Philanthropy New Zealand response to Charities Act proposals

May 2021

Introduction

Thank you for the opportunity you provided via the Sector User Group to provide feedback on items you are currently developing options for as part of modernising the Charities Act.

As we have previously noted, the timeframe provided for feedback has been very tight and so these views should be treated as an initial response. Ideally, we would have liked to engage with you face to face to fully understand the knowledge you are drawing on and context for options development and to test your understanding of the nature of philanthropic and grant making organisations.

In many cases our members have not had a chance to seek detailed advice on any unintended consequences of the proposed options. We also note that many front-line charities have not had the resource available to respond to these written proposals in the timeframe. Other organisations with a key interest in the matters being discussed have not been aware of this consultation. We ask that in any subsequent Cabinet Paper that the restricted nature of this engagement is duly noted.

Philanthropy New Zealand (PNZ) is a not for profit and independent organisation and the peak body for philanthropy and grantmaking in Aotearoa New Zealand. Our membership includes funders and community organisations from a range of sectors. Many are charities and/or are donating to organisations with charitable status. This submission largely draws on the views of some Community Trusts, Community Foundations, grantmaking trusts and family foundations. Some of our members have submitted in their own right.

In the time available, Philanthropy New Zealand has sent your options papers to our funder members and as such most of the feedback is concentrated on accumulation of funds, given it is a necessary activity for many philanthropic and grant-making organisations to generate income for distribution to communities and philanthropic causes (especially when funding is the result of returns derived from investments and endowments). The contribution of the philanthropic and grant making sector to New Zealand was estimated to be worth $3.8 billion in 2018 (J B Were, *The New Zealand Support Report*, 2020).

Finally, whilst we appreciate that the Government is trying to make progress on issues previously raised in the Charities Act review, we do have concerns about these particular issues being considered outside the context of a fuller review that would likely focus on the purpose of the charitable sector and how it can be enabled - as well as transparency promoted and risk managed.

Accumulation of funds

We note the DIA intention to improve transparency around charities accumulating and distributing funds. Philanthropy New Zealand supports there being more transparency around why funds are being accumulated and how and when they are intended to be used to ensure that charitable organisations are delivering on their charitable purpose as a funder and grantmaker.

Option 5 around a minimum distribution level goes beyond transparency. Philanthropy New Zealand is not opposed to minimum distribution per se for funder charities. But this is a complex undertaking with a range of potential unintended consequences (some at this stage unknown and not discussed in the proposal paper) that would require in our view detailed consultation and workshopping to ensure that the most appropriate solution is developed. We would be happy to talk to you further about potentially collaborating on bringing together funders from across the charitable sector to contribute to more detailed discussions.

At this time, there are mixed views within our membership on whether there should be a minimum distribution requirement given the complexities of implementing this scheme to suit the diversity of funder situations. Nevertheless, comments are provided on options to inform policy consideration. We also hope that analysis will occur to test proposals against recent changes to the Trusts Act and Incorporated Societies Act.

Definition of a fundraising charity

We find the way the term “fundraising charities” is used in this paper to be confusing. Many charities fundraise to deliver their front-line activities. You state you are discussing charities who are distributing funding to achieve their charitable purpose. Is this the group of charities that under charities registrations are described in their main activities as “making grants or loans to individuals” and “making grants to organisations”?

Similarly, there is no definition in the paper of what “accumulated funds” might include – this would be helpful to clarify. For example, there is no reference to foundations who have invested donor funds in perpetuity and distribute at a rate relative to annual investment returns.

Accumulation of funds not a problem in itself

As mentioned above, accumulation of funds is often a necessary activity for many philanthropic and grant-making organisations to generate income for distribution to communities and philanthropic causes.

Depending on the breadth of charities captured by the definition of “fundraising charities” above, we are keenly aware that not for profits often need accumulated funds to cover charitable activities and services. Many are undercapitalised and are therefore vulnerable to disruption in income flows where they are over dependant on government funding and/or only several sources of private funding. An appropriate level of working capital allows time to source alternative funding without needing to make changes to operations.

We are not sure what evidence supports that a lack of information about what accumulated funds are being used for/when they will be distributed leads to undermining public trust and confidence in the charitable sector. However we understand that there may be regulatory concerns at this point that some organisations are not fulfilling their charitable purpose and that current reporting for Tiers 1-3 charities on accumulated funds may not provide enough information. We are not aware of the scale of this problem and in the appraisal of options, we do feel that the scale of the solution should be balanced against this.

Commentary on Option 3: Require fundraising charities to report reasons for accumulated funds in their annual return

Some points raised by our members for consideration:

- It should be noted that some endowment funds will report reserves that result from revaluation of investments and these valuations could be volatile.

- Some grantmaking organisations are particularly interested that large bequests or tagged donations are visible to them when assessing charitable organisations' applications for funding.

Commentary on Option 4: Require fundraising charities to have a funding distribution plan

Some points raised by our members for consideration:

- This option could guard against a lack of transparency in some private foundations who are accumulating funds and giving away little or nothing while taking the tax benefit.

