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FOMANA CAPITAL

REPORT 2

Charitable Purposes and Tax Compliance Systems Programme

RESEARCH REPORT 30 SEPTEMBER 2008

1. Generic risks for Māori entities with charitable status
2. Requirements of registered charitable entities and Roles of Charities Commission and IRD in new operational regime.
3. Awareness and practice of eight pilot Māori charitable entities and areas of risk.

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Prepared by FOMANA CAPITAL LIMITED for Te Puni Kokiri

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Introduction

Charitable Purposes and Tax Compliance Systems Programme

Introductory Section

Prepared by FOMANA CAPITAL LIMITED for Te Puni Kokiri

Introductory

Purpose

The purpose of this report is to fulfil the requirements of Outputs 2, 3 and 4 in the Investment Agreement ("Agreement") dated 1 May 2008 between Te Puni Kokiri and FOMANA Capital Ltd. Schedule C of that Agreement sets out the reporting requirements for this Report:

Short Term Outcome	Outputs	Due Date
An informed understanding of the scale of affected Māori entities under the Charities Act 2005.	1. Preliminary research and legal advice obtained.	Completed 31 May 2008
	2. Research reports completed on generic risk for Māori entities with charitable status.	30 September 2008
	3. Detailed research report completed on the requirements of the new charities and tax compliance framework.	30 September 2008
	4. Research report and profile completed on each pilot entity outlining areas at risk of compliance with the charities/tax regime.	30 September 2008

Scope

The scope of this report is to expand on the high level overview of Report 1 and to provide a more informed and in-depth understanding of:

1. Generic risks for Māori entities with charitable status;
2. The respective roles of Charities Commission and IRD and their interface;
3. The eight pilot Māori charitable entities; their understanding of the new regime and their own constitution; their practices and policies for tax exemption status.

Format

The report is presented in the following format:

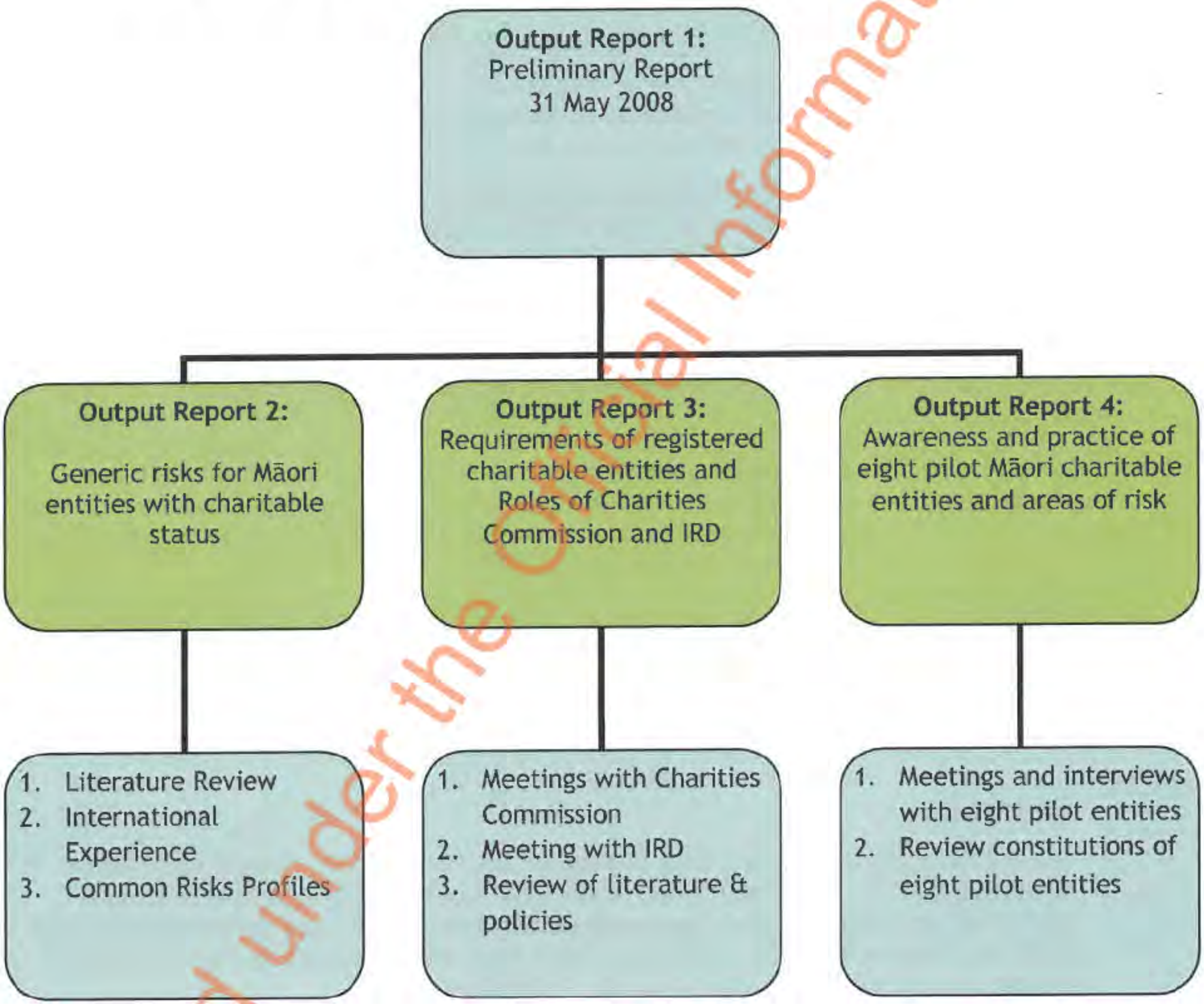
Introductory Section	Including purpose, format, methodology, definitions, acknowledgments
Executive Summary	Summary of key information
Section 1	Generic risks for Māori entities with charitable status.
Section 2	Requirements of registered charitable entities and Roles of Charities Commission and IRD in new operational regime.
Section 3	Awareness and practice of eight pilot Māori charities and areas of risk.
Appendices & Bibliography	

Methodology

The methodology for this report comprises three strands of research that contribute to an informed understanding of the charities and tax compliance framework and identification of risks for Māori charitable entities. The three strands are:

1. Research on generic risks for Māori entities with charitable status.
2. Research the roles of Charities Commission and IRD in new operational regime and the interface.
3. Research on the level of understanding, awareness and practice of eight pilot Māori charitable entities and areas of risk.

Diagram 1: Three Strands of Research



Limitation

This report is limited to providing Te Puni Kokiri with an overview in relation to the monitoring regime of the Charities Commission, the auditing role of the Inland Revenue Department, the analysis of generic risk for Māori entities with charitable status and the level of awareness within the nominated Māori charitable entities of relevant risk.

Definitions

For the purposes of this report, the following working terms and definitions are used:

Term	Definition
Charities Act 2005	Refereed to as the Charities Act 2005 or the Act
Charities Commission	Referred to in the report as the Charities Commission or Commission
Constitution	Governing documents such as the organisation deed, constitution or charter
IRD	Referred to in the report as IRD or Inland Revenue
Māori charitable entities	Legal entities that are registered or eligible for registration with the Charities Commission and which are majority owned by Māori or whose members or beneficiaries, the majority of which are of Māori descent.
Risk	The chance of something occurring that will, should the event occur, have an impact on the achievement of organisational objectives. It is measured in terms of the likelihood of something happening and the consequences if it happens.
Reputation Risk	The risk of damage to the organisation's credibility and reputation.
Compliance Risk	The risk of failing to meet government standards/laws and regulations.
Risk Management	A systematic and logical process of identifying, analysing, evaluating, treating, monitoring and communicating risks associated with any activity, function or process in a way that will enable an organisation to minimise losses and maximise opportunities.
Stakeholders	Those individuals, groups, institutions etc (either internal or external to the organisation) who are or perceive themselves to be affected by a decision or activity.
Board	Includes boards of directors, trustees, or other governance entity.

Disclaimer

This report presents the research findings of the stated three strands of research. It is prepared for Te Puni Kokiri only. It does not purport to provide specific legal advice for any entity on their legal obligations under or relating to the Charities Act 2005, the Income Tax Acts and or any other relevant legislation and or case law. It should not be relied upon by any entity accordingly.

Acknowledgements

FOMANA would like to acknowledge Te Puni Kokiri for supporting this project. We would like to thank Katrina Williams, John Moreno and Jacquie Hayes of IRD who gave helpful assistance in clarifying the role of IRD in terms of charitable entities. We extend our thanks to the Charities Commission, especially to the Chief Executive Trevor Garrett who gave generously of his time to answer our questions, and to Adrian Shields, Policy Manager, who provided useful information to assist in the writing of Section Two of this report.

We acknowledge the work of consultants Hayden Wano, Jane Hawkins-Jones and Rangimahora Reddy of Tui Ora Ltd, who carried out the extensive literature review and research that contributed to Section One. Rangi is primarily responsible for conducting all the interviews with the eight pilot Māori charitable entities and for producing the foundational and informative research that comprises Section Three. Thanks also to the administration and information technology staff at Tui Ora, whose assistance is appreciated. We acknowledge with thanks the work of consultant Brian O'Sullivan of Solas Consulting, who met with staff at IRD and Charities Commission. Brian's research for Section Two has added greatly to our understanding of the respective roles and interface of these two key agencies.

Finally, we acknowledge the representatives of the eight pilot Māori charitable entities who engaged candidly and with considerable forethought at the interview sessions. The discussions held and the information gleaned at the interviews has already prompted some organisations to reassess their current practice and risk management strategies. We appreciate your commitment to the research phase of the pilot programme.

Our next phase will be to take the research findings of this report and to work with you to prepare risk management tools and develop tax exempt assurance & beneficiary training systems for each of your organisations. He mihi nui ki a koutou:

- Ngati Rarua Atiawa Iwi Trust Board
- Taranaki Iwi Trust
- Taranaki PHO Ltd
- Te Aroha Medcare Ltd
- Te Atiawa Ki Te Upoko O Te Ika A Maui Potiki Trust
- Te Kaahui o Rauru
- Te Rau Pani Māori Mental Health Trust
- Tui Ora Ltd

Forward Programme and Outputs

The following table outlines the outputs for the next two reports[1].

Short Term Outcome	Output 6	Due Date
Increased awareness of the requirements of the new charity and tax compliance framework.	Report completed on risk profile and systems, policies and audit model completed.	20 February 2009
	Output 7	**Due Date**
	Report completed recommending risk mitigations to ensure consistency and compliance with the charities/tax regime.	30 March 2009

[1] Note: Output 5 is for filing of accounts only.

Executive

Charitable Purposes and Tax Compliance Systems Programme

Executive Summary Section

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Summary

This report combines three separate output reports. These being:

1. Generic risks for Māori entities with charitable status;
2. The respective roles of Charities Commission and IRD and their interface;
3. The eight Māori charitable entities; their understanding of the new regime and their own constitution; their practices and policies for tax exemption status.

The rationale is that these are interdependent pieces of work that assist in building a greater understanding of the risks and responsibilities of charitable entities and tax exempt status.

Generic Risks

The first section of the report provides key information that assists with understanding generic risks. Included as part of this body of knowledge is an international scan of similar jurisdictions that have recently established commissions or similar bodies to oversee charitable purposes and tax exemption with powers to register, monitor, educate, and regulate compliance and non-compliance.

This report has identified eight generic risks (listed below). Further research could be undertaken to determine the scale of risk across the sector of registered charitable entities, and particularly to research the highest risk factors for Māori charitable entities.

1. Operating outside "charitable purposes" as per Trust Deed or Rules
2. Misapplication of Trust funds
3. Loss of reputation
4. Legal Action against Trustees/Directors
5. Misappropriation of Trust funds
6. Penalties applied by IRD resulting from loss of tax exemption status
7. De-registration by the Charities Commission
8. Loss of tax exemption status

International studies from Canada, England & Wales have highlighted some key areas of non-compliance by charitable entities, particularly related to inadequate financial systems, failure of duty of care by trustees/directors, and non-compliance with stated charitable purposes. The Canadian non-compliance factors are of particular interest to New Zealand and Māori charitable entities because of the parallels in historical experiences, and more recently, in the post-settlement developments that have occurred in both nations.

While the Canadian literature did not specifically mention indigenous charities, there could be value in undertaking such a comparative research study in the future.

The need for all charitable organisations to practice effective governance and excellent administration and record-keeping is critical and cannot be underestimated.

The international findings are consistent with the findings from the eight pilot projects in Section Three. This also aligns with anecdotal evidence provided by the eight pilot entities, other key Māori entities and from discussions with numerous central and local government departments.

International findings:

Inaccurate tax receipts	Inaccurate tax receipts	Weak Financial controls
Deficient filing (inaccurate, late, missing)	Deficient filing (inaccurate, late, missing)	Inappropriate remuneration or benefits for Directors
Inadequate books and records	Non-charitable Activities	Deficient filing, (inaccurate)
Concerns with other Income Tax Act matters	Inadequate books and records	Failure of duty of prudence by Trustees
Non-charitable activities	Cannot meet disbursement quota	Failure of duty of care by Trustees (Governance issues equal fifth in rank)

<u>Charities Commission & Inland Revenue</u>
Section Two provides an insight into both the Charities Commission and Inland Revenue.

In this report work is done to clarify:
1. Charities Commission's role in monitoring compliance against the charitable purposes of the organisation in the annual returns process;
2. Inland Revenue's role in administering the Revenue Acts and what action it can or will take if it considers that an organisation may be operating outside the legislation or been de-registered by the Charities Commission; and
3. How the two agencies will work together on charitable purpose compliance matters.

From 1 Feb 2007, the Commission has been responsible for registering entities as charitable entities on the Register of Charitable Entities. Existing entities that have tax exemption status under the old system had until 1 July 2008 to register with the Commission. The Commission decides if an entity qualifies for registration as a charitable entity by evaluating whether it is operating within its charitable purposes. Once registered, charitable entities must:

a. file an annual return within six months of their balance date (i.e. end of financial year)[2]; and
b. notify the Commission within three months if certain information about their organisation changes (see below).

The Annual Return Form requires specific information. Charitable entities have a duty to notify the Commission of certain changes under section 40 of the Act. The Act specifies six changes that must be notified, including the date when the changes come into effect.

The Commission has a monitoring role; the key focus is to determine whether or not a registered charitable entity continues to be qualified for registration under the Act. The fundamental part of the Commission's monitoring role is likely to be ensuring a registered 'charitable entity's' compliance with the defined 'charitable purpose'.

[2] There may be potential for extending this deadline providing agreement is provided by the Commission

If the Commission comes to a view that an entity is not fulfilling its obligations under the Charities Act 2005, or no longer qualifies to be registered as a charity, the entity is advised of the concern and given the opportunity to address it. The Commission does, however, have a number of regulatory mechanisms available it under the Charities Act 2005. These include:

- issuing warning notices;
- publication of possible breach, this may result in an investigation of the entity by Inland Revenue as well as the Commission;
- issue administrative penalties.

Possibly the most significant enforcement mechanism is the ability to deregister a charitable entity under section 31 of the Charities Act 2005. A deregistration entity would lose its tax exemption status. This is also likely to lead to investigation by Inland Revenue and subsequent repayment of liable income tax, with potential penalties.

The Commission also has powers to control activities of non-registered entities that claim to be a charitable entity. Under section 37, the Commission can stop a person using a style or title including the words 'registered charity' or stating or implying that the person is registered as a charitable entity or that an entity the person acts on behalf of is a registered charity. An offence under section 37 is liable on summary conviction to a fine not exceeding $30,000.

