

## Interpretation Statement 18/05 – Fact Sheet

### Applying the “safe harbour” approach

*This fact sheet sets out the most important information from interpretation statement IS 18/05, including an explanation of Inland Revenue’s “safe harbour” approach to administering section LD 3(2)(a). For more detailed information please refer to the full statement.*

### What is the interpretation statement about?

1. Interpretation statement IS 18/05 explains what is required to qualify as a donee organisation under section LD 3(2)(a) of the Income Tax Act 2007 (the key provision) in terms of how an organisation applies their funds.
2. People making monetary gifts of \$5 or more to a donee organisation can obtain a tax benefit (see key tax benefit).
3. An organisation can qualify as a donee organisation if it applies its funds “wholly or mainly” to specified purposes within New Zealand (see key terms).
4. The statement clarifies the interpretation of important aspects of the “wholly or mainly” requirement and **explains Inland Revenue’s safe harbour approach to administering the requirement** (see key terms).
5. The statement provides guidance on how a donee organisation can retain this status under the key provision while applying some of its funds to purposes other than specified purposes within New Zealand.

#### Key provision

**Section LD 3(2)(a):** A **donee organisation** includes an organisation whose funds are applied wholly or mainly to specified purposes within New Zealand.

#### Key terms

**“New Zealand”** does not include Niue, the Cook Islands, Tokelau, or the Ross Dependency of Antarctica.

**“Organisation”** means a society, institution, association, organisation, or trust that is not carried on for the private pecuniary profit of an individual.

**“Specified purposes”** mean charitable, benevolent, philanthropic, or cultural purposes.

### Who does the statement apply to?

6. The statement is relevant to an organisation that applies their funds to specified purposes within New Zealand **and** to other purposes (for example, overseas purposes).
7. The statement is not relevant to an organisation that only applies their funds to specified purposes within New Zealand. It is also not relevant to overseas donee organisations listed in schedule 32 of the Income Tax Act 2007.

#### Key tax benefit

If a person makes a monetary gift of \$5 or more to a donee organisation, they can receive a refundable tax credit or income tax deduction. Therefore, people may be more motivated to give to an organisation that qualifies as a donee organisation than to one that does not qualify.

### When does the statement apply from?

8. The statement applies to and from the 2019/20 income year. This means from 1 April 2019 or the first day of the 2019/20 income year for an organisation with a non-standard balance date.

## Important information

### “Wholly or mainly” will be administered as meaning at least 75%

9. “Wholly or mainly” requires considerably more than 50% of a donee organisation’s funds to be applied to specified purposes within New Zealand.
10. Inland Revenue will administer the “wholly or mainly” requirement on a “safe harbour” basis of “75% or more”. This means Inland Revenue will generally accept without further enquiry that an organisation meeting or exceeding the safe harbour percentage of 75% has wholly or mainly applied funds to specified purposes within New Zealand.

### “Funds” means money readily available

11. The most appropriate meaning of “funds” is “money readily available” to an organisation at any point (that is, “cash on hand”). This includes cash and other highly liquid assets available to meet commitments.
12. For the purposes of the safe harbour calculation, the term “funds” is accepted as equating to the accounting concepts of “cash” and “cash equivalents”.

### “Applied” means used or devoted to

13. “Applied” means “devoted to” or “put to use”. Funds can be applied by being spent or accumulated. Accumulated means the funds are either set aside for future spending or invested.
14. While there are no specific limits on the extent to which funds can be accumulated, an organisation that simply accumulates funds will need to show that their funds are applied wholly or mainly to specified purposes within New Zealand.

### “Funds are applied” requirement

15. The legislative requirement that “funds are applied” has the following components:
  - The application of funds arises as a result of the organisation undertaking an affirmative act to accumulate money for, or spending it on, specified purposes within New Zealand.
  - The affirmative act necessary to invest or set aside funds is a decision to accumulate funds that has been made at the appropriate level in the organisation for decisions of that type according to the organisation’s established management practices. For example, the trustees of a charitable trust resolve to set aside **money in the trust’s on-call savings account** for a capital purchase in New Zealand.
  - The decision to accumulate funds needs sufficient detail to characterise the application of funds as advancing charitable, benevolent, philanthropic, or cultural purposes within New Zealand.
16. If the funds are not spent and there is no appropriate decision to accumulate the funds for a purpose, the funds are not considered to have been applied to any purpose (see [47] to [49] below).
17. Funds are applied on a continuing basis over the lifetime of the donee organisation (although, for purposes of the safe harbour calculation it is practicable to look at funds applied over a year – see [35] below).

### **Specified purposes must be “within New Zealand”**

18. It is the specified purposes that must be “within New Zealand”, not the application of funds. This means the location where funds are spent is not relevant.
19. The purpose sought to be achieved is determined objectively (see [20] to [24] below).

