



Philanthropy New Zealand

Tōpūtanga Tuku Aroha o Aotearoa

Submission to the Discussion Document
“Streaming and Refundability of Imputation Credits”
C/- Deputy Commissioner
Policy Advice Division
Inland Revenue Department
PO Box 2198
Wellington

Introduction

Philanthropy New Zealand (PNZ) is the peak body bringing together New Zealand's leading private philanthropists, trusts, foundations, businesses, including the Community Trusts, created when community banks and energy utilities were sold.

Executive Summary

This submission is in response to the Discussion Document **Streaming and Refundability of Imputation Credits** issued by the Minister of Finance and the Minister of Revenue in August 2008 (“the DD”). Right from the foundation of PNZ in 1990, PNZ has been concerned about the inequities inherent in the imputation credit system.

The key points made in this submission are:

1. PNZ strongly supports the introduction of a mechanism for the refunding of imputation credits to registered charitable entities and the Community Trusts.
2. The principles of the imputation credit system are consistent with (and in reality necessitate) refunds to tax-exempt charities (and the Community Trusts). In approaching the DD, it is important that Government does not simply concentrate on refund of imputation credits being a loss or “tax expenditure” by Government. The effects of volunteer labour in the voluntary sector provide the opportunity for a leveraging of imputation



credits refunded to the charitable sector.

In addition, and very importantly, the refunding of imputation credits to tax-exempt charitable entities (and community trusts) is entirely consistent with the fundamental principles of the imputation system.

3. The value added by the voluntary sector is of enormous importance. The VAVA research project undertaken by PricewaterhouseCoopers for the NZ Federation of Voluntary Welfare Organisations in 2004 of 10 nation-wide social service organizations clearly demonstrates the significant cost savings that these agencies are making across the fields of health, social wellness, justice and education. The key findings indicate that, for every \$1 provided to a voluntary agency, between \$3 and \$5 worth of services are delivered; and the net economic benefit of the selected activities was estimated at \$750 million, from an investment of government funding of less than \$50 million.
4. The taxation effects are generally considered in the context of the development of a Statement of Investment Policies and Objectives ("SIPO") or similar document. A SIPO will usually set the parameters for the asset allocations of the charitable entity. It is quite likely that the enactment of a rule permitting such refunds will trigger a review of the asset allocations of each charitable entity
5. PNZ wishes to state that it is of the view that clearly stated rules are preferable to vaguely worded provisions that refer to purposes or effects of streaming. Most charitable entities do not have direct experience of the income tax system and thus it would be unfair to require them to have an understanding of difficult concepts such as those applying in relation to the general anti-avoidance provision. Accordingly, any rules that might be enacted should (in the opinion of PNZ) be "black letter" provisions that are easily applied in practice.
6. PNZ notes its earlier supplementary dividend suggestion, but expresses its preference for a refund system.

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This submission from Philanthropy New Zealand to the Discussion Document, "Streaming and Refundability of Imputation Credits", is in two parts. The first part addresses features of the imputation system and important features of the voluntary sector. The second part deals specifically with the questions raised in the DD.

Imputation System

1. The basic principle of the imputation system has always been that the tax rate payable by a company and its shareholders should reflect the tax rate applying to the shareholder.
2. The imputation system of New Zealand and other jurisdictions was primarily aimed to overcome the double taxation inherent in the so-called classical system of taxation of companies. Under the classical system, the company paid income tax and the dividends paid to shareholders were also taxed, without any credit for the corporate income tax paid by the company.
3. It is unfortunate that the potential size of the charitable sector was not predicted in 1986-87 when the imputation system was being proposed in New Zealand. It appears that that is the major reason why there was insufficient attention given to the over-taxation of charities and other tax-exempt entities.¹ That over-taxation arises from the use of an imputation system without some mechanism that alleviates the position of charities and other tax-exempt entities.
4. During the past 15 years, PNZ has made a number of submissions to Government concerning the refundability of imputation credits. Initially, those submissions simply sought a refund mechanism. Subsequently, the submissions focused on a mechanism whereby the refunds could be effectively provided by way of a supplementary dividend payable by the company itself, rather than by Inland Revenue. It should therefore not be surprising that PNZ and its members welcome the publication of the DD.
5. Members of PNZ feel strongly that the Foreign Investor Tax Credit ("FITC") rules provide a tax preference to non-resident

