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Taxation and the not-for-profit sector
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Tēnā koe Deputy Commissioner

Taxation and the not-for-profit sector

The Institute of Directors (IoD) appreciates the opportunity to make a submission on your officials' issue paper *Taxation and the not-for profit sector*, released on 24 February 2025.

Scope of our submission and summary

This submission is presented in two parts:

- Proposals that impact directors and boards of not-for-profit organisations; and
- Proposals that impact the IoD and its members, in our capacity as a not-for-profit organisation.

We note this submission does not and cannot address specific impacts of the proposed tax changes on individual not-for-profit organisations, including registered charities.

For the boards of these organisation, this submission does address the pressures on those organisations (financial and more broadly), the largely volunteer nature of the boards and the organisations and the continuing battle for financial sustainability of many of these organisations. Boards/ committees will have to support management working with the proposed changes and pay attention to tax governance, with the increased risk and complexity the changes involve.

For the IoD, the proposal to tax the profits on members subscriptions would have a detrimental impact on our ability to support directors and their boards with a consequential impact on their governance capability and the design of policy, legislation and regulations that supports governance practice. This will reduce company, not for profit organisation and public sector entity performance and their ability to deliver services to and support our community.

About the Institute of Directors

The IoD is Aotearoa New Zealand's pre-eminent organisation for directors with approximately 10,500 members and is at the heart of the governance community.

We believe in the power of governance to create a strong, fair and sustainable future for New Zealand.

Our role is to drive excellence and high standards in governance.

We support and equip our members who lead a range of organisations from listed companies, large private organisations, state and public sector entities, small and medium enterprises, not-for-profit organisations and charities.

Our Chartered Membership pathway aims to raise the bar for director professionalism in New Zealand, including through continuing professional development to support good governance. This includes a focus on directors and boards leading their organisation by actively defining their strategy and purpose, setting expectations of management about how that will be addressed, and considering reporting on implementation of those actions.

Proposals that impact directors and boards of not-for-profit organisations

While not speaking for individual not-for-profit organisations, this submission outlines the broader governance implications for the boards and committees responsible for their oversight. We highlight below how the proposed changes could affect the sustainability, governance obligations and risk profile of not-for-profits, most of which are governed by unpaid volunteer boards.

Financial and structural pressures on the not-for-profit sector

Boards in the not-for-profit sector are already operating under significant financial and structural pressures. Many organisations face ongoing funding challenges, growing demand for services, and increasing compliance obligations across a range of regulatory areas.

These pressures are further compounded by rising expectations around transparency, performance measurement, and public accountability.

The proposals outlined in the consultation document - particularly the removal of tax exemptions for unrelated business income and the introduction of integrity rules for donor-controlled charities - would add to the financial and administrative burden on many organisations.

Even with proposed thresholds or de minimis exemptions, the changes would still require boards to commit more time and resources to compliance, oversight, and tax governance.

The volunteer nature of governance in the not-for-profit sector

Many not-for-profit boards are made up entirely or predominantly of volunteers. In many cases, board members also contribute to the day-to-day operations of their organisations. While these boards are characterised by a strong mission focus and deeply connected to their communities, they often lack easy access to professional tax, legal, or accounting advice – largely due to limited funding.

Although some larger Tier 1 or Tier 2 organisations have more established governance and support structures in place, most of the sector – made up of Tier 3 and Tier 4 entities - operate with lean governance and operational models. According to the consultation document, these smaller Tier 3 and Tier 4 organisations account for 88% of registered charities reporting business income in 2024.

Imposing new obligations to assess and manage unrelated business income and manage tax obligations would place a disproportionate compliance burden on these smaller, volunteer-led organisations. This added complexity is unlikely to generate significant tax revenue or improvements in compliance, yet it would significantly stretch already limited governance capacity.

Governance implications of increased tax complexity

If the proposed changes proceed, boards will be required to exercise increased diligence in overseeing compliance with tax obligations. This includes:

- Ensuring appropriate systems are in place to distinguish between related and unrelated business activities
- Monitoring distributions and accumulations to ensure they meet any new rules
- Overseeing the implementation of reporting systems, especially where small-scale trading or donor-controlled structures are present

- Navigating additional integrity and anti-avoidance rules, particularly if investment restrictions or distribution requirements are introduced

Boards and committees, which are ultimately accountable for an organisation's compliance with tax law, will need to allocate governance time and resources to understanding the new rules and overseeing implementation. There will be a greater need for tax expertise at board or management level and increased attention to documentation and evidence trails supporting tax positions. For many of the organisations that will have to implement that proposed changes, this expertise is not readily available.