## **How does an organisation decide if their funds are applied to specified purposes within New Zealand?**

### **Funds applied must have a sufficient connection to specified purposes within New Zealand**

20. An organisation usually applies funds by spending them on goods or services in the course of carrying on some activity. It may also accumulate funds for future spending or donate funds to another organisation (see [29] to [32] below).
21. The character of an activity is determined by the reason for which the activity is carried out. That is, the underlying purpose sought to be advanced, as assessed objectively from the results of the activity.
22. An organisation needs to identify objectively whether a sufficient relationship (connection or nexus) exists between the purposes served by the actual or proposed activity and advancing specified purposes within New Zealand. The connection needs to be sufficiently direct, although it does not need to be an immediate connection (see [25] below).
23. Each application of funds must be assessed objectively on its own merits to determine whether some results are incidental or consequential to other results (see [26] below) or whether more than one purpose exists (see [27] to [28] below).
24. The examples after [55] below will help an organisation decide how much of its funds are applied to specified purposes within New Zealand.

### **Funds applied may have immediate and less immediate purposes**

25. The purpose or purposes served by an application of funds may be the immediate or less immediate purposes. For example, where trading activities:
  - directly achieve a certain object or objects of the organisation as set out in its founding documents, the funds applied to the immediate purpose of the trading activities are also applied to that object or objects;
  - are a way of raising funds, the funds applied to the immediate purpose of the trading activities are considered as being applied to the less immediate purpose or purposes to which the net surplus from trading will be applied.

### **Funds applied may have incidental results**

26. Some results of applying funds arise incidentally or as a consequence of achieving other results directly relatable to the objects of the organisation. These incidental or consequential results can be ignored when deciding whether the results bear a sufficient relationship to specified purposes within New Zealand (see examples 2, 7 to 9 and 15).

### **Applying funds to more than one purpose**

27. Results not naturally arising incidentally or as a consequence of other results that are pursued as a result in their own right may indicate the presence of another independent purpose for the funds applied. If so, the expenditure concerned may need to be

apportioned to different purposes, if the purposes differ as to whether they are specified purposes within New Zealand or other purposes.

28. The approach to apportionment is similar to apportioning deductions for expenditure for income tax. See the discussion about apportioning overheads in [40] to [46], the worked example in [54], and examples 3 and 4 below.

### Donating funds to another organisation

29. Where a donee organisation applies funds by donating them to another organisation, the donee organisation may need to establish it has applied funds to specified purposes within New Zealand to ensure it meets the safe harbour.
30. The distinctive objects of the other organisation may indicate that the donated funds have been applied wholly to specified purposes within New Zealand and can be counted as such.
31. For example, a donation to a public institution or fund that has donee status under sections LD 3(2)(b), (c) or (d) would be a donation to an organisation or fund that is required to exclusively apply its funds to specified purposes within New Zealand. In other situations, the other organisation may have objects such that it is obvious any donations received by it are applied to specified purposes within New Zealand.
32. In other cases, such as an overseas donee organisation listed in schedule 32 of the Income Tax Act 2007, the presumption, without evidence to the contrary, would be that the donated funds are applied to that organisation's distinct overseas objects, rather than to specified purposes within New Zealand.

## How does the administrative safe harbour work?

### Introduction

33. An administrative safe harbour is a calculation method an organisation can adopt to arrive at a "safe harbour percentage". If an organisation meets or exceeds the minimum safe harbour percentage, Inland Revenue will generally accept without further enquiry that the organisation meets the wholly or mainly requirement of s LD 3(2)(a). Inland Revenue has set the safe harbour figure at a minimum of 75%.
34. The safe harbour percentage is relevant only if the organisation applies funds to purposes that are not specified purposes within New Zealand.

### Steps in the calculation

35. Calculating an organisation's safe harbour percentage involves three steps:
- **Step 1:** Use the organisation's statement of cash flows in its financial statements or statement of receipts and payments in its performance report to find the organisation's "total funds". "Total funds" is the sum of the cash on hand at the end of a year and the cash spent during the year (that is, all cash outflows whether capital or revenue).
  - **Step 2:** Find the amount of the organisation's "funds applied to specified purposes within New Zealand". This is a combination of the cash spent, invested or set aside during the year entirely for specified purposes within New Zealand and amounts reasonably apportioned to those purposes.
  - **Step 3:** Divide the cash spent or set aside for specified purposes within New Zealand (as per step 2) by the organisation's "total funds" (as per step 1) and express this as a percentage. This is the organisation's safe harbour percentage for the year.

36. The financial statements or performance report for the organisation should be used, rather than any consolidated accounts that include financial information for other entities. An organisation that is not a registered charity may use their statement of cash flows or its equivalent from their financial reports.

### Investing and setting aside funds

37. Step 2 in the safe harbour calculation requires finding the amount of cash an organisation has spent or accumulated (ie, invested or set aside) for specified purposes within New Zealand.
38. Funds invested or set aside for future spending for some purpose or purposes are applied at the time the investment is acquired or the decision to set the funds aside is made. Practically this means that funds set aside but still on hand at balance date will **be considered in every year's safe harbour calculation** up to and in the year they are spent. However, funds invested will be considered only in the year they are invested and again in the year it is spent.
39. Because the safe harbour calculation adopts **the accounting terms "cash" and "cash equivalents" as a proxy for "funds" these terms will provide the basis for differentiating between funds set aside and investments. Generally, "cash equivalents" are short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value. Often these funds will be set aside for funding an organisation's on-going operational expenses and will be, therefore, usually set aside for the purpose of advancing all the objects of the organisation.**

