Inland Revenue
Te Tari Taake

PUBLIC RULINGS UNIT

ISSUES PAPER No. 9

Donee organisations — clarifying when funds are applied wholly or mainly to specified purposes within New Zealand

Office of the Chief Tax Counsel
Inland Revenue

ISSUES PAPERS

Inland Revenue's Public Rulings Unit is responsible for developing and publishing binding public rulings and other public statements on aspects of tax law.

Occasionally, the technical and practical issues involved in these statements are such that it is necessary or useful for us to seek comments and submissions from external parties before preparing a draft statement. This is done by researching and preparing an issues paper. The purpose of an issues paper is to stimulate discussion and invite submissions from interested parties.

The purpose of this issues paper is explained in paragraphs 1 to 11. The matters considered in this issues paper may form the basis of a future public statement, which we would circulate to interested parties for comment in the usual manner.

STATUS OF ISSUES PAPERS

Draft issues papers produced by the Office of the Chief Tax Counsel represent the initial views of the Commissioner of Inland Revenue.

These items may not be relied on by taxation officers, taxpayers or practitioners. Only finalised items represent authoritative statements by Inland Revenue of its stance on the particular issues covered.

SUBMISSIONS

To assist our consideration of the complex and important issues involved, we are seeking submissions from interested parties. The Commissioner is interested in receiving written submissions on the interpretation, practical issues and policy outcomes raised in this paper.

As stated, the views expressed in this Issues Paper represent the initial views of the Commissioner. No change in the Commissioner's current position or practices would occur until Public Rulings' usual public consultation process was completed and all issues have been identified and thoroughly considered including determining what transitional arrangements (if any) are required.

Email your submission to **Public.Consultation@ird.govt.nz**

We would appreciate receiving your submission by **24 June 2016.**

Please quote reference: IRRUIP9

ISSUES PAPER: IRRUIP9

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All legislative references are to the Income Tax Act 2007 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this issues paper.

Contents

Introduction

Purpose of this issues paper

1. The Commissioner is aware of a lack of clarity and consistency in relation to some aspects of the requirements for an entity to have "donee organisation" status under the Income Tax Act 2007. Subject to some limits, tax advantages can arise to a donor for gifts made to donee organisations. This is due to the potential benefit to New Zealand society that arises from gifts to such organisations.

2. The tax advantage for natural persons is a refundable tax credit set at $33^1/_3$ percent of cash gifts of $5 or more made to donee organisations. Donations made by companies and Māori authorities qualify for a tax advantage in the form of a deduction for the amount of the gift.

3. If an entity cannot attain or maintain donee organisation status, not only will donors to that entity be ineligible for tax advantages, but the ability of the entity to raise the funds it needs to carry out its purposes may also be affected. The Commissioner considers it important that these aspects of the requirements are

clarified as it would provide greater certainty about the provision of tax advantages for charitable and other public benefit gifts.

4. Accordingly, the purpose of this paper is to discuss interpretative and practical issues relating to some of the requirements under the Act for an entity to be a "donee organisation".

5. Under the Act, a donee organisation is an organisation that is described in s LD 3(2) or listed in Schedule 32. The issues discussed in this paper primarily concern a donee organisation as described in para (a) of s LD 3(2).

6. Under s LD 3(2)(a), a donee organisation is:

> a society, institution, association, organisation or trust which is not carried on for the private pecuniary profit of any individual and whose funds are applied wholly or mainly to charitable, benevolent, philanthropic, or cultural purposes within New Zealand.

7. There is little judicial guidance on the interpretation of s LD 3(2)(a). A predecessor of the section was examined in *Molloy v CIR* [1981] 1 NZLR 688 (CA). However, the focus in *Molloy* was whether or not the main purposes or objects of the entity concerned were charitable, benevolent, philanthropic or cultural purposes. The Court of Appeal noted (at 690) that the legislation raised a number of problems, but was not required to resolve these problems. The problems identified were:

- the meaning of "in New Zealand" and when purposes are "within New Zealand;
- whether "funds" refers to the whole or the principal part of an entity's funds or just income;
- whether applying funds relates to just an income year or a longer period; and
- whether holding funds is applying them.

8. As mentioned, the Commissioner is aware of confusion about the interpretation of s LD 3(2)(a). For instance, there is a lack of clarity about whether it is:

- the purposes that must be within New Zealand; or
- the application of funds that must be within New Zealand.

