**Submission**

**by**

**to Inland Revenue**

**on the**

# IRD Issues Paper:
# Taxation and the not-for-profit sector

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## 1. INTRODUCTION AND SUMMARY

1.1 This submission on Question 12 of the Inland Revenue issues paper *Taxation and the not-for-profit sector* is made by The New Zealand Initiative (the Initiative), a Wellington-based think tank supported primarily by major New Zealand businesses. In combination, our members employ more than 150,000 people.

1.2 The Initiative undertakes research that contributes to developing sound public policies in New Zealand. We advocate for the creation of a competitive, open and dynamic economy and a free, prosperous, fair and cohesive society.

1.3 The Initiative's members span the breadth of the New Zealand economy; independent, rigorous public policy research is crucial for effective governance and economic prosperity. The views expressed in this submission are those of the author rather than the New Zealand Initiative's members.

1.4 The New Zealand Initiative strongly recommends retaining the income tax exemption for bodies promoting scientific or industrial research (Section CW 49) as it applies to independent public policy think tanks. The exemption is not a historical anachronism but remains vital to New Zealand's policy development ecosystem.

1.5 This submission addresses Question 12 of the Issues Paper, which asks about the implications of removing or significantly reducing the exemption for bodies promoting scientific or industrial research.

## 2. STRUCTURAL IMPORTANCE OF THE RESEARCH BODY EXEMPTION

2.1 Section CW 49 of the Income Tax Act 2007 serves a crucial structural purpose in New Zealand's knowledge ecosystem by supporting organisations that produce public benefit research. The exemption recognises that independent research constitutes a public good that would be undersupplied without appropriate policy frameworks.

2.2 Independent research bodies like the Initiative operate on a fundamentally different model from commercial entities. They:

- generate knowledge primarily for public benefit, not private gain.
- publish research findings freely and openly.
- operate without pecuniary gain to members, shareholders, or associates.
- reinvest any surpluses into future research activities

2.3 For these organisations, income is not profit in the commercial sense but rather the means to fulfil their research mission. Taxing such income would directly reduce the resources available for research and public engagement without serving the usual redistributive or behavioural functions of taxation.

2.4 The regulatory requirements for qualification under Section CW 49, including approval by the Royal Society of New Zealand and the prohibition on pecuniary gain, already provide robust guardrails to prevent abuse of the exemption.

## 3. THE RESERVE-BUILDING FUNCTION

3.1 A critical but often overlooked aspect of the research body exemption is that it enables organisations to build and maintain financial reserves. This capability is not an incidental benefit but core to their function for several interconnected reasons:



3.2 **Independence protection:** Financial reserves are essential for maintaining genuine independence in research. Without adequate reserves, research organisations become vulnerable to financial pressure from funders, government funding shifts, or other external influences that could compromise research integrity.

3.3 **Income volatility management:** Research organisations typically rely on membership subscriptions, grants, and donations that can fluctuate significantly with economic conditions. The Initiative experienced this firsthand during the COVID-19 pandemic, when some member organisations faced financial constraints. Reserve funds allowed research work to continue uninterrupted despite temporary revenue declines.

3.4 **Long-term research capacity:** Complex policy challenges require sustained, multi-year research programs. Reserves enable organisations to commit to and complete longer-term research initiatives that might otherwise be abandoned during funding fluctuations.

3.5 Taxing the income of research organisations would effectively function as a tax on building reserves, undermining these crucial functions while generating minimal fiscal benefit. This would be counterproductive to the very purpose the exemption serves – ensuring New Zealand has robust, independent research capacity.

## 4. FISCAL CONTEXT AND POLICY COHERENCE

4.1 From a fiscal perspective, the current exemption for research bodies creates a coherent, principles-based approach to taxation that recognises the distinctive role of knowledge production in society. This principle remains as valid today as when the exemption was established.

4.2 The revenue gain from removing this exemption would be minimal. There are relatively few organisations that qualify under Section CW 49's stringent criteria, and most operate with modest surpluses that are reinvested in research activities. However, the impact on the research capacity of affected organisations would be disproportionately large.

4.3 It is worth noting that investment income (such as interest and dividends) earned by these organisations on their reserves is already subject to taxation. The current system thus strikes a reasonable balance: core operational income used to conduct research and build essential reserves is exempt, while passive investment earnings are taxed.

4.4 Removing the exemption would create an inconsistent policy approach, where government directly funds some research through universities and Crown Research Institutes while simultaneously taxing the operational income of independent research organisations pursuing similar public-interest work.

## 5. RISKS OF REMOVING THE EXEMPTION

5.1 Removing the research body exemption would pose serious risks to New Zealand's knowledge infrastructure and policy development capacity. Key concerns include:

5.2 **Reduced research output:** Every dollar diverted to tax is a dollar less for researching solutions to pressing national challenges. Organisations would need to reduce research staff, publish fewer reports, or limit public engagement activities.

5.3 **Compromised independence:** With reduced ability to build reserves, research organisations would become more vulnerable to shorter-term funding pressures, potentially compromising the independence that is their core strength.

5.4 **Diminished policy innovation:** Independent research bodies often explore ideas outside the political mainstream and initiate debates that government agencies may be reluctant to pursue. Weakening these organisations would narrow the "marketplace of ideas" that drives policy innovation.

5.5 **Unintended consolidation:** Larger organisations with diversified funding streams might absorb the impact, while smaller research bodies with focused missions could become unviable, leading to unhealthy concentration in the research sector.

## 6. CONCLUSION

6.1 The tax exemption for bodies promoting scientific or industrial research (Section CW 49) remains a vital structural element of New Zealand's knowledge ecosystem. It enables independent research organisations to build necessary reserves, maintain genuine independence, and contribute meaningfully to policy development and public discourse.

6.2 The exemption represents sound, principles-based tax policy, recognising the public good nature of independent research and the non-profit operating model of qualifying organisations. The fiscal cost is minimal, while the public benefit is substantial.

6.3 We strongly urge that the tax exemption for bodies promoting scientific or industrial research (Section CW 49) be retained in full. Removing it would yield negligible fiscal upside but pose significant risks to independent research capacity, policy development, and the quality of public discourse in New Zealand.

**ENDS**