THE FUTURE OF THE MĀORI AUTHORITY REGIME IN NEW ZEALAND

Peter Muzariri* & James Adams†

Companies, trusts, and other entities that hold Māori land or assets returned as part of a Treaty of Waitangi settlement can elect to be treated as a Māori authority for income tax purposes. This brings various benefits, but these benefits are not available to wholly owned subsidiary companies of Māori authorities. This article discusses how this has given rise to an accumulation of unusable tax credits by Māori authorities and incentivised them to use alternative corporate forms. It concludes by recommending a legislative change that would remedy this issue, although it also identifies various related issues that are less clear-cut.

I Introduction

This article discusses a recent recommendation by the Tax Working Group on the taxation of Māori authorities in New Zealand. At present, some entities that own Māori land may elect to be treated as a Māori authority for income tax purposes. This brings several benefits, including an income tax rate of 17.5 per cent, tax-free distributions made from capital gains, and tax credits that can be refunded to members if unused. However, these benefits are not generally available to subsidiaries, whether wholly owned or not, of Māori authorities. A company that is wholly owned by a Māori authority therefore pays income tax at the ordinary company rate of 28 per cent and passes on a tax credit for this amount to its parent authority.

In practice, Māori authorities are accumulating more tax credits than they can use or pass on. But because Māori authorities may only distribute tax credits to members at or below a prescribed rate, these additional credits are of little use to an authority.

* BCom, LLB(Hons), University of Auckland.
† BA, LLB(Hons) student, University of Auckland.
The authors wish to acknowledge Professor Michael Littlewood for his support.

They are effectively subject to a higher tax rate, and it is unlikely that Parliament intended this to be the case. The Tax Working Group has therefore recommended that the 17.5 per cent Māori authority income tax rate be extended to wholly owned subsidiaries of Māori authorities.

This article supports that recommendation. It explains the issue in some detail, and also discusses various related issues, including the use of alternative corporate entities by Māori authorities, the justifications for the regime in general, and the default rate of Resident Withholding Tax (RWT) that applies to Māori authority distributions. The article concludes by showing why the Tax Working Group's proposal is consistent with the principles that underpin the Māori authority regime.

II Māori Authorities

A Background

Parliament has recognised the need for special tax treatment of Māori land.[1] This is appropriate given the significance of land to Māori, both within Māori culture and to the redress provided by the Crown for historical wrongs. Specifically, keeping land in Māori ownership allows for the strengthening of genealogical connections between people, their ancestors, and the land. It also provides a place for important cultural practices to be observed.[2] Settlements for breaches of the Treaty of Waitangi by the Crown have often included the return of land, and if this were taxed at a high rate, that is likely to be seen as undermining the Crown's commitment to remedying past wrongs.

New Zealand's tax system has not always treated Māori land fairly. The Native Land Act 1931, for example, prevented income derived by certain Māori organisations on behalf of their members from being used to meet the members' tax liability.[3]

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1 Dating back to the Land and Income Tax Act 1923, s 71(1), which provided that "native freehold land" would be exempt from tax where it was occupied by its native owner or their trustee. This article focuses on the current iteration of this intention: the Māori authority regime.

2 Tanira Kingi "Maori land ownership and economic development" [2009] NZLJ 396 at 396–397.

3 Native Land Act 1931, s 550(1)(b).

The result was that Māori often needed to find another source of funds to meet their income tax obligations, separate from the income which gave rise to that liability. This iniquitous rule was reversed six years later by the Land and Income Tax Amendment Act 1939.[4]

The Income Tax Act 1976 was the first to use the term "Māori authority", as well as to prescribe specific rules for Māori authorities of different sizes.[5] Later, these rules were simplified and a lower income tax rate (of 19.5 per cent) was introduced.[6] This was intended to reflect the low personal tax rates that applied to the majority of individuals deriving benefits from Māori authorities.[7]

In 2004, for example, when Parliament reconsidered the regime, most members of Māori authorities at the time had annual incomes below $38,000 and therefore paid income tax at 19.5 per cent.[8] If income from Māori authorities was taxed and withheld at this rate, the majority of members would have no additional income tax obligations arising from distributions received from Māori authorities. However, if Māori authorities were taxed at a higher rate, Inland Revenue would have to refund a large number of taxpayers for the difference in tax rates. Alternatively, if no refunds were available, this would create a serious inequity, as income from Māori authorities would effectively be subject to a higher rate of tax than other income. Today, these two factors — the need for special treatment of Māori land and the low incomes commonly received by Māori — remain the primary justifications for the Māori authority regime.

It should also be noted that Māori authorities differ from other corporate entities in a number of ways. There are currently over 5,000 Māori authorities, and they vary

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4 Land and Income Tax Amendment Act 1939, s 29.
5 Income Tax Act 1976, ss 234–240.
6 Income Tax Act 2004, sch 1, pt A, cl 2.
7 Charmaine Edward and Audrey Sharp "The Taxation of Māori Authorities" (2003) 9 NZJTLP 287 at 300–302.
8 Taxation (Annual Rates, Maori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Bill (213-2) (select committee report) at 5–7.

significantly in size.[9] They tend to pursue political, cultural and social objectives in addition to their commercial activities. This includes providing financial and non-financial services, such as donations that support the education or health of their members. Māori authorities are also constrained by specific legislation on Māori land, as well as by their own rules. In short, although Māori authorities are like companies in some respects, their unique tax treatment reflects important differences.[10]

B The Māori Authority Regime

The Māori authority rules are contained in subpart HF of the Income Tax Act 2007 (ITA). A Māori authority is an entity that is eligible to be a Māori authority under s HF 2 and has made an election to become a Māori authority under s HF 11.[11] Requiring eligible entities to elect to be treated as a Māori authority makes it easier for Inland Revenue to keep track of which entities are Māori authorities, which would be difficult to achieve if all eligible entities automatically came within the scope of the regime.