9. Also, the requirement for an entity to "wholly or mainly" apply funds to charitable, benevolent, philanthropic, or cultural purposes within New Zealand suggests that something less than 100 percent of an entity's funds can be applied to these purposes within New Zealand. However, it is not clear how much less than 100 percent is acceptable. This is particularly an issue when a donee organisation applies funds to purposes outside New Zealand.

10. Other issues concern the meaning of "funds", what it means to apply funds to purposes within New Zealand, and whether funds can be paid only within New Zealand. Considering the issue of the application of funds raises practical questions about how to measure the extent of the application of funds to one purpose or another so as to gauge compliance with the "wholly or mainly" requirement.

11. For convenience, the phrase "charitable, benevolent, philanthropic, or cultural purposes" used in s LD 3(2)(a) is referred to in this paper as "specified purposes". Any purposes that are not specified purposes are referred to as "non-qualifying purposes". Similarly, gifts eligible for tax advantages, defined in s LD 3 as "charitable or other public benefit gifts", are referred to as "gifts".

Summary of analysis

12. The issues and arguments are discussed in the body of this paper. In summary, the Commissioner's initial views are:

- An entity's funds must be wholly or mainly applied to specified purposes, and it is the specified purposes that must be within New Zealand.
- An entity's funds may be applied to specified purposes within New Zealand even when this results in money being paid outside New Zealand.
- There is no separate requirement in s LD 3(2)(a) for funds to be spent within New Zealand.
- An entity's funds may be applied to specified purposes within New Zealand when those funds are held for spending in the future on those purposes.
- "Wholly or mainly" does not have a set meaning, but in the context of s LD 3(2)(a) it should be treated as a conjunctive or composite phrase that means "substantially all" or "close to 100 percent".
- This interpretation of "wholly or mainly" ensures tax advantages mainly accrue for gifts to entities that apply their funds to specified purposes within New Zealand and that benefit New Zealand society.
- For practical purposes and for greater certainty about the application of the legislation, "wholly or mainly" should be taken to mean 90 percent or more.
- This means an entity could apply 10 percent or less of its funds to non-qualifying purposes and be considered to meet the "wholly or mainly" requirement.
- A suitable method should be formulated by which an entity's position in relation to the 10 percent figure could be calculated.
- The Commissioner suggests that one method could be to calculate the proportion of an entity's total expenses incurred or payments made to non-qualifying purposes in an income year. This could be derived from information summarised in the entity's statement of financial performance or statement of receipts and payments for the income year.

13. The Commissioner's views about this calculation are:

- "Funds", as the term is used in s LD 3(2)(a), should be viewed as the receipts of an entity from all sources (income and capital).
- How funds are "applied" could be determined from the expenses incurred or payments made in a period, ignoring funds held or on hand at the end of that period.
- Expenses incurred or payments made towards both specified purposes within New Zealand and non-qualifying purposes should be apportioned on some reasonable basis. This should include administration and overhead costs incurred by entities that do not apply their funds 100 percent to specified purposes within New Zealand.
- To ensure the intended benefit to New Zealand society is achieved, compliance should be measured annually and be based on an entity's expenses incurred or payments made for an income year.
- In most cases, this calculation would effectively provide a "safe harbour" in the sense that, where the calculation confirms that an entity has applied 10 percent or less of its funds to non-qualifying purposes, the Commissioner would not need to make further enquiries. Generally, it would be accepted on the basis of the calculation that the entity was complying with the requirement for a donee organisation to apply its funds "wholly or mainly" to specified purposes within New Zealand.
- To the extent that some form of safe harbour calculation became the Commissioner's decided approach, the result of the calculation would be

indicative only. Compliance with the "wholly or mainly" requirement for those entities falling outside of the safe harbour calculation would be considered on a case-by-case basis. Any decisions as to an entity's status as a donee organisation would not be based solely on the calculation without taking into account all the circumstances.

- It is unlikely that donee status would be withdrawn retrospectively but full transitional arrangements would need to be established as part of the Commissioner deciding on any final approach.

14. Entities unable to satisfy the "wholly or mainly" requirement may have alternatives if they wish donors of gifts to them to be eligible for tax advantages:

- They could seek to be listed in Schedule 32 (in which case all gifts to the entity could be eligible for tax advantages).
- They could establish and maintain a separate fund exclusively for specified purposes within New Zealand (in which case only gifts to that fund would be eligible for tax advantages).

