Aged Care Association NEW ZEALAND

Aged Care Association submission to Inland Revenue's issues paper on 'Taxation and the not-for-profit sector'

March 2025

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About the Aged Care Association

This submission is from the Aged Care Association (ACA), the peak body for the aged residential care (ARC) sector in New Zealand.

New Zealand has over 670 aged residential care facilities, with more than 40,000 beds and 35,000 residents. In comparison, Te Whatu Ora oversees 10,748 public hospital beds.

Our members provide rest home, hospital, dementia, psychogeriatric, respite, and palliative care and care for around 700 younger people with disabilities.

Sixty six percent of beds are run by religious institutions, charitable trusts, family-owned, not-for-profits, and privately owned facilities. Most of the remaining beds are operated by listed companies (34 percent), with less than 1 percent provided by Te Whatu Ora.

Residents may be

- very frail and clinically unstable,
- well but disabled and have very high care needs,
- cognitively impaired or with mental health issues, with some requiring a secure environment,
- receiving end of life care.

Funding for aged residential care is a mix of means-tested user-pays and government subsidy.

Aged residential care providers are contracted by Te Whatu Ora to provide care services at a rate that is set annually.

We thank Vicki Ammundsen of Vicki Ammundsen Trust Law Limited for her advice and support in drafting this submission.”

The Association welcomes the opportunity to be contacted by Inland Revenue for further discussion.

Context

1. The aged residential care sector (ARC) is a core pillar in New Zealand's health system, providing shelter and care services to those with ageing related health issues who are assessed as needing care.
2. New Zealand has over 670 aged residential care facilities, with more than 40,000 beds and 35,000 residents. In comparison, Te Whatu Ora | Health NZ oversees 10,748 public hospital beds.
3. The aged residential care (ARC) sector provides care at four core levels - rest home, hospital, dementia, psychogeriatric and respite care for those above 65 years of age, and care for around 700 younger people with disabilities.
4. People 65 years and older are assessed by Te Whatu Ora | Health NZ's Needs Assessment and Service Coordination (NASC) service and allocated to one of four ARC care categories. The NASC assessor typically uses interRAI assessment tool to assess the person's current abilities, resources, goals and needs before advising a care plan and the type of support services a person may require, of which admission into ARC is one of the support services advised.
5. Multiple reports over the last decade have continued to draw attention to the reality that the daily (24-hour care) rates paid by Te Whatu Ora | Health NZ are manifestly insufficient to support the maintenance and refurbishment of older beds or the building of additional capacity for the recognised and documented number of New Zealanders who will need this care.
6. The Aged Care Association (ACA) is the peak body for ARC in New Zealand, representing over 90% of the sector via its membership.
7. Sixty six percent of the facilities we represent are owned and operated by religious institutions, charitable trusts, family-owned, not-for-profits, and privately owned facilities. The remaining facilities are operated by listed companies (34 percent of our membership). Across the sector of ARC provision, Te Whatu Ora | Health NZ provides less than 1 percent of the available residential care capacity.
8. We have drawn upon the submissions by Sue Barker of Charities Law Reform and Business NZ in drafting this submission.

Key points of submission

9. This submission is from the ACA and its members, representing a significant portion of the ARC sector in Aotearoa New Zealand. Our members are deeply committed to providing high-quality care and support to older people, with **one in five member facilities operating as not for profit**. We appreciate the opportunity to provide feedback on the Inland Revenue issues paper on taxation and the not-for-profit sector, dated 24 February 2025.

10. The ACA and its members recognise the importance of a fair and effective tax system. We also believe it is crucial that the tax treatment of the not-for-profit sector, and in particular charitable aged care providers, appropriately reflects the significant contribution this sector makes to the well-being of New Zealanders and the broader society.
11. We have carefully reviewed the issues paper and have significant concerns regarding a number of the proposals. We believe that some of these proposals are **based on underlying assumptions that do not accurately reflect the realities of the charitable aged care sector** and could have far-reaching and unintended negative consequences for our members, the people they care for, and the wider community.
12. This submission will address key areas of concern raised in the issues paper, drawing on the principles of charities law and the unique operational environment of aged care providers operating as not-for-profits. We will also highlight alternative approaches that we believe would be more appropriate and effective.
13. This submission reflects the perspectives of three key parts of our sector:
    a. **The Association itself:** As a not-for-profit industry body, which currently represents over 90% of the aged residential care sector in the country through its membership.
    b. **The Association's education trust arm:** A registered charity focused on training and education within the aged care sector. Since 2018, the ACA Education Trust has played a critical role in providing professional development and knowledge-sharing to the ARC workforce (including care workers, registered nurses and facility managers), who often find limited training opportunities that are specific to the aged residential care sector.
    c. **Association's members:** ACA's membership is made up of a cross-section of aged care facilities, which includes small to large, rural and urban, publicly listed and charitable providers. Approximately 20.4 percent of our membership are facilities that are registered not-for-profits and charities delivering essential aged care services.