Companies, trusts and a selection of specific entities are eligible to become Māori authorities.[12] The entity must also own land that is subject to Te Ture Whenua Māori Act 1993, or receive and manage assets that are transferred by the Crown as part of the settlement of a claim under the Treaty of Waitangi (or be contemplated by the deed of settlement as performing such functions). Somewhat different qualifying rules apply to specific entities, such as mandated iwi organisations recognised under the Māori Fisheries Act 2004.

Māori authorities are taxed in a similar way to companies, regardless of whether the authority is itself a company or a trust.[13] A "Māori authority distribution" is analogous to a dividend, and the manner in which Māori authority members can use Māori

9 See Inland Revenue Department and the Treasury *Māori Authorities: Background Paper for Session 6 of the Tax Working Group* (April 2018) at 3. For example, Ngāti Whātua Ōrākei currently has approximately 5,000 members, whereas Waikato-Tainui has almost 70,000 members, according to their respective websites. See Ngāti Whātua Ōrākei <https://ngatiwhatuaorakei.com>; and Waikato-Tainui <https://waikatotainui.com>.

10 See generally Edward and Sharp, above n 7, at 296–297.

11 Income Tax Act 2007 [ITA], s HF 1(1).

12 Sections HF 2(2)–HF 2(8).

13 See generally subpart HF.

authority credits (MACs) mirrors the manner in which shareholders can use imputation credits.[14] Both forms of tax credits are attached to distributions made to the recipient to reflect tax paid by the distributing entity and can be used by the recipient to offset their own income tax liability.[15]

The three primary benefits enjoyed by Māori authorities are: a reduced rate of income tax (17.5 per cent);[16] cash-refundable MACs;[17] and flowthrough tax treatment for distributions made from capital gains.[18] This means that Māori authorities can provide tax credits to their members in conjunction with the payment of a distribution subject to various restrictions (which are outlined below). Members can use the tax credits to offset their own income tax obligations and, if they have tax credits left over, Inland Revenue will provide a cash refund. Capital gains accrued by the Māori authority can also be passed on to members with the members incurring no additional tax liability as a result.

The restrictions on the provision of MACs to members are threefold. First, the Māori authority cannot distribute more MACs in a year than it has paid in income tax.[19] After all, the rationale for permitting Māori authorities to provide tax credits to members is that these credits represent tax already paid. Secondly, the Māori authority must distribute tax credits equally to all members to whom it makes a distribution in that year.[20] Finally, the value of the tax credits provided in conjunction with any distribution may not exceed 17.5 per cent of the sum of the value of the tax credits and the distribution.[21] This ensures that members of Māori authorities who have incomes

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14 Sections LE 1(1) and HF 4(5).

15 In respect of ordinary companies, s CD 15(1)(a) provides that a dividend includes an imputation credit attached to the dividend. In respect of Māori authorities, s HF 4(5) provides that a Māori authority distribution includes the amount of a Māori authority credit [MAC] attached to it.

16 Schedule 1, pt A, cl 7.

17 Section LA 6(1)(e) provides that MACs constitute "refundable credits". This means that, to the extent that a Māori authority member's marginal income tax rate is below 17.5 per cent, they are entitled to a refund for overpaid tax on the Māori authority distribution.

18 Section HF 7.

19 Sections OK 2(1) and OK 19(1).

20 Section OK 20.

21 Section OA 18(2).

between $14,000 and $48,000 do not receive more credits than they can use, reducing the number of refunds that must be provided by Inland Revenue.

For example, if a Māori authority distributes to 100 members $100 in cash each, provided the authority has (or will shortly) pay sufficient income tax to satisfy the first restriction, it may attach a maximum of 21.21 MACs to each distribution. This is because the total value of the distribution is $121.21 and therefore the MAC component is 17.5 per cent of the total. If the total value of the distribution were $100, the tax credit component would be worth $17.50, and the cash component would be worth $82.50.

Each of these features reflects Parliament's intention to reduce compliance and administration costs for Māori authorities while simultaneously achieving the goals of the regime. However, as this article will now explain, such an intention is undermined by the problem of Māori authorities accumulating excess MACs.

III The Tax Working Group Proposal

A The Problem

The Tax Working Group was established by the government to provide recommendations on improving the fairness, balance and structure of the New Zealand tax system. Chaired by the Hon Sir Michael Cullen, it released its Final Report in February 2019.[22] This report received significant media coverage on account of the majority of the Tax Working Group's members endorsing a capital gains tax, a recommendation later rejected by the government.[23] However, the Tax Working Group also made extensive unanimous recommendations in many other areas, including the taxation of Māori authorities.[24]

22 Tax Working Group "What is the Tax Working Group?" (28 April 2020) <taxworkinggroup.govt.nz>.
23 Tom Pullar-Strecker "Capital gains tax abandoned by Government" (17 April 2019) Stuff <www.stuff.co.nz>.
24 Tax Working Group *Future of Tax: Final Report Volume I – Recommendations* (21 February 2019).

The Tax Working Group supported the present regime in many respects. It noted that the 17.5 per cent income tax rate imposed on Māori authorities:[25]

> … is set at a level that is intended to reflect the most common marginal tax rate of the economic owners of Māori authorities; tax paid at the entity level is essentially a withholding mechanism for the final tax paid by Māori authority members.

The Tax Working Group noted that this reduces both compliance and administration costs, particularly because of New Zealand's Pay As You Earn (PAYE) system, in which most individuals do not need to file a tax return because their employers withhold tax on their behalf.[26] By setting the Māori authority income tax rate at a level which reflects the most common marginal income tax rate of Māori authority members, compliance costs are minimised because Māori authority members are similarly less likely to need to engage with the tax system directly.

The Tax Working Group found that the current rate of tax paid by Māori authorities was appropriate. In 2018, the median annual income for Māori was around $32,000.[27] This had increased since the Māori authority income tax rate was last reviewed (in 2010), but approximately 80 per cent of Māori authority members continue to receive annual incomes below $48,000. Those members therefore pay tax at a marginal rate of 17.5 per cent or lower, and consequently stand to benefit from the Māori authority regime.[28]

However, the Tax Working Group was concerned about the accumulation by Māori authorities of excess MACs. At the end of the 2010/2011 financial year, Māori authorities held $98 million in excess credits, and, by the end of the 2016/2017

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25 Inland Revenue and the Treasury, above n 9, at 105.