Questions for submitters

The conclusions reached in this paper are the Commissioner's initial views. To assist with our further consideration of these issues we are inviting submissions from interested parties. Submissions may relate to legal interpretation, practical aspects or the appropriate policy outcomes.

The Commissioner welcomes submissions on the following questions:

- Should "wholly or mainly" be interpretatively treated as meaning "substantially all" (eg, 90% or more), a bare majority or something else?
- How should the requirement for donee organisations to apply funds to specified purposes within New Zealand be measured?
- What are the practical difficulties that arise in terms of measuring compliance with the "wholly or mainly" requirement:
    - Should calculations be based on an entity's "funds" in terms of amounts receivable or received for an income year, or some other figure(s)?
    - Should calculations be based on an entity's application of funds in terms of how it has spent funds in an income year or some other figure(s)?
    - Should some expenditure be apportioned, and how should apportionment calculations be undertaken?
    - Should administration and other overheads be apportioned on the basis of the ratio of other spending or some other basis?
    - Is the requirement an on-going one so that measurements should be undertaken periodically based on an entity's income year or some other period?
- If some entities would not meet the "wholly or mainly" requirement as described in this paper, one possibility would be for them to separate their operations to establish and maintain a fund exclusively for specified purposes within New Zealand. Would any practical issues or disadvantages arise from this approach?
- What transitional arrangements would be appropriate for any existing donee organisations that were unable to meet the "wholly or mainly" requirement as described in this paper?

Issues

15. Three main issues are considered in this paper:

- How s LD 3(2)(a) should be understood in terms of what is required to be "within New Zealand".
- The meaning of the phrase "wholly or mainly", and the extent to which funds need to be applied before they are considered "wholly or mainly" applied to specified purposes within New Zealand.
- Whether there are alternatives to s LD 3(2)(a) for entities that otherwise meet the requirements of the legislation, but do not apply their funds "wholly or mainly" to specified purposes within New Zealand.

16. The legislation is set out in full in the Appendix, but the relevant portions of s LD 3 provide:

> **LD 3 Meaning of charitable or other public benefit gift**
>
> *Meaning*
>
> (1) For the purposes of this subpart, a charitable or other public benefit gift—
>
> (a) means a gift of $5 or more that is paid to a society, institution, association, organisation, trust, or fund, described in subsection (2) or listed in schedule 32 (Recipients of charitable or other public benefit gifts):
>
> ...
>
> *Description of organisations*
>
> (2) The following are the entities referred to in subsection (1)(a):
>
> (a) a society, institution, association, organisation, or trust that is not carried on for the private pecuniary profit of an individual, and **whose funds are applied wholly or mainly to charitable, benevolent, philanthropic, or cultural purposes within New Zealand**:
>
> ...
>
> (c) a fund established and maintained exclusively for the purpose of providing money for any 1 or more of the purposes within New Zealand set out in paragraph (a), by a society, institution, association, organisation, or trust that is not carried on for the private pecuniary profit of an individual:
>
> [Emphasis added]

Analysis

What is required to be "within New Zealand"?

17. The wording of s LD 3(2)(a), where it refers to an entity's funds being applied to specific purposes within New Zealand, may leave some doubt about what the "within New Zealand" requirement applies to. In the Commissioner's opinion, the phrase "within New Zealand" relates to where the specified purposes are carried out or achieved, rather than to where the funds are spent.

18. There are two questions in relation to this issue. The first question is a general one about whether the location of where the funds are spent is relevant. The second question is more specific about whether the meaning of applying funds requires the funds to be spent. It may be thought that the requirement in s LD 3(2)(a) for funds to be "wholly or mainly" applied to specific purposes within New Zealand means this can be determined only once the funds have been spent or that the funds have to be spent within New Zealand.

No requirement to apply funds in New Zealand

19. The first question is whether the location of where funds are spent or utilised is relevant to the issue of whether funds are "wholly or mainly" applied to specified purposes within New Zealand. This relates to where the funds are paid (that is, whether they are paid to recipients inside or outside New Zealand).

