

#### 4. TAX DEDUCTIBILITY OF ELECTORAL EXPENSES INCURRED BY CANDIDATES

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The purpose of this report is to advise the Council as to what the options are in seeking a change to the current non-deductibility of elected members' electoral expenses. This is to provide a basis for approving the draft submission to the Minister of Finance and the Minister of Local Government as requested by Council.

##### **BACKGROUND**

In September 2002, the Committee discussed this issue and made the following report and recommendation to the Council:

*The purpose of this report is to advise the Council of the outcome of the representations to the combined Zone 5/Zone 6 meeting on the proposal to make representations to the Government seeking an amendment to the taxation rules to allow for expenses incurred in seeking election to be tax deductible.*

*This matter was considered by the Council at its meeting on 27 June 2002. At that meeting the Council resolved that a report be presented to the next Zone 5 meeting asking that the Zone take this matter up with the Local Government New Zealand National Council.*

*In accordance with the Council resolution a report was presented to the combined Zone 5/6 meeting on 22/23 August proposing that the National Council be requested to make representations to the Government seeking to have the costs incurred by candidates seeking local elected office and paid for personally by the candidate treated as a deductible expense for income tax purposes.*

*This proposal was not supported by the majority of delegates although it was suggested that if the proposal were limited to sitting members seeking re-election it may have more support. The concern was that the tax deductibility would have to extend to all people who incurred expenses in seeking new employment, a proposition Central Government was unlikely to agree to.*

*The Committee considered that this was not a valid argument given the significant difference in the costs incurred by election candidates and those incurred by other job seekers. A suggestion by Councillor Corbett that the Council pursue this matter direct with the Government was endorsed by the Committee.*

**Recommendation:** *That the Council make a submission to the Minister of Finance and the Minister of Local Government seeking an amendment to the taxation rules to allow for expenses incurred in seeking election to be tax deductible.*

The writer has analysed what options are available in seeking a change to the current non-deductibility of elected members' electoral expenses as the starting point before drafting a submission to the Minister of Finance and the Minister of Local Government. This analysis identified that there were three options. These are as follows:

1. Support the case of a successful candidate, who was re-elected, through the courts.
2. Raise the issue again through Local Government NZ.
3. Make a submission to the Minister of Finance and the Minister of Local Government on public policy grounds.

The case for deductibility is analysed below so the Committee can determine which of the public policy grounds identified they wish to include in the submission to increase its likelihood of success.

The analysis was provided to the Council's taxation advisers, Ernst & Young. Ernst & Young's comments and recommendation have been included later in this report.

##### **ANALYSIS OF THE CASE FOR DEDUCTIBILITY**

The key section of the Income Tax Act is BD 2, Allowable Deductions. This states:

*An amount is an allowable deduction of a taxpayer*

*...(b) to the extent that it is an expenditure or loss*

- (i) incurred by the taxpayer in deriving the taxpayer's gross income, or*
- (ii) necessarily incurred by the taxpayer in the course of carrying on a business for the purpose of deriving the taxpayer's gross income.*

Subsection 2 of BD 2, Allowable Deductions details the deductions that are excluded:

*An amount of expenditure or loss is not an allowable deduction of a taxpayer to the extent that it is*

- (a) of a private or domestic nature, or*
- ...(b) incurred in deriving exempt income under Part C (Income Further Defined), D (Deductions Further Defined) or F (Apportionment and Recharacterised Transactions), or*
- (c) incurred in deriving income from employment, or*
- ...(e) of a capital nature, unless allowed as a deduction under Part D (Deductions Further Defined) or E (Timing of Income and Deductions)*

In 1981, the Taxation Review Authority heard cases stated by elected members seeking to deduct electioneering expenses.

In Case F38, the deduction claimed by a successful candidate who was re-elected, was disallowed. The expenditure was held to be of a private nature as it only put the elected member in a position to derive assessable income. Electioneering was held not to be part of the income earning process as a councillor.

In Case F39, the deduction claimed by a successful candidate who stood for the first time, was disallowed. The expenditure was held to be of a private nature as it only put the elected member in a position to derive assessable income. He did not incur the expenditure in the course of his councillor duties.

In both cases, Judge Barber followed an Australian case that referred to "a number of well known authorities". Therefore it is unlikely that a successful challenge could be mounted through the courts.

#### **PUBLIC POLICY REASONS FOR SUPPORTING THE CHANGE**

- Reducing the financial hurdle for those standing for elected office to help ensure that elected members are representative of their communities.
- Negate, as far as possible, the advantage that wealthier candidates have over those of more limited means.
- Minimise the financial sacrifice that members of the community can incur in standing for public office.
- Follow the example of overseas jurisdictions, such as the New South Wales state government, that have legislated to make tax electioneering expenses deductible, perhaps in recognition of the detrimental effects the Courts' interpretation of such expenses being non-deductible for income tax purposes, can have on the democratic process.

#### **ERNST & YOUNG COMMENTS AND RECOMMENDATION**

"Ernst & Young Limited have reviewed the current position in respect of the deductibility of electoral expenses.

We confirm the position as stated by John Mackey in this report. As decided cases have concluded that electioneering expenses are non deductible, a deduction claimed by a candidate in respect of such expenditure will almost certainly be denied by the Inland Revenue Department.

However, we note that the decided cases are old, not well decided, and the approach to taxation under the Income Tax Act 1994 has changed since those cases were decided. On this basis it is

possible, but not certain, that the current law would support a deduction for electioneering expenses incurred by a sitting member seeking re-election.

On this basis, it may be possible to achieve a change to the law through supporting the case of a sitting member seeking re-election through the court process. However, this approach is likely to be time consuming and expensive, with no guarantee of success. Accordingly, it is not our recommended approach.

Rather, we recommend a submission to the Ministers of Finance and Local Government seeking a change to the law. Such a submission should focus on policy reasons for the change sought. The draft submission included with this report appropriately focuses on public policy considerations, and we recommend it be submitted.”

## **CONCLUSION**

1. The case for deductibility for expenses incurred in seeking election to be tax deductible for unsuccessful and successful candidates not currently in office is weak from a fiscal and taxation perspective as it runs counter with general rules on the deductibility of expenses and therefore has virtually no chance of being changed, other than for specific public policy reasons, because it could seriously compromise the tax base. However, creating a tax incentive for people to stand for public office for public policy reasons provides a reason to implement such a change.
2. The case for deductibility for expenses incurred in seeking election to be tax deductible for unsuccessful and successful candidates currently in office is stronger but has been rejected by the courts in New Zealand and overseas. Therefore there is little chance this being changed other than for specific public policy reasons.
3. In the interest of natural justice, any submission should also seek tax deductibility for those not yet in office.

The suggested grounds for justifying the submission are those of equity and the encouragement by minimising the financial hurdles to those seeking elected office.

**Recommendation:** That the attached submission requesting deductibility for expenses incurred in seeking election to public office be approved.