26 ITA, s RD 3 provides that salaries and wages constitute a "PAYE income payment". Section RA 5 provides that a person making a PAYE payment must withhold PAYE income tax. Therefore, employers must withhold PAYE income tax and pay this on behalf of their employees.

27 Tax Working Group *Future of Tax: Interim Report* (20 September 2018) at 105. See also Inland Revenue Department and the Treasury, above n 9, at 4, where it was admitted that although there is limited information on Māori authority members, the information available was based on the 2013 Census.

28 Tax Working Group, above n 27, at 105.

financial year, that figure had risen to $239 million.[29] This is because Māori authorities with companies as subsidiaries generally receive more imputation credits than are necessary to satisfy their own tax liability. These leftover credits are treated as MACs but cannot be passed on to members, as MACs can only be distributed in proportion to the income tax rate paid by the Māori authority (that is, 17.5 per cent). Inland Revenue cannot refund the Māori authority, as MACs are only refundable to members. Nor can wholly owned subsidiaries of Māori authorities elect to be treated as Māori authorities themselves unless they qualify independently.

This situation creates a disincentive for Māori authorities to use companies as subsidiaries. As a result, alternative corporate forms, such as limited partnerships, have become common, although arguably at a cost to commercial sense.[30] Such structures are often chosen for no other reason than to optimise the Māori authority's tax position. Not only might these structures be unsuitable, it is widely accepted that the tax system should avoid distorting taxpayers' choices. There is no principled explanation for why Māori authorities that carry out business themselves or through a limited partnership should pay less tax than a Māori authority that carries out business through a subsidiary company. For this reason, the Tax Working Group identified that the current approach to the taxation of subsidiaries of Māori authorities should be reformed.[31]

B An Illustration

To better demonstrate this flaw in the current regime, consider a hypothetical scenario. The Crown reaches an agreement with two hypothetical iwi. Both receive some land along with other commercial assets, and both elect to be treated as a Māori authority for tax purposes. The first, Ngā Tahi, transfers those assets to a subsidiary company, Ngā Tahi Ltd. As Ngā Tahi Ltd is a company, it must pay income tax at a rate of 28 per cent. Any remaining money may be reinvested or distributed to its parent

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29 Inland Revenue Department and the Treasury, above n 9, at 4–5. This reflects an increase of 244 per cent in six years.
30 Tax Working Group, above n 27, at 106.
31 Tax Working Group, above n 24, at 17.

authority as a dividend. The dividend would include a tax credit for the amount that Ngā Tahi Ltd has already paid in income tax, which can be used by Ngā Tahi to offset its own income tax liability.

Suppose that Ngā Tahi Ltd made a profit of $100,000. This will be subject to $28,000 of corporate tax. If Ngā Tahi Ltd (the subsidiary) chooses to distribute the entirety of its after-tax profits, it can do so by distributing $72,000 in cash to Ngā Tahi (the parent) and attaching 28,000 imputation credits. The imputation credits are converted into MACs in the hands of the Māori authority.[32] It must itself pay tax on its income, which in total is $100,000 (the sum of the dividend and the imputation credits). It, therefore, owes $17,500, which it can satisfy with the credits it received. The leftover 10,500 MACs are retained by Ngā Tahi in its Māori Authority Credit Account (MACA), as are new MACs representing the income tax paid by the authority. This means Ngā Tahi now has $72,000 in cash and 28,000 MACs.

Suppose further that Ngā Tahi has 100 members and wishes to distribute the entirety of its profits to them. Each member receives $720 plus the maximum number of MACs that can be provided consistently with the restrictions discussed previously — that is, Ngā Tahi can distribute a maximum of $28,000 in MACs, it must distribute an equal number of MACs to each recipient, and the value of the MACs provided to any recipient must not exceed 17.5 per cent of the sum of cash and tax credits which together make up the total distribution. In this case, the maximum value of MACs that can be attached to each distribution is $152.73.[33]

Ignoring Ngā Tahi's withholding obligations for the moment,[34] a member of the Māori authority therefore receives income amounting to $872.73 (that is, $720 in cash and $152.73 in MACs). Supposing that this member earns more than $14,000 but less than $48,000 each year, the additional income from the Māori authority will be

32 ITA, ss OK 6–OK 8.
33 This can be calculated by multiplying the cash component of the distribution by 0.2121.
34 In practice, the member receives only the after-tax cash component.

taxed at 17.5 per cent. That liability can be entirely satisfied with the MACs, leaving the member with just the cash component: $720.

For completeness, suppose instead that the member earned less than $14,000 each year. Their personal marginal tax rate would then be 10.5 per cent and their tax liability for this additional distribution would be $91.64, leaving them with 61.09 MACs, which Inland Revenue would refund them in cash. Their after-tax income from the Māori authority would then be $781.09. Alternatively, if the member's annual income was above $48,000, then their tax liability would exceed the value of the MACs they received. This means that, after paying the additional amount, they would effectively receive less than $720 after tax.

This may appear to be a neat solution: the majority of Ngā Tahi's members will have no additional tax obligations as a result of receiving money from the Māori authority. For less well-off members, MACs are cash-refundable, whereas for those with higher incomes, additional tax must be paid out of the distribution. However, the flaw in the regime is that the Māori authority is left with MACs that cannot be passed on. It had 28,000 MACs, but the effect of the restrictions is that only 15,273 MACs could be distributed to members, leaving the authority with $12,727 in effectively unusable tax credits.

C The Alternative

Recall that this scenario involved two hypothetical iwi. Suppose that the second, Ngā Rua, has been advised that the corporate structure adopted by Ngā Tahi will result in an accumulation of MACs that are effectively useless. Ngā Rua therefore chooses a different arrangement. It wishes for its subsidiaries to be taxed at the same low tax rate that it enjoys. However, since Māori authorities cannot establish look-through companies,[35] Ngā Rua decides to establish a limited partnership, which is

35 ITA, s YA 1. This was the one of the effects of the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017.

similarly transparent for tax purposes.[36] That is, income received by a limited partnership is subject to tax at the marginal income tax rate of its parent entity.