### Apportioning "overheads"

40. Step 2 includes apportioning amounts where they have been spent or accumulated for specified purposes within New Zealand and for other purposes.
41. In some cases funds are applied in such a way that different purposes are served without distinction and the relative application of funds does not lend itself easily to **measurement. This situation may arise for "overhead" type costs (for example, sundry office expenses).** It may also arise for investments where funds have been accumulated for the general purposes of the organisation. It may also be true for the general operating funds of the organisation on hand at year-end. In many cases, the general operating funds of the organisation on hand at year-end will equate to all the **"funds"** (cash and cash equivalents) an organisation has set aside at year-end.
42. In such cases, some basis of apportionment is still required. Inland Revenue will generally accept apportioning these remaining funds based on the ratio established when the application of all the other funds is considered. That is, the ratio of the other funds applied to specified purposes within New Zealand (being those applied entirely to those purposes or those apportioned already to those purposes on some other reasonable basis) compared to the total of all these other funds.
43. For example, an organisation determines that the total funds in a year it has spent or accumulated entirely for specified purposes within New Zealand is \$1,000. It determines that other funds totalling \$500 have been spent or accumulated for specified purposes within New Zealand and for other purposes. Using some apportionment method that is reasonable given the particular nature of these funds, the organisation apportions \$200 of this total to specified purposes within New Zealand. The ratio of funds applied to specified purposes within New Zealand established so far is, therefore, 80%  $((1,000 + 200) / (1,000 + 500))$ .

44. The organisation has remaining funds of \$800 that have been applied to a combination of purposes. This amount includes the organisation's cash and cash equivalents on hand at year-end held as operating funds and other "overhead" expenses that relate to all the purposes of the organisation without distinction. It is assumed there is no discernable and reasonable basis on which to apportion these funds. Therefore, Inland Revenue will generally accept that these funds can be apportioned using the percentage arrived at by considering the way the other \$1,500 of the organisation's funds have been spent or accumulated (that is, 80% to specified purposes within New Zealand).
45. In that case, the \$800 of remaining funds is apportioned to specified purposes within New Zealand to the extent of \$640 ( $800 \times 80\%$ ). This means, assuming all of the organisation's funds for the year have been applied to a purpose, the organisation's "total funds" of \$2,300 ( $1,500 + 800$ ), have been applied to specified purposes within New Zealand to the extent of \$1,840 ( $1,000 + 200 + 640$ ). The organisation's safe harbour percentage is 80% ( $1,840 / 2,300$ ).
46. Including these remaining funds in the calculation does not affect the safe harbour percentage already determined from the consideration of the other funds spent or accumulated because the \$800 in this example is apportioned using the same ratio of 80%. Practically, therefore, these funds could be ignored for the purposes of the calculation. However, as mentioned, this applies only to funds spent or accumulated for different purposes where no other reasonable basis on which they can be apportioned exists.

### Treatment of funds not accumulated for a purpose

47. Most organisations are likely to have spent or accumulated all of their funds for a purpose in any given year. In other words, they will not have any funds that have not been spent or accumulated for a purpose. This is because the organisation has taken some affirmative act to spend or accumulate all of its funds for a purpose.
48. If so, in the safe harbour calculation the total of funds applied to specified purposes within New Zealand plus the funds that have been applied to other purposes will always equal the organisation's "total funds" for the year.
49. However, if an organisation does have funds that have not been accumulated for a purpose, this will not be the case. The funds that have not been accumulated for a purpose will still be part of the "total funds" for the purposes of calculating the organisation's safe harbour percentage. However, by definition, these funds have not been accumulated for any purpose. Therefore, they cannot be counted as funds that have been accumulated for specified purposes within New Zealand. The practical implication of this may be to reduce the percentage of funds applied to specified purposes within New Zealand for that year.

### Failing to achieve the safe harbour percentage

50. If an organisation fails to meet the safe harbour of 75% in any year, Inland Revenue will accept a revised calculation based on the current year and the two preceding years. In such a case, the organisation can recalculate the percentage on the basis of the cumulative total of its funds applied over the current and preceding two years (including years before the commencement of the statement). This allows some year-on-year variation for exceptional years. Table 1 provides an example of the rolling three-year cumulative approach that Inland Revenue will accept.

**Table 1: Example of the rolling three-year cumulative approach to the safe harbour calculation**

	Year -2 \$	Year -1 \$	Current year \$
Total funds	10,000.00	5,000.00	5,000.00
Funds applied to specified purposes within New Zealand	9,000.00	4,000.00	3,000.00
Percentage of total funds applied to specified purposes within New Zealand (safe harbour percentage)	90%	80%	<b>60%</b>
Cumulative total funds	10,000.00	15,000.00	20,000.00
Cumulative funds applied to specified purposes within New Zealand	9,000.00	13,000.00	16,000.00
Cumulative percentage of total funds applied to specified purposes within New Zealand (cumulative safe harbour percentage)	90%	87%	<b>80%</b>

51. This means an organisation can be below the safe harbour percentage of 75% in an exceptional year provided the rolling three-year cumulative percentage is 75% or more. However, it would not be expected that an organisation would apply 50% or less of its funds to specified purposes within New Zealand in any particular year.
52. If the rolling three-year cumulative safe harbour percentage of funds applied to specified purposes within New Zealand in a year is below 75% or the figure in any year is 50% or below, then the organisation should contact Inland Revenue as soon as possible.
53. Some options may be available if an organisation finds complying with the wholly or mainly requirement of s LD 3(2)(a) difficult. For example, an organisation may wish to consider whether to establish and maintain a fund exclusively for specified purposes within New Zealand under section LD 3(2)(c). In that situation, the fund, rather than the organisation, would hold donee organisation status and tax benefits could accrue to donors to the fund. **In cases where the safe harbour is not met, an organisation should discuss their situation with Inland Revenue.**

## Example of how the safe harbour percentage is calculated

54. The following example from the statement shows how the safe harbour is calculated.

EduParcel is an organisation established primarily to provide grants to New Zealand students, but it also provides occasional assistance in developing countries by distributing food parcels. EduParcel has generally funded its operations through donations from the public.