The Inland Revenue has a regulatory role to ensure that taxpayers fulfil their tax obligations with respect to income received. Charitable organisations are liable for income tax if:

- they operate with no written rules, constitution or trust deed;
- they operate under a set of rules, a constitution or a trust deed that does not meet the requirements for an income tax exemption;
- they use business income for charitable purposes outside New Zealand;
- they are, from 1 July 2008, not registered by the Charities Commission.

The Income Tax Act 2007 (sections CW 41 and CW 42) and the Estate and Gift Duties Act 1968 (section 73) set out a number of income tax and duty exemptions. Some of these give benefits to charitable organisations and some give benefits to people or companies who make donations to such organisations. There are, generally, three main conditions that a charitable organisation must meet to qualify for these exemptions:

- The organisation's aims and activities must be exclusively charitable.
- The organisation's income or funds cannot be used (or be available for use) to benefit any of its members, trustees or associates.
- As of 1 July 2008, charities must also be registered with the Commission to qualify for income tax exemptions

Inland Revenue accepts the Commission's decision to register a charitable entity as proof that the entity meets the definition of charitable purpose and is eligible for exemptions from income tax on all or some of its income and other tax benefits.

While the Charities Commission is responsible for monitoring compliance with the stated charitable purpose of charitable entities, it is Inland Revenue that monitors charitable entities to ensure that their tax obligations are fulfilled with respect to income received. Charitable entities may be in breach of their tax obligations by failing to pay the appropriate tax on any income they receive by the appropriate time or by claiming tax benefits where they are not eligible. Registered charitable entities are likely to be in breach of their tax obligations predominantly by:

- applying the funds to a purpose outside the charitable purposes stated in the empowering documents; or
- applying funds to a charitable purpose but those funds are subsequently misapplied by the recipients.

The Commissioner of Inland Revenue has a number of regulatory mechanisms available under the Revenue Acts to be used in regard to non-compliance with tax obligations. In general, however, failure to meet tax obligations may result in civil penalties[3], criminal penalties[4], or both. The penalties resulting from a breach could also result in include increased periodic audits of the charitable entity.

The establishment of the Charities Commission has essentially set up a formal process around an area that was relatively informal in the past. Although the Commission has overall accountability for that area of work, Inland Revenue continues to have responsibility for deciding whether the entities are eligible for tax exemptions.

There is potential for the Commission and Inland Revenue to cooperate on a number of fronts and equally likely is the potential for this entities to disagree on the definition of 'charitable purposes', particularly where an organisation (or sector) that was not previously accepted by Inland Revenue as having a charitable purpose is registered by the Commission as a 'charitable entity'.

Eight Pilot Entities

Section Three studies the awareness of eight Māori entities that have chartable purposes and tax exemption status. What become evident was that these entities were linked to numerous other community and Māori entities, many that operated with charitable purposes. A questionnaire was developed and this along with the FOMANA 31 May 2008 report: Māori Charitable Entities under the Charities Act 2005 and the Income Tax Act where sent to each participant. Then interviews were held.

Participant structures range from trusts to private limited liability companies. Core activities included:

- mandated iwi organisations;
- post settlement iwi resource management trust;
- Māori development organisation;
- primary healthcare organisation;
- general practice; and
- specialist Māori mental health service provider.

The average length of time in operation was less than five years across the group. The range for participants went from less than two years in operation to more than ten. Participants were asked to do the following for each factor:

- Describe the organisation's level of understanding;
- Describe the potential impact they thought it would have on their organisation if it was to occur; and
- Describe the steps they would take to mitigate against the risk.

The majority of participants identified their level of understanding of the:

- role of the Charities Commission as Good (range Basic to Good).

[3] A civil penalty is one imposed by Inland Revenue rather than a court (i.e. late filing penalties; non-electronic filing penalties; late payment penalties; and shortfall penalties).

[4] A criminal penalty is one imposed by a court upon conviction of an offence (i.e. evasion; obstruction; and aiding or abetting another person to commit an offence).

- monitoring functions of the Charities Commission as Good (range Basic to High).
- role of IRD as Good (range Basic to High).

The review of participant's activities against its constitution indicated an area of potential improvement as the majority did not conduct an internal or external review.

Participants identified eight potential impacts to their organisation across all the risks:

1. Backlash from beneficiaries
2. De-registration (loss of charitable status)
3. Financial challenge (loss of cashflow)
4. Financial viability and sustainability
5. Loss of Reputation
6. Loss of tax exemption
7. Loss of Mana / Stigma attached
8. Reputation risk-several levels, personal, professional etc

Participants identified a detailed list of mitigation strategies: including but not limited to:

- Annual external audit & audit & risk committee
- Board with sound business acumen & skill
- Clear lines of delegation
- Educate all Trustees of charities requirements
- Ensuring processes are up to date and good policy & procedures
- Insurance (Public Liability, Directors etc)
- Process in place prior to distribution to beneficiaries (documentation in place to evidence acceptance of terms)
- Reviewing activities against constitution, contractual obligations
- Staying within core activities
- Training of beneficiaries

All recommended that the FOMANA report dated 31 May 2008 outlining Preliminary research on the legal framework affecting Māori Charitable Entities under the Charities Act 2005 and the Income Tax Act be used across their stakeholder groups, notably staff, trustees, beneficiaries and other relevant stakeholders.

The benefits sought from this project as identified by participants were:

- Clarification of roles & organisation responsibilities
- Feedback on weakness
- Suggested ways of improvement
- Good practice checklists (to assist with compliance)
- Guide on best practice
- Identify what constitutes acceptable documentation for IRD audit re: misapplication
- Another set of eyes looking at compliance "charities regime"
- Continuous updating around obligations and responsibilities

Throughout the interviews it was noticeable that participants had an openness and willingness to further improve systems and knowledge. It was also apparent that many of the issues faced by participants were similar and that there was an opportunity to gain real efficiencies and consistency (without compromising the autonomy of participants) in addressing compliance risk.

Section One

Charitable Purposes and Tax Compliance Systems Programme

Section One

Generic Risks for Māori Entities with Charitable Status

Prepared by FOMANA CAPITAL LIMITED for Te Puni Kokiri

Section One: Generic risks for Māori entities with charitable status.

Generic Risks for Māori Entities with Charitable Status

Introduction

This section identifies eight generic risks and looks at overseas experiences with regards to charities and tax exempt registration and compliance systems.

Eight Risk Factors

In our previous Report dated 31 May 2008, FOMANA identified seven risk factors. Since that report we have identified an additional risk factor to make a total of eight risk factors, namely:

1. Operating outside "charitable purposes" as per Trust Deed or Rules

This risk exists when an organisation operates outside of the charitable purposes as set out in its constitution.

2. Misappropriation of Trust funds

This risk exists when an organisations funds are applied for purposes which were not approved and do not benefit the organisation. This could amount to criminal activity.

3. Misapplication of Trust funds

This risk exists when an organisation applies funds to a related organisation or entity for charitable purposes but those funds are subsequently misapplied by the recipient.

4. Penalties applied by IRD for failure to comply with charitable purposes

This risk exists when an organisation has not complied with its charitable purposes and faces financial penalties of interest and/or taxes that can be backdated to the period when the non-compliance occurred.

5. De-registration by the Charities Commission

This risk exists when an organisation is removed from the Charities Register.

6. Loss of tax exemption status

This risk exists when an organisation loses its tax exempt status.

7. Loss of reputation

This risk exists when an organisation faces reputation damage at a public level through adverse media attention.

8. Legal Action against Trustees/Directors

This risk arises as a result of non-compliance either with its constitution and or relevant legislation and exists when trustees/directors face legal action for their role in the breach.

These eight risk factors form the basis for the questions around risk awareness and mitigation used in the interviews with the eight pilot Māori charitable entities, and which are reported on in Section Three of this report.

Overseas Experience (Canada & England – Wales)

For the purposes of this report, we conducted a brief literature review and research of other countries with similar charities/tax regimes to identify any similarities or differences in the key risk areas or areas of non-compliance.

The highest ranking factors contributing to non-compliance of charities with their respective regimes were determined from three sources of data. They were the Canada Customs and Revenue Agency (CCRA) compliance division files, CCRA revoked organisations and the Charities Commission for England and Wales. The table below reveals the rankings of factors for non-compliance.

Table 1: Factors of Non-Compliance

Ranking of factors for non-compliance	CCRA Compliance (Canada)	CCRA Revoked (Canada)	Charities Commission (England - Wales)
1.	Inaccurate tax receipts	Inaccurate tax receipts	Weak Financial controls
2.	Deficient filing (inaccurate, late, missing)	Deficient filing (inaccurate, late, missing)	Inappropriate remuneration or benefits for Directors
3.	Inadequate books and records	Non-charitable Activities	Deficient filing, (inaccurate)
4.	Concerns with other Income Tax Act matters	Inadequate books and records	Failure of duty of prudence by Trustees
5.	Non-charitable activities	Cannot meet disbursement quota	Failure of duty of care by Trustees (Governance issues equal fifth in rank)

According to this table the highest ranking factor for non-compliance by registered charities is linked to weak financial systems and processing. This factor resonates across all three data sets. Other key factors for non-compliance are brought about by charities engaging in non-charitable activities and Trustees' failure in their duties. The Canadian regime is unique in that it has a disbursement quota[5] that must be met each year unless approval is gained from the CCRA to temporarily accumulate for large projects.

[5] Canadian Inland Revenue Department. (2001). Tax and Charities - A Government Discussion on Taxation Issues Relating to Charities and Non-Profit bodies.

Factors impacting on Charitable Registration Compliance

In this section an overview of charitable registration compliance and its impact on the entity, the Governance Board, and the public is highlighted. From an entity viewpoint, charitable registration compliance means the ability to:

- maintain or secure tax-exempt status;
- secure (as not needed for existing donees) in some cases "donee" status with the IRD;
- maintain or secure the ability to secure grants or other benefits from government and philanthropic agencies that may require charitable status; and
- raise public profile and credibility (particularly in fund-raising activities).

From the viewpoint of the Governance Board, being part of a compliant charitable organisation requires demonstration of compliance with the rules of the entity and the relevant legislation through:

- implementation of best practice operational and governance systems and processes; and
- securing or accessing relevant skills for the entity to ensure compliance and best practice is maintained.

From a public viewpoint, a compliant registered charitable organisation is beneficial in terms of its:

- ability to demonstrate sector accountability and transparency; and
- ability to enhance public confidence in registered entities.

Factors deemed best practice in governance and decision making systems and processes for charitable organisations

A review of good governance literature in New Zealand and overseas reveals a common theme in that there is no "one size fits all". However, there are three factors that are critical to best practice for charitable organisations. These are:

- Legal Compliance
- Effective Governance and
- Financial Oversight.

Legal compliance

Legal compliance is one of the three critical factors identified by the Panel on the Nonprofit Sector Report (US) "Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations", October 2007. In essence it aims to identify if the organisation has systems, policies and/or processes that:

- clearly identify, monitor and evaluate governance and management responsibilities;
- clearly identify and monitor the legislation applicable to the organisation;
- support a code of ethics and conduct;
- address the handling of conflicts of interest, whistleblower protection, legal breaches whether intentional or intentional;
- secure important business documents and records; and
- ensure major risks to the organisation are identified, reviewed and mitigation plans are implemented.

The presence of these elements within an organisation will assist charitable entities in complying with their relevant legal obligations. However, the absence of such will naturally pose a possible risk for non-compliance as well as potentially support a need for education/training packages.

Effective Governance

A second key factor is to identify if the board fulfil its oversight and governance role effectively through systems, policies and/or processes that:

- regularly review and approve core organisational documentation ie. the mission statement, strategic plan, business plan and financial budget;
- clearly identify delegated authorities;
- clearly identify how roles on the board are allocated to its members;
- facilitate documentation of regular formal meetings of the board;
- address conflicts of interest and removal or disqualification of board members;
- regularly evaluate the performance of the CEO;
- provide a induction process for new board members;
- regularly evaluate the performance of individual board members as well as the group;
- clearly identify remuneration for board members and the underlying rationale for the remuneration level implemented; and
- ensure major risks to the organisation are identified, reviewed and mitigation plans are developed or implemented.

The presence of these elements within an organisation will assist the board in fulfilling its supervision and governance responsibilities effectively. However, the absence of such will naturally identify areas of possible risk of non-compliance as well as potential areas of development needed via education/training packages.

Strong Financial Oversight

The third key component is to identify if the organisation can demonstrate robust financial stewardship of resources through systems, policies and/or processes that:

- ensure complete, current and accurate financial records are kept and reported to the board at regular intervals;
- ensure actual financial performance is measured and monitored against budget;
- facilitate regular independent review or audit from an appropriately qualified party; and
- ensure financial transactions are not in breach of legal requirements or governing organisational documents; and
- clearly identify remuneration for staff members and the underlying rationale for the remuneration level implemented.

This area is particularly relevant given the results of the non-compliance study as outlined in section 1.2 above. The absence of these elements from an entity's operations will give rise to possible risk/s of non-compliance as well as potential areas of development needed via additional capacity and/or education/training packages.

Conclusions

Section One of this report identifies eight distinct risk factors for Māori entities with charitable status. These are not ranked in any order of importance or likelihood of occurrence as there is insufficient data available, principally due to the relative short time that the new charities and tax regime has been in operation. We suggest that this research be undertaken around three to five years after the Commission's registration system has been in place. Meanwhile, we have looked to examples overseas to gain an insight into risk factors with the highest likelihood.

International experience in Canada and the UK (England - Wales) indicates that the highest risk factors are linked to:

- Inaccurate tax Receipts
- Weak Financial controls
- Deficient filing (inaccurate, late, or missing files)
- Inadequate books and records
- Failure of duty of prudence or duty of care by Trustees (or Governance Officers)
- Non-charitable activities.

The Canadian non-compliance factors are of particular interest to New Zealand and Māori charitable entities because of the parallels in historical experiences, and more recently, in the post-settlement developments that have occurred in both nations. While the Canadian literature did not specifically mention indigenous charities, there could be value in undertaking such a comparative research study in the future.

The need for all charitable organisations to practice effective governance and excellent administration and record-keeping is critical and cannot be underestimated.

The risks are real but can be mitigated and managed by good practice from the boardroom to the marae atea. Ideally, everyone involved in the organisation should understand the charitable purposes of the organisation, the need to always operate within them, and that the tax-exemption status should never be put in jeopardy. That requires vigilance across all activities and levels of the organisation.

Resources that offer valuable information to charitable organisations from an international perspective are provided as follows:

Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations (US)
The guide outlines 33 practices designed to support board members and staff leaders of charitable organisations to assist improve operations.

Charities Good Practice Checklist (Canadian)
Guidelines for maintaining registered status. Easy to follow checklists to help with the responsibilities of operating a registered charity.

For further Information Sources on effective governance, see the Bibliography section at the rear of this report.

Section Two

Charitable Purposes and Tax Compliance Systems Programme

Section Two

Requirements of registered charitable entities
and
Roles of Charities Commission and IRD in new operational regime.

Prepared by FOMANA CAPITAL LIMITED for Te Puni Kokiri

Section Two: Requirements of registered charitable entities and Roles of Charities Commission and IRD in new operational regime.

Introduction

The objectives of Section Two of the report are to:

- Clarify the Charities Commission's role in monitoring compliance against the charitable purposes of the organisation in the annual returns process;
- Clarify Inland Revenue's role in administering the Revenue Acts and what action it can or will take if it considers that an organisation may be operating outside the legislation or been de-registered by the Charities Commission; and
- Clarify how the two agencies will work together on charitable purpose compliance matters.