20. This issue arose in Taxation Review Authority *Case T50* (1998) 18 NZTC 8,346. *Case T50* concerned whether the taxpayer was a charitable trust where a payment of trust money was made as a donation to an entity outside New Zealand. Judge Willy stated at 8,361–8,362:

> I think the only fair conclusion to be drawn from that evidence is that although the monies were actually utilised in Australia for the preparation of the video material there, the whole purpose of the donations was to enable the New Zealand League of Rights to have access to that material as of right for use in New Zealand and **although the trustees have power to apply trust funds to entities outside of New Zealand I am not satisfied on the evidence in this case that such has occurred.** [Emphasis added]

21. Accordingly, Judge Willy looked past the mere location of where the funds were spent to the purpose for which the money was outlaid. He concluded that the purpose of the expenditure in Australia was for a benefit to arise in New Zealand (the right to use video material).

22. *Case T50* was appealed to the High Court (*CIR v Dick* [2002] 2 NZLR 560). In the High Court, Glazebrook J stated at 565:

> The Commissioner concentrated on some donations made by the foundation that were paid directly to the Australian League of Rights. The Australian League of Rights used the funds to defray part of the costs of video educational material which was used in both Australia and New Zealand.
>
> Judge Willy held first that the donations were to a charitable object and this finding was not challenged on appeal. Secondly he held (*Case T50* at para 103) that the purpose of the donations was to enable the New Zealand League of Rights to have access to the video material for use in New Zealand. He regarded the payments as being to the New Zealand League of Rights who in turn decided to apply them for the production of material out of New Zealand for use within New Zealand.
>
> ...
>
> From a review of the evidence (part of which is quoted by the Judge at paras 95(v) - 101) Judge Willy's findings would appear to be findings that were available to him. The findings should not be disturbed on appeal and will not be.
>
> **This means that all the donations made so far have been for purposes in New Zealand (given that Judge Willy's finding is upheld).** [Emphasis added]

23. Glazebrook J's decision was appealed in *CIR v Dick* [2003] 1 NZLR 741 (CA), although the aspect of the case discussed here was not challenged.

24. Accordingly, it appears that where funds are spent or paid in geographical terms does not determine whether they have been applied to specified purposes within New Zealand. An entity's funds need to be applied to specified purposes within New Zealand, even if this results in money being paid outside New Zealand to achieve those purposes. There is no separate requirement in s LD 3(2)(a) for funds to be spent within New Zealand. Also, spending money in New Zealand in the achievement of overseas purposes would not be sufficient.

The holding of funds

25. In relation to the second question, in *General Nursing Council for Scotland v Commissioners of Inland Revenue* (1929) 14 TC 645, Lord Sands considered that funds could be "applied to" a particular purpose when being held, rather than spent. He stated at 653:

> If the directors of a charitable trust deem it desirable that a capital sum should be accumulated for the service of the trust or that a reserve fund should be formed for the greater security of the trust, the income carried to the credit of any such account is, in my view, applied to a charitable purpose.

26. In the same case, Lord Blackburn had reservation about whether money could be held indefinitely and still be considered as being "applied to" a particular purpose. Lord Blackburn stated at 656–657:

> **Some income then which otherwise would be entitled to exemption is not to be exempt unless it is actually applied to charitable purposes**, and I agree with Lord Sands that these words are apt to apply to the income in question, assuming that the Council was itself a charitable institution. I should hesitate to give them so strict a construction as to attach to small sums necessarily carried forward in the accounts of a charitable trust from one year to another to enable the trust to be conducted in a businesslike manner. **But it seems to me that they do require that the income, if not actually expended on a charitable purpose during the year of assessment, must at least be appropriated to expenditure on charity in the immediate future.** Now, the income for which exemption is claimed in the present case has never been so applied. It has admittedly been used for at least five years for no other purpose whatever than to increase the capital of the surplus fund. Nor indeed does it appear that there is any immediate charitable purpose to which it is intended to be applied. It was admitted that there was no way in which the surplus fund or the annual income thereof could be applied except in reducing the fees charged to the nurses to a figure which would not produce a sum sufficient

> to meet the annual expenses. It was not said definitely that the Council had any intention of so applying it, and I do not know whether they have any such intention. It may be very desirable that they should accumulate a sum which will provide them eventually with a sufficient income to reduce the fees collected from the nurses or to enable them to dispense with charging the nurses any fees at all. If they succeed in doing so, then the income so applied might possibly be held to be expended on a charitable purpose, and, if so, would be entitled to exemption from Income Tax**. But so long as the Council merely apply the income accruing from year to year to increasing the capital sum, then even had they been a body established for charitable purposes I would have hesitated to agree that it was being applied to charitable purposes only and therefore entitled to exemption. In my opinion the question should be answered in the negative.** [Emphasis added]

27. Although the issue of whether an accumulation of funds for relevant purposes is an application of funds to those purposes did not arise in *Molloy*, the Court of Appeal (at 690) noted in passing the contrasting views of Lords Sands and Blackburn in *General Nursing Council for Scotland* explained above. In doing so, the court seemingly considered those views as relevant to the issue of the application of funds in the context of s 84B(2)(a) of the Land and Income Tax Act 1954 (a predecessor of s LD 3(2)(a)).

