FACT SHEET | PUKA MEKA

Income tax – Charities – Business income exemption

Issued | Tukuna: 16 September 2024

IS 24/08 FS 1

This fact sheet accompanies interpretation statement 'IS 24/08: Charities – Business income exemption'. IS 24/08 provides guidance on when business income a registered charity derives is exempt from tax under s CW 42 of the Income Tax Act 2007. It explains that:

- business income is exempt to the extent that it can be apportioned, on a reasonable basis, to a registered charity's charitable purposes in New Zealand; and
- all business income is taxable if a person with some control over the business is able to direct or divert business income away from charity.

A registered charity is an entity registered as a charitable entity under the Charities Act 2005.

Introduction | Whakataki

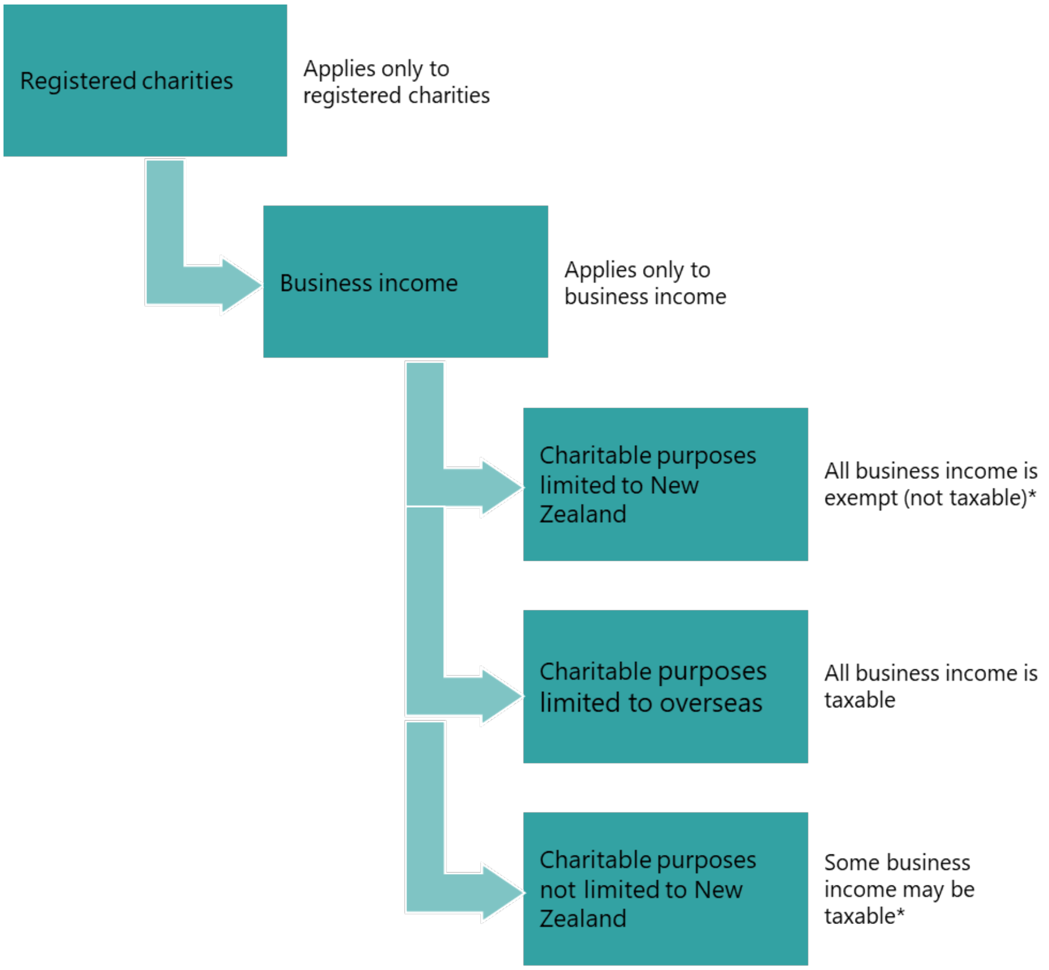
1. Generally, non-business income a registered charity derives is exempt (non-taxable) (s CW 41 of the Income Tax Act 2007). Business income is subject to different rules that can result in some, or all, of a registered charity's business income being taxable (s CW 42 of the Income Tax Act 2007).

2. In determining whether a registered charity's business income is exempt, two main questions need to be answered:

- What, if any, income derived by a registered charity is income from a business?
- If a registered charity derives business income to what extent is that income attributable to its charitable purposes outside of New Zealand?