The format for this section of the report is:

Background
Diagram 2 - Application for registration as a charitable entity
Regulatory role of Charities Commission under the new operational regime
Regulatory role of IRD under the new operational regime
Working together - the interface between Charities Commission and IRD

Background

Charitable organisations can receive many types of income, including subscriptions, grants, subsidies, donations or koha, fees, raffle money, trading profits, proceeds from asset sales etc.

In the past, income tax exemptions have been available to entities such as trusts, societies and institutions that met Income Tax Act 2004 requirements in terms of deriving income for charitable purposes. Organisations were obliged to self-assess using sections CW 34 (non-business income) and CW 35 (business income) of the Income Tax Act 2004 to see if the income tax exemption applied to them. In practice, many sought the opinion of the Commissioner of Inland Revenue on their tax status. On 1 July 2005 the Charities Commission was established by the Charities Act 2005. The key functions of the Commission are determined by the Act and include:

1. To establish and maintain a registration and monitoring system for charitable organisations; and
2. To provide support and education to the charitable sector on good governance and management.

From 1 July 2008, entities that wish to be eligible for tax-exempt status by operating under a charitable purpose must first have qualified and be registered as charitable entities with the Charities Commission before they apply. That exemption applies to:

- exemption from income tax for non business income;
- exemption for business income derived by or in support of charities;
- exemption from gift duty for persons who make gifts for charity.

Once organisations are registered as charitable entities they receive information from the Inland Revenue outlining the exemptions that they are entitled to and what they have to do to comply with requirements for the exemptions.

Registration Process

The following statistics have been sourced from the Charities Commission website and provide a snapshot of the registration statistics to date:[6]

4 August 2008	10,260	Currently making initial reviews of applications received from **19 May 2008**
8 September 2008	12,119	Our registration analysts are currently making initial reviews of applications received from: **12 June 2008**
15 September 2008	12,470	Currently making initial reviews of applications received from: **19 June 2008*** *Remember: many straightforward applications, once they reach the front of our queue, are processed within several weeks. However, if there are any **complex issues** involved, or the application requires **additional work** by a senior analyst to confirm an analyst's initial view, it will take longer to complete the process - **currently several additional months.**

The same website in July reported that:

...Our early estimates of there being around 25,000 charitable organisations in New Zealand appear to have been reasonably accurate - in total, we have received almost 24,000 applications (about 1,500 of those in the last two days of June).

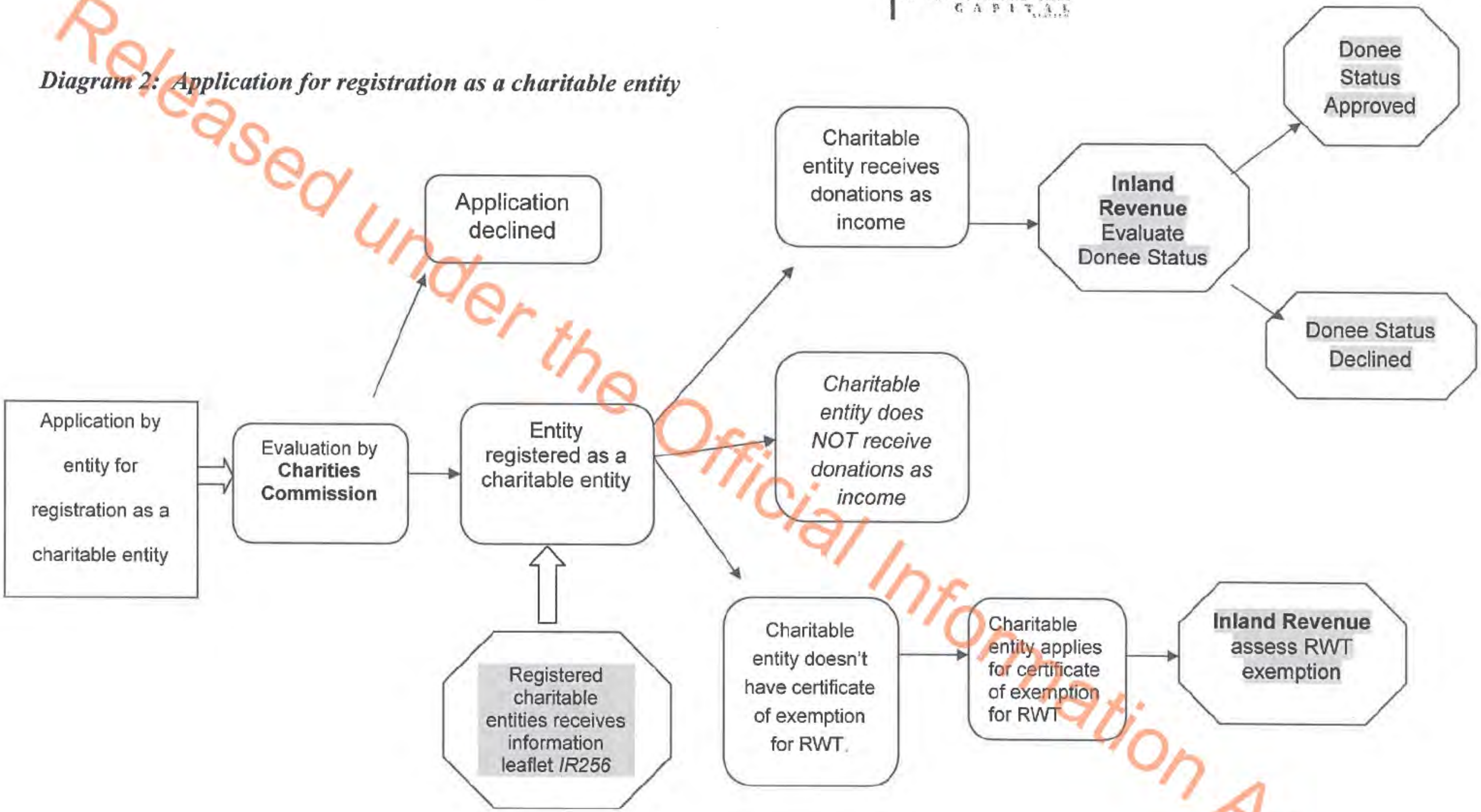
It is likely that it will take us to the end of the year to process all of them, so please be patient - and remember that where necessary, we can backdate properly-completed applications.

Based on these numbers, it appears that roughly half the applications received have been registered and there remains a significant backlog which will likely take several months to clear.

A Diagram of the application process for registration as a charitable entity follows on the next page.

[6] See also Appendix Three Charities Commission Registration Update

Diagram 2: Application for registration as a charitable entity



Regulatory role of the Charities Commission under the new operational regime

From 1 Feb 2007, the Commission has been responsible for registering entities as charitable entities on the Register of Charitable Entities. Existing entities that have tax exemption status under the old system had until 1 July 2008 to register with the Commission (or risk forfeiting this status).

Section 17 of the Charities Act 2005 sets out what is required by an application for registration with the Commission.

On receipt of an application from an organisation for registration as a 'charitable entity', the Commission decides if it qualifies for registration as a charitable entity by evaluating whether it is operating within its charitable purposes [using well-established common law tests for charitable purposes] and whether the organisation's name and officers meet the requirements of the Act.

Once registered, charitable entities must:

c. file an annual return within six months of their balance date (i.e. end of financial year)[7]; and
d. notify the Commission within three months if certain information about their organisation changes (see below).

For the purposes of the Charities Act 2005, an Annual Return consists of a completed Annual Return Form and a copy of the 'charitable entity's' accounts. Once a charitable entity is registered, the Commission informs the entity of the date by which it has to submit the Annual Return.

The Annual Return Form requires information from the registered charity (although some of this information is unlikely to change from the initial application) such as:

- the sectors the charity operates in
- the activities it is involved in
- who benefits from those activities
- its geographical area of operation
- information about the people in the charity (e.g. how many people work as volunteers etc.
- Financial information relating to income and expenditure, assets and liabilities and equity[8].

Charitable entities have a duty to notify the Commission of certain changes under section 40 of the Act. The Act specifies six changes that must be notified, including the date when the changes come into effect[9]. The changes are:

- a change to the name of the charitable entity;
- a change to the address for service of the charitable entity;
- a change in the officers of the charitable entity, whether as the result of an officer ceasing to hold office or the appointment of a new officer, or both;
- a change in the balance date of the charitable entity;
- a change to the rules of the charitable entity;
- a change to the purposes of the charitable entity.

[7] There may be potential for extending this deadline providing agreement is provided by the Commission
[8] This is broken down into several categories, including membership fees, donations, grants, salaries and wages, investments.
[9] Entities must use a specific 'Notification of Change Form' or the 'Annual Return Form'.

Monitoring compliance of charitable purpose under the Charities Act 2005

The Commission's key monitoring focus is to determine whether or not a registered charitable entity continues to be qualified for registration under the Act. The future balance between the Commission's regulatory and non-regulatory functions are still being worked through, however, a fundamental part of the Commission's monitoring role is likely to be ensuring a registered 'charitable entity's' compliance with the defined 'charitable purpose'.

In 2008/09, the Commission's focus is to complete the processing of applications for registration of the budgeted 25,000 charities[10]. Monitoring is unlikely to form a significant part of this as applications for registration are still being processed and a significant number of registered, or potentially registered, charitable entities have yet to submit an Annual Return. The intelligence available for monitoring purposes is, therefore, still being assembled.

Although it will continue to register new charitable entities, the Commission's focus will shift in 2009/10 (and beyond) to the receipt and processing of annual returns and monitoring activities[11] to ensure that entities registered as charitable entities continue to be qualified for registration as charitable entities .

Monitoring activities are likely to be driven by:

1. The Commission's Framework for monitoring of registered charitable entities activities (expected 31 March 2009) using information and intelligence derived from:
   - Annual returns submitted by registered charitable entities
   - Notifications of changes to the rules etc.
   - New applications for registration for charitable entities.

2. Complaints about registered charities brought to the Commissions attention.

Where the intelligence obtained on a charitable entity provides the Commission with reason to investigate further, it can inquire into that charitable entity or into persons engaged in conduct that constitutes a breach of the Act or serious wrongdoing in connection with the charitable entity. No such investigations have been carried out at this stage.

Regulatory Mechanisms under the Charities Act 2005:

If the Commission comes to a view that an entity is not fulfilling its obligations under the Charities Act 2005, or no longer qualifies to be registered as a charity, the entity is advised of the concern and given the opportunity to address it. The Commission does, however, have a number of regulatory mechanisms available it under the Charities Act 2005. These include:

[10] Statement of Intent, 2008-2011

[11] The focus will also shift to the provision of information and support on governance and good management.

(1) Warning Notices

Under section 54 of the Charities Act, in the event of a breach, the Commission may give a warning notice to the charitable entity where:

- A charitable entity or person in connection with the charitable entity, has engaged in, or is engaging in, conduct that constitutes a breach of the Act or serious wrongdoing; or
- A charitable entity is, or may be, no longer qualified to be registered as a charitable entity; or
- A person has engaged in, or is engaging in, conduct that constitutes, or may constitute, a breach of section 37.

Giving a warning notice to the charitable entity being investigated is likely to be the first enforcement mechanism used by the Commission in the event of a breach identified under the Charities Act 2005.

(2) Publication of Possible Breaches /Serious Wrongdoings

If the Commission considers that the entity (or person) to whom a warning notice has been given has failed to remedy one or more of the matters identified by the Commission by the date referred to in sections 54(3)(d), the Commission may publish details of a possible breach, possible serious wrongdoings, and other matters under section 55 of the Act. This would likely result in immediate investigation of the entity by Inland Revenue (if the Commission has not already instigated such an investigation by reporting its concerns to them).

(3) Administrative Penalties:

Under section 58 of the Charities Act 2005, the Commission may also utilise administrative penalties for:

a failure by the charitable entity to send or deliver to the Commission a notice under section 40 within the time prescribed by that section	*Time Period* *Within 3 months of the later of:* *(i) the effective date of the change; or* *(ii) the charitable entity first becoming aware of the change*	Penalty $100
a failure by the charitable entity to send or deliver to the Commission an annual return under section 41 within the time prescribed by that section.	Time Period Within 6 months after each balance date	Penalty $200

Regulatory Role of Inland Revenue in the new operational regime

Inland Revenue has a regulatory role to ensure that taxpayers fulfil their tax obligations with respect to income received.

Charitable organisations are liable for income tax if:

- they operate with no written rules, constitution or trust deed;
- they operate under a set of rules, a constitution or a trust deed that does not meet the requirements for an income tax exemption;
- they use business income for charitable purposes outside New Zealand;
- they are, from 1 July 2008, not registered by the Charities Commission.

The Income Tax Act 2007 (sections CW 41 and CW 42) and the Estate and Gift Duties Act 1968 (section 73) set out a number of income tax and duty exemptions. Some of these give benefits to charitable organisations and some give benefits to people or companies who make donations to such organisations. There are, generally, three main conditions that a charitable organisation must meet to qualify for these exemptions:

- The organisation's aims and activities must be exclusively charitable.
- The organisation's income or funds cannot be used (or be available for use) to benefit any of its members, trustees or associates.
- As of 1 July 2008, charities must also be registered with the Commission to qualify for income tax exemptions

A transitional measure in budget night legislation allows for charities that have taken reasonable steps to commence the process of registration by 1 July 2008 to retain their tax exemptions.

Registered Charitable Entities

Inland Revenue accepts the Commission's decision to register a charitable entity as proof that the entity meets the definition of charitable purpose and is eligible for exemptions from income tax on all or some of its income and other tax benefits.

Once approved, registered charitable entities receive the Inland Revenue leaflet *Tax information for charities registered under the Charities Act 2005 (IR256)* advising about the exemptions available to registered charities.

Registered charitable entities that derive business income are expected to self-assess the extent to which their charitable purposes are carried out in New Zealand on an annual basis using the information provided. Registered charitable entities with non-business income will *prima facie* qualify for the income tax exemption in respect of that income.

Inland Revenue will assess applications from newly registered charitable entities and, based on information obtained from the Commission, decide whether to approve donee status for those charitable entities which identify donations as a source of income. Registered charities that already have donee status will receive a letter of confirmation from Inland Revenue. This process is automatic and outlined in paragraphs 28 and 29 of Inland Revenue's Operational Statement OS 06/02.

Inland Revenue will assess applications for 'Certificate of Exemption for Resident Withholding Tax' from newly registered charitable entities. Those entities with a current certificate need not apply. They will be reviewed once the bulk of charities have registered.

Registered charitable entities that have GST activities, or employees, are expected to comply with the usual IRD filing obligations for those activities.

Non-Registered Charitable entities

We note that there are charitable entities that are not registered with the Charities Commission, whether by choice, or because they do not meet the Commission's criteria for registration, for example, because their funds may be applied for charitable purposes overseas.

These organisations are not within the scope of this project, but may apply to Inland Revenue for approval as donee organisations (under Section KC 5[12] of the Income Tax Act 2004).

Monitoring compliance obligations of registered charitable entities

While the Charities Commission is responsible for monitoring compliance with the stated charitable purpose of charitable entities, it is Inland Revenue that monitors charitable entities to ensure that their tax obligations are fulfilled with respect to income received.

Charitable entities may be in breach of their tax obligations by failing to pay the appropriate tax on any income they receive by the appropriate time or by claiming tax benefits where they are not eligible.