28. Despite Lord Blackburn's reservations, the Commissioner notes that s LD 3(2)(a) applies to a variety of entities, including trusts. The full High Court of Australia in *FCT v Bargwanna (as Trustees of the Kalos Metron Charitable Trust)* [2012] HCA 11, 2012 ATC 20-312 noted that a trust normally would hold funds without expending them in the form of the trust's corpus (at 13,482):

> As Dixon and Evatt JJ pointed out in *Attorney-General (NSW) v Perpetual Trustee Co (Ltd)* [(1940) 63 CLR 209 at 223; [1940] HCA 12], the purpose of a charitable trust most usually does not involve the expenditure or consumption of corpus. **The Commissioner now accepts that a fund may be "applied" for charitable purposes without immediate expenditure of income as it is derived.** [Emphasis added]

29. Accordingly, it appears that the requirement in s LD 3(2)(a) for the application of funds to specified purposes within New Zealand does not mean those funds have to be spent before they can be considered to be "applied". That is, it will be sufficient if those funds are clearly being used in some way for specified purposes within New Zealand, including being held for use for those purposes. However, this conclusion raises practical issues about how to measure the extent of an entity's application of funds to different purposes (see the discussion from paragraph 92).

What is the meaning of "wholly or mainly"?

30. The terms "wholly" and "mainly" and the phrase "wholly or mainly" are not defined in the Act, so their ordinary meanings apply. The terms "wholly" and "mainly" are relevantly defined in the *Shorter Oxford English Dictionary on Historical Principles* (6th ed, Oxford University Press, New York, 2007) as follows:

> **wholly** … **1** As a whole, in its entirety, in full. … **2** Completely, entirely; without limitation or diminution. … **3** Exclusively, solely, only.
>
> **mainly** … **3** For the most part; in the main; as the chief thing, chiefly, principally.

31. From this definition of "wholly" there seems little doubt that "wholly" would, in the context of s LD 3(2)(a), require 100 percent of an entity's funds to be applied to specified purposes within New Zealand. The definition of "mainly", however, indicates that something less than 100 percent of an entity's funds could be applied to specified purposes within New Zealand.

32. The issue then becomes one of deciding the meaning of "mainly" and the extent to which an entity's funds need to be applied to specified purposes within New Zealand and still come within the requirements of the legislation. This involves considering the additional question of whether "mainly" takes on any different meaning when used in a phrase with the word "wholly".

33. When considering these questions, it is worth noting that "exclusively" is one of the meanings given for "wholly" in the above dictionary definition. Similarly, one of the meanings given for "mainly" is "principally". In the latter case, support for the proposition that "mainly" and "principally" have similar meanings can be found in s KC 5(1)(aa) of the Income Tax Act 2004 (a predecessor of s LD 3(2)(a)), which used "principally" instead of "mainly" in the phrase "wholly or principally".

34. Accordingly, other terms and phrases could be seen as comparable to "wholly or mainly". Comparable phrases would include "exclusively or mainly" and "wholly or principally".

35. The meaning of "wholly or mainly" in the context of the application of an entity's funds to particular purposes has not been considered in the New Zealand or overseas courts. There has, however, been consideration in the courts of "wholly or mainly" or comparable phrases in other contexts. This case law is considered next.