Limited partnerships are more complicated than companies. Whereas a person can be both a shareholder and a director of a company, limited partners of limited partnerships cannot engage in management activities.[37] It is, therefore, common for parent companies (or Māori authorities) to incorporate a company to manage the limited partnership on the parent entity's behalf. For this reason, Ngā Rua incorporates a company, Ngā Rua Management Ltd, as well as a limited partnership, Ngā Rua Trading Inc.

Suppose that the limited partnership, Ngā Rua Trading Inc, makes $100,000 in profit. This is considered taxable income in the hands of Ngā Rua, and because Ngā Rua is a Māori authority, it must pay 17.5 per cent of its taxable income in tax, which amounts to $17,500. At this point, the iwi has $82,500 in cash and 17,500 in MACs.

Again, suppose that Ngā Rua also has 100 members and wishes to distribute the entirety of its profits to those members. Each member therefore receives $825 plus the maximum value of MACs that can be passed on consistently with the restrictions which, in this scenario, is 175. A representative member of Ngā Rua with an annual income between $14,000 and $48,000 consequently must pay 17.5 per cent in income tax on the sum of the distribution and the tax credit, a liability that is satisfied perfectly by the 175 MACs received with the distribution. The member's after-tax income from the Māori authority is $825; and the authority is left with no spare MACs.[38]

In short, a member whose income is between $14,000 and $48,000 each year will receive $720 after-tax for every $1,000 per member paid by a subsidiary company to the Māori authority. All other things being equal, had the Māori authority instead established its subsidiary as a limited partnership, the member would have

36 ITA, s HG 2.

37 Limited Partnerships Act 2008, s 20.

38 As before, a member with a lower income would receive a refund; a member with a higher income would have to pay an additional amount to satisfy their larger tax liability.

received $825. The difference, $105, amounts to tax paid by the corporate subsidiary that cannot be used by the authority or its members.

IV Evaluation

So far, this article has focused on identifying a flaw in the current tax treatment of Māori authorities. As a result of the difference between the rate of tax paid by subsidiary companies and the rate at which Māori authorities may pass tax credits on to its members, some Māori authorities have accumulated excess MACs. Other Māori authorities are using alternative corporate structures, such as limited partnerships, which eliminate this difference in tax rates. Consequently, the after-tax income received by members of different Māori authorities varies merely as a result of how each authority structures its affairs.

The Tax Working Group has recommended reforming this system by extending the Māori authority income tax rate to wholly owned subsidiaries of Māori authorities.[39] This would have several advantages. Most significantly, there would be no issue of excess MACs. Additionally, Māori authorities and their advisers would be able to focus on commercial effectiveness as the key driver for choosing which type of entity to use, as the tax effect of the chosen entity would no longer differ between subsidiary companies and other options.[40] Further, the taxation of Māori authorities and their subsidiaries would be simplified as their income tax rates would be the same. This would require less reconciliation than is otherwise necessary where two entities in a group are taxed at different rates.

Several aspects of this analysis deserve further consideration. This Part will discuss the merits of limited partnerships, the alternatives to the Tax Working Group's proposal, and the justification for the Māori authority regime more generally. In short, there are good reasons why Māori authorities may wish to use limited partnerships, aside from their advantageous tax treatment. Preventing Māori authorities from using

39 Tax Working Group, above n 24, at 17.
40 Tax Working Group, above n 27, at 106.

limited partnerships or other flow-through structures is a poor alternative to the Tax Working Group's proposal. So too should Parliament refrain from eliminating the restrictions on the rate at which MACs can be provided to members, as this would create additional compliance and administration costs. Opposition to the Tax Working Group's proposal may also come from those who consider the Māori authority regime to be discriminatory on the basis of ethnicity. However, the proposal is no more discriminatory than the existing scheme; indeed, it would remove an inequity between two groups of low-income New Zealanders. For these reasons, the Tax Working Group's proposal is preferable to any alternative.

A Limited Partnerships

Limited partnerships have some advantages, including for Māori authorities, aside from their beneficial tax treatment compared to subsidiary companies. Limited partnerships were introduced to facilitate foreign investment in New Zealand.[41] Like a company, they have separate legal personality.[42] Each limited partnership is governed by a written partnership agreement, which allows for significant flexibility, although the agreement must contain certain information and is ineffective insofar as it is inconsistent with the Limited Partnerships Act 2008.[43] The Act is less prescriptive than New Zealand's company legislation.[44] Limited partnerships are ideal where different parties wish to pool their capital but entrust the management of the entity to a third party (the general partner). General partners owe contractual and fiduciary obligations to the limited partnership, and bear residual liability for the limited partnership's debts, which provides a degree of protection for the limited partners.

However, New Zealanders are significantly more familiar with the use of companies than with limited partnerships. New Zealand has had decades of legislative experience with companies, in particular through the Companies Act 1955 and the Companies Act 1993. Legal issues in this area are well-litigated. On the other hand,

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41 Limited Partnerships Act, s 3.
42 Section 11.
43 Sections 9–10.
44 The primary example being the Companies Act 1993.

limited partnerships are a relatively recent development, having been introduced in 2008. This means that both ordinary New Zealanders and their advisers will generally be more comfortable carrying out transactions through companies rather than through limited partnerships. Additionally, there is less judicial guidance on the proper administration of limited partnerships, potentially creating a greater risk of expensive and uncertain litigation.

The details of the comparison between companies and limited partnerships are ultimately of less importance than the fact that they are broadly comparable. That some Māori authorities can minimise their tax liability by arranging their affairs in a particular way is a problem not because it incentivises the use of riskier corporate forms, but because doing so creates inequity between Māori authorities that use companies and those that use limited partnerships. If limited partnerships had no merits for Māori authorities, one option to remedy the inequity would be to prohibit Māori authorities from using this type of entity (just as Māori authorities cannot incorporate look-through companies). However, that would prevent limited partnerships from being used where they can be justified for non-tax reasons. Likewise, if companies had little merit, then Parliament could rely on Māori authorities switching to using limited partnerships. That too would be undesirable. Parliament should, therefore, ensure there is parity between the tax treatment of the two corporate forms.