Registered charitable entities are likely to be in breach of their tax obligations predominantly by:

- applying the funds to a purpose outside the charitable purposes stated in the empowering documents; or
- applying funds to a charitable purpose but those funds are subsequently misapplied by the recipients.

It is assumed that in 2008/09, Inland Revenue's focus with respect to the monitoring of charitable entities will be to assist the Commission, where appropriate, in the processing of applications for registration of the budgeted 25,000 charities. The number of charitable entities subject to monitoring by Inland Revenue is unlikely to be significant as applications for registration are still being processed. At the date of this report, only about half (approximately 12,500) have been registered by the Commission. The intelligence available for monitoring purposes is, therefore, still being collated.

The focus for monitoring of registered charitable entities may shift in 2009/10 once most registrations are completed and additional information on these entities is

[12] Section KC 5 provides for a tax rebate in respect of donations of money of $5 or more to a society, institution, association, organisation, trust, or fund, the funds of which are, in the opinion of the Commissioner of Inland Revenue, applied wholly or principally to any charitable, benevolent, philanthropic, or cultural purposes within New Zealand. Entities given approval are known as donee organisations or as having donee status.

available from the Commission. Monitoring activities for registered charitable entities are likely to be triggered when Inland Revenue becomes aware that the registered charitable entity is not complying with compliance obligations, or is operating outside its stated charitable purposes.

Inland Revenue will also continue to monitor non-registered charitable entities and future work is likely to focus on:

- charities with previous tax exemptions that have had an application for registration declined by the Commission
- charities with a previous tax exemption that have not registered with the Commission[13]
- charities that have applied for exemption without evidence of registration as a charitable entity or tax exempt status before 30 June 2008 but not yet registered with the Commission
- charities with a Certificate of Exemption from Resident Withholding Tax that have not yet registered with the Commission.

Where intelligence provides Inland Revenue with reason to investigate a registered charitable entity, the following might occur:

- the charitable entity might be a candidate for audit by Inland Revenue; or
- Inland Revenue may pass on the intelligence to the Charities Commission, if it is related to the performance of the Commission's functions and duties.[14]

Regulatory mechanisms under the Revenue Acts[15]

The Commissioner of Inland Revenue has a number of regulatory mechanisms available under the Revenue Acts to be used in regard to non-compliance with tax obligations. In general, however, failure to meet tax obligations may result in civil penalties[16], criminal penalties[17], or both. A single breach of tax obligations could, potentially result in both a civil and a criminal penalty (e.g. tax evasion is subject to both criminal and civil penalties). These are outlined in **Appendix Two.**

The penalties resulting from a breach could also result in include increased periodic audits of the charitable entity.

Working Together – the interface between Charities Commission and IRD

In the past Inland Revenue had no explicit compliance strategy for charities as there was no specific requirement under the legislation to approve these entities for tax exemption. In general, charities were treated like any other non-profit organisation entity unless they identified themselves as having a charitable purpose in order to request tax exemption (usually to obtain donee status).

[13] If they have not registered they must return their income in their annual income tax returns and any exemption certificates will be cancelled.
[14] subject to the constraints of section 81 of the Tax Administration Act.
[15] See Appendix Two for list of legislation administered by IRD
[16] A civil penalty is one imposed by Inland Revenue rather than a court (i.e. late filing penalties; non-electronic filing penalties; late payment penalties; and shortfall penalties).
[17] A criminal penalty is one imposed by a court upon conviction of an offence (i.e. evasion; obstruction; and aiding or abetting another person to commit an offence).

It is noteworthy that some organisations would ask Inland Revenue for a view on whether they met the charitable purpose so they could receive the tax exemption. In such situations, 'letters of comfort' were issued to clarify the situation and there was an informal register noting those organisations listed as charities for the purposes of noting that they had tax exemptions. There were also a number of 'non-charities' (i.e. other non-profit trusts etc.) who would also apply in a similar manner to obtain tax exemption. This process of requesting status became more prevalent with the introduction of the Resident Withholding Tax (RWT) (in order to get an exemption the organisations needed a certificate for the bank to avoid having to pay RWT) and the introduction of GST. The GST register automatically triggered an income tax return that encouraged charities to return to IRD outlining their charitable purpose status. The 'letters of comfort' stopped being issued from February 2007 when the Charities Commission took over.

The establishment of the Charities Commission has essentially set up a formal process around an area that was relatively informal in the past (i.e. the decision on whether an entity was considered to have a charitable purpose). Although the Commission has overall accountability for that area of work Inland Revenue continues to have responsibility for deciding whether the entities are eligible for tax exemptions.

There is potential for the Commission and Inland Revenue to disagree on the definition of 'charitable purposes', particularly where an organisation that was not previously accepted by Inland Revenue as having a charitable purpose is registered by the Commission as a charitable entity.

The key overlap between the Commission and Inland Revenue is likely to be in the area of monitoring of compliance and, in this respect, both the Commission and Inland Revenue could potentially share intelligence and information (for example, at present the Commission currently downloads a list of the latest registered charitable entities to Inland Revenue on a weekly basis). Until the majority of applications received by the Commission have been processed (and annual returns submitted), however, it will be difficult for compliance work to commence in earnest.

There are unlikely to be more referrals for investigations under the new operational system as the compliance risks for a 'charitable entity now are the same as they always were, except that Inland Revenue will now have more intelligence available when considering compliance actions and strategies. There is also the potential for both entities to work together on prosecutions of charitable entities. There is likely to be more work for IRD in the area of donations approvals. New (and significantly higher) thresholds have been set for rebates on donations made to donee organisations. This means that the risk of tax avoidance in this area is also likely to be greater and require greater scrutiny

Decisions by Inland Revenue to prosecute are also dependent on the proportion of the income diverted to a non-charitable entity such as a non-registered sports club. Where a large amount of money was involved there would be more reason to treat the breach seriously and prosecute.

Section Three

Charitable Purposes and Tax Compliance Systems Programme

Section Three

Awareness and practice of eight pilot Māori charitable entities and areas of risk

Prepared by FOMANA CAPITAL LIMITED for Te Puni Kokiri

Section Three - Awareness and practice of eight pilot Māori charitable entities and areas of risk.

Scope

The scope of this section of the report is to present the findings of the interviews held with participating organisations with a particular emphasis on the generic risk for Māori entities with charitable status.

Format

The format for Section Three of this report is:

Summary of key information
Methodology
Profile of eight pilot Māori charitable entities
Interview Findings
Conclusions

Report Objectives

The objective is to provide an understanding of the generic risks Māori charitable entities currently face under the Charities Act 2005.

Summary of Key Information

Interviews were held over a period of three weeks and participants were provided the questionnaire in advance along with the FOMANA report dated 31 May 2008. Participant structures range from trusts to private limited liability companies. The average length of time in operation was less than five years across the group. The range for participants went from less than two years in operation to more than ten.

The majority of participants identified their level of organisational understanding of the roles of the Charities Commission and IRD as Good (range Basic to Good). More than half of the participants had attended a Charities Commission information workshop and received regular information. Participants were not clear of the relationship between the two entities.

The questionnaire used the eight risk factors identified and participants were asked to do the following for each factor:

- Describe the organisation's level of understanding;
- Describe the potential impact they thought it would have on their organisation if it was to occur; and
- Describe the steps they would take to mitigate against the risk.

The common factors participants identified as a potential impact to their organisation across all the risks were:

- Backlash from beneficiaries
- De-registration (loss of charitable status)
- Financial challenge (loss of cashflow)
- Financial viability and sustainability
- Loss of Reputation
- Loss of tax exemption
- Loss of Mana / Stigma attached
- Reputation risk-several levels, personal, professional etc

Participants identified possible mitigations to manage risks:

- Annual external audit & audit & risk committee
- Board with sound business acumen & skill
- Clear lines of delegation & ensure processes and policies are up to date
- Educate all Trustees of charities requirements
- Insurance (Public Liability, Directors etc)
- Reviewing activities against constitution, contractual obligations
- Staying within core activities
- Training of beneficiaries

Areas for improvement were identified by the entities themselves as including:

- the importance of governing documents,
- the need for awareness of their key contents by all parties concerned and
- the reliance on people (external and internal), skills, policies, processes and education to assist mitigate compliance risk.
- This was an unexpected benefit from the questionnaire and interview process.

All of those who had received and read the FOMANA report dated 31 May 2008 outlining Preliminary research on the legal framework affecting Māori Charitable Entities under the Charities Act 2005 and the Income Tax Act recommended it for use across such groups as staff, trustees, beneficiaries and other relevant stakeholders.

Methodology

The Questionnaire is the tool used to gather information from pilot participants to develop a risk assessment model for Māori charitable entities. Two main types of questions were used, they were:

- Multiple choice questions - where one of many answers needed to be selected (noting that a maximum of four choices instead of five were used); and
- Comment box questions - where comment boxes allowed for information to be entered.

The Questionnaire had a series of fifty five questions split up into seven sections as follows:

- Understanding role & functions of the Charities Commission
- Understanding role & functions of Inland Revenue Department
- Organisation's Constitution and its Requirements
- Organisation's Activities and Maintaining Tax Exempt Status
- Risk Understanding, Identification, Management, and Mitigation
- Other Organisation Data
- Participant Feedback

The Questionnaire provided the focus of a two to three hour semi-structured interview with each participant. Definitions used in the Questionnaire are as follows:

Term	Definition
Constitution	Governing documents such as the organisation deed, constitution or charter
the Act	Charities Act 2005
the Commission	Charities Commission
Organisation's	in reference to the knowledge, understanding or general practice of the organisation as a whole and not that of the interview participant(s)
Risk	The chance of something occurring that will, should the event occur, have an impact on the achievement of organisational objectives. It is measured in terms of the likelihood of something happening and the consequences if it happens.
Reputation Risk	The risk of damage to the organisation's credibility and reputation.
Compliance Risk	The risk of failing to meet government standards/laws and regulations.
Risk Management	A systematic and logical process of identifying, analysing, evaluating, treating, monitoring and communicating risks associated with any activity, function or process in a way that will enable an organisation to minimise losses and maximise opportunities.
Stakeholders	Those individuals, groups, institutions etc (either internal or external to the organisation) who are or perceive themselves to be affected by a decision or activity.

The intention of the interviews was to have a governance member/trustee and a member of management present to provide a broader view of the level of understanding and practice within each participating organisation. Due to work commitments and tight timeframes only three of the eight participating entities were able to have both views presented at the interview.

An "assurance of confidentiality" was provided to all participating organisations in that all information received in the course of the interviews will remain confidential to the project. In addition all reports will be written in a generic manner and will not identify any particular organisation or person. The results of this research will assist in determining what risks participants currently face, what support in terms of mitigation systems and useful risk profile tools are needed and what subject matters to focus on. As a result, resources will be deployed in a more efficient and effective manner and a greater value added to Māori participants through a better understanding of their operations, compliance requirements and risk.

Once the Questionnaires and interviews were completed they were electronically stored in a database.

Profile of the eight pilot Māori charitable entities

The following are details of the participating organisations:

Legal Name of Entity	Type & Companies Register No.	Charities Commission Register No.	Nature of Activities	Size[18]
Ngati Rarua Atiawa Iwi Trust Board (NRAIT)	Charitable Trust Reg No 608274	CC20248	Statutory entity and tribal lands management	Medium
Taranaki Iwi Trust	Charitable Trust Reg No 2065763	Awaiting confirmation of registration from Charities Commission	Mandated Iwi Organisation (Māori Fisheries Act)	Small
Taranaki PHO Ltd	Company Reg No 1273404	CC21526	Primary Healthcare Organisation	Large
Te Aroha Medcare Ltd	Company Reg No 1224185	Awaiting confirmation of registration from Charities Commission	General Practitioner Service	Medium
Te Atiawa Ki Te Upoko O Te Ika A Maui Potiki Trust	Charitable Trust Reg No 1800801	Awaiting confirmation of registration from Charities Commission	Mandated Iwi Organisation (Māori Fisheries Act)	Small
Te Kaahui o Rauru	Charitable Trust	Awaiting confirmation of registration from Charities Commission	Post-settlement Entity and Mandated Iwi Organisation (Māori Fisheries Act)	Medium
Te Rau Pani Māori Mental Health Trust	Charitable Trust Reg No 1546840	CC10717	Specialist Māori Mental Health Service Provider	Medium
Tui Ora Ltd	Company Reg No 899217	CC20369	Māori Development Organisation	Large

[18] As per the descriptions outlined in The Review of the Financial Reporting Act Discussion Document Part II

Interview Findings

The findings of the interviews will be presented following the structure of the questionnaire which was as follows:

1. Understanding role & functions of the Charities Commission
2. Understanding role & functions of Inland Revenue Department
3. Organisation's Constitution and its Requirements
4. Organisation's Activities and Maintaining Tax Exempt Status
5. Risk Understanding, Identification, Management, and Mitigation
6. Other Organisation Data
7. Participant Feedback

Understanding role & functions of the Charities Commission

The majority of participants identified their level of organizational understanding of the role of the Charities Commission as Good (range Basic to Good). The majority were able to demonstrate their understanding by identifying such roles as:

- Registration body;
- Monitoring compliance;
- Ensure compliance with "charitable objectives"; and
- Support & education focus.

More than half of the participants had attended a Charities Commission information workshop and received regular information. Information received by participants was used most commonly:

- To ensure compliance; and
- For distributing via email and BOT reports (to network or marae or trustees).

The majority of participants identified their level of organizational understanding of the monitoring functions of the Charities Commission as Good (range Basic to High). The majority were able to demonstrate their understanding by identifying such functions and impacts as:

- Filing of accounts and/or an annual return - with an impact of audit requirements and compliance.

Generally this section was instrumental in gauging understanding of a key aspect of the Charities regime. An organisations ability to engage in this area ensured that the information needed to raise awareness (and therefore identify potential risk issues) was readily accessible and therefore ensured responses to any potential issues would be timely.

Understanding role & functions of Inland Revenue Department (IRD)

The majority of participants identified their level of organizational understanding of the role of the IRD as Good (range Basic to High). To demonstrate their understanding roles such as the following were identified:

- Pay Taxes applicable
- Role in relation to tax exemption
- Wind-up clause for IRD
- IRD-major role in tax "umbilical cord" between taxpayers-Charities Commission & IRD
- Charities Commission registration, monitoring
- Focus on requests of Charities Commission to satisfy IRD reports
- Able to audit the organisation regarding the charitable status for tax exemption
- Donee status
- Investigate activities adverse to charitable objectives of organisation

Throughout the interviews it was noted that whilst there was awareness of what the IRD had done prior to the development of the Charities Commission the relationship between the two and the boundaries within which each operate was not clear. This presents an opportunity for further communication to be developed by the two to clarify their respective roles and the situations in which they may or may not take precedent over the other.

Clarity around this issue will minimise the factors effecting compliance risk for all charitable entities.

The majority of participants identified the following as key to ensuring their organisation maintained tax exempt status:

- Activities meet requirements of constitution/deed;
- Compliance issues met;
- Maintain not for profit status;
- Registration maintenance; and
- Contractual arrangements' that support & evidence "not for profit" status.

These issues are in alignment with ensuring compliance in concept. Generally this section also highlighted an opportunity for improvement in terms of bridging information gaps. An organisations ability to be clear in this area ensured that their priorities in concept would enforce compliant activities thereby minimizing potential risk issues.