EduParcel is approved as a registered charity with Charities Services and has donee organisation status under s LD 3(2)(a). Since it is a small organisation, EduParcel has opted to apply the tier 4 reporting standards for registered charities. This requires EduParcel to file an annual performance report and annual return to Charities Services.

EduParcel commences its activities on 1 April 2019 with unpaid volunteer staff. It has a 31 March balance date. In its first year of operations, EduParcel receives donations of \$22,000. **Included in the donations is a \$10,000 bequest. EduParcel's** management board resolves to invest this amount as surplus operating funds to be applied to all its purposes in the future. Accordingly, it resolves to invest the funds in a term deposit for future spending **on all of the organisation's purposes.**

EduParcel opens a cheque account with a trading bank specifically for the purpose of meeting its on-going operating costs. It also opens a savings account with the bank for the purpose of holding operating funds not needed immediately on an interest-bearing basis. The savings account generates \$20 of interest income for the year.

EduParcel rents an office, and pays for office supplies, contents insurance, power, phone, internet and a website. It also rents a small storage unit to house the food parcels and related material. These costs amount to \$9,300. To fund these expenses, it initially borrows \$2,000 interest-free from a supporter. This amount is repaid from donations later in the year. EduParcel also purchases some office furniture for \$800 during the year.

During the year, EduParcel provides Sally, a New Zealand physics student from a disadvantaged background, with a \$1,150 grant to assist her New Zealand university studies. It also spends \$50 to send a food parcel to an overseas developing country.

At year-end EduParcel has set aside \$300 in its cheque account and \$420 in its savings account for future operating costs.

For the year ended 31 March 2020, EduParcel produces a performance report including the following statement of receipts and payments:



**Table 2: Example – EduParcel’s statement of receipts and payments for the year ended 31 March 2020**

<b>EduParcel</b> <b>Statement of Receipts and Payments</b> “How was it funded?” and “What did it cost?” For the year ended: <b>31 March 2020</b>				
	Notes	Actual		
		This Year	Last Year	
		\$	\$	
<b>Operating Receipts</b>				
Donations, fundraising and other similar receipts		22,000		
Fees, subscriptions and other receipts from members		-		
Receipts from providing goods or services		-		
Interest, dividends and other investment income receipts		20		
Other operating receipts		-		
<b>Total Operating Receipts</b>		<b>22,020</b>	-	
<b>Operating Payments</b>				
Payments relating to public fundraising		-		
Volunteer and employee related payments		-		
Payments related to providing goods or services	3	9,300		
Grants and donations paid	3	1,200		
Other operating payments		-		
<b>Total Operating Payments</b>		<b>10,500</b>	-	
<b>Operating Surplus or (Deficit)</b>		<b>11,520</b>		
<b>Capital receipts</b>				
Receipts from sale of resources				
Receipts from borrowings		2,000		
<b>Capital payments</b>				
Purchase of resources	3	800		
Repayment of borrowings	3	2,000		
<b>Increase / (Decrease) in Bank Account and Cash</b>		<b>10,720</b>	-	
Bank accounts and cash at beginning of the financial year		-		
<b>Bank accounts and Cash at the End of the Financial Year</b>		<b>10,720</b>	-	
<b>Represented by:</b>				
Cheque account(s)		300		
Savings accounts(s)		420		
Term Deposit account(s)		10,000		
Cash Floats		-		
Petty Cash		-		
<b>Total Bank A/cs and Cash at the End of the Financial Year</b>		<b>10,720</b>	-	

Following the method in Figure 1 above, EduParcel uses the statement of receipts and payments from the performance report to determine its “total funds”. “Total funds” comprises the amounts highlighted in green in Table 2. They are the:

- Operating and Capital Payments made ( $10,500 + 2,800 = \$13,300$ )
- Bank Accounts and Cash at the End of the Financial Year ( $\$10,720$ ).

Accordingly, EduParcel has spent funds of \$13,300 and has \$10,720 left over that it has accumulated by investing or setting aside at the end of the year, giving it a "total funds" figure of \$24,020.

"Total funds" of \$24,020 is the same amount obtained by adding EduParcel's:

- opening bank accounts and cash (nil); and
- receipts from all sources for the year (22,020 + 2,000 as highlighted in yellow in Table 2).

Step 2 in the safe harbour calculation requires finding the amount of cash EduParcel has spent or accumulated for specified purposes within New Zealand. In this example, EduParcel does not have any cash that has not been spent or accumulated for a purpose. Accordingly, all of its "total funds" have been "applied" by being spent or accumulated.