¹ The proposal to create an imputation system was first announced in the **Statement on Taxation and Benefit Reform 1985** of the Minister of Finance of 20 August 1985. There were two studies that preceded the release of the Government's **Consultative Document on Full Imputation** in December 1987. Those studies are Richard Vann **Eliminating the Double Tax on Dividends – Legal and Practical Issues** (IPS, VUW, 1986) and Matt Benge and Tim Robinson **How to Integrate Company and Shareholder Taxation** (IPS, VUW, 1986). The position of charities and other tax-exempt entities in an imputation system was not considered in those studies.

shareholders in New Zealand companies, when their position is compared to that of charities that are shareholders in New Zealand companies.

6. PNZ strongly supports the introduction of a mechanism for the refunding of imputation credits to registered charitable entities and the Community Trusts.

Current Anti-Streaming Rules (Ch.3)

7. PNZ and its members do not have a direct interest in the anti-streaming rules contained in the Income Tax Act 2007 (and previous Income Tax Acts). Despite that, PNZ is of the view that slight enhancements to the current rules may be necessary in the context of the proposal to provide refundability of imputation credits.
8. It is important that any new rules do not create burdens for companies and shareholders.
9. It seems unlikely that any members of PNZ will be entering into transactions that would be the concern of the anti-streaming rules.
10. Most charitable entities do not have direct experience of the income tax system and thus it would be unfair to require them to have an understanding of difficult concepts such as those applying in relation to the general anti-avoidance provision. Accordingly, any rules that might be enacted should (in the opinion of PNZ) be "black letter" provisions that are easily applied in practice. Despite that, PNZ wishes to state that it is of the view that clearly stated rules are preferable to vaguely worded provisions that refer to purposes or effects of streaming.
11. PNZ is conscious that there is a progressive convergence of the Australian and New Zealand capital markets, and so it understands that there may be a need for some harmonisation of the imputation anti-streaming rules of New Zealand and Australia. However, the points made in paragraph 10 are important and should not be subjugated to the harmonisation process.

Refund Rules (Ch.4)

12. Chapter 4 of the DD seeks comment on three matters:

- Does the absence of a rule allowing a refund for imputation credits affect the type of investments a tax-exempt organisation makes?
- If rules were introduced to allow imputation credits to be refunded, it would be necessary to ensure they did not undermine the objectives of the imputation system. What checks and balances would a responsible refund mechanism have?
- Do other options exist to deal with concerns identified in this chapter?

13. A fourth question appears to be posed in Chapter 4 (at para. 4.18) that concerns the nature of the parties to whom imputation credits should be refundable. Paragraph 4.18 refers to "registered charities, other entities with specific statutory tax exemptions, taxpayers whose marginal tax rates are lower than the company rate, and taxpayers in loss".

Investment Behaviour

14. PNZ is of the view that tax is only one influence on investment decisions. The lack of a rule permitting refunds of imputation credits has affected the proportion of New Zealand equity investments that are made by a number of charitable entities.
15. The taxation effects are generally considered in the context of the development of a Statement of Investment Policies and Objectives ("SIPO") or similar document. A SIPO will usually set the parameters for the asset allocations of the charitable entity. It is quite likely that the enactment of a rule permitting such refunds will trigger a review of the asset allocations of each charitable entity
16. It is important to note that there are a number of tax influences on the investments made by charitable entities, in addition to the non-refundability of imputation credits. For many years (and certainly before the introduction of the imputation system in 1988), direct investment in property and in debt securities were preferred investments for charities. RWT exemption certificates which ameliorate the imposition of Resident Withholding Tax on interest (as introduced in 1989) and provide encouragement for investment in all forms of debt security (whether in the form of bank deposits, company bonds and debentures, and convertible notes).
17. With those comments in mind, PNZ wishes to provide the following information that it has obtained from its members by a survey

conducted in September 2008.