- A related issue is seen to be where there is high spend on administrative costs and professional services fees with little distribution (and no transparency around recipients). This is of particular concern in relation to deceased estates where there is a question as to who holds trustees accountable for distributions.

- How often would these plans be able to be adapted to make way for changing times (especially useful to reflect on in our current volatile environment)?

- There is a practical concern around who at Charities Services could judge if plan is acceptable and how would distributions for charitable purpose be demonstrated?

- If this option proceeds, a simple to use template for a funding distribution plan would be helpful.

Commentary on Option 5: Require fundraising charities to distribute five per cent of their net assets per annum

As referenced earlier, we are not opposed to minimum distribution, however this is a complex option that requires careful consideration, with inherent risk to:

  - the long-term sustainability of business models;

- integrity of the application process (including if there weren't suitable candidates to receive funding);
- ability to respond in times of need through unexpected distribution in any given year (which could impact the years following) or enabling steady granting despite investments taking a dive – consider the global financial crisis and COVID-19 context; and
- strategic grant-making practice and impact investments spread over multiple years but paid in one lump sum or accumulated for future payment

We would not support this option as currently drafted and recommend that proposals need to be fully explored and tested with the sector. Some points raised by our members for consideration are:

- The rate of 5% is not seen to be appropriate to a low interest rate and low return environment. The 5% distribution figure used in Australia for some purposes was set a time of higher investment returns and higher inflation. If the required distribution rate is this high (5%) then it may well be above returns and impact the sustainability of endowment funds set up as perpetual. There may be times where a Board chooses to increase granting to meet particular needs e.g. COVID

- Any set rate of distribution would need to be appropriate to the New Zealand setting and different charity types (which was a key issue raised in a member survey PNZ ran in 2019) and reviewed post implementation. Our members' feedback suggested an annual distribution rate of between 2-3% of equity might generally be appropriate, having been modelled against historic market returns from conservative investment portfolios.

- If a minimum level of distribution was mandated then it could force charities to hold a riskier range of investments in order to generate higher returns. Riskier investments are by their nature more likely to be volatile in terms of capital returns, leading to volatility of capital values. Most charities, understandably, are averse to suffering capital losses, not least because their donors do not expect to see the value of their donations decline.

- It is unclear what net assets would represent, however it would be unreasonable to expect it is the total of assets less liabilities in a climate of low interest rates. This approach may also ignore the different types of assets that are held, including where they are held to achieve a social return.

- If a minimum distribution approach option is pursued, we must state again that there are strong views amongst our membership that this should sit alongside the implementation of a refund of imputation credit scheme for eligible organisations (who apply their funds wholly or mainly to charitable purposes within NZ), who invest in New Zealand companies and use Tiers 1-3 accounting standards (over $500k operating expenditure).

- Further to the point above, whilst Australia is referenced for having a minimum distribution rate in the DIA paper, the full context must be acknowledged i.e. they provide an imputation tax credit refund scheme (for those who can't use their credits).

- For Community Foundations and Community Trusts (and some other charitable trusts), it should be noted that a set distribution rate annually would present problems given their reliance on investment income and external influences out of the Foundations or Trusts' control such as the Global Financial Crisis, Christchurch Earthquakes, COVID where distribution rates were determined with the appropriate level of fiduciary responsibility.

- Charities can hold illiquid investments which don't produce a steady cash income. There would be no cash flow from which to pay a minimum distribution.

- Revaluations of land and buildings are reported as 'income' under many accounting standards, but such revaluations do not generate any cash. Where revaluations occur only every three years there can be large movements, without any cash income.

Charities with business activities

You mention that some submitters in the 2019 discussion document raised that the current approach for charitable business registration was arbitrary and without legal basis. We wanted to check that the current approach and application of case law has undergone a full and independent review. This seems a necessary first step before either maintaining or formally approving the current approach.

Other points raised by our members for consideration are:

- Option 3 sounds useful with more information being developed on the approach to charitable business registration requirements and the criteria used, and the process being set out in simple language

- In relation to this issue - all business decisions are inherently risky. If this risk needs to be managed, then there could be a requirement for a Risk Management Framework to be used for governance decision making. This could be basic to apply to small charities as well and be developed by Charities Services.

Reporting requirements for small charities

Overall, we support Charities Services and the Department of Internal Affairs working to find efficiencies in the way all charities need to report and how this information can be shared across Government (e.g. agreed data sharing arrangements, greater use of information available in the charities register, pre-populating forms etc).

In our last submission on the Charities Act, Philanthropy New Zealand also supported there being more assistance given to small charities to complete any reporting requirements (and potentially them having lesser reporting requirements depending on the detail of this proposal). This is represented in options 2, 3 and 5.

We acknowledge that XRB has just released a new template option for small charities which may contribute to addressing Option 2.

Other points raised by our members include:

- the current system is useful in that Charities Services applies a tiered system differentiating by scale which determines reporting standards for those wanting registered charitable status and an External Reporting Board sets those standards

- it would be useful to see more checks made on accuracy in reporting (with more support provided to organisations where errors identified, including ensuring that suitably qualified auditors are used)

We look forward to engaging with you on next steps.

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