3. How these factors apply is illustrated in Figure | Hoahoa 1.

Figure | Hoahoa 1: How s CW 42 of the Income Tax Act 2007 applies



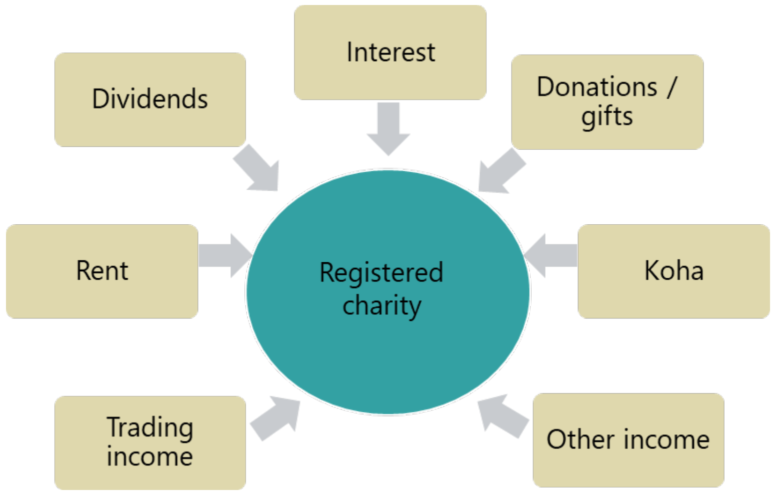
* All business income is taxable if a person with some control over the business is able to direct or divert business income away from charity.

What constitutes business income

4. Before s CW 42 applies there must first be a person who is carrying on a business. Whether a person is carrying on a business is a factual question. For further explanation, read [24] to [32] in IS 24/08.

5. A registered charity conducting a business might derive different types of income. It may earn income from its trade or business activities and other income such as interest, dividends, rent, donations, gifts and koha, as illustrated in Figure | Hoahoa 2.

Figure | Hoahoa 2: Types of income



6. Whether these other amounts are "business income" depends on the nature of the registered charity's business and its relationship with these amounts. It is a question of fact and depends on whether the income arises from the business activity. Not all income derived by a registered charity that conducts a business is business income, see Example | Tauira 1.

Example | Tauira 1

Cooks for Good Ltd is a registered charity. Its charitable purpose is to advance religious education. To raise funds for its charitable purpose, it runs a café that sells food and drink. Cooks for Good Ltd has an interest-bearing business on-call account that it uses to deposit the takings from the café and pay for the café's expenses. It receives a donation from a member of the public who has heard about and wants to support its work in advancing religious education.

The income from running the café (that is, selling food and drink) and the interest income on the business on-call account are both income from the business.

This outcome arises because the interest income is closely connected to Cooks for Good Ltd's business (and not as a result of the name or nature of the bank account, ie, a "business on-call account"). The ordinary day-to-day transactions of the business give rise to or produce the interest income. The interest income is effectively paid on the takings from the café when they exceed the café's expenses.

The donation is not Cooks for Good Ltd's business income because it is unrelated to its business. Further, any interest income earned on the donation is not income from the business. No part of the business activity gives rise to or produces the interest income.

Whether charitable purposes are limited to New Zealand

Charitable purposes are limited to New Zealand

7. For a registered charity's charitable purposes to be limited to New Zealand it is not enough that its rules limit its charitable purposes to New Zealand. Its charitable purposes must in fact be limited to New Zealand.

8. Sometimes a registered charity that previously carried out charitable purposes only in New Zealand will make a donation in response to an unexpected event overseas, eg a natural disaster. A registered charity that donates to charitable purposes outside New Zealand is itself carrying out charitable purposes overseas. This means its charitable purposes are **no longer** limited to New Zealand.

Charitable purposes are not limited to New Zealand

9. Business income is exempt only to the extent it can be apportioned, on a reasonable basis, to a registered charity's charitable purposes in New Zealand.

10. A registered charity's split of business income between its charitable purposes in and outside New Zealand does not need to be exact to the last dollar but must be reasonable. For a discussion of possible approaches to splitting business income, read 'IS 24/08: Charities – business income exemption'.

11. Generally, once a registered charity determines an approach to splitting its business income it can use the same approach in the following years.

12. There may be situations where it is reasonable to allocate all of a registered charity's business income to charitable purposes in New Zealand despite the registered charity

carrying on charitable purposes in and outside New Zealand, see Example | Tauira 2 for one such situation.

Example | Tauira 2

The Onward Trust is a registered charity. It provides religious services and pastoral care to its local community in New Zealand. Its trust deed does not limit its charitable purposes to New Zealand.

The Onward Trust derives business income. Its trust deed does not provide for its business income to be ring-fenced for its charitable purposes in New Zealand.

The Onward Trust carries out its charitable purposes in New Zealand. Occasionally it donates overseas in response to natural disasters that occur outside New Zealand. It does not carry out other overseas charitable purposes.

The funds for the donation come from the local community who donate to the Onward Trust in response to the particular natural disaster. The Onward Trust keeps records of the donation amounts received from the community and donates this amount to the overseas charitable purposes.

In this case it is reasonable for the Onward Trust to treat any business income it derives as exempt on the basis that all its business income is for charitable purposes in New Zealand.

13. How much tax a registered charity needs to pay on its taxable business income depends on what proportion of its deductible business expenses relate to that taxable business income. No deduction can be claimed for business expenses that relate to exempt business income. A registered charity can split its deductible business expenses (between its taxable and exempt business income) on the same basis it split its business income. For further explanation, read Example | Tauira 22 and Example | Tauira 23 in IS 24/08.

About this document | Mō tēnei tuhinga

Some of the Tax Counsel Office's longer or more complex items are accompanied by a fact sheet that summarises and explains an item's main points. While it summarises the Commissioner's considered views, a fact sheet should be read alongside the full item to completely understand the guidance. Fact sheets are not binding on the Commissioner. See further Status of Commissioner's advice (*December 2012*).