Case Law

Hatschek's patents

36. *In re Hatschek's patents, ex p Zerenner* [1909] 2 Ch 68 concerned a challenge to the decision of the Comptroller General to revoke a patent. The legislation at issue provided that any person could apply to the Comptroller seeking the revocation of another person's patent provided the patented article or process was manufactured or carried on "exclusively or mainly outside the United Kingdom". If so, the Comptroller could revoke the patent, if some activity was not being carried on within the United Kingdom to an "adequate extent". On the "exclusive or mainly" issue, Parker J stated (at 82–84):

> The first question is this: What is the state of circumstances the existence of which imposes this serious liability on a patentee? In the words of sub-s. 1, it is whenever "**the patented article or process is manufactured or carried on exclusively or mainly outside the United Kingdom." There is no difficulty in the use of the word "exclusively," but the use of the word "mainly" gives rise to difficulty. The sub-section may, and it was argued that it did, include every case in which the patented, article or process is manufactured or carried on to a greater extent outside than inside the United Kingdom. If this be its true meaning, then in every case in which more than 50 per cent, of the patented articles manufactured anywhere are manufactured abroad, the patentee can be called upon to justify the use he has made of his monopoly and defend his patent rights. I cannot think that this is the true meaning of the sub-section.** However great may be one's belief in the industrial supremacy of the inhabitants of these islands, it would, nowadays at least, be somewhat arrogant to assert that wherever the manufacture of a patented article in the United Kingdom is less than one half of the total manufacture of the whole world there arises a presumption that British trade has not had fair play-a presumption that the patentee has been abusing his monopoly. If the patented article be manufactured in the United Kingdom to as great an extent as can reasonably be expected, having regard to the industrial development of other countries, I do not think any presumption against the patentee can fairly arise, nor do I think that the Legislature intended it should arise. **The word "mainly" is used in the sub-section in close connection with and as an alternative to "exclusively", and, having regard to this fact, I do not think that a process or article can be said to be mainly carried on or manufactured abroad merely because it is carried on or manufactured abroad to a somewhat greater extent than within the United Kingdom.** For example, if the total manufacture in the United Kingdom were 1200 and the total manufacture elsewhere 1250, giving a total of 2450 in all, I do not think it could be said that the manufacture was mainly abroad within the meaning of the section; **to come within the sub-section the disparity must, in my opinion, be greater than a mere small percentage**, and, indeed, if the article be manufactured or the process be carried on within the United Kingdom, not only to a substantial extent, but to an extent as substantial as may reasonably be expected having regard to what is done abroad, I do not think the state of circumstances is that contemplated by sub-s. 1. [Emphasis added]

37. Parker J rejected the argument that "mainly" meant simply "more than 50 percent". He considered that if this was the word's meaning then the disparity between the activities carried on inside the United Kingdom and the activities

carried on outside the United Kingdom could be quite small in some cases. He concluded that Parliament must have intended for the disparity between the two activities to be greater than a small percentage. This was because of the connection with, and use of, "mainly" as an alternative to "exclusively".

38. Although Parker J did not state what percentage would be required, it is clear he considered that "mainly" must mean something significantly greater than 50 percent. However, in the context of the case nothing turned on his failure to specify a more exact percentage, because the patented article was being manufactured exclusively outside the United Kingdom.

Radio Authority

39. *R v Radio Authority, ex p Bull* [1997] 2 All ER 561 (CA) considered whether Amnesty International (British Section) was a body whose objects were "wholly or mainly" of a political nature. If so, it would be prohibited from advertising on the radio. This was a judicial review proceeding and the court was called on to determine whether the Radio Authority had correctly interpreted the law and considered all relevant matters. Lord Woolf MR stated (at 570):

> **"Wholly or mainly" is a phrase the meaning of which is not free from ambiguity. Clearly it requires a proportion which is more than half. But how much more? 51% or 99% and anything in between are candidates.** The same phrase appears elsewhere in the Act in a different context (see s 2 [of the Broadcasting Act 1990] where it is not directly concerned with freedom of communication).
>
> Here it has to be construed as a part of a provision which restricts the ability of [Amnesty International (British Section)] to promote itself on the media by advertising. This constitutes a restriction on freedom of communication. Freedom of communication is protected alike at common law and by the European Convention on Human Rights … The restriction is a general one in the sense that it applies a blanket ban on any advertising by the body concerned, and applies no matter how desirable a particular advertisement which the body may wish to broadcast is. In this sense it is a restriction which is significantly more intrusive than that contained in the second rule contained in s 92(2) [of the Broadcasting Act 1990] which requires a judgment to be reached as to whether a particular advert offends the rule.
>
> The issue is not whether the restriction contained in the first rule is justifiable but how the restriction should be construed having regard to its blanket or discriminative effect in relation to a political body. In view of this restriction **the ambiguous words "wholly or mainly" should be construed restrictively.** By that I mean they should be construed in a way in which limits the application of the restriction to bodies whose objects are **substantially or primarily** political. **This corresponds with the Shorter Oxford English Dictionary meaning of "mainly" as being "For the most part; chiefly, principally". Certainly a body to fall within the provision must be at least midway between the two percentages I have identified ie more than 75%.** This approach to the interpretation of a provision which impedes freedom of communication corresponds with the general approach of the courts of this country, the European Court of Human Rights and many Commonwealth courts in this area... [Emphasis added]