B Two Alternative Solutions

As explained above, the reason why Māori authorities often accumulate excess MACs is that they receive more tax credits from their subsidiary companies than they can pass on to their members. This situation is analogous to a bath, where the flow of water through the taps is greater than that through the plughole. A solution, as recommended by the Tax Working Group, is to turn the taps down, by requiring wholly owned subsidiaries of Māori authorities to pay income tax at only 17.5 per cent.[45] One alternative is to increase the flow through the plughole,

45 Tax Working Group, above n 24, at 17.

by repealing the rule that restricts the number of MACs passed on to 17.5 per cent of the total value of distribution.[46]

There is an apparent simplicity to this alternative. In the example above concerning Ngā Tahi, the Māori authority's subsidiary received $100,000 in profit. It passed on $72,000 as a dividend to the authority along with 28,000 in imputation credits. The imputation credits were converted into MACs in the hands of Ngā Tahi, which satisfied its own tax liability by paying 17,500 of those credits to Inland Revenue. It paid each of its members $720 in cash but could pass on no more than 152.73 MACs to each, leaving it with 12,727 unusable credits. Had the restriction on the ratio of cash to tax credits been repealed, all 28,000 MACs available could be distributed. Each member would therefore receive $720 in cash and $280 in tax credits, and would incur a tax liability of $175. That tax liability could be met using the tax credits with the remaining tax credits refunded, resulting in a total after tax income of $825 — just the same as if the Māori authority had used a limited partnership, as in the Ngā Rua example.

The difference between this solution and the Tax Working Group's proposal is the compliance and administration costs. The restriction on the ratio of cash to tax credits is intended to ensure that members of Māori authorities with annual incomes between $14,000 and $48,000 owe no additional tax as a result of receiving a distribution from the Māori authority — *and nor are they owed a refund*. Repealing this rule would result in many more New Zealanders having to file tax returns and Inland Revenue having to refund them approximately twelve cents for every dollar received from a Māori authority. In short, the Māori authority regime would no longer act as a withholding system.

By way of comparison, the Tax Working Group's proposal actually reduces the compliance burden for Māori authorities and their wholly owned subsidiaries. Under the current system, as wholly owned subsidiaries of Māori authorities are taxed at a different rate from their parent company, a degree of reconciliation is

46 That is, by removing any reference to Māori authority distributions from the ITA, s OA 18(2).

necessary, for it makes a significant difference whether income or expenses can be attributed to the parent or the subsidiary. This would become less important if both entities were to be taxed at the same rate.

A second alternative is to merely rely on Māori authorities to transfer Māori land to their subsidiary companies so that those companies may qualify as Māori authorities themselves. If the tax savings that arise from doing so are significant, it would appear to be rational for Māori authorities to take this step. However, the reason why land is so important in Māori culture is because of the connection that people have to the land. It may be contrary to the cultural significance of land if corporate groups with a Māori authority parent sought to manipulate the ownership of land purely to achieve commercial ends. The Tax Working Group's proposal would allow the value of land in Māori culture to be preserved, because any dealings with land otherwise entitling a taxpayer to elect to become a Māori authority would stem from genuine cultural and social connections to the land, rather than the pursuit of profit.

C Special Treatment?

A significant issue with the Tax Working Group's proposal is that it may be considered to be discriminatory on the basis that it provides preferential treatment for Māori. This issue has been raised on previous occasions when the Māori authority regime was amended, such as in the early 2000s.[47] Chen Palmer, for example, posited that providing tax concessions to commercial entities merely because they were owned by Māori was discriminatory on the grounds of race or ethnic origin.[48] The firm argued that this was in breach of the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.[49] This argument was made specifically in relation to a proposal to include wholly owned subsidiaries of Māori authorities within the proposed

47 See Inland Revenue Department and the Treasury *Taxation (Annual Rates, Maori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Bill: Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill* (November 2002) vol 2 at 9.

48 At 9. Chen Palmer is a New Zealand law firm which specialises in Employment and Public Law.

49 Section 19(1) of the New Zealand Bill of Rights Act 1990 provides for freedom from discrimination on the grounds of discrimination contained in the Human Rights Act 1993. Section 21 of the Human Rights Act provides for the prohibited grounds of discrimination. The two Acts work in tandem in this sense.

definition of “Māori authority”. That would have had an identical effect to the Tax Working Group’s more recent proposal.

The official response to this argument was that tax concessions were granted to Māori authorities due to the constraints imposed on them.[50] As noted above, Māori authorities typically pursue a wider range of goals than most commercial entities. They also tend to hold Māori land, which cannot easily be sold or used to raise capital — for example, as security for a mortgage. Further, there are often restrictions on how members of a Māori authority may dispose of their interests in the assets of the authority. Therefore, the official view was that the sharing of a common ethnic tie was merely incidental, and not a dominant reason for the tax concessions.

This debate is likely to be revisited in the event that the Tax Working Group’s proposal is considered by Parliament. That said, Chen Palmer’s critique and the official response appear to be more concerned with the discriminatory effect of the Māori authority regime itself, rather than the proposal to extend the lower income tax rate to wholly owned subsidiaries of Māori authorities. Even if the overall regime is discriminatory, it is hard to see how the Tax Working Group’s proposal could make this discrimination worse, as Māori authorities can presently avail themselves of more advantageous tax treatment by establishing their subsidiaries as limited partnerships (which was not the case in 2002). Indeed, the intent of the proposal is to remedy an inequity between Māori authorities that arrange their affairs in this way and those that do not.

In other respects, the claim that the Māori authority regime is discriminatory on the basis of race is worthy of further investigation. Parliament should hardly be concerned with a minor issue, such as the tax treatment of wholly owned subsidiaries of Māori authorities, if the entire regime needs to be reformed.