The notes to the performance report provide further details of EduParcel's payments (see Table 3):

**Table 3: Example – EduParcel's notes to the performance report for the year ended 31 March 2020**

<b>EduParcel</b>				
<b>Notes to the Performance Report</b>				
<b>For the year ended:</b>				
<b>31 March 2020</b>				
<b>Note 3: Analysis of Payments "What did it cost?"</b>				
<b>Payment item</b>	<b>Analysis</b>	<b>This Year</b>	<b>Last Year</b>	
		\$	\$	
Payments relating to public fundraising		-		
	<b>Total</b>	-	-	
<b>Payment item</b>	<b>Analysis</b>			
Volunteer and employee-related payments		-		
	<b>Total</b>	-	-	
<b>Payment item</b>	<b>Analysis</b>			
Payments related to providing goods or services	Rent on NZ office	7,800		
	Rent on storage unit	300		
	Office supplies	200		
	Contents Insurance	500		
	Power/phone/internet	300		
	Website costs	200		
	<b>Total</b>	<b>9,300</b>		-
<b>Payment item</b>	<b>Analysis</b>			
Grants and donations paid	NZ scholarship grant	1,150		
	African food parcel programme	50		
	<b>Total</b>	<b>1,200</b>		-
<b>Payment item</b>	<b>Analysis</b>			
Other operating payments		-		
	<b>Total</b>	-		-
<b>Payment item</b>	<b>Analysis</b>			
Capital payments	Property, plant and equipment	800		
	Repayment of borrowings	2,000		
	<b>Total</b>	<b>2,800</b>		-

To find the amount spent and accumulated for “funds applied to specified purposes within New Zealand” EduParcel first finds the amounts spent or accumulated *entirely* for specified purposes within New Zealand. The only amount spent entirely for specified purposes within New Zealand is the education grant of \$1,150.

EduParcel then finds the amounts that have been spent or accumulated *entirely* for purposes other than specified purposes within New Zealand. These amounts are the rent on the storage unit of \$300 and the food parcel of \$50 because both these amounts relate to EduParcel’s activities for advancing purposes overseas.

All of EduParcel’s remaining funds have been spent or accumulated for both specified purposes within New Zealand and other purposes. EduParcel next considers whether any of these funds can be apportioned between these different purposes on some discernible and reasonable basis. It concludes that, because the contents insurance covers property in both its office and the storage shed, most of the insurance premium of \$500 relates to its office furniture based on the relative insured values of the property. From this, it determines the relative insured values are 20% for overseas purposes and 80% for specified purposes within New Zealand. Accordingly, it apportions \$400 of the premium to specified purposes within New Zealand.

EduParcel considers that in relation to the remaining funds no readily discernible basis on which to make an apportionment exists. This is because none of these other amounts can be specifically attributed to its New Zealand educational activities, or to its foreign food parcel programme.

However, these remaining amounts need to be apportioned between specified purposes within New Zealand and other purposes on some basis. The amounts in question are the:

- payments relating to providing goods or services (such as the office rent and office supplies but excluding the storage unit rent and contents insurance) of \$8,500;
- capital payment to purchase office furniture of \$800;
- funds spent on repaying the loan of \$2,000;
- funds invested in the term deposit of \$10,000; and
- funds set aside as operating funds and held in the cheque and savings accounts at year-end of \$720.

For the purposes of this example, it is assumed that these amounts serve all of EduParcel’s purposes without distinction and that there is no more reasonable basis to apportion these amounts. As such, they can be apportioned on the ratio of the previous amounts referred to that relate entirely to a purpose or can be reasonably apportioned on some other basis.

EduParcel prepares a spread sheet (in Table 4) showing these amounts:

**Table 4: Example – EduParcel safe harbour calculation**

<b>EduParcel – Safe harbour calculation</b>			
<b>Item</b>	<b>Specified purposes within NZ \$</b>	<b>Other purposes \$</b>	<b>Total \$</b>
<i>Funds applied entirely for a purpose:</i>			
NZ scholarship grant	1,150		1,150
Overseas food parcel programme		50	50
Storage unit rent		300	300
<i>Funds applied for both purposes – apportioned on some reasonable basis</i>			
Contents insurance	400	100	500
<b>Total</b>	<b>1,550</b>	<b>450</b>	<b>2,000</b>
<i>Percentage of funds applied</i>	78%	22%	100%
<i>Funds applied for a combination of purposes apportioned on above percentage:</i>			
Operating payments	6,630	1,870	8,500
Purchase of office furniture	624	176	800
Loan repayment	1,560	440	2,000
Term deposit	7,800	2,200	10,000
Cash held for general operating purposes	562	158	720
<b>Total</b>	<b>17,176</b>	<b>4,844</b>	<b>22,020</b>
<i>Funds applied to no purpose</i>	-	-	-
<b>Total funds applied</b>	<b>\$18,726</b>	<b>\$5,294</b>	<b>\$24,020</b>

EduParcel finds its safe harbour percentage by taking its “funds applied to specified purposes within New Zealand” (\$18,726) and dividing it by its “total funds” (\$24,020) to arrive at a percentage of 78%. On the basis of this single year’s results, Inland Revenue would generally accept without further enquiry that EduParcel has applied 78% of its total funds to specified purposes within New Zealand and is within the 75% wholly or mainly administrative safe harbour.

