2019	Review public submissions Develop policy proposals for Cabinet approval
Legislation	Mid 2019 onwards	Develop draft legislation Passage through the House of a bill to amend the Act

9. The review's terms of reference, agreed to by Cabinet in April, notes that the following matters are specifically excluded:
 - The definition of charitable purpose;
 - Regulation of the broader not-for-profit sector; and
 - Tax exemptions that result from registration under the Act.



10. While tax exemptions sit outside the scope of the review, DIA noted that the Tax Working Group may consider the tax treatment of charities in its work. Any interim findings of the Tax Working Group relevant to charities would be considered as part of the Act's review. You may also suggest to the EDAs that they could collectively make a submission during the review's consultation period and investigate further options.

Initial advice on setting up SPVs

11. SPVs are established for a specific project or purpose. In the case of an EDA, a SPV could be set up to split the EDA's charitable and non-charitable activities. This could involve separating activities that advance an EDA's charitable purposes and placing those activities into the operations of a SPV. Vice-versa, an EDA's activities that are non-charitable could alternatively be placed into a SPV.
12. In either case, it would be easiest for the primary activities of an EDA to remain its core function, while its secondary activities are spun-off into a SPV. For example, an EDA whose activities are mostly non-charitable would find it easiest to spin-off its charitable activities.
13. The resulting entity, which may be a SPV or a continuing EDA with solely charitable purposes, can then apply for charity status under the Act and gain charitable tax status.
14. The SPV could be structured as a subsidiary of the EDA or its controlling entity as a "sister entity". If the EDA is controlled or owned by a local authority, the SPV could be deemed as either a council-controlled organisation, or a council-controlled trading organisation.³
15. At the face of it, there does not seem to be any legal or practical basis stopping EDAs or councils from restructuring the affected EDA. However, how an EDA (or its controlling entity) restructures its charitable and non-charitable purposes will vary from agency to agency - some business-oriented EDAs, for example, may conduct very few activities that qualify as charitable.

Risks

16. Given that the Tax Working Group may consider the tax treatment of charities in its work, possible changes to tax law could undermine the tax status of SPVs established by EDAs or their controlling organisations. You may wish to signal to EDAs that any restructuring activities should take in account possible future changes to tax laws.

Next Steps

17. It is unlikely that the review of the Act will result in EDAs qualifying for tax exemptions on surplus income. However, there could be further work conducted by the Tax Working Group that is relevant to the concerns of the EDAs, and officials could liaise further with Treasury and Inland Revenue officials to discuss directly the tax treatment of EDAs.

³³ According to the Office of the Auditor General, a non-profit council-controlled organisation with charitable purposes, that is not a company, may be recognised as exempt from income tax.



18. Provincial Development Unit (PDU) officials could also work with Economic Development New Zealand, the national industry organisation of EDAs, to facilitate discussions and solutions for EDAs around setting up SPVs, and restructuring their charitable and non-charitable activities.
19. If you wish, officials could also (with DIA's assistance) compile a stocktake of EDAs around New Zealand that have charitable purposes versus those that do not have charitable purposes. This work could be completed by the end of August 2018.

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