50 Inland Revenue Department and the Treasury, above n 47, at 9–10.

The official response given almost two decades ago suggests that the regime does not provide for a difference in tax treatment for Māori authorities because their members are Māori, but because their incomes tend not to fall within the top marginal income tax bracket. However, this is only part of the rationale for the regime. It was also intended to provide concessionary treatment for Māori land, because land plays a central role within Māori culture and is a significant part of the redress provided by the Crown for historical wrongs. The Māori authority regime is not merely a targeted withholding mechanism for those with lower incomes; if it were, Parliament would presumably have permitted a wider range of entities to avail themselves of the scheme's benefits, and not only those entities that — with a few exceptions — hold Māori land. In short, the regime is not meant to be entirely neutral in its application. It deliberately discriminates in favour of Māori values and interests.

Perhaps that too can be justified. Section 19 of the New Zealand Bill of Rights Act, which provides for freedom from discrimination, is not absolute. As with all rights and freedoms affirmed by the New Zealand Bill of Rights Act, it is subject to "such reasonable limits prescribed by law as can be demonstrably justified in a free and democratic society".[51] Arguably, both the present regime and the Tax Working Group's proposal for its extension can be demonstrably justified. Improving the taxation of wholly owned subsidiaries of Māori authorities would mean that more funds would be available for their commercial expansion. As a result, the size of Māori authority corporate groups could grow significantly over time, and these corporate groups would be able to continue making funds available for the benefit of the Māori community. This would also improve the equity of New Zealand society generally, given the disparities that presently exist between Māori and other groups.

Moreover, s 19 also states that "[m]easures taken in good faith for the purpose of assisting persons or groups of persons disadvantaged because of discrimination … do not constitute discrimination".[52] Insofar as the Māori authority regime seeks to remedy past injustices, the fact that it provides concessions to some New Zealanders

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51 New Zealand Bill of Rights Act, s 5.
52 Section 19(2).

and not others is not contrary to the New Zealand Bill of Rights Act. Therefore, this issue alone is certainly not a sufficient reason to refrain from proceeding with the Tax Working Group's recommendation.

D Māori Authorities and Charities

The difference in tax treatment between Māori authorities and other types of entity may be justified, but the difference between the tax treatment of subsidiary companies and other types of subsidiary lacks any principled rationale. There is, however, another reason why this flaw in the Māori authority regime should be remedied: it is inconsistent with the tax treatment of charities.

In their advice to the Tax Working Group, Inland Revenue and the Treasury wrote:[53]

> … it is arguable that subsidiaries of Māori authorities should also be able to access the same tax rate as its ultimate economic owners. By way of comparison, wholly owned commercial subsidiaries of charities are able to access the same tax rate as their parent entity …

Charities are exempt from income tax, and so are their wholly owned subsidiaries — even if the subsidiary is a company carrying on a business.[54] This is because any profit made by the subsidiary must be reinvested or used in pursuit of charitable purposes.[55]

Unlike charities, Māori authorities do not receive a total exemption from income tax. The lower tax rate reflects the considerations discussed above: the importance of Māori land; the low incomes of members of Māori authorities; and the need to minimise compliance and administration costs. Income from subsidiaries of Māori authorities may either be reinvested or passed on to the parent authority for its use, just as is the case for charities. But if wholly owned commercial subsidiaries of charities

53 Inland Revenue Department and the Treasury, above n 9, at 5.
54 See generally ITA, ss CW 41–CW 43, which exempt specific income of charities from income tax.
55 There is extensive case law and debate in New Zealand about what constitutes a "charitable purpose", but that is not within the scope of this article.

are tax exempt like their parent entity, why are wholly owned subsidiaries of Māori authorities not entitled to the same reduced tax rate as their parent entity?

One response is that subsidiary companies of Māori authorities should continue to pay tax at 28 per cent because "the lower entity rate would confer a competitive advantage and distort competitive neutrality".[56] However, if this is true of wholly owned subsidiaries of Māori authorities, the same can be said of wholly owned commercial subsidiaries of charities. Relevantly, the Tax Working Group also rejected the suggestion that competitive neutrality should mean that subsidiaries of charities should not be tax exempt. This is despite some charities engaging in extensive commercial activity: for example, the Sanitarium Health and Wellbeing Company has previously made profits of almost $200 million, which were exempt from tax as the company is owned by a charitable organisation.[57] Ultimately, the Tax Working Group took the view that, so long as these profits were indeed being used for charitable purposes, the large profits made by charities should not be a concern.[58] Accordingly, the fact that subsidiaries of Māori authorities compete with other companies should also not be a sufficient justification for permitting the current inequity between Māori authorities from being remedied.

V Implementation

A Legislative Change

Implementing the Tax Working Group's proposal would be feasible but would require legislative change. This section discusses what that change might look like.

The ITA and the Tax Administration Act 1994 (TAA) contain various provisions which have adequately provided for the Māori authority regime so far — with the exception of the issue of accumulating excess MACs. Both Acts demonstrate a thorough

56 Inland Revenue Department and the Treasury, above n 9, at 4.

57 Christopher Adams "Sanitarium safe from charity crackdown" *The New Zealand Herald* (online ed, New Zealand, 23 February 2015).

58 Tax Working Group, above n 27, at 121.

consideration of the issues that may otherwise arise under the regime. An example is s HF 3 of the ITA. This provision illustrates legislative recognition that there are ways the Māori authority rules could be used to benefit taxpayers not genuinely entitled to the benefit of the regime. As the Māori authority regime is closely based on the imputation system used by companies, the most common methods of conferring benefits on unintended persons would be through joint business activities with other taxpayers,[59] and the use of tax losses.[60] For this reason, s HF 3 restricts Māori authorities from amalgamating or operating as part of a consolidated group with companies that are not themselves Māori authorities.

In addition, s GB 43(2) of the ITA provides that the Commissioner of Inland Revenue has the power to decide whether a Māori authority must reduce the value of MACs it can pass on. This wide scope of power conferred on the Commissioner can be used to address any unintended mischief that may be perpetrated through Māori authorities. Because there are currently extensive legislative provisions for the taxation of Māori authorities, in the event that the Tax Working Group's proposal is accepted, only a minor amendment would be necessary.