Charity business income

14. We note that the issues paper raises concerns about potential competitive advantages gained by charities through tax exemptions and the accumulation of funds. However, it is crucial to acknowledge the fundamental principles underpinning the tax exemptions afforded to charities. **These exemptions are not intended to provide an unfair advantage but rather to recognise the public benefit provided by charitable organisations** and to support their ability to further their charitable purposes.
15. The charitable sector, including aged care providers, contributes significantly to social capital, social cohesion, and societal trust. This contribution extends far beyond the direct services provided and strengthens the fabric of our society. As noted by Sue Barker Charities Law, the **charitable sector also plays a role as risk takers in the provision of basic social services**, often innovating and addressing needs that the public sector cannot readily meet.

16. The independence of charities is also a critical aspect to protect. Just as Inland Revenue does not dictate how businesses should operate, it is equally important that legal and policy settings do not unduly direct charities in how they further their charitable purposes.
17. The Association is concerned that some of the proposed changes appear to be based on evidence of a problem within a very specific set of charities. But the proposals stand to affect the wider sector, including the aged care sector. The Issues Paper, while inviting feedback, creates uncertainty for our members who are dedicated to providing essential care services.
18. We strongly believe that some of the points of consideration suggested in the paper would create challenges and problems for the wider sector. It is our firm belief that **strengthening compliance of the existing rules should sufficiently address existing issues** within the charity sector without having to introduce new changes and uncertainty.

Accumulation of Funds

19. The issues paper expresses concern about the accumulation of funds by charities.
20. However, it is important to note that for several charitable organisations, accumulated funds are important to ensure the sustenance of their service delivery.
21. For charitable aged care providers, the ability to accumulate funds is often **essential for long-term sustainability and the continued provision of high-quality care**. The aged care sector is characterised by:
    a. **Significant capital expenditure:** Building and maintaining aged care facilities requires substantial upfront and ongoing investment. Accumulating funds allows providers to plan for future capital projects, upgrades, and the replacement of aging infrastructure.
    b. **Long-term planning:** Providing care for an aging population necessitates a long-term perspective. Charities need to be able to accumulate funds to ensure their financial viability and ability to meet future needs.
    c. **Volatile profitability:** The aged care sector can be subject to fluctuations in funding, wage increases, occupancy rates, and operating costs. Retaining capital provides a buffer against these uncertainties and ensures the continuity of care.
    d. **Social enterprise models:** Many charitable aged care providers operate with a social enterprise model, where surpluses are reinvested to further their charitable purposes. Restrictions on accumulation would directly impede this model and their ability to grow and adapt.
22. Accumulated funds have been critical for the charities in aged residential care, particularly as the government's funding have been notably low to meet the actual cost of operations.[1]
23. The ARC sector has also shared their frustrations with inability to access bank loans for refurbishments and other capital investments, due to this poor funding and, often, loss-making nature of their operations.[2]

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[1] Sapere (2024). A review of aged care funding and service models

[2] Ansell Strategic (2023). New Zealand Aged Residential Care Financial Performance Study – Summary of Findings