As can be seen in this example, the safe harbour percentage could be established by just considering the funds entirely applied to a purpose plus those able to be apportioned on some other discernible and reasonable basis (ie, the funds applied totalling \$2,000 shown in the first part of Table 4). This is because the funds applied to a combination of purposes that cannot be apportioned on some other discernible and reasonable basis are apportioned on the same ratio (in this case, 78%).

Organisations apportioning funds applied on this basis will need to be able to show that there is no other basis for apportionment (eg, floor area or time basis – see the discussion of apportionment above). However, Inland Revenue will generally accept this basis applying at least to the extent of funds set aside and on hand at year-end as operating funds.

Following this simplified approach it would be possible for EduParcel to calculate the safe harbour percentage in the following manner shown in Table 5:

**Table 5: Example – EduParcel safe harbour calculation (simplified)**

<b>EduParcel – Safe harbour calculation</b>			
<b>Item</b>	<b>Specified purposes within NZ \$</b>	<b>Other purposes \$</b>	<b>Total \$</b>
<i>Funds applied entirely to a purpose:</i>			
NZ scholarship grant	1,150		1,150
Overseas food parcel programme		50	50
Storage unit rent		300	300
<i>Funds applied to both purposes – apportioned on some reasonable basis</i>			
Contents insurance	400	100	500
	<b>1,550</b>	<b>450</b>	<b>2,000</b>
<i>Percentage of funds applied</i>	78%	22%	100%
<i>Funds applied to a combination of purposes apportioned on above percentage:</i>			
	<b>17,176</b>	<b>4,844</b>	<b>22,020</b>
<b>Total funds applied</b>	<b>\$18,726</b>	<b>\$5,294</b>	<b>\$24,020</b>

## Examples – how to determine when funds are applied to specified purposes within New Zealand

55. As mentioned, the following examples from the statement will help an organisation decide how much of its total funds are applied to specified purposes within New Zealand.

*The following examples involve the Foliage Foundation. This foundation is a charitable organisation with donee organisation status under s LD 3(2)(a). The Foundation was established with the primary object of supporting and undertaking the restoration or maintenance of New Zealand native forests by promoting or undertaking native tree planting programmes in New Zealand bush reserves. Other objects include public education on indigenous forest conservation issues in New Zealand and overseas as well as assisting or co-operating with other people or organisations with similar aims in New Zealand or overseas.*

### **Example 1 – Spending overseas to further New Zealand specified purposes**

The Foliage Foundation purchases and imports from a foreign supplier certain specialty tools used for clearing land and planting trees. Although the purchase involves spending offshore, the purpose of the expenditure is to advance the **foundation's New Zealand tree planting activities**. Therefore, the spending is regarded as funds that have been applied to specified purposes within New Zealand.

### **Example 2 – Spending in New Zealand to further overseas purposes**

The Foliage Foundation becomes concerned about the loss of rain forest in the Amazon basin of South America through logging and land clearing for agriculture. In response, it carries out a campaign in New Zealand to raise awareness about deforestation in the Amazon.

The campaign involves a series of road shows around New Zealand for which the **foundation pays each speaker's expenses and a speaker's fee. It pays an Auckland business to create a new website, separate from the foundation's general website**, with information specific to the Amazon rainforest issues. It also produces a number of television and radio advertisements that are broadcast on New Zealand stations.

The campaign is directed at bringing about a halt to deforestation outside New Zealand. Any result this would bring about within New Zealand, for instance the effects this might arguably have on **New Zealand's climate, arises incidentally to the primary purpose of the campaign**. Accordingly, the application of funds to the campaign does not bear a sufficiently direct relationship to specified purposes within New Zealand. Therefore, the various costs are not regarded as funds that have been applied to specified purposes within New Zealand.

### **Example 3 – Apportionment of expenses – wage costs dissected or apportioned**

The Amazon rainforest campaign in example 2 is very successful, so the Foliage Foundation hires one additional staff member to work full time on Amazon rainforest issues. The foundation has 19 other staff employed to carry on its New Zealand planting programme. It needs to dissect its total wage expense by staff member and consider the purpose for which each staff member is employed.

The salaries of the 19 staff are funds applied to specified purposes within

New Zealand. However, the salary for the employee working on the Amazon rainforest issues is not.

If any staff member was employed for more than one purpose, some apportionment **of the individual's wage expense** on a reasonable basis might then be needed (for example, by hours spent on each purpose). This would require the foundation keeping adequate records to substantiate any apportionment calculation.

#### **Example 4 – Apportionment of expenses – electricity bill apportioned**

The Foliage Foundation is based in temporary accommodation from where all its **activities are undertaken or directed and where all of the organisation's staff are** located. It receives and pays a \$300 electricity bill for its accommodation. Unlike the previous example, it cannot reasonably trace the exact usage of electricity and dissect the electricity bill into the portion that relates to specified purposes within New Zealand and the portion that relates to its activities in relation to the Amazon. Accordingly, it needs to find some reasonable basis on which to apportion the electricity bill.

In the absence of a more reasonable basis, Inland Revenue will generally accept apportionment of overhead expenses, such as electricity, on the basis of the percentage established by the funds that have been applied entirely to a single purpose plus those that have been apportioned using some other apportionment method.