Organisation's Constitution and its Requirements

The majority of participants identified the following:

- The board's level of understanding of the charitable purposes obligations contained within their constitution as Good (range Basic to High); and
- The management's level of understanding of the charitable purposes obligations contained within their constitution as Good (range Good to High);

Whilst the range of response differentiated the two, the level of understanding was the same for both groups. Given that the board in the majority of cases is paid, a good understanding by members is expected. However given the charities compliance requirements and potential risk issues it would be much more beneficial to the participant if management's understanding was at the higher level. The use of professional advice was identified by a high majority of participants, with the most common reasons identified as follows:

- Compliance issues
- Entering into Joint ventures with other organisations
- New area of service (development)

Throughout the interviews it was noted that there was an openness and willingness to further improve systems by participants. This may be further demonstrated by the organisations willingness to participate in the project. This factor is a contributor to minimizing potential compliance risk as it indicates the right environment needed to adapt, modify and or enhance systems when and where needed to address risk exists.

Organisation's Activities and Maintaining Tax Exempt Status

Participant structures range from trusts to private limited liability companies. Core activities as outlined in Section Two of this report include mandated iwi organisations, an iwi resource management trust, a Māori development organisation, a primary healthcare organisation, a general practice and a specialist Māori mental health service provider.

The average length of time in operation for participants currently is less than five years across the group. The range for all participants is from less than two years in operation to more than ten.

As expected the mandated iwi organisations are the "rangatahi" entities in the group, although the expertise and skill at both the board and management level is very high.

Length of operation, competency of board and management, paid governance and size are factors which highlight the skill base, experience and resources available to the organisation for ensuring compliance risk is adequately addressed.

The review of participant's activities against its constitution indicated an area of potential improvement as the majority did not conduct an internal or external review. Whilst this does not mean this factor and the constitution is not looked at it does mean that regularly ensuring governing documents are in alignment with the needs of the beneficiaries, operating environments and activities are not happening systematically. This in itself gives rise to potential compliance risk.

Risk Understanding, Identification, Management, and Mitigation

The following eight risk factors were identified in the FOMANA report.

1. Operating outside "charitable purposes" as per Trust Deed or Rules
This risk exists when an organisation operates outside of the charitable purposes as set out in its constitution.

2. Misappropriation of Trust funds
This risk exists when an organisation funds are applied for purposes which were not approved and do not benefit the organisation. This could amount to criminal activity.

3. Misapplication of Trust funds
This risk exists when an organisation applies funds to a related organisation or entity for charitable purposes but those funds are subsequently misapplied by the recipient.

4. Penalties applied by IRD for failure to comply with charitable purposes
This risk exists when an organisation has not complied with its charitable purposes and faces financial penalties of interest and/or taxes that can be backdated to the period when non-compliance occurred.

5. De-registration by the Charities Commission
This risk exists when an organisation is removed from the charitable register.

6. Loss of tax exemption status
This risk exists when an organisation loses its tax exempt status.

7. Loss of reputation
This risk exists when an organisation faces reputation damage at a public level through adverse media attention.

8. Legal Action against Trustees/Directors
This risk arises as a result of non-compliance and exists when trustees/directors face legal action for their role in the breach.

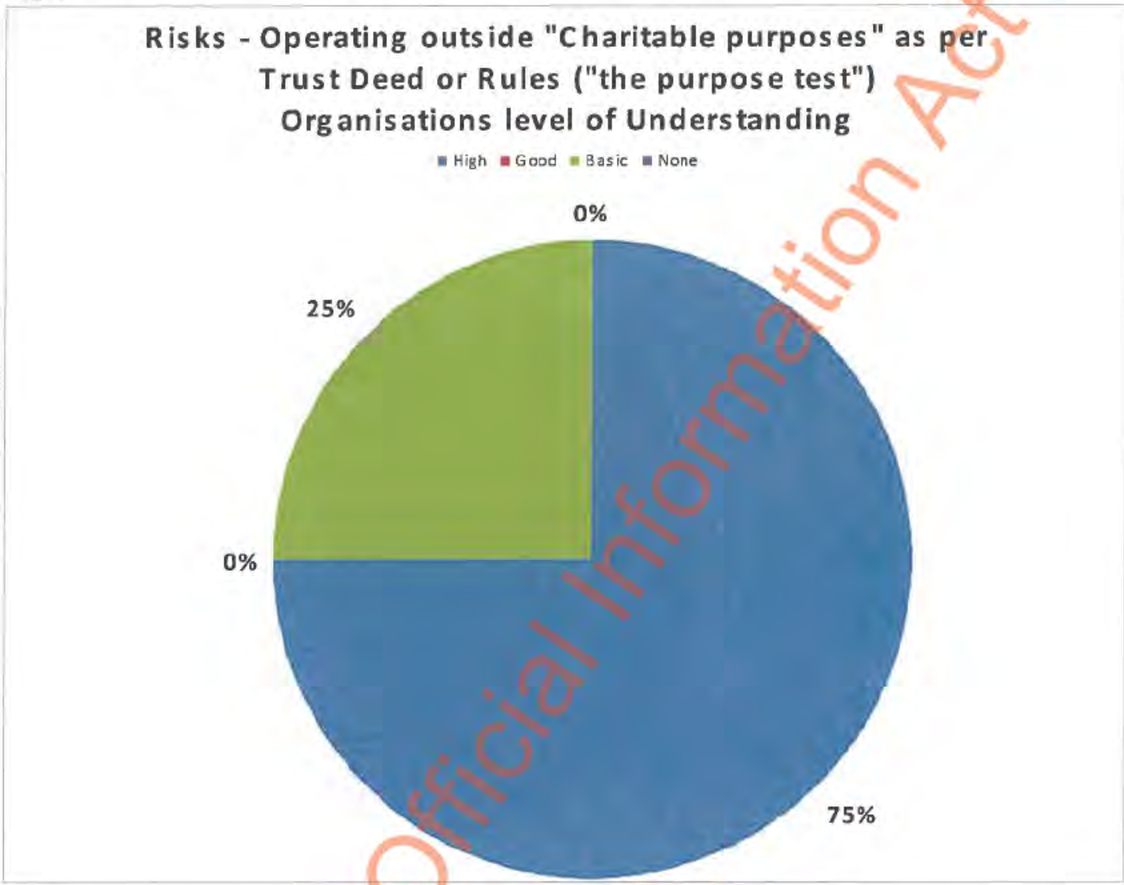
Participants were asked to do the following for each factor:

- Describe the organisation's level of understanding;
- Describe the potential impact they thought it would have on their organisation if it was to occur; and
- Describe the steps they would take to mitigate against the risk.

The following is the consolidated results of this section of the interview.

1. Operating outside "charitable purposes" as per Trust Deed or Rules

Describe the organisation's level of understanding.
The level of understanding for this risk across the group was High (range Basic to High).



The five main factors participants identified as a potential impact to their organisation if the risk was to occur were:

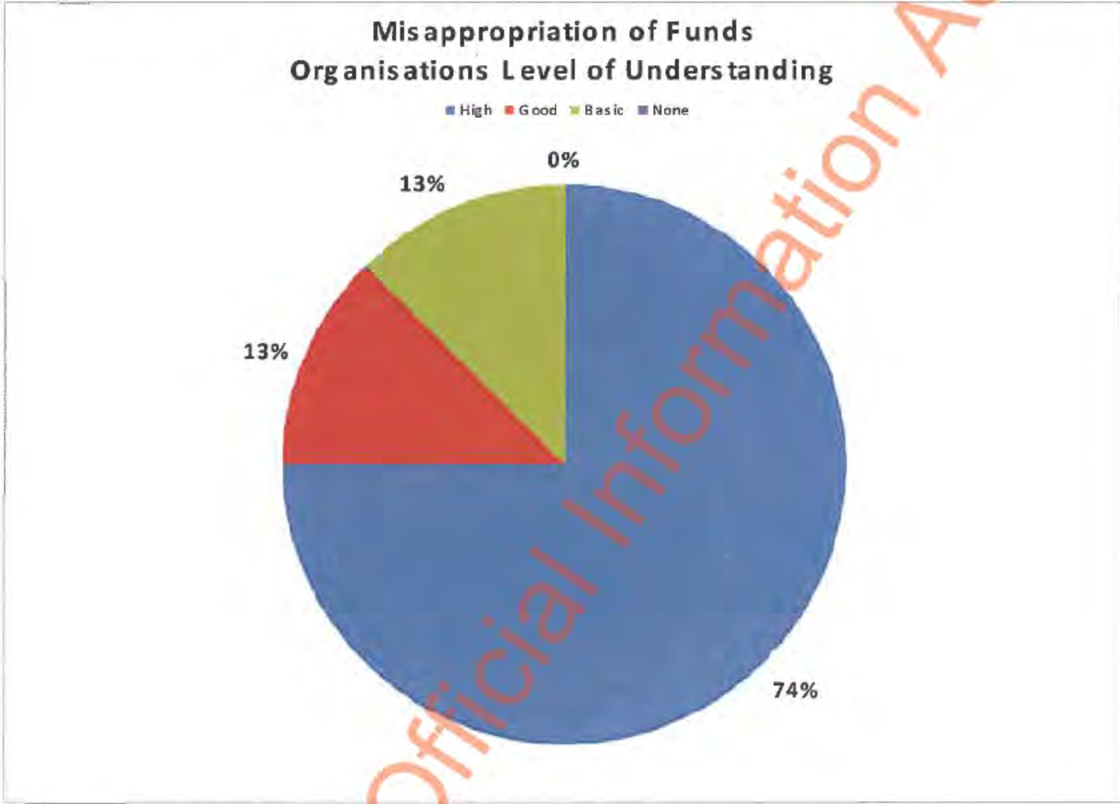
- Loss of tax exemption
- Pay back taxes and then subject to tax thereafter
- Financial challenge (loss of cashflow)
- Reputation risk-several levels, personal, professional etc
- Loss of contracts (as a result of funders not preferring a non "not for profit")

The five main steps participants identified they would use to mitigate against the risk were:

- Reviewing activities against constitution, and contractual obligations
- Ensuring processes are up to date
- Staying within core
- Educate all Trustees of charities requirements
- Follow policy to the rule

2. Misappropriation of Trust funds

Describe the organisation's level of understanding.
The level of understanding for this risk across the group was High (range Basic to High).



The five main factors participants identified as a potential impact to their organisation if the risk was to occur.

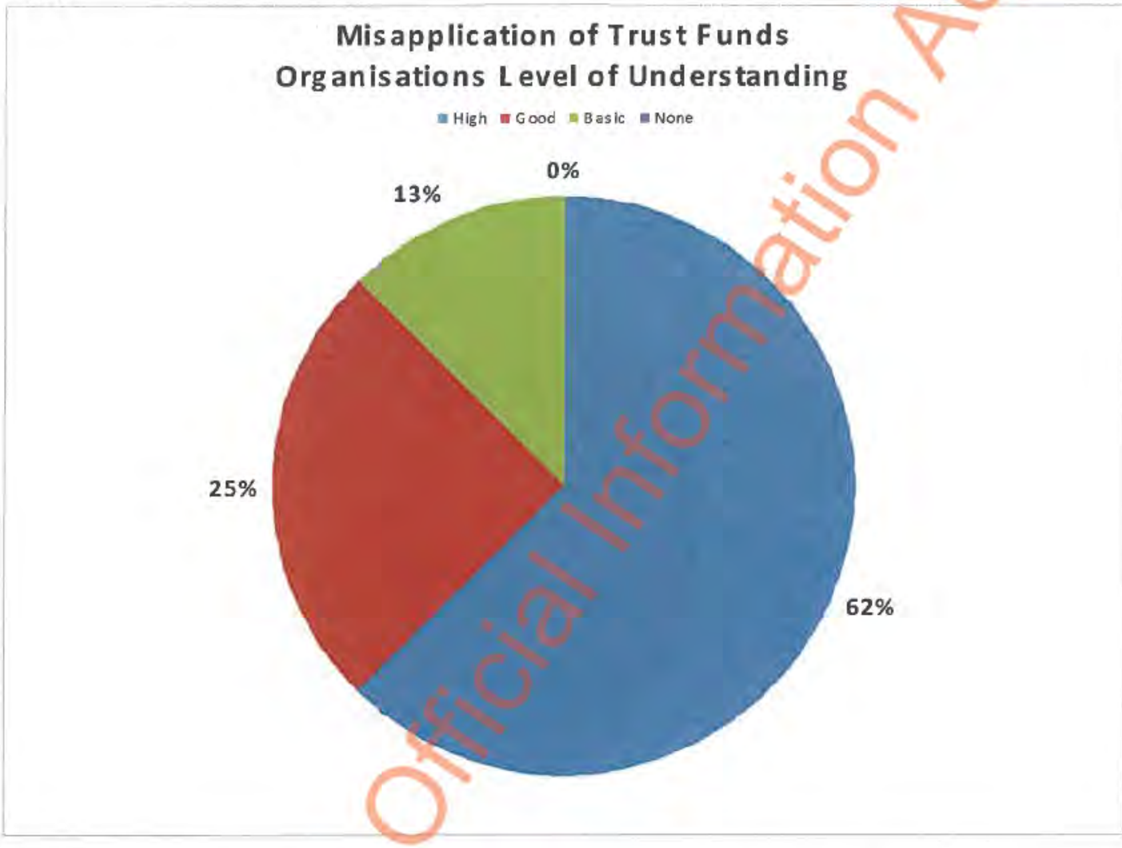
- The organisation would go broke
- May not be able to meet contractual obligations
- Impact on providers (related entities) and their services
- Staff obligations unable to be met
- Backlash from beneficiaries

The five main steps participants identified they would use to mitigate against the risk.

- Annual external audit
- Good internal control process
- Clear lines of delegation
- Audit & Risk
- Board with business acumen & skill levels

3. Misapplication of Trust funds

Describe the organisation's level of understanding.
The level of understanding for this risk across the group was High (range Basic to High).



The five main factors participants identified as a potential impact to their organisation if the risk was to occur.

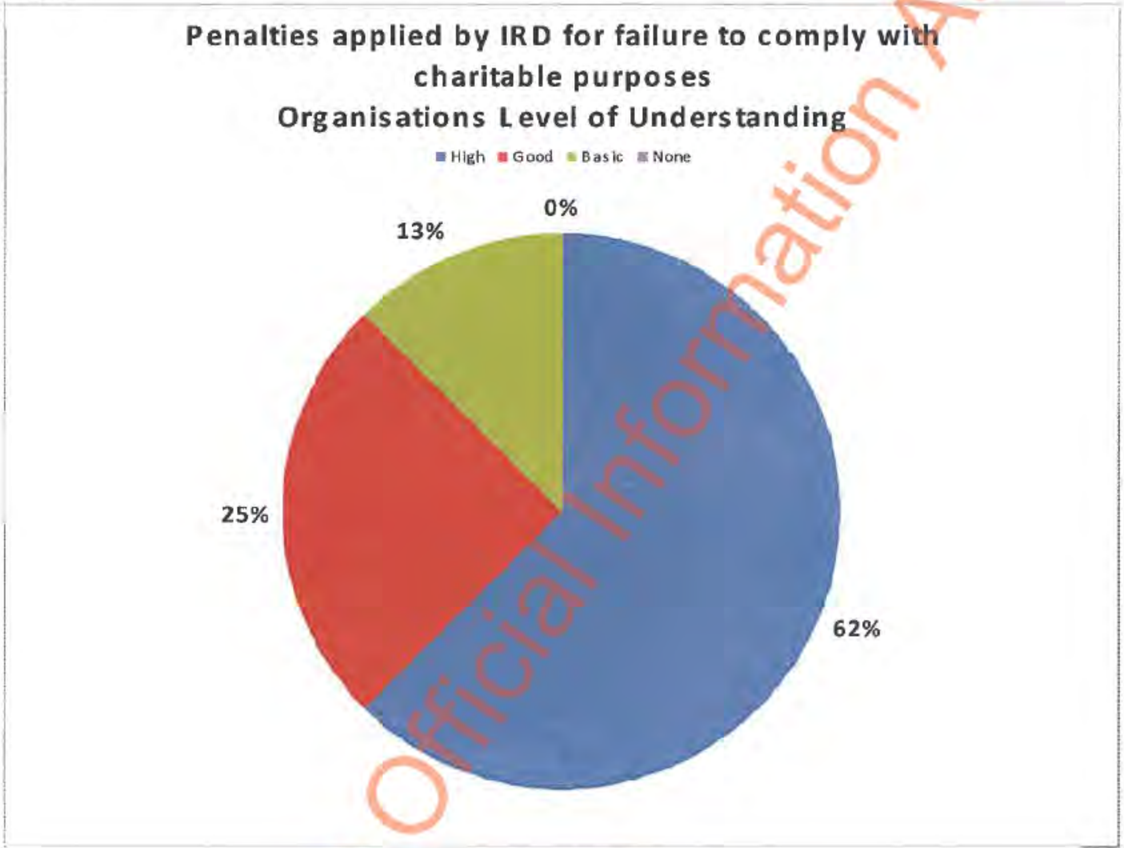
- Loss of tax exemption
- Loss of contracts (funding)
- Loss of Reputation
- Backlash from beneficiaries
- De-registration (loss of charitable status)

The five main steps participants identified they would use to mitigate against the risk.