Risk, accountability and tax governance

With the introduction of a more complex tax framework, the risk profile for NFPs will change. Boards will need to adopt a more deliberate approach to tax governance, including:

- Ensuring tax is considered as part of organisational risk management
- Including tax compliance within internal audit and assurance scopes
- Seeking external tax advice where relevant, particularly on related-party transactions and business structuring
- Documenting board oversight of tax compliance and decisions made in respect of distributions and accumulations

For many organisations, this will require a shift in governance maturity which some may never achieve and potentially the development of new policies and practices. In the long term, this could lead to stronger governance capability, but in the short term it will likely create additional pressures on volunteer board members, many of whom already commit significant time without remuneration or other benefits.

Financial sustainability and policy design

The sector's financial sustainability is already fragile. Not-for-profits, and particularly charities, are "squeezed" at both ends: if providing or supporting services for the community and funded in part by the government, the full costs of service provision are not generally met; there is an assumption that there will be fundraising or donations from the community that will make up the difference. At other end, the ability to fundraise is equally constrained, particularly in difficult economic conditions. Adding the proposal tax changes has the potential to reduce retained earnings from business activities could undermine a not-for-profit organisation's ability to reinvest in its mission – one that both government and the community want to see delivered. This is especially the case for those organisations using business income to fund core services in areas such as housing, education, health, and social services. Boards may need to revisit investment and funding strategies and consider alternative models for income generation.

To mitigate these impacts, policy settings should be designed with careful attention to governance capacity and sector sustainability, including analysis that is systemic rather than myopically focused on tax policy settings. To achieve this, we recommend that the final consideration of the proposals include:

- Clear and practical definitions of unrelated business income, with examples and interpretive guidance
- De minimis thresholds aligned with reporting tiers, especially to protect Tier 3 and 4 charities

- Relief mechanisms for distributed surpluses, including transitional support to help boards adjust financial strategies
- Simplified compliance options for smaller entities and those predominantly run by volunteers

Proposals that affect the IoD and its members

The IoD is a Tier 2 not-for-profit incorporated society which supports directors to positively transform the future. IoD is not a charity.

While we do not describe ourselves as being a mutual association, we function in a similar way with our 10,500 members furthering our ‘mutual purpose’ of promoting excellence in governance.

In line with the comments noted in 4.5 of the official issues’ paper, we do not currently pay tax on profits from our member subscriptions. We do, however, pay tax on all our commercial operations – governance development courses, governance services, and national and local events – and agree this tax treatment is fair.

Our constitution prohibits the distribution of surpluses to our members including on winding up (consistent with section 216 of the Incorporated Societies Act 2022), meaning IoD would not qualify for mutual treatment as outlined in 4.6.

The impact of imposing tax on the profits from member subscriptions would significantly impact IoD’s financial model with a considerable impact including:

- Increasing fees for members thereby disadvantaging potential members, including younger people and supporting not for profit organisations, from being part of a community of leading governance professionals in New Zealand
- reducing the availability of governance training and other development offerings to support good practice governance in New Zealand – across companies, not for profit organisations and the public sector because of the need to increase the price of governance development training and/or reduce the investment IoD makes to recover the additional tax expense the proposals will generate.
- curtailing the contribution to the public policy, legislation and regulation to support good practice governance would be curtailed.

Based on impacts we cannot support a change to the tax treatment of membership subscriptions.

Conclusion

The taxation proposals in the discussion need to reflect on the nature of New Zealand’s not-for-profit sector made of predominantly small and volunteer lead and run organisations.

While delivering for the government (in many cases) and their communities, their financial situation is fragile, their ability to cope with major changes in tax arrangements low and their financial situation precarious.

The weight of this and the risks and complexity of the proposed taxed changes, fall on predominantly volunteer boards of not-for-profit organisations.

For these reasons we advocate for significant care in proceeding with the proposals in the discussion document, along with a rigorous and systemic cost-benefit analysis, notably in relation to the additional tax revenue collected, the compliance costs involved and the unintended consequences for organisations that are at the heart of the fabric of our society.

For the IoD itself, the proposed change to the tax treatment of member subscriptions would have a detrimental impact on the quality of governance in New Zealand, with impacts on the performance and delivery of services by New Zealand's major companies, not-for-profit organisations and public sector entities.

Ngā mihi

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