In this case, the foundation works out that it has applied funds entirely to specified purposes within New Zealand to the extent of \$8,000 and entirely to purposes that are not specified purposes within New Zealand of \$2,000. It has no other funds it can apportion on another discernible and reasonable basis. Accordingly, it apportions its electricity bill as being applied to specified purposes within New Zealand in the same ratio. This means the electricity bill is apportioned to specified purposes within New Zealand to the extent of \$240 ( $\$8,000 / \$10,000 \times \$300 = \$240$ ).

#### **Example 5 – Scholarships for New Zealand students to study overseas**

The Foliage Foundation decides to start providing scholarships to high-achieving New Zealand arboriculture students to increase expertise in New Zealand. The scholarships allow students to undertake a year of study on courses specialising in the restoration of native forests at a foreign university. Although the scholarship funds are spent offshore and the students carry out their studies overseas, the students are required to return to New Zealand and many continue to work in related sectors in New Zealand. The results of having increased arboriculture skills and knowledge available to the foundation and New Zealand in general provide a sufficient connection to specified purposes within New Zealand. Therefore, the scholarship costs are regarded as funds that have been applied to specified purposes within New Zealand.

#### **Example 6 – Sending employees to overseas conference**

The Foliage Foundation joins the Native Tree League, a worldwide network of organisations promoting native tree development programmes. Joining is free and **entitles the foundation to attend the league's annual conference and access technical resources and expertise from the league members.**

The foundation decides to send two of its **employees to the league's annual** conference held that year in Argentina and has to pay for flights and accommodation. No holiday element is included in the trip. The employees return with increased knowledge of native tree preservation.

The results of having increased skills and knowledge available to the foundation provide a sufficient connection to specified purposes within New Zealand. As such, the travel costs are regarded as funds that have been applied to specified purposes within New Zealand.

### **Example 7 - Sending a speaker to an overseas conference**

The Foliage Foundation decides to send another employee to present a paper at the annual Native Tree League conference in Argentina. The paper will be about their involvement in a recent study into kauri conservation. The foundation pays for the flights and accommodation and the employee attends the conference. No holiday element is included in the trip.

One result of the expenditure is to benefit the foreign conference attendees with increased **knowledge of kauri conservation issues. However, the employee's** presentation will also raise the profile of the foundation and international awareness of indigenous forest conservation issues in New Zealand. The employee will return with increased knowledge of these issues from attending the balance of the conference.

Any personal benefit to the employee and any benefit to the other conference **attendees who attend the paper's presentation is incidental to these purposes.** Therefore, the travel costs are regarded as funds that have been applied to specified purposes within New Zealand.

### **Example 8 – Hosting overseas representatives**

Following the conference (example 7), the Foliage Foundation hosts two Native Tree League representatives while they are visiting New Zealand. Whether the expenditure incurred in hosting the representatives can be regarded as advancing specified purposes within New Zealand **will depend on the purpose of the representatives' visit.**

For instance, if the representatives are hosted while carrying on activities for the Native Tree League or during a private visit to New Zealand the expenditure will not **advance the foundation's** objects. Therefore, the hosting costs are unlikely to be regarded as funds that have been applied to specified purposes within New Zealand.

However, if the representatives were hosted, for example, because they were the **keynote speakers at the foundation's annual conference, then the hosting costs would** be considered as being applied to advance specified purposes within New Zealand with any benefit to the Native Tree League being incidental. In other circumstances, the hosting costs might advance the purposes of both organisations in which case some apportionment on a reasonable basis would be acceptable.

### **Example 9 – Contribution to a foreign organisation**

A representative from the Native Tree League contacts the Foliage Foundation and **asks for a contribution to the construction of the league's worldwide headquarters in** Argentina. The foundation decides that it will contribute a lump-sum payment **because of the organisations' shared interest in developing native tree planting** programmes throughout the world.

The contribution directly advances the purposes of the league overseas as it helps bring about the result that the league has new headquarters. This may have some indirect results that benefit members of the league in other countries, such as the foundation. However, such results are incidental to the direct advancement of the **league's purposes. This means the contribution** does not bear a sufficiently direct relationship to specified purposes within New Zealand. Therefore, the contribution is



not regarded as funds that have been applied to specified purposes within New Zealand.

### **Example 10 – Investment in New Zealand and overseas**

To fund major planting projects planned for the South Island for coming years, the Foliage Foundation decides to use funds to invest in a portfolio of shares and bonds. Some of the shares and bonds it buys are in New Zealand companies, but most are in overseas listed companies. Most of the income from its investments is from overseas. The investment income will be reinvested until such time as all the investments are sold to fund the planned planting projects.

The purchase of the shares and bonds and subsequent reinvestment of investment income involves the application of funds. The purpose advanced by the application of these funds is the less immediate purpose to which the investments will ultimately be applied. This purpose is the **foundation's tree**-planting purposes within New Zealand. It is not relevant that some of the investments are overseas or that the source of some of the investment income is from overseas. Therefore, the accumulation of funds is regarded as being funds that have been applied to specified purposes within New Zealand.

When the investments are realised in the future, the cash spent on the South Island planting projects will also be an application of funds to specified purposes within New Zealand.

### **Example 11 – Purchase of materials by trading activity**

The Foliage Foundation decides to run a small trading activity making and selling designer bush shirts from a shop in Wellington. It uses cash from its general operating funds to buy from overseas and New Zealand suppliers the raw materials used to manufacture the shirts. The shirts are then sold and the surplus used to fund **the foundation's New Zealand** planting programmes.