40. Again, the court rejected the view that "mainly" could mean simply more than 50 percent. The court considered that while "wholly or mainly" was an ambiguous phrase, regard should be taken of the context in which the phrase was being used. The context in this case was the imposition of a statutory fetter on the freedom of speech. While not setting a definite percentage, Lord Woolf MR considered that in the context of the provision under consideration "wholly or mainly" meant "more than 75%".

British Association of Leisure Parks

41. *British Association of Leisure Parks, Piers & Attractions Ltd* [2011] TC 01504 involved whether an association's membership was restricted "wholly or mainly to individuals or corporate bodies whose business or professional interests are directly connected with the purpose of the association". At issue was whether the association's membership subscriptions should be exempt from value added tax where 69 percent of members' business interests were directly connected with the association's purposes. The taxpayer argued that it met the relevant test as

"mainly" meant 51 percent or greater. In finding against the taxpayer, Sir Stephen Oliver QC (Chairman) considered the meaning of "wholly or mainly" (at [39]):

> The Association's reading of "mainly" is, I think, incorrect. **The word cannot be read in isolation. It is part of the compound phrase "wholly or mainly". In that connection it must, I think, mean all or substantially all, e.g. 100% or a near percentage**, rather than simply a bare majority. [Emphasis added]

42. Accordingly, it was considered that "mainly" cannot be read in isolation when used as part of a composite term with "wholly", and that the term meant "all or substantially all" or "100% or a near percentage". The decision was unsuccessfully appealed by the taxpayer, but the meaning of "wholly or mainly" was not considered in the appellate decision (*British Association of Leisure Parks, Piers and Attractions Ltd v Revenue and Customs Commissioner*s [2013] UKUT 130 (TCC)).

Mason

43. In contrast to the previous cases, in *Minister of Agriculture, Fisheries and Food v Mason* [1968] 3 All ER 76 (QB) the court considered "mainly" did mean simply "more than 50%". In this case the court considered whether an employee was employed "wholly or mainly" in connection with certain activities carried on by way of a business. The employee in question spent only 10 to 15 percent of his time carrying out activities related to the business (rather than private gardening activities for his employer). The court found that "it is quite clear that in order to qualify the gardener must devote more than 50% of his time to the commercial side and not to the ordinary private garden".

Imperial Chemical

44. In *Imperial Chemical Industries plc v Colmer* [1999] BTC 440 (HL) the House of Lords also accepted that "mainly" means simply more than 50 percent, although its meaning was not directly in dispute. The House of Lords was considering a definition of "holding company" that was defined as a company "the business of which consists wholly or mainly in the holding of shares or securities of companies which are its 90% subsidiaries".

45. At issue was whether the reference to subsidiary companies applied only to those companies resident in the United Kingdom. The taxpayer company had 23 subsidiary companies of which only four (or just over 17 percent), were resident in the United Kingdom. The House of Lords accepted the view of the parties that "mainly" simply meant a majority or more than 50 percent based on a head count of the subsidiaries and that the taxpayer clearly failed to meet the requirement if non-resident companies were included. Lord Nolan delivered the leading speech. He referred to the meaning of "wholly or mainly" (at 442):

> It was accepted by the parties and by your Lordships that for the purposes of the present case—though not as a universal proposition—the "wholly or mainly" requirement should be judged on the basis of a simple head count of the subsidiaries, so that if all or a majority of the subsidiaries satisfied the UK residence condition Holdings would qualify, but otherwise not. On this basis, of course, Holdings clearly failed to qualify.

Mitchell

46. *CIR v Mitchell* (1986) 8 NZTC 5,181 considered whether a taxpayer's dining room was used "wholly or principally" in connection with employment. The employment use of the dining room was between 55 and 59 percent. This was found to be sufficient to meet the legislative requirements of "wholly or principally". The court expressly rejected the proposition that "principally" meant greater than 85 percent.

47. Davison CJ stated (at 5,183):

> **Issue 1. Meaning of "principally"**
>
> **I agree that the word must be used in its context.** The dictionary definition of the word as used in