The key change would be to enact a provision providing that wholly owned subsidiaries of Māori authorities are eligible to elect to be a Māori authority. This would necessitate a change to the list of entities eligible to elect to become a Māori authority in s HF 2 of the ITA. This amendment could be achieved by the insertion of a subsection (2)(e) in s HF 2, for example:[61]

> (e) A company that, —
>
> > (i) is a wholly owned subsidiary of a Māori authority.

Apart from the recommended amendment, the Māori authority regime would operate in the same manner. Where legislation makes reference to a Māori authority, this will

59 ITA, s HF 3(2).
60 Section HF 3(3).
61 The way this article sets out the proposed amendment to s HF 2 best complies with the current structure of s HF 2.

apply to both the parent authority and to any of its subsidiaries which are also Māori authorities in their own right.

There are two further benefits of implementing the Tax Working Group's proposal in this way, rather than by enacting a new provision, providing that the benefits enjoyed by Māori authorities are available to their wholly owned subsidiaries. First, where the parent company in a Māori authority corporate group ceases to be eligible to be a Māori authority, this ineligibility will automatically extend to any wholly owned subsidiaries. This may incentivise all entities within Māori authority corporate groups to ensure that the parent company continues to comply with its obligations under the regime. However, this creates a risk that a wholly owned subsidiary could lose its Māori authority status as a result of its parent authority ceasing to be eligible in circumstances where the wholly owned subsidiary had no real ability to avoid the event that gave rise to the parent company's ineligibility. On balance, this would be a cost worth imposing on Māori authority corporate groups. To some extent, it would likely reduce the extent to which Inland Revenue will need to police groups of companies operating with a Māori authority parent, as all parts of the group have an interest in self-regulating.

Secondly, implementing the Tax Working Group's proposal through the recommended change will assist Inland Revenue by reducing the potential administration costs. In addition to being eligible under s HF 2 of the ITA, the entity must also elect, under s HF 11, to become a Māori authority. This means that, in order to become a Māori authority, a wholly owned subsidiary of a Māori authority will need to make an election. Since the election must be notified to the Commissioner,[62] Inland Revenue will more readily have a record of all wholly owned subsidiaries of Māori authorities who are within the scope of the regime. Without this mechanism, the cost of administering the Māori authority regime would increase given that Inland Revenue would need to do extra work to ensure that it keeps track of every wholly owned subsidiary that is within the scope of the regime. In addition, this mechanism decreases the likelihood of

62 See generally s HF 11.

tax avoidance behaviour which may otherwise be engaged in through contrived arrangements designed to receive the benefits of being a wholly owned subsidiary of a Māori authority while not being genuinely eligible.

In summary, s HF 2 of the ITA is the optimal provision through which to implement the Tax Working Group's proposal, as it entails minimal disturbance to other provisions of the ITA and the TAA. Implementing the proposal by inserting a subsection (2)(e), as suggested above, also imposes an obligation on eligible wholly owned subsidiaries to elect to enter into the regime if they intend to receive the benefits afforded by it. This effectively creates a registration process which aids Inland Revenue in keeping track of the number of Māori authority entities currently within the scope of the regime. Such a system would not exist if wholly owned subsidiaries of Māori authorities automatically received the benefit of the regime by virtue of their parent entity's status, without the need to make an election.

B Transitional Considerations

Given the significant increase in MACs held by Māori Authorities,[63] it is likely that many Māori authorities will have excess MACs remaining in their MACAs at the time the Tax Working Group's proposal is implemented. The government will need to address this.

The most desirable solution would be for the government to allow Māori authorities to pass remaining MACs on to their members without the requirement of attaching the MACs to a distribution (as is normally the case). This solution would be temporary because it should only apply to MACs held at the time the Tax Working Group's proposal is implemented, and not to subsequent MACs received by a Māori authority, as the problem of excess MACs would then cease to exist. In this way, it acts as a transitional provision. A failure to provide such a provision may create an incentive for

63 See Inland Revenue Department and the Treasury, above n 9, at 4–5.

Māori authorities to look for novel ways to use these excess MACs, which may constitute avoidance — although it is not clear how this could be achieved.

Permitting a one-off distribution of excess credits would mean that in the year that the proposal is implemented, Inland Revenue would likely have to process a larger-than-usual number of refunds. This would create a cost to the Crown of approximately $250 million, amounting to the present value of excess MACs held by Māori authorities. If Parliament is unwilling to permit this, that would blunt the effect of the proposal as the issue of excess MACs is the primary reason for the proposed change in the first place.

C The Ancillary Issue of RWT

This article has noted previously that the unique manner in which Māori authorities are subject to income tax effectively operates as a withholding system. That is, Māori authority distributions generally include tax credits (MACs) that satisfy the amount of tax owing as a result of the distribution. Members of Māori authorities consequently receive only the cash component of the distribution. So long as a member's annual income is between $14,000 and $48,000, the member will generally not owe any additional tax on the distribution nor will they be entitled to a refund.

In the Ngā Tahi example, members of the Māori authority do not actually receive $720 in cash and $152.73 in tax credits; the tax credits are withheld by the authority and paid to Inland Revenue in satisfaction of the member's tax liability. If the member has an annual income above $48,000, Ngā Tahi is obligated to withhold the tax credits and a share of the cash payment, just as employees receive only their wages after tax has been deducted at source. This obligation to withhold is known as a RWT obligation.

The Māori authority must pay RWT on a monthly basis.[64] Assuming the distribution is more than $200, the rate of RWT withheld will be 17.5 per cent, unless the Māori authority does not have a record of the recipient's IRD number. In such cases,

64 ITA, s RE 21(7).

the rate of RWT withheld will be 33 per cent (the default RWT rate).[65] Curiously, even if the Māori authority knows that one of its members has an annual income below $14,000 or above $48,000, the rate at which RWT is withheld is still 17.5 per cent; in these cases, the member must apply for a tax refund or pay additional tax at the end of the financial year.