The relevant purpose to which the cash used to purchase raw materials is applied is the less immediate purpose of generating funds for the foundation to apply to its purposes of tree planting in New Zealand. Therefore, the purchase of the raw materials is regarded as being funds that have been applied to specified purposes within New Zealand.

### **Example 12 – Funding a future project**

The Foliage Foundation decides to buy a small block of land adjacent to a bush reserve and build an office and storage yard. It intends to use the premises for its permanent New Zealand head office from which all its activities are undertaken or directed and where its equipment is stored. All foundation staff will be located in the head office. The foundation appeals to its supporters for financial assistance.

Tim, a foundation supporter, donates all the money needed to buy the land. **In anticipation of Tim's donation being spent on the new property, the foundation's** officers make a decision to invest the donation and create a building reserve fund in **the foundation's financial accounts**. **As further donations and funds arise** they will be invested as a result of further decisions to accumulate funds towards this capital project.

**Ultimately, the capital project will result in advancing all the foundation's** objects by **providing the site of the foundation's future premises**. As with example 4, apportionment of the funds accumulated is required as the **foundation's objects are** advanced both within and outside of New Zealand.

### **Example 13 – Expenses related to a fixed asset**

The Foliage Foundation realises its investments and completes the capital project (from example 12) in a subsequent financial year. At this point, it needs to reconsider whether the cash realised from the investments is being spent for specified purposes within New Zealand. As it still intends to use the property for all of its activities, the funds being applied to the project will need to be apportioned on the same basis as previously.

In the future, any costs of holding the property (such as local authority rates and insurance) may also need to be apportioned on a reasonable basis between all the **foundation's purposes**. The holding costs could be apportioned using a similar approach to that used in example 4.

### **Example 14 – Loan funds and repayments**

Instead of receiving all of the money needed for its new premises from a donation (as in example 12), the Foliage Foundation borrows some of what is needed from a trading bank. On borrowing the money from the bank, the money immediately becomes part of the **foundation's total funds for the purposes of the safe harbour** calculation. The borrowed funds are applied by being accumulated until they are spent, as in the earlier example.

When the borrowed funds are spent, the foundation will need to consider the purpose for which the premises will be used. If, (as in example 13) all the funds are being applied to more than one purpose, they will need to be apportioned for the purposes of the safe harbour calculation. Subsequently, the foundation will apply further funds to repay the loan from the bank. The purpose of the funds applied to the loan repayments will follow the purposes to which the original loan money was spent on.

### **Example 15 – Overseas people viewing the Foliage Foundation's general website**

The Foliage Foundation maintains two websites. One has general information about the foundation and details its New Zealand planting programmes and scholarships. **The second, separate, website holds information about the foundation's Amazon rainforest work (see example 2) and links to the Native Tree League's website (see example 6). The foundation's general website includes a link to this second website, but contains none of its content.**

The foundation finds that both of its websites get hits from visitors from overseas countries. **However, because the general website's content is not specifically directed to the foundation's overseas activities, any use of the website by overseas persons is incidental.** The expenditure involved in running the general website will still be **viewed as advancing the foundation's purposes in New Zealand.** Therefore, the **general website's costs are regarded as being an application of funds to specified purposes within New Zealand.**

However, if in the future any of the content of the general website was specifically directed at advancing overseas purposes, some apportionment of the on-going website costs on a reasonable basis may be necessary.

### **Example 16 – Spending for foreign posted worker holidaying in New Zealand**

After a few years, the Foliage Foundation's Amazon rainforest campaign's effectiveness declines. The foundation thinks it can make a greater difference by spending the same amount to engage somebody to travel to South America to

undertake rainforest protection work. The foundation sends one of its long-time supporters, Emma, to Brazil.

After spending a year in Brazil, Emma returns to New Zealand for a two week holiday to see her family and friends. At the end of her holiday Emma will return to her duties in Brazil.

The foundation **helps pay for Emma's travel and accommodation while she is in New Zealand**. Although the travel and accommodation costs are spent in New Zealand, **they are costs involved in advancing the foundation's overseas purposes** because Emma is primarily engaged in the activity of advancing rainforest protection work in Brazil even though she is temporarily visiting New Zealand. Therefore, the travel and accommodation costs will not be regarded as being an application of funds to specified purposes within New Zealand.

### **Example 17 – Government contracts**

The Foliage Foundation enters into an agreement with a government department where, in return for the payment of a grant, the foundation carries out native forest restoration on Crown conservation land. On receipt, the grant will be part of the **foundation's total funds for the purposes of the safe harbour calculation**.

The foundation uses the grant to purchase native tree seedlings and to pay temporary employees to plant them. The grant spent on seedlings and employee wages are costs associated with the provision of outputs under the government contract. The purpose of the expenditure will, therefore, follow the purpose of the government contract. Since the purpose of the government contract is to restore New Zealand native forests, the expenditure advances specified purposes within New Zealand. Therefore, the grant money spent and the portion set aside for future spending under the grant agreement are regarded as being an application of funds to specified purposes within New Zealand.

The same conclusion will apply, if the contract is terminated and, under the terms of the grant agreement, any unspent grant money is required to be repaid to the government department.