24. Accumulated funds have helped them navigate such an uncertain financial ecosystem while ensuring that critical services remain available for our kaumatua. We would like to draw these realities to the attention of Inland Revenue so that they are aware about the different ways in which accumulated business income is used in the ARC sector and ensure that an updated policy does not hinder these efforts.
25. We, therefore, strongly disagree with the underlying assumption in the issues paper that charities do not further charitable purpose until they distribute funding. **Accumulating funds for legitimate future charitable activities is itself a responsible exercise of fiduciary duty**, allowing charities to strategically plan and maximise their long-term impact. Trustees have a duty to act in the best interests of their charitable purposes, which may well involve the prudent retention of capital.
26. The suggestion that the default setting for charities should be distribution **fails to recognise the diverse nature and long-term objectives of many charities**, including those in the aged care sector with intergenerational goals.
27. Rather than imposing arbitrary rules on accumulation, a better approach would be to **rely on the existing fiduciary duties of charity trustees**, the **transparency provided by the charities register** and the role of Charities Services, Ngā Ratonga Kaupapa Atawhai, which we respectfully submit is better and more properly placed to monitor charities. Tax charities are already required to provide comprehensive information about their income and expenditure, which is publicly available. This allows for scrutiny by stakeholders, including donors and the public. If there are concerns about a particular charity unduly hoarding funds, these can be addressed through questioning by Charities Services, informed by the information on the register.
28. Inland Revenue itself acknowledged in its 2001 discussion document that removing the business income tax exemption "might not be necessary if accumulations were monitored". The comprehensive information now available on the charities register provides the basis for such monitoring.

Business Income Tax Exemption

29. The issues paper appears to be reconsidering the business income tax exemption for charities.
30. Most importantly, if the tax exemption for unrelated business income is to be reviewed, it is crucial that the definition of "unrelated business" is narrowly and clearly defined. **Activities undertaken to directly fund and support charitable purpose should not be deemed "unrelated business," even if they generate some revenue to offset costs.** Clear guidance and consultation with the sector will be essential to avoid ambiguity and unintended consequences. The alternative is to dramatically skew options for generating business income on an entirely unprincipled basis that would essentially amount to Inland Revenue dictating how charities operate.
31. The case of *Commissioner of Taxation of Australia v Word Investments Ltd* highlights the complexities of defining "charitable institution" in the context of business activities. The

Australian High Court recognised that a business run by a charity to raise funds for its charitable purposes could still be considered a charitable institution.

32. We note that Inland Revenue's interpretation statement IS 24/08, which comments on the business income exemption. While we understand the need for clarity, we believe that any changes to the current exemption must **carefully consider the operational realities of charitable aged care providers**, where additional income outside of providing care services mentioned in ARRC, is inherently linked to their charitable purpose.
33. Concerns about unfair competitive advantage are not well-founded. As the 1995 Australian Industry Commission report found, the income tax exemption does not necessarily provide charities with a competitive advantage in terms of either pricing or expansion. Charitable aged care providers often operate in a complex funding environment, with government contracts that may only partially cover the cost of providing services.
34. Taxing the business income of charities may **further exacerbate the financial pressures** faced by the charitable sector and **undermine their ability to provide much-needed housing and care** for older people.
35. For many charitable aged care providers, income generated from providing additional services (which may be considered a business activity) is integral to their ability to fund their charitable purposes. Any move to tax this income would reduce the resources available for direct care and support for older people.
36. The ARC sector has been historically underfunded, with various government reviews attesting to the same. A recent study had noted a decrease in financial performance of 83% between 2017 and 2023, with no signs of improvement, with at least 44% of care homes in NZ making a loss.
37. Adding premium charges (additional charges for a room that has features that are NOT required under the Age Related Residential Care Agreement (ARRC)), have been a standard practice followed by nearly 95 percent of all facilities to help bridge the funding gap between government funding and the actual cost of care.[3]
38. However, it is worth noting that only 63 percent of individually owned charitable care facilities charged accommodation supplements or premium charges in 2023.[4] This ensures the availability of standard rooms which are affordable for the subsidized residents in care.
39. Additional income, which could be seen as 'unrelated business income' depending on how it gets defined, could include premium charges, income from operation of cafes, op-shops, retirement or rental villages, and other activities have been a vital source of funds for the providers to keeping the ARC facilities running. **Many of our members have attested to how critical these business incomes have been for cross subsidising the cost of care in ARC**.
40. An ideal outcome would be to have the government adequately funding the cost of care and operations for ARC. But in its absence, business incomes are critical sources of funds for the sector to serve its charitable purpose.