18. Of the members responding to the survey, over 80% indicated that if their charity were permitted a refund of imputation credits they would review the current investment strategy. Over 60% of those responding indicated that they would consider increasing the percentage of their investments in New Zealand shares by between 5-20+ percent. Although 40% of respondents indicated that although they would consider increasing the percentage of investments they did not know by how much.

Checks and Balances

19. The second question posed in Chapter 4 must be considered in the light of the objectives of the imputation system. The key objective is that company income ought to be taxed at the relevant tax rate payable by its shareholders. That objective is very important. PNZ submits that any checks and balances should be related to that key objective.
20. The DD suggests (at para. 4.10) that "refunding tax credits could also create greater incentives for charities to be used in "tax planning" arrangement". As already noted in this submission, PNZ prefers that any rules that might be enacted in relation to this small risk are clear and precise, and do not create uncertainty. A lack of certainty will create additional costs and risks for charities.
21. In addition, PNZ notes that (registered) charitable entities are subject to regulatory oversight and supervision by the Charities Commission. Similarly, there is regulatory oversight and supervision of the twelve Community Trusts by the Minister of Finance.

Other Options

22. PNZ has previously suggested that a modification of the supplementary dividend method of providing the foreign investor tax credit ("FITC") could be used to provide a refund equivalent to charities. Under such a method, it would be necessary for charities and community trusts to be given a new RWT exemption certificate. In addition, the administrative costs of providing the refund equivalent would be borne by New Zealand resident companies.
23. PNZ only developed the supplementary dividend suggestion because of Inland Revenue suggestions that there were difficulties in designing and implementing a refund mechanism for imputation credits. In the light of the registration of charitable entities by the Charities Commission, it would appear that Inland Revenue has better information now than previously about (registered) charitable entities. Accordingly, PNZ merely notes the

supplementary dividend suggestion, but expresses its preference for a refund system.

Scope of Refund System

24. As noted above, para. 4.18 of the DD poses the question of scope of the refund system in terms of which entities should qualify for refunds of imputation credits.
25. PNZ represents charitable entities and community trusts. PNZ submits that both these groups of entity should be within the scope of the proposed refund system. These groups of entities are subject to forms of regulatory oversight and supervision by the Charities Commission in respect of (registered) charitable entities and by the Minister of Finance in respect of the community trusts (under the Community Trusts Act 1999).
26. PNZ does not express any view about the application of the proposed system to other entities in the Third Sector, to local government entities, or to taxpayers in a tax loss position.

Appendix 1

The VAVA Project - September 2004

Inherently, the intrinsic value of the outputs provided by community and voluntary agencies and the outcomes they affect is known and recognised. From a social perspective, these agencies are acknowledged as important contributors to our communities. The immense value of their outcomes (their activities and achievements), however, has gone unmeasured and unrecorded. Hence, it is often not fully appreciated.

The 2004 VAVA report, undertaken by Price Waterhouse Coopers and the New Zealand Federation for Voluntary Welfare Agencies, examines the inputs of 10 voluntary agencies and estimates total inputs-voluntary-value-added. IVVA is defined as the voluntary and/or in-kind contributions of the labour, donations and capital the agency combines with other inputs to provide outputs (services and goods).

This report examines the inputs of 10 voluntary agencies and estimates their total inputs-voluntary-value-added. IVVA is defined as the voluntary and/or in-kind contributions of the labour, donations and capital the agency combines with other inputs to provide outputs (services and goods).

The 10 agencies are:

- Barnardos New Zealand
- New Zealand Association of Citizens Advice Bureaux Inc.
- Diabetes New Zealand Inc.
- Literacy Aotearoa
- IHC New Zealand Inc.
- National Association of ESOL Home Tutor Schemes (NAEHTS)
- New Zealand Playcentre Federation Inc.
- Royal New Zealand Foundation of the Blind
- Royal New Zealand Plunket Society Inc.
- Victim Support New Zealand.

1.1 Key findings

The key results are based on data available from the 10 participating agencies for a 12 month period, at least part that falls within calendar 2002 (the research year).

Key findings are as follows:

- The estimated total number of hours of volunteer work carried out by the 10 VAVA agencies is 7.63 million hours for the year.
- The estimated total number of full-time equivalents (FTEs) worked

by volunteers for the 10 VAVA agencies during the research year were 4,063.

