



8 September 2014

Get the Regulations right – or start over?
Taxation of community housing entities

Community Housing Organisations (CHOs) are operating under great uncertainty of their income tax status. While most organisations continue to be income tax exempt under the Charities Act, the Taxation (Annual Rated, Employee Allowances and Remedial Matters) Act 2014 set an April 2015 deadline by which Charities Services must review all organisations operating with housing as a purpose. At the current time, regulations have not been set for the Tax Act 2014 to establish the thresholds for the new form of income tax exemption, as a Community Housing Entity (CHE). For one organization, QLCHT, this ongoing uncertainty means it is no longer tax exempt as a charity, and yet cannot confirm it is tax exempt as a CHE – until the regulations are set. If this situation were to occur for other organisations in the sector that become deregistered through a change in policy -no fault of their own- they face further setbacks that take significant time and resource that would better serve local housing need.

Actions to take

We see the need to test two options:

- adjustments to the Charities Act that bring the community housing sector clearly within a charitable tax exemption; or,
- adjustments to the Tax Act that extend the grace period and that either remove the use of a household income test, or find a better test than the lower quartile household income currently in the Act.

We propose that government pause before implementing regulations called for under the Taxation (Annual Rated, Employee Allowances and Remedial Matters) Act 2014 (hereafter referred to as the Tax Act). Were such regulations to use the Accommodation Supplement as the household income test, the outcome would be fraught and lead to an extremely complicated and expensive compliance regime for both Government and CHOs. The consequence would force organisations to restructure into three sets of entities:

- tax paying entities
- tax exempt CHEs (under the new Taxation Act)
- charities (under the current Charities Act)

This would mean a significant increase in the complexity (and overheads) of trying to run an organization with 3 component organizational structures, each with its own tax considerations and legal constraints. Doing so would increase the cost to government as well.

Is the Charities Act review an option?

We ask that this option remain on the table- as we are still of the view it is a less costly compliance solution and offers a more effective outcome. Habitat for Humanity and others are of the view that there are significant benefits to using a charity-based form of tax exemption, to provide continuity to the foundations, businesses, volunteers, and donors that help it deliver \$1 to \$2 of housing for every \$1 of government support. In the past year they logged over 29,000 hours of volunteer labour, and significant donations of materials. Such community contributions are an essential part of the housing supports they provide to the community, and sit alongside the homeownership programmes they offer.

It is unclear whether community contributions will be as forthcoming under the CHE form of tax exemption, which cause the following concerns:

- The probability that some, if not most granting trusts and foundations may not be constitutionally able to grant funds to organisations that are not registered as ‘charities’.
- A concern that the public will be less likely to support organisations that are not registered as ‘charitable’. Included in this would be response to direct mailer appeals and bequests.
- Possible reduction in preparedness of the corporate sector to offer gifts in kind, pro bono work, sponsorships, volunteer teams, etc.
- Potential for reduction in levels of support from other community organizations such as Rotary and Lions Clubs, churches, schools and prisons, all of whom we receive support from currently.

We think this makes for a very strong case for amending the Charities Act so all activity delivered by registered CHOs would be confirmed as tax exempt.

We do appreciate the amount of effort that government has expended in establishing the parallel CHE framework but a workable solution has still not been found. It therefore seems prudent to look at the Charities Act, and fix the issue that has arisen from the de-registration of Queenstown Lakes Community Housing Trust five years ago.

What would a fix to the Tax Act look like?

If amendments to the Charities Act are not viable, then we suggest there is a strong basis for setting the regulations for the new Community Housing Entity (CHE) income tax exemption at levels that do not require reference to the household incomes of the families who benefit from such housing. The Tax Act already includes a requirement that all surpluses are directed toward the objects of the organisation – to deliver community housing, and prevents their use for private pecuniary gain. We think this is the essential test- and an adequate protection for the crown- when combined with effective monitoring by the Community Housing Regulatory Authority (CHRA). The Tax Act already provides for this.

If a household income test must be included, then it makes sense from our perspective to align it with Welcome Home Loan and the Kiwisaver home deposit/Homestart programmes. It is a positive step to

hear the Government announcements of 24-25 August 2014 which expand their effectiveness. Making housing affordable for low and moderate income New Zealanders requires multiple actions, which are well coordinated.

We think there is a direct connection between the success of government's Welcome Home Loan and Homestart programmes, and what community housing organisations, are doing in projects like Waimahia Inlet. Delivery through registered CHOs ensures maximum retention and recycling of public investment. New developments need to include crown investment like the \$29M investment in Waimahia Inlet, tools like Welcome Home Loans and the value chain efficiencies that the Tamaki Makaurau Community Housing partnership are achieving.

The regulations for the new Community Housing Entity (CHE) income tax exemption need to be set at levels that support growth and innovation and the government social housing reform programme. CHEs should be able to deliver housing to families eligible for Welcome Home Loan and Homestart – which means the household income test (\$80,000 per annum for a single borrower and \$120,000 for two borrowers) and asset tests for CHEs needs to be set at the same upper limits as these two government programmes. Yet it has been proposed that the income levels and asset tests may be much lower creating significant risks and barriers for CHO and their ability to deliver mixed tenure, mixed income developments- a hallmark of what the housing reforms are trying to achieve.

Amendments to the Tax Act also need to provide more time for Charities Services to conduct its reviews. Given the delays in setting regulations, organisations will need more time to complete their charitable status review, and potential de-registration, to achieve tax exemption under the CHE provisions. Referred to as the 'grace period' in Section 129 of the Tax Act, we propose this period is extended to April 2016 before retrospective tax penalties would apply for failure to retain tax exemption.

What are the risks to government of such an alignment?

We hear concern that the CHE provisions, if set at the Welcome Home Loan and Homestart levels, will lead to a rapid use of the CHE provisions to deliver a wider segment of the housing market supply, undermining the tax base.

That concern can be addressed in two ways:

- Monitoring that only registered CHEs (through Community Housing Regulatory Authority) use the provisions.
- Undertaking analysis on whether this concern would occur in practice, so long as the requirement for registered CHEs is part of the process.

If this risk were real, then we would have thought there would be evidence of tax avoidance when delivering entry-level housing. Instead it appears the market has responded in exactly the opposite way- by building larger, more expensive houses, which have higher profit margins-which of course generate more taxable income. Since there appears very little incentive – e.g. profit - to deliver homes at price points affordable to low and median income families, then clarifying that such housing can be delivered by tax exempt CHEs should not pose any significant risk.

Proposed steps

We ask that government commit to the following:

- 1) Undertaking analysis on what the potential reduction in the tax take would be if regulations allowed CHEs to deliver housing to families eligible for Welcome Home Loan & Homestart, measured against the cost of the more complicated compliance structure- for both CHOs and government.
- 2) Analysis on the regulation settings required to ensure that all CHOs currently at risk can be confirmed as tax exempt – including Queenstown Lakes Community Housing Trust, Habitat for Humanity, Marlborough Sustainable Housing Trust, New Zealand Housing Foundation and all Tamaki Makaurau Community Housing partners in the Waimahia Inlet project.
- 3) Prepare amendments to the Income Tax Act – for November 2014- that include:
 - a. Amend Section 129 regarding HR12 - non-exempt income, providing an extension of the Grace Period from April 2015 to April 2016, to ensure adequate time for organisations to complete the Charities Services review, and have adequate time to achieve compliance with the new regulatory environment before penalties apply.
 - b. Amend Section 225D(2) regarding the household income test - and the regulations required as a result of the work set out above.

We look forward to working with Ministers and officials to achieve a solution that works for the long term.