There are at least two benefits to the Māori authority regime operating as a withholding system in this way. First, it benefits the Māori authority members, whose tax liability as a result of the distribution is already satisfied before they receive it. This eliminates any compliance burden on their part as they do not need to interact with the tax system directly. Secondly, this system benefits Inland Revenue. By imposing the obligation to withhold RWT on the Māori authorities, Inland Revenue needs only to deal with tax returns for Māori authorities themselves, rather than tax returns for both Māori authorities and their members, which would impose a greater administrative burden.

However, one consequence of the 33 per cent default rate of RWT is potential over-taxation. Māori authority members at a marginal income tax rate of 17.5 per cent whose IRD number is not known to the authority would, for instance, be subject to over-taxation of 15.5 per cent. Furthermore, this over-taxation may not be due to any failing of Māori authority members. Members may fail to provide their IRD numbers to a Māori authority for justifiable reasons.[66] For instance, they could be minors whose parents are unaware that they can apply for an IRD number on behalf of their child. Members may also reside overseas, meaning that they may perceive a New Zealand IRD number to be of limited use to them and thus may not provide it. To this extent, their income will be overtaxed.[67]

If the default RWT rate were changed to 17.5 per cent, as the Tax Working Group considered, a potential issue of tax evasion could arise. To the extent that a Māori

65 Schedule 1, pt D, cl 6.
66 Chapman Tripp "Taxation of Māori authorities" *Te Pūrongo Ture* (New Zealand, May 2019).
67 Tax Working Group, above n 27, at 105, n 63. This notion is also supported by practitioners that regularly work with Māori authorities and their members.

authority member's marginal income tax rate is above 17.5 per cent, the member may potentially reduce their tax liability by deliberately failing to provide the Māori authority with their IRD number.[68] However, if Inland Revenue continues to implement adequate reporting and compliance mechanisms, it is unlikely that evasion of this nature should be a significant issue. Examples of reporting and compliance mechanisms include the requirements for Māori authorities to:

- give a notice of amounts distributed to each member who receives a taxable distribution;[69]
- file returns in respect of taxable income every year;[70]
- file returns in relation to their MACA;[71] and
- provide evidence in respect of MACs, such as an RWT withholding certificate for the amount of any RWT withheld on distributions made by it.[72]

Given that most Māori authority members are taxed at a marginal income tax rate of 17.5 per cent, the number of Māori authority members who are affected by this issue is fairly small. In general, the Māori authority regime does not serve those on higher or lower incomes well. A more substantial reform could include withholding tax on Māori authority distributions at the recipients' own marginal rates. That would rely on members providing their details and estimating their annual income for the year. If this were to occur, the incentive created by imposing a 33 per cent default RWT rate would be more clearly justified. Presently, however, it is not clear that the cost of the higher default RWT on those who fail to provide their details for justifiable reasons outweighs the benefits that this rule provides.

68 This issue has also been considered in the past, albeit in relation to the decision to change the Māori authority tax rate from 25 per cent to 19.5 per cent in 2003.
69 Tax Administration Act 1994 [TAA], s 31.
70 Section 57.
71 Section 69B.
72 Section 78D(c).

VI Conclusion

The Māori authority regime recognises the unique role of land in Māori culture and New Zealand society more generally. It ensures that Māori land, including land returned as part of a settlement for breaches of the Treaty of Waitangi, is not subject to unduly burdensome rates of tax. This is especially appropriate because members of Māori authorities tend to have comparatively low incomes.

However, under the current regime, wholly owned subsidiaries of Māori authorities are not automatically entitled to the benefit of the regime unless they qualify as Māori authorities themselves. Taxable income received by subsidiary companies of Māori authorities is thus taxed at 28 per cent. Imputation credits for the amount of tax paid by a subsidiary company can be passed on to the parent authority, which can use the credits to satisfy its own tax liability (17.5 per cent of its taxable income). If the Māori authority wishes to distribute its earnings to its members, it may also attach MACs to this distribution, subject to various restrictions. The effect is that Māori authorities with subsidiary companies are accumulating excess credits that cannot be used or passed on to members without violating the restrictions.

This creates an incentive to use alternative corporate structures, such as limited partnerships. Taxable income received by a limited partnership is taxed at the rate of its parent, which in the case of Māori authorities is 17.5 per cent. Members of Māori authorities who use limited partnerships stand to receive a larger after-tax distribution compared to those that incorporate subsidiary companies. Not only is this inequity not what Parliament intended, the use of limited partnerships may also come at the cost of commercial sensibility, given that such structures are more complicated than is generally necessary.

The Tax Working Group's proposal to remedy this problem by extending the Māori authority tax rate to wholly owned subsidiaries is advantageous for several reasons. It eliminates the inequity created by the accumulation of excess MACs. This allows the funds to be used for purposes beneficial to the Māori authority, its corporate group, its community and wider society. Moreover, unlike various alternative proposals,

it would simplify the taxation of Māori authorities, rather than making this issue more complicated. Only a minor legislative change would be required: adding "wholly owned subsidiaries of a company that is a Māori authority" to the list of entities that can elect to be treated as a Māori authority.

The proposal is likely to result in a renewal of debates over whether the Māori authority regime as a whole is justified. In the early 2000s, arguments about the regime's preferential treatment of Māori influenced the decision not to extend the benefits of the regime to wholly owned subsidiaries of Māori authorities. However, whatever the merits of the regime — a debate which cannot be avoided by downplaying the fact that the regime explicitly aims to protect Māori land ownership — this does not provide a rationale for not proceeding with the Tax Working Group's proposal. Indeed, allowing wholly owned subsidiaries to benefit from the tax treatment of their Māori authority parent is consistent with how charities are taxed in New Zealand.

Less clear-cut is the ancillary issue of the default rate of RWT that should be applied where a member of a Māori authority does not provide their IRD number to the authority. There are also arguments either way for what should happen to the excess MACs that have accumulated up until now: either the Crown must keep the tax that these credits represent; or it must provide this money to Māori authority members as credits or refunds. At the time of writing, these issues have been considered for inclusion in the government's Tax Policy Work Programme but do not appear to be a priority.[73] It remains to be seen whether the government proceeds to implement this commendable reform in the future.

73 New Zealand Government *The Government's response to the recommendations of the Tax Working Group* (17 April 2019) at 3.