[3] Aged Care Association. Aged residential care sector profile 2024

[4] Aged Care Association. Aged residential care sector profile 2024

Practical implications if the tax exemption is removed for charity business income

41. Speaking for the aged residential care sector specifically, we believe that if tax exemption is removed, it would create an additional financial burden on the not for profit providers.
42. Taxing charity business income could compel facilities to increase their premium rates, which would further widen inequity in access to ARC. It would also reduce access to supplementary funds to help sustain the quality of care they deliver in the ARC facilities, or their ability to reinvest for renovation and improvements.
43. This could also increase the facilities' dependency on increased government funding to sustain their operations. In the absence of this, we could potentially see more closure of beds, which would cripple New Zealand's healthcare system.

Taxation on member subscription

44. The Association is deeply concerned about the potential implications of the view presented in the paper that trading and other normally taxable transactions with members, including some subscriptions, are taxable income. This would represent a significant shift in the tax treatment of membership subscriptions for many not-for-profit organisations like the Association, where member subscriptions primarily cover operating costs, and could negatively impact their financial sustainability and their ability to represent and support their members.
45. For the Association, taxation on member subscription would compel us to increase membership rates to mitigate any loss in operating costs. This in turn could affect the ability of our members, over 60 percent of which are small and medium providers, to continue with their membership.
46. We strongly oppose the proposition and believe that taxing subscription income would impose additional financial strain on the ARC sector, and limit our ability to adequately represent a cross-section of the sector. It would also affect our capacity to invest in advocacy, research, training, and engagement, all of which have been critical to supporting the sector.

Minimum Distribution Requirements

47. The proposal to impose minimum distribution requirements on charities is a significant concern for the ACA and its members. This option was **strongly opposed by stakeholders** during the review of the Charities Act, as noted by the Department of Internal Affairs (DIA).
48. Imposing mandatory distribution requirements would be **inflexible** and **fail to recognise the careful planning and long-term objectives** of charitable aged care providers. It could:
    a. **Damage perpetual funds** by requiring the distribution of more funds than are available in a given year.
    b. **Adversely impact efforts to support the long-term prosperity** and sustainability of aged care organisations.
    c. **Fail to account for the specific capital needs and cyclical nature** of the aged care sector.

d. **Be arbitrary** and not reflect the diverse operational models and strategic goals of different aged care charities.

49. Defining an appropriate baseline for minimum distribution, such as a percentage of net assets, is also problematic. "Net assets" may not be an accurate indicator for various reasons, and an arbitrary percentage could be **short-sighted** and too high, particularly in a low-interest rate environment.
50. The experience of other jurisdictions with minimum distribution requirements, such as Canada, highlights the complexities and potential negative consequences of such regimes. The Ontario Law Reform Commission noted that there are other ways to ensure that charitable resources are devoted to charitable purposes, such as **enforcing fiduciary duties**.
51. We believe that **New Zealand should learn from the experiences of other jurisdictions** and avoid imposing restrictive measures that could harm the charitable aged care sector.

Donor-Controlled Charities

52. The issues paper also focuses on "donor-controlled" charities, raising concerns about potential tax avoidance. While we acknowledge the need to address any genuine instances of abuse, we believe that **existing provisions in the Income Tax Act 2007**, such as section CW 42(1)(c) and (5)-(8), which can remove the business income tax exemption if a controlling person can direct funds to their benefit, already provide safeguards.
53. Furthermore, the **rigorous registration process for charities**, including Charities Services' strict approach to conflicts of interest, acts as an initial filter against potential abuse.
54. Any new measures targeting donor-controlled charities should be **carefully targeted and proportionate**, ensuring they do not inadvertently penalise legitimate charitable activities within the aged care sector that may involve donor contributions and governance.

Refundability of Imputation Credits

55. New Zealand charities have long advocated for the refundability of imputation credits. The current non-refundability **discourages investment by charities in New Zealand companies**.
56. Australia has allowed the refunding of surplus imputation credits to charities since 2000, creating an inconsistency between the two countries.
57. Making imputation credits refundable would **remove a significant barrier to investment** by New Zealand charities, including aged care providers, and provide additional funds that could be directed towards their charitable purposes. Despite Inland Revenue raising concerns about fiscal cost, there has been no analysis comparing this cost with the associated benefits.

Fringe Benefit Tax (FBT)

58. The issues paper again raises the possibility of removing the FBT exclusion for charitable organisations. This exclusion recognises the **unique circumstances of the charitable sector** and the challenges charities face in attracting and retaining staff, often with limited resources.