- This is comparable in size to the total time worked by people in paid employment in the dairy industry and to about 2/3rds the hours worked by those employed by New Zealand's biggest employer, the Ministry of Social Development.
- Each of the participating agencies' volunteer hours adds up to an estimated 50 FTEs or more. This is as large as the paid staff of the top 5% of New Zealand enterprises.²
- The table below aggregates the total hours worked by three groups of voluntary workers at the 10 VAVA agencies during the research year, and based on this information, the total volunteer FTEs are estimated on the regular number of hours worked each year by paid employees.

Level of work	Hours worked	FTEs
Vol. Worker	6,850,130	3,644
Vol. Manager	720,214	383
Vol. Board member	67,894	36
Totals	7,638,238	4,063

Source: Data supplied by 10 voluntary agencies for the research year applying to each. Analysis by PricewaterhouseCoopers for the Value Added by Voluntary Agencies project, April 2004.

- Based on data from eight agencies, the average for volunteer staff is 406 FTEs and 472 paid FTEs.
- The value of the 10 VAVA agencies' total volunteer labour inputs has been estimated based on three scenarios, applying low, medium and high, pay rate assumptions.
- As the next table illustrates, the estimated inputs-voluntary-value-added by volunteers totals between \$88 million and nearly \$170 million for the 10 agencies for 12 months ending in 2002 (the research year).

Total value volunteer labour	Lower value scenario: \$ yr	Medium value scenario: \$ yr	Higher value scenario: \$ yr
	\$88.1m	\$125.8m	\$169.5m

² In 1998, only 3% of New Zealand enterprises employed 50 or more FTEs while 86.5% employ fewer than five FTEs Statistics New Zealand (1998) *Business Demographic Statistics*

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Source: Data supplied by 10 voluntary agencies for the research year applying to each. Analysis by PricewaterhouseCoopers for the Value Added by Voluntary Agencies project, April 2004.

- Other voluntary inputs of the participating agencies are in-kind contributions, including donated goods, services and imputed annualised values of assets. The total monetised value of such inputs received by eight VAVA agencies³ with appropriate data was \$9.5 million during the research year. This was made up of \$3.6 million from donated goods and \$5.9 million for other subsidised resources such as rent-free accommodation.
- In addition, cash donations are also a key input of voluntary organisations. Donated money received by all the 10 VAVA agencies during the research year totalled \$42.1 million.
- Total inputs-voluntary-valued added include the monetised value of volunteer labour, in-kind contributions (value of donated goods and subsidised resources) and monetary (cash) donations. The estimated range of the potential total inputs-voluntary-value-added that is attributable to the operations of the 10 VAVA agencies was between \$140 million and \$221 million in the research year. The table shows the range under the 3 scenarios.

Total input-voluntary value-added for 10 VAVA agencies	Lower value scenario \$ yr	Medium value scenario \$ yr	Higher value scenario \$ yr
Total value of volunteer labour	\$88.1m	\$125.9m	\$169.5m
Total value of donated goods	\$3.6m	\$3.6m	\$3.6m
Total value of subsidised resources	\$5.9m	\$5.9m	\$5.9m
Total monetary donations	\$42.1m	\$42.1m	\$42.1m
Totals	\$139.7m	\$177.5m	\$221.1m

Source: Data supplied by 10 voluntary agencies for the research year applying to each. Analysis by PricewaterhouseCoopers for the Value Added by Voluntary Agencies project, April 2004

- Agencies operate with both paid inputs and voluntary inputs. The voluntary component of inputs ranged from an agency where its voluntary inputs were 8% of inputs from all sources, to an agency that is almost entirely resourced by voluntary inputs equal to 94% of its total inputs.

³ n.b. The composition of these eight agencies is different from the eight which reported numbers of paid FTEs.

This detailed examination, based on a sample of only 10 voluntary agencies, provides a basis for providing a more comprehensive description of the sector than has been previously documented. It indicates that the magnitude of the volunteer contribution made each year by the voluntary sector is significant and that the operations of voluntary agencies provide a significant investment in community-based services.