- Process in place prior to distribution (docs in place to evidence acceptance of terms)
- Policies & procedures maintained
- Checking the credentials of organisations that are sub-contracted
- Training of beneficiaries
- Distributions to beneficiaries but payment to third party on invoice basis e.g. Uni Fees

4. Penalties applied by IRD for failure to comply with charitable purposes

Describe the organisation's level of understanding.
The level of understanding for this risk across the group was High (range Basic to High).



The five main factors participants identified as a potential impact to their organisation if the risk was to occur.

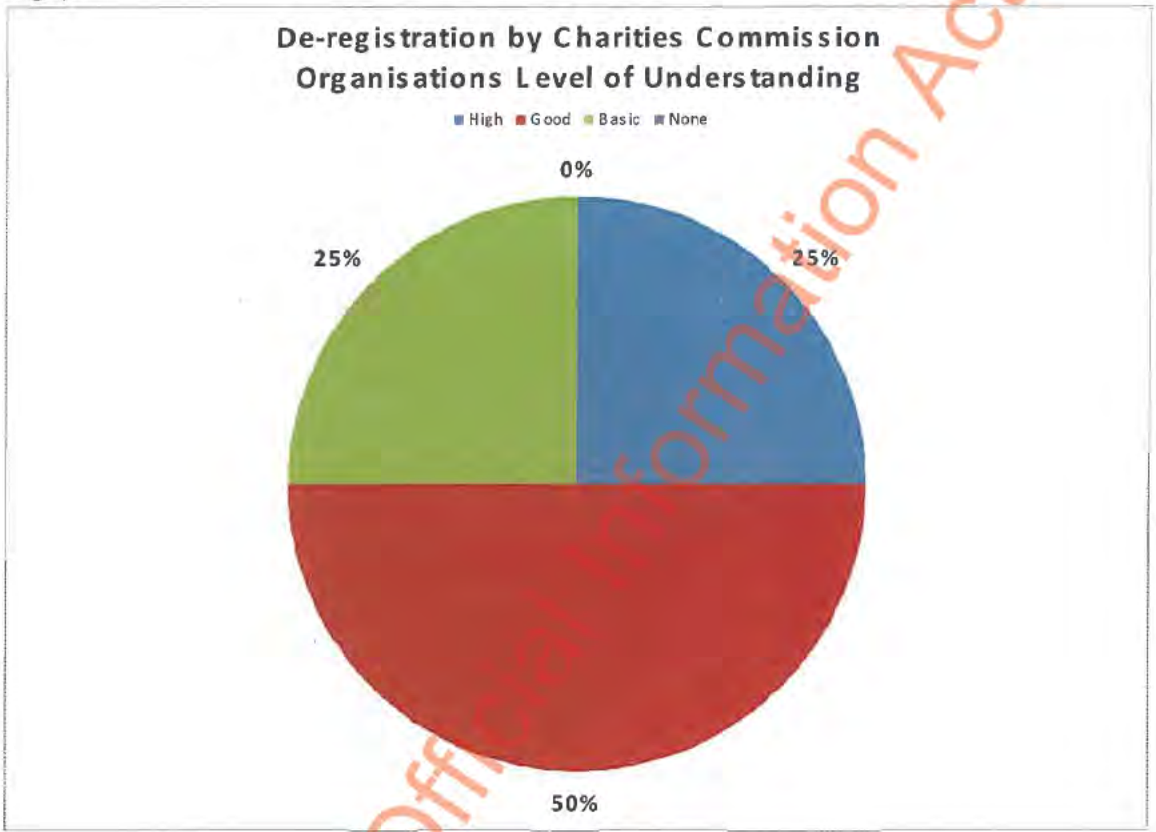
- Financial challenge (loss of cashflow)
- Reputation risk-several levels, personal, professional etc
- Pay back taxes and then subject to tax thereafter
- Loss of contracts (as a result of funders not preferring a non "not for profit")
- Backlash from beneficiaries

The five main steps participants identified they would use to mitigate against the risk.

- External control measures
- Staying within core
- Reviewing activities against constitution, contractual obligations
- Ensuring processes are up to date
- Good policy & procedures

5. De-registration by the Charities Commission

Describe the organisation's level of understanding.
The level of understanding for this risk across the group was Good (range Basic to High).



The five main factors participants identified as a potential impact to their organisation if the risk was to occur.

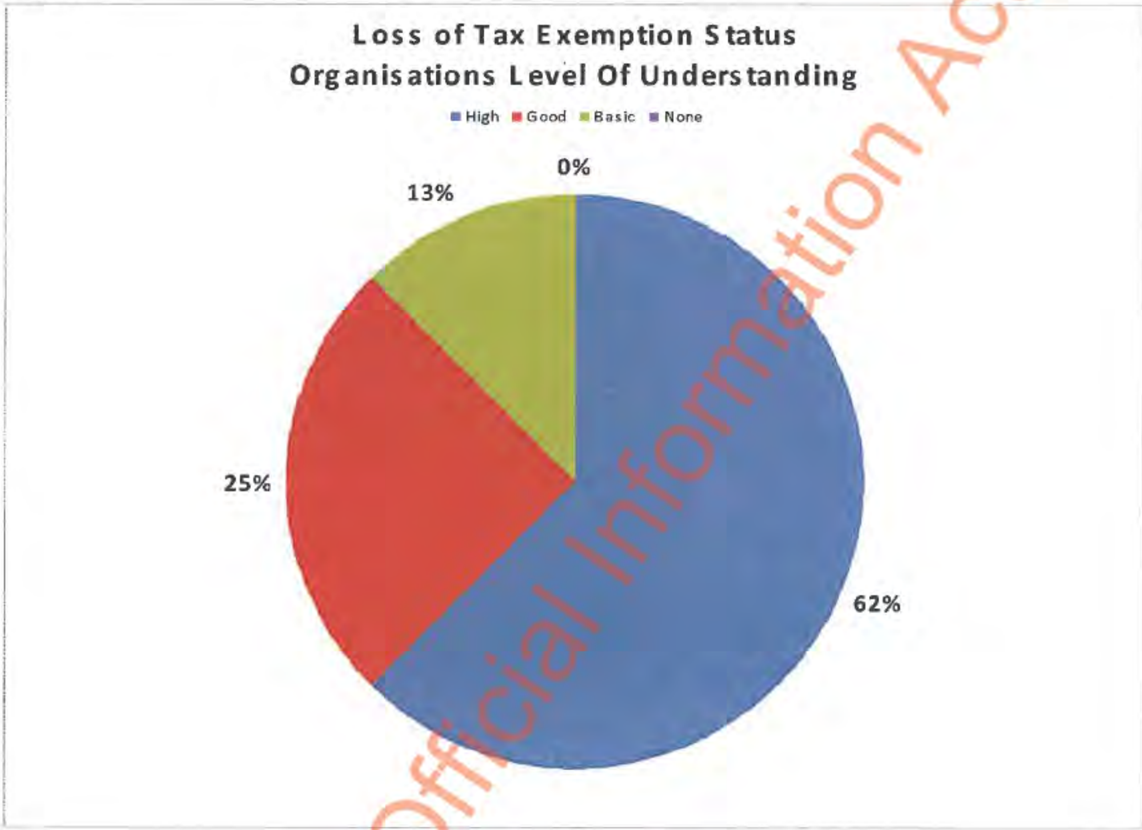
- Reputation Loss
- Pay back taxes and then subject to tax thereafter
- Financial challenge (loss of cashflow)
- Reputation risk-several levels, personal, professional etc
- Loss of Mana / Stigma attached

The five main steps participants identified they would use to mitigate against the risk.

- Staying within core
- Good Internal and external controls
- Annual external audit
- Board with business acumen and skill levels
- Reviewing activities against constitution and contractual obligations

6. Loss of tax exemption status

Describe the organisation's level of understanding.
The level of understanding for this risk across the group was High (range Basic to High).



The five main factors participants identified as a potential impact to their organisation if the risk was to occur.

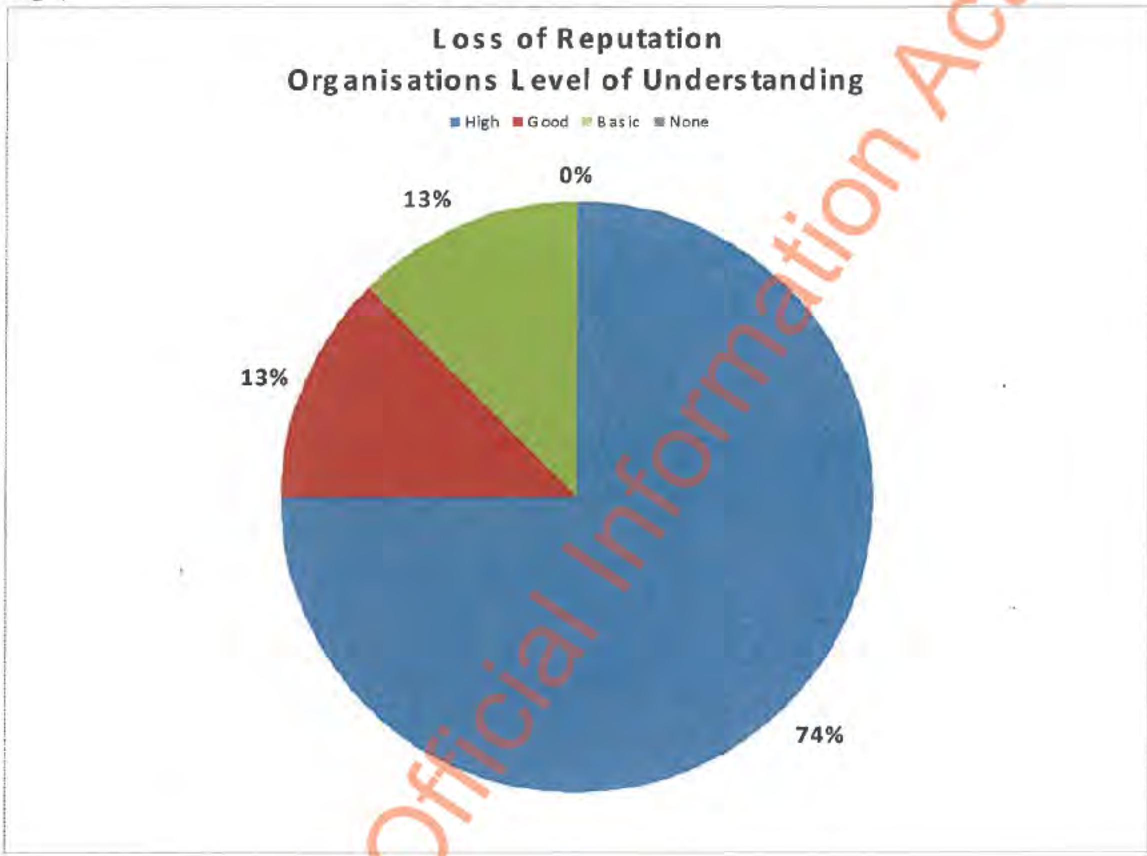
- Financial challenge (loss of cashflow)
- Reputation risk-several levels, personal, professional etc
- Reputation Loss
- Pay back taxes and then subject to tax thereafter
- Loss of Mana / Stigma attached

The five main steps participants identified they would use to mitigate against the risk.

- Good Internal control process
- Annual external audit
- Reviewing activities against constitution, contractual obligations
- Audit & Risk Committee
- Board with sound business acumen & skill

7. Loss of reputation

Describe the organisation's level of understanding.
The level of understanding for this risk across the group was High (range Basic to High).



The five main factors participants identified as a potential impact to their organisation if the risk was to occur.

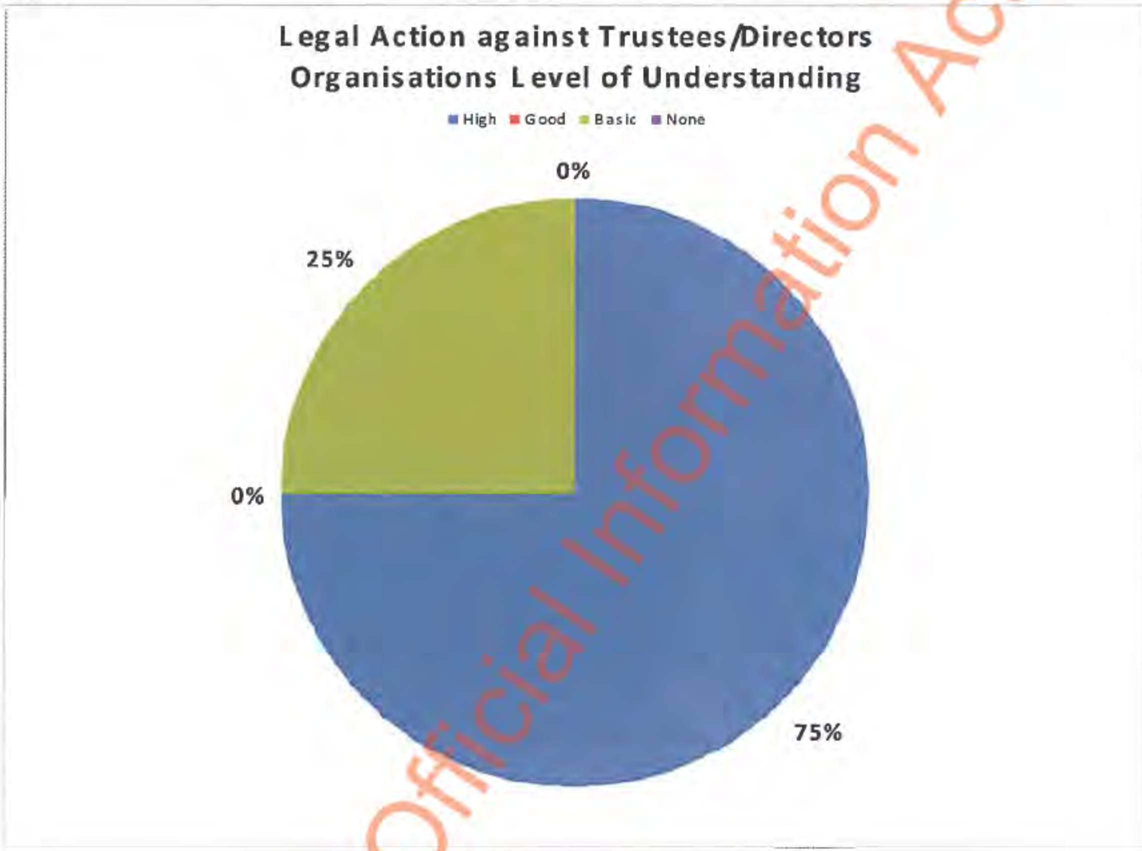
- May lose professional & personal integrity
- Loss of mana
- May lose contracts, staff, board members
- May lose affiliated providers (GPs)
- Financial viability and sustainability

The five main steps participants identified they would use to mitigate against the risk.