59. Removing the FBT exclusion would **increase the operating costs** for charitable aged care providers, potentially impacting their ability to deliver services and retain valued staff.
60. Concerns that the FBT exemption provides an unfair competitive advantage appear overstated and appear to overlook the significant difficulties charities have in attracting and retaining staff and has inference that staff employed by charities should accept lower pay due to the employer's charitable status.
61. We support the need to modernise FBT and reduce compliance costs, as highlighted in Inland Revenue's regulatory stewardship review. However, we believe that the **current exclusion for charitable organisations should be retained** due to the vital role they play and the financial constraints they often face.

Volunteers

62 We support the issues paper's proposal to treat honoraria payments for volunteers as salary and wages to reduce compliance costs. Volunteers are the backbone of many charitable aged care organisations, and any measures to simplify tax compliance for them are welcome.

63 We also note the previous consideration of introducing a tax rebate or grant for individuals who donate their time to charities. Such initiatives could further **recognise the vital contribution of volunteers** to the aged care sector and encourage more people to give their time.

Consultation Process

64. We have significant concerns about the **abbreviated consultation period** for this issues paper, particularly given the breadth and potential impact of its proposals. The fact that the consultation period ends on 31 March, coinciding with the financial year-end for many charities, further limits the ability of the sector to provide comprehensive feedback.
65. We urge Inland Revenue to ensure that the consultation process is **genuine and allows for meaningful engagement** with the charitable sector. The Generic Tax Policy Process (GTPP), which emphasises early and informed consultation, should be properly followed.

Conclusion and Recommendations

66. The ACA and its members believe that the issues paper raises important questions but that several of its underlying assumptions and proposed solutions **do not adequately consider the unique operating environment and fundamental principles of the charitable aged care sector**.
67. We are deeply concerned that some of the proposals, such as restricting the accumulation of funds and removing the business income tax exemption, could **significantly undermine the financial sustainability of charitable aged care providers** and ultimately **negatively impact the care and support available to older people in New Zealand**.
68. **We strongly recommend that Inland Revenue:**

a. **Retain the current business income tax exemption for registered charities**, recognising the integral role that income-generating activities play in funding charitable purposes in the aged care sector.
b. **Not proceed with the proposal to impose mandatory minimum distribution requirements on charities**, as this would be inflexible, potentially harm long-term planning, and fail to recognise the diverse needs of the sector. Instead, rely on existing fiduciary duties and the transparency of the charities register.
c. **Retain the FBT exclusion for charitable organisations**, acknowledging the financial constraints faced by the sector in attracting and retaining staff.
d. **Support measures to simplify tax compliance for volunteers**.
e. **Undertake a more thorough and genuinely consultative process** regarding any potential changes to the taxation of the not-for-profit sector, ensuring adequate time for feedback and proper consideration of the diverse perspectives within the sector.
f. **Consider the potential benefits of refunding imputation credits to charities**, which would remove a disincentive for investment and provide additional resources for charitable activities.
g. **Ensure that any measures targeting "donor-controlled" charities are carefully targeted and proportionate**, avoiding unintended negative consequences for legitimate charitable activities.

69. If an updated policy regime makes it tougher for a not-for-profit or charity to operate, we could potentially end up losing thousands of services run by these charities which has helped reduce pressure on the public system for decades.
70. The aged care sector, and especially its not-for-profit members, are effectively subsiding the provision of health care in New Zealand. 8000 of the 35000 beds in ARC in the country are run by not-for-profit organisations.
71. If the Government does change the rules for not for profits and charities, the real cost of providing care would become a lot more apparent with crippling consequences for the health systems in the country. There is no doubt the any increase of in the tax burden on already struggling not for profit providers will shift the cost of care for our elders onto the public hospital system – at cost of at least $1700 per day.
72. Private providers of aged care that top-up government funding with retirement village revenue are already leaving the market. If these changes force kaupapa-driven not-for-profits from the sector it will be a disaster.
73. We believe that a collaborative approach, based on a clear understanding of the charitable sector and its vital contributions, is essential to developing fair and effective tax policies. The ACA and its members are willing to engage further with Inland Revenue to discuss these issues in more detail.