- Professional communicators for advice or to front (for media etc)
- Audit & Risk Committee
- External Audit
- Policy & Procedures
- Use of external expertise

8. Legal Action against Trustees/Directors

Describe the organisation's level of understanding.
The level of understanding for this risk across the group was High (range Basic to High).



The five main factors participants identified as a potential impact to their organisation if the risk was to occur.

- Loss of mana
- Loss of governance (board) & staff
- Financial consequences for individuals
- Financial viability and sustainability
- Difficulty in securing other governance & staff

The five main steps participants identified they would use to mitigate against the risk.

- Insurance (Public Liability, Directors etc)
- Good board process (incl induction)
- Strategic planning ensure aligns with constitution
- Induction process, ensure constitution review
- Educate all Trustees of charities requirements

The most common factors participants identified as a potential impact to their organisation across all the risks were:

- Backlash from beneficiaries
- De-registration (loss of charitable status)

- Difficulty in securing other governance & staff
- Financial challenge (loss of cashflow)
- Financial consequences for individuals
- Financial viability and sustainability
- Impact on providers (related entities) and their services
- Loss of governance (board) & staff
- Loss of tax exemption
- Loss of contracts (funding)
- Loss of Mana / Stigma attached
- May lose professional & personal integrity
- May not be able to meet contractual obligations
- Pay back taxes and then subject to tax thereafter
- Reputation risk-several levels, personal, professional etc
- Staff obligations unable to be met

The main steps participants identified they would use to mitigate against the various risks were:

- Annual external audit
- Audit & Risk Committee
- Board with sound business acumen & skill
- Clear lines of delegation
- Check credentials of organisations that are sub-contracted
- Distributions to beneficiaries but payment to third party on invoice basis e.g. Uni Fees
- Educate all Trustees of charities requirements
- Ensuring processes are up to date
- Good Internal and external controls
- Good policy & procedures
- Insurance (Public Liability, Directors etc)
- Process in place prior to distribution (docs in place to evidence acceptance of terms)
- Professional communicators for advice or to front (for media etc)
- Reviewing activities against constitution, contractual obligations
- Staying within core activities
- Strategic planning ensure aligns with constitution
- Training of beneficiaries
- Use of external expertise

Throughout the interviews this section generated the most thought provoking discussion and it was often during these sessions that areas for improvement were identified by the entities themselves. In addition this area often brought home the importance of:

- governing documents,
- the need for awareness of their key contents by all parties concerned and
- the reliance on people (external and internal), skills, policies, processes and education to assist mitigate compliance risk.
- This was an unexpected benefit from the questionnaire and interview process.

Other Organisation Data

The charitable registration status for half of the participants is secured whilst the other half await confirmation. The Charities Commission registration backlog is lengthy and as a result is not a surprising factor in terms of the registration status of participants.

The table below presents the number of people involved in the participant organisations. Provided is their average and low to high range for each category.

Description of Group	Average	Low	High
Governance Paid	4	2	9
Governance Unpaid	3	3	8
Governance Total	7	5	17
Management Paid	2	0	5
Management Unpaid	0	0	0
Management Total	2	0	5
Other Paid	8	0	20
Other Unpaid	-	0	0
Other Total	8	0	20
TOTAL	17	5	42

As clearly indicated governance are the highest category that are not paid and are very close in numbers on average to their paid counterparts. The role of officers in the governance of the entity is critical, the personal risk they face in their role, and the time and commitment needed to minimize compliance risk for an entity warrants appropriate compensation. Without such, paid competing demands for time will take priority and adequate commitment needed to manage compliance risk will not understandably be forthcoming.

According to the potential financial reporting requirements under the Charities Act, the table below indicates the applicable category as identified by participants.

Description	*Total Income Level per annum*	*Potential reporting requirement*	*Numbers*
"Small charities"	less than $100,000 of income	Entitled to report on a receipts and payments basis with no audit requirement	2
"Medium charities"	from $100,000 to $2,500,000	Report on an accrual basis with the account only subject to independent review	4
"Large charities"	income greater than $2,500,000	Report based on International Financial Reporting Standards with full audit	2

The highest category for participants lay in the "medium charities" area with reported annual income from $100,000 to $2,500,000. It was noted that the level of income was relevant at the time as each year will vary but will be in a similar realm. In terms of compliance risk the potential reporting requirements increase as income increases. However the entity's governing documents may still require an audit even if charitable requirements do not.

Participant Feedback

A high majority of participants identified that they had received and read (prior to the interview) the FOMANA report dated 31 May 2008 outlining Preliminary research on the legal framework affecting Māori Charitable Entities under the Charities Act 2005 and the Income Tax Act.

All of those who had received and read the report recommended it for use across such groups as staff, trustees, beneficiaries and other relevant stakeholders. Other comments about the report noted during the interviews were references to its ease of use, clarity and understandability.

The preferred methods for reporting on the finding of this research were identified by participants as:

- Written report
- Regular feedback and a executive summary of overall and individual performance and recommendation
- Two page summary
- Recommendations at FOMA conference

The benefits sought from this project as identified by participants were:

- Clarification of roles & organisation responsibilities
- Feedback on weakness
- Suggested ways of improvement
- Good practice checklists (to assist with compliance)
- Guide on best practice
- Identify what constitutes acceptable documentation for IRD audit re: misapplication
- Another set of eyes looking at compliance "charities regime"
- Continuous updating around obligations and responsibilities

Throughout the interviews it was noted that there was an openness and willingness to further improve systems and knowledge by participants. As an interviewer it was apparent that many of the issues faced by participants were similar and that there was an opportunity to gain real efficiencies and consistency (without compromising the autonomy of participants) in addressing compliance risk.

Conclusions

Throughout the interviews the need to communicate the obligations that entities faced as a result of the Charities Act 2005 was highlighted. This was mainly noted as a need for beneficiaries as opposed to just trustees. The aim was to create an informed environment so that there was no lack of clarity on what their respective entities could and could not do for them under legislation. An informed environment supports awareness which reinforces the behaviour needed to maintain compliance. This is particularly pertinent for the misapplication risk identified in the FOMANA report.

Key areas that participants identified for further training were as follows:

Area Identified	Governance Officers	Management/ Staff	Beneficiaries
Roles, Responsibilities and Obligations under the Charities Act 2005 (with particular emphasis on training to address risks factors 3 - 6);	√	√	
Overview of key areas of the entity's governing documents	√	√	
What registered charitable entities can and cannot do			√
The benefits of charitable registration			√
What recipients of grants from registered charitable entities can and cannot do.			√
The application process for grants/distributions from registered charitable entities			√

There are certain areas where relevant legislation is in conflict and there is a need to access a guide that will provide a system of determining what takes precedence. An example of a conflict is in what a distribution can and cannot be made for under the Charities Act 2005 versus The Ngati Rarua-Atiawa Trust Empowering Act 1993.

Final areas of need identified in the course of the audit are best practice checklists (to assist with compliance) for policies, procedures and systems needed at both a governance and management level. A particular emphasis on what the IRD would consider as sound practice especially when undergoing an audit was noted. There were a number of similar issues faced by participants which if addressed will assist in managing compliance risk. This opportunity and the acknowledgement of the large economic resources currently being managed by Māori have the potential to enhance Māori economic asset infrastructure, knowledge and potential. This could be done by streamlining compliance processes and systems, facilitating the development and implementation of a self assessment risk profile tool for Māori entities as well as customised training packages.

Appendices

Appendix One	Charities Commission Output Classes in monitoring compliance against charitable purposes
	OUTPUT CLASS 1.1 Registration and monitoring of charitable entities
	OUTPUT CLASS 1.2 Investigate Complaints and make enquiries about registered Charities
Appendix Two	Tax Penalties and Legislation administered by IRD
Appendix Three	Charities Commission Registration Update
Appendix Four	IRD Administrative Guidelines for Charitable organisations

Appendix One: Charities Commission Output Classes in monitoring compliance against charitable purposes

OUTPUT CLASS 1.1 Registration and monitoring of charitable entities

Figures based on number of charities registered at 30 June 2008

Performance Measures 07/08	Std/Target 07/08	Std/Target 08/09
No. Charities registered	Up to 18,000	Up to 17,000
% of completed applications for registration decided within 30 working days	85%	20-25%
No. of annual returns received and processed	Up to 10,000	8,000 - 10,000*
No. of annual returns processed within 25 working days	90%	90%
Register online and fully operational to public and charities	No less than 97% availability/month	No less than 97% availability/month
Quality audit on sample of recommendations for registration	Indicates no significant areas for improvement and only minor inconsistencies in decisions	
Six-monthly independent quality audit on sample of up to 1% of the recommendations for registration		Indicates no significant areas for improvement and only minor inconsistencies in decisions

OUTPUT CLASS 1.2 Investigate Complaints and make enquiries about registered Charities

Performance Measures 07/08	Std/Target 07/08	Std/Target 08/09
% of complaints about registered charities brought to the Commissions attention which are acknowledged and on which work is commenced to resolve the compliant within 25 working days	100%*	90%
Framework for inquiring into the conduct of registered charities is developed and approved by the Board	NA (similar target: Framework for the monitoring of registered charitable entities activities developed by 30 June 2008)	By 31 March 2009

* Slightly different target in 2007/08

Appendix Two: Tax Penalties and Legislation administered by IRD

If an organisation doesn't pay tax in full and on time, late payment penalties and interest are charged. Additionally, some actions, such as not providing accurate information, may attract shortfall penalties and/or other penalties. Failure to meet tax obligations may result in civil penalties[19], criminal penalties[20], or both. A single breach of tax obligations could, potentially result in both a civil and a criminal penalty (e.g. tax evasion is subject to both criminal and civil penalties).

Civil Penalties:

(1) Late Filing Penalties

If tax returns are not filed on time, a late filing penalty may be applied. Entities can avoid this penalty where they have a valid reason for not filing the return on time (i.e. illness or accident, and being unable to obtain the information needed to complete the return). The amount of the penalty depends on the net income. The three penalty bands are:

- Below 100,000 ($50 penalty);
- Between $100,000 to $1 million ($250 penalty); and
- More than $1 million ($500 penalty).

The late filing penalty for a reconciliation statement is $250. Once a penalty has been imposed it must be paid 30 days from the date of the statement advising of the penalty, or by the end-of-year tax.

(2) Late Payment Penalties

If tax is not paid on time a late payment penalty may be applied. The late payment penalty consists of an initial penalty for paying tax late and a monthly incremental penalty on the amount owing. The initial late payment penalties are calculated on the amount of late or unpaid tax. The initial penalty is 5% of the unpaid tax and comprises a 1% penalty the day after the due date and 4% penalty of the total outstanding amount not paid within a week of the due date.

Late payment penalties are not charged on unpaid tax of $100 or less. An additional penalty of 2% per month and 1% (on a compounding basis) applies on the outstanding amount of any unpaid tax and penalties. Where a taxpayer is in financial difficulty, Inland Revenue may choose to remit tax or enter into payment arrangements. If Inland Revenue is contacted before the due date, the 4% penalty or the incremental late payment penalty can be waived. If Inland Revenue is contacted after the due date the incremental late payment penalty can be waived.

[19] A civil penalty is one imposed by Inland Revenue rather than a court (i.e. late filing penalties; non-electronic filing penalties; late payment penalties; and shortfall penalties).

[20] A criminal penalty is one imposed by a court upon conviction of an offence (i.e. evasion; obstruction; and aiding or abetting another person to commit an offence).

(3) Shortfall Penalties

Failing to take reasonable care in calculating your tax can result in shortfall penalties on unpaid tax. A shortfall penalty is imposed on unpaid tax that should have been included in the original tax calculation. There are five categories of behaviour that decide the penalty to be applied. The penalties (only one of which will apply to a tax shortfall) are applied as a percentage of the tax shortfall. The penalty increases in proportion to the seriousness of the breach. The categories are:

- Failure to take reasonable care (20% penalty);
- Adopting an unacceptable interpretation (20% penalty);
- Gross carelessness (40% penalty);
- Abusive avoidance, where shortfall exceeds $10,000 (100% penalty); and
- Evasion (150% penalty).

Aiding and Abetting

These do not include aiding and abetting penalties or obstruction penalties (if you obstruct IRD in calculating your tax income an additional penalty of 25% on the unpaid tax can be imposed on you. Penalties can be reduced if you disclose the tax shortfall. However timing of the disclosure is critical.

Criminal penalties for knowingly offending include:

- Imprisonment for a maximum of 15 years; and
- Up to $50,000 for each offense

LEGAL RESPONSIBILITIES as stated in IRD Annual Report 2007, Figure 40, page 124

Inland Revenue administers the following main Acts:

- Child Support Act 1991
- Estate and Gift Duties Act 1968
- Gaming Duties Act 1971
- Goods and Services Tax Act 1985
- Income Tax Act 1994
- Income Tax Act 2004
- Stamp and Cheque Duties Act 1971
- Student Loan Scheme Act 1992
- Tax Administration Act 1994
- Taxation Review Authorities Act 1994

KiwiSaver Act 2006 Parts 1 to 3 and Schedule 3 and provisions in Part 5 as authorised by the Prime Minister. The Ministry of Economic Development administers Part 4 and Schedules 1 and 2 and provisions in Part 5 as authorised by the Prime Minister. See section 224 of the KiwiSaver Act.

Aspects of the Parental Leave and Employment Protection (Paid Parental Leave) Act 2002 are administered by Inland Revenue under authority delegated (under section 71ZA of that Act) by the Chief Executive of the Department of Labour.

Appendix Three: Charities Commission Registration Update

Date	Number registered	Processing Time
25 January 2008	2,142	currently reviewing applications received from 29 August.
Feb 2008	3.121	reviewing applications received from early November 2007
29 April 2008[21]	4,990	reviewing applications received from 30 January 2008.
19 May 2008	5,902	Currently making initial reviews of applications received from 26 Feb 08.
4 August 2008	10,260	Currently making initial reviews of applications received from **19 May 2008**
8 September 2008	12,119	Our registration analysts are currently making initial reviews of applications received from: **12 June 2008**
15 September 2008	12,470	Currently making initial reviews of applications received from: **19 June 2008*** *Remember: many straightforward applications, once they reach the front of our queue, are processed within several weeks. However, if there are any **complex issues** involved, or the application requires **additional work** by a senior analyst to confirm an analyst's initial view, it will take longer to complete the process - **currently several additional months.**

1 JULY 2008 - "BUSINESS AS USUAL"[22]

...Our early estimates of there being around 25,000 charitable organisations in New Zealand appear to have been reasonably accurate - in total, we have received almost 24,000 applications (about 1,500 of those in the last two days of June).

It is likely that it will take us to the end of the year to process all of them, so please be patient - and remember that where necessary, we can backdate properly-completed applications.

SNAPSHOT Overview of types of charities registered as at 31 August 2008[23]

The "big three" most common:

Sectors - Education/training/research, Religious activities, Other

Activities - Other, Provides religious services/ activities, Provides services (e.g. care/ counselling)

Beneficiaries - General public, Children/young people, Other charities

Areas of operation were as follows (note: the total is greater than the total number of registered charities, as some organisations tick two or more categories on their application):

[21] Update 29 - April 2008
[22] http://www.charities.govt.nz/news/updates/july-2008.htm

[23] www.charities.govt.nz/news/updates/september-2008.htm

New Zealand	
Auckland - 1,991	Northland - 626
Bay of Plenty - 780	Otago - 770
Canterbury - 1,412	Southland - 427
Chatham Islands - 21	Taranaki - 392
Gisborne -220	Waikato - 928
Hawkes Bay - 525	Wellington - Wairarapa - 1,261
Manawatu - Wanganui - 652	West Coast - 248
Nelson - Marlborough - Tasman - 545	Nationwide - 2,786

Overseas	
Africa - 197	North America - 116
Antarctica - 18	Oceania - 322
Asia - 325	South America - 112
Europe - 159	

CIRCUMSTANCES THAT PREVENTED APPLYING BEFORE 1 JULY?

A change has been made to the Income Tax Act, for charitable organisations that ran into difficulty with completing their registration application before 1 July 2008, owing to circumstances that may be beyond their control. It will not cover organisations that merely did not get around to applying for registration before the deadline.

The legislation provides a limited discretion for Inland Revenue to preserve the tax-exempt status of charities that were not able to apply to register with the Charities Commission before 1 July 2008, but who can prove to IRD that they began the process of preparing their application before that deadline.

Guidelines about what Inland Revenue requires as proof of having begun the process of preparing an application for registration are available on IRD's website. See next Appendix for a copy.

Appendix Four: IRD Administrative Guidelines for Charitable organisations

Administrative guidelines about the tax position for charities that have not completed the process of registering with the Charities Commission by 1 July 2008[24]

These administrative guidelines are intended to provide clarity about the tax position for entities that have not completed the process of registering with the Charities Commission by 1 July 2008. The guidelines describe:

- what happens to tax exempt and/or gift duty exempt status if a charity hasn't completed the Charities Commission registration process by 1 July 2008
- what a charity needs to do to retain tax exempt and/or gift duty exempt status
- how a charity can prove it has taken "reasonable steps" to register with the Charities Commission
- what won't count as proof that a charity has started the registration process
- answers to common questions for charities that have not completed the registration process with the Charities Commission by 1 July 2008.

The 1 July 2008 law change

Under law that comes into force on 1 July 2008, a charity must be a "tax charity" to be entitled to the charitable purpose income tax exemption and for gifts to that entity be exempt from gift duty.

Charities that do not register by 1 July 2008 may be subject to income tax and will therefore no longer be exempt from resident withholding tax in their investment income.

The Charities Act 2005 gives powers to the Charities Commission to backdate registration to the date on which a properly-completed application was received. There is more information about this on the Charities Commission's website.

Transitional measures

Budget night legislation, section CW 41(5)(ii) of the Income Tax Act, contains a transitional measure for entities that have not completed the registration process by 1 July 2008. Entities that qualify will be treated as income tax exempt and gifts made to them will not attract gift duty.

The legislation preserves the income tax-exempt status of organisations currently exempt as a charity that can show that they have started to take reasonable steps in the process of preparing an application for registration before 1 July 2008, and that intend to complete the registration process.

The transitional measure is intended to apply to entities that need more time to complete the registration process, where those entities have genuinely tried to comply with the registration requirements, rather than to those entities that have just not turned their mind to the issue or decided not to comply. The measure is to be applied in limited circumstances.

[24] www.ird.govt.nz/charitable-organisations/chart-orgs-admin-guidelines-registering.html

We intend to review, by 31 March 2009, the income tax exempt status of those charities that have not registered with the Charities Commission or have not taken reasonable steps to start the process of registration.

What a charity needs to do to retain tax exempt and/or gift duty exempt status

The new section CW 41(5)(ii) of the Income Tax Act 2007 deals with transitional tax consequences for charities that need more time to complete the registration process. It applies to entities that:

- started, before 1 July 2008, to take reasonable steps in the process of preparing an application for registering as a charitable entity under the Charities Act 2005, and
- intend to complete the process of preparing an application in future, and have not been notified by the Inland Revenue that they are not a "tax charity".

The entity must first meet the technical requirements of a charity as set out in sections CW 41, 42, and 43 of the Income Tax Act.

Entities that meet the requirements of this transitional measure will retain their exemption from income tax and any gifts they receive will continue to be exempt from gift duty. This also means that for those entities that have been issued with a Certificate of exemption from resident withholding tax (COE), the exemption will continue to apply. If the application for registration as a charity is declined, the above exemptions will cease to apply from 1 July 2008.

Proving a charity has taken "reasonable steps" to register with the Charities Commission

A "process" is defined as a systematic series of actions directed to some end, in this case, being a properly completed application for registration.

An application for registration with the Charities Commission by 1 July 2008, whether online or otherwise, will be regarded by Inland Revenue as constituting a reasonable step in the process.

Applications by 1 July 2008 aside, Inland Revenue requires documented evidence that, by 1 July 2008, a charity has taken reasonable steps in the process of preparing an application for registration. For example, any board minutes, resolutions recording formal decisions and commitments to register (with timeframes given), any documented decisions to take active steps towards preparing a proper application (such as a recorded decision to instruct solicitors/advisors or other third party to begin preparation).

What your charity needs to give the Charities Commission

Section 17 of the Charities Act 2005 sets out what is required by an application for registration with the Charities Commission. The application must:

- be sent or delivered to the Commission and must be in the prescribed form, and
- be accompanied by a document in the prescribed form, signed by, or on behalf of, every person who is an officer of the entity, that contains a

certification that the person is not disqualified from being an officer of a charitable entity in relation to the entity under section 16, and
- be accompanied by a copy of the rules of the entity, and
- be accompanied by the prescribed fee for the application (if any), and
- contain, or be accompanied by, any other prescribed information or documentation.

Starting the process of registration must include starting any of the steps to meet the application requirements. The process above can also be carried out online with the Charities Commission.

How to prove a charity has started the registration process

The following actions will be considered to be evidence of preparing an application for registration. Provided they commenced before 1 July 2008 and are supported by documentary evidence:

- request for professional advice to commence registration of an existing charity
- request for professional advice to draft rules/charter for an existing or proposed charity that will then be registered
- charter or draft rules are in the process of being prepared by an organisation that intends to register as a charity
- preparation of registration application form, even if not yet fully completed, that clearly shows intention to register
- commenced online registration with the Charities Commission, even where the submission stage has not been reached.

Each of these actions must include copies of file notes, draft copies of rules/charter, committee minutes, director or trustee resolutions, draft copy of registration form, a letter from a third party that the process has started for registration, or similar evidentiary documentation, if applicable. All documentary evidence must be dated. For a commenced online application, the record will be an electronic document held by the Charities Commission and the applicant will also have a log-in code.

Case by case assessment will be made of an entity's actions to determine whether a real intent can be shown. This will include consideration of an intention to make an application to complete the registration process within a reasonable timeframe.

What won't count as proof a charity has started the registration process

None of the following on their own will normally be considered sufficient evidence in preparing an application for registration by 1 July 2008:

- a call to Inland Revenue/advisor/Charities Commission expressing an intention to form a charity
- any general information requests about the registration process
- a call to Inland Revenue/advisor/Charities Commission for information about registering an existing charity
- request to Inland Revenue/advisor/Charities Commission to send registration forms
- "do I need to register" request to Inland Revenue/advisor/Charities Commission
- letter from Inland Revenue that an organisation needs to register

- downloading registration information and/or form from Charities Commission website.

A letter from Inland Revenue that an existing operating charity is exempt from tax will no longer have effect from 1 July 2008 if the registration process has not started.

A genuine enquiry to Inland Revenue to clarify an organisation's current tax status may indicate the start of a registration process if the purpose of that registration is solely to be treated as a tax charity. This will be determined on a case by case basis.

Questions and answers

What actions would prove a charity is serious about registering in future?

There should be a stated intention and commitment to register with the Charities Commission. An entity must have a genuine intention to complete the process of a Charities application in the near future.

An entity is required to specify the time period in which they intend to submit an application to the Charities Commission and complete the registration process.

What if a charity withdraws their application?

If an entity has submitted an application prior to 1 July 2008, but then withdraws the application, this on its own, is not an indication of having an intention to complete the process. An entity needs to satisfy the criteria set out above to qualify for the transitional measure.

What happens if an entity has started the process but has not submitted an application for registration within a reasonable period?

An entity would continue to have tax charity status provided the entity can demonstrate that it intends to complete the registration process within a reasonable timeframe, as set out in the administrative guidelines criteria.

What happens if an entity has submitted an application for registration and the registration had been declined, or the entity has been previously declined charitable status by Inland Revenue?

If the entity is found not to have a charitable purpose then the entity would fail to meet the requirements of the charities commission and income tax exemption.

BUT

If an entity is found not to have made a properly completed application, and intends to remedy this, by submitting a further application to the Charities Commission within a reasonable timeframe, Inland Revenue will consider the transitional measures criteria. Inland Revenue needs to be satisfied that all reasonable steps have been taken, and documented evidence provided, with a clear intention to complete the registration process within a reasonable timeframe

Does the entity need to register?

A non-profit body is any society, association or organisation, whether incorporated or not, that is not carried on for the profit or gain of any member, and whose rules/constitution do not allow money, property, or any other benefits to be distributed to any of its members.

Non profit organisations that do not qualify for an income tax exemption can qualify for a deduction against their net income. The deduction available to non-profit bodies is for an amount equal to the lesser of $1,000, or the amount that would be the net income of the society, association or organisation.

A non-profit body must have written rules in order to qualify for an income tax exemption or deduction. These rules give an organisation a set direction and purpose. If an organisation does not have rules or a constitution they will not qualify for an exemption or deduction, because there is nothing in writing to bind members to a particular course of action and ensure its funds are used in ways which are in line with its aims.

A charitable organisation will be required to be registered by the Charities Commission to be eligible for an income tax exemption. The requirement to register with the Commission will have no effect on other non-profit bodies that are not registered charities, although non-profit bodies will continue to be eligible for the $1,000 deduction from income.

An organisation is working to be group registered as a group, what is the effect of this?

Group registration with the Charities Commission will cover all organisations that are a party to that group registration and the Commission will notify Inland Revenue of the names of those organisations included in the group registration.

The organisation has numerous branches or associations that will be covered by a parent body's registration - what is the effect of this?

When sending an application for the transitional measure, please inform us of all the entities that your application relates to. The transitional measure will apply to all the entities that are covered by the registration of the parent body provided they are all operating under the parent body's rules or constitution.

A marae has started working through an application last year. Many people are required to be consulted, so the application hasn't been sent in to the Charities Commission yet. Do the transitional measures apply here?

Yes, they should apply in this situation. The entity would need to provide Inland Revenue with documentation of what steps have been taken, and a timeline of when it intends to have the process completed. Include anything that may be relevant. If we need more information we will contact you.

An application has been sent to the Charities Commission - if it isn't approved by 1 July 2008 will the entity have to apply for the transitional guidelines?

No, the transitional guidelines are not intended for organisations that have already applied to the Charities Commission. When the Charities Commission approves your application they may backdate the registration to the date you applied. Please refer to the Charities Commission website for more details.

What is the tax position if an application for registration is filed and approved after 1 July 2008?

We will consider the circumstances on a case by case basis. If the entity can show it started the process of registration before 1 July 2008 then the transitional measure will apply.

Applications for transitional guidelines should be sent to:
Inland Revenue
PO Box 761
Waikato Mail Centre
Hamilton 3240

Other pages in: Charitable organisations

- Income tax, tax rates and exemptions
- Charitable organisations for the purposes of Student Loan Scheme 1992
- Registration of charities

- Filing income tax returns

Bibliography and Information Sources

Agency or Author	Title of Publication or Website	Date
Charities Commission	Statement of Intent 2008-2011	2008
	Information Sheet Form 4 Annual return for a charitable entity	June 2008
Inland Revenue	Tax and Charities - A Government Discussion on Taxation Issues Relating to Charities and Non-Profit bodies.	2001
	http://www.ird.govt.nz/charitable-organisations/	
	Tax information for charities registered under the Charities Act 2005 (IR256)	
Charity Commission for England and Wales	Sound strategy for effective delivery: A Report on the views of key external stakeholders on progress since 2004	Dec 2006
Panel on the Nonprofit Sector Report (US)	Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations www.nonprofitpanel.org/report/principles/Principles_Guide.pdf	October 2007
Canada Revenue Agency	Charities Good Practice Checklist (Canadian) www.cra-arc.gc.ca/tx/chrts/chcklsts/menu-eng.html	
Voluntary sector initiative Joint Regulatory table	Frequency of Various Types of Non-Compliance by Registered Charities	
Charities Review Council, Minnesota, USA	Survey Of Minnesotans' Charitable Giving Habits And Perceptions Of Charitable Organizations	July 2007
Other	The Review of the Financial Reporting Act Discussion Document Part II	

Information Sources for Effective Governance

Resources that offer valuable information on this with a NZ perspective are: provided on the following http://www.community.net.nz website as selected publications and resources about best practice in governance and management of not-for-profit organisations.

Effective governance of Māori organisations (details)
Te Puni Kōkiri's website for effective governance education, designed to help trustees and directors of Māori organisations with their responsibilities and role as guardians and leaders.
Date updated: 30 June 2008

Indigenous Concepts of Governance (details)
This paper by Robyn Kamira looks at indigenous models of governance and their relevance in contemporary settings, and in particular in relation to control of information by Māori in the health. Date updated: 30 June 2008

Nation Building and Māori Development - The Importance of Governance (details)
In this paper, Materoa Dodd of School of Māori and Pacific Development, University of Waikato, outlines the importance of good governance in developing effective structures for Māori. Date updated: 30 June 2008

Managing Well resource catalogue (details)
The Managing Well resource catalogue (online in the Community Centre section of this web site) includes references or links to manuals, websites, information sheets, books, and other documents. Date updated: 1 April 2008

Committees, roles and meetings (details)
This section of SPARC's Club Kit provides an overview of who organisations will need to form a committee, their roles and how to run successful meetings. Date updated: 9 October 2007

Six key competencies which lead to board excellence (details)
Six page article that identifies competencies which lead to board excellence. Based on a five year study of 20 U.S. nonprofits and schools by Richard Chait, Thomas Holland and Barbara Taylor. Date updated: 4 December 2006

Simple Policy and Procedures Manual (details)
Why you need them, with examples of policies and procedures. Updated: 4 December 2006

Board development workbooks (details)
Downloadable workbooks on developing job descriptions for board members, developing boards, developing policies and other topics. Date updated: 27 November 2005

Good Governance Guides (details)
Chartered Secretaries New Zealand has prepared a series of Good Governance Guides in the area of corporate governance with the intention being to "provide value to individuals as a starting point. Date updated: 19 November 2005

Nine Steps to Effective Governance (details)
This practical SPARC governance resource covers a wide range of governance functions: defining the role of the board; induction; board meetings; planning; board and CEO evaluation; and succession. Date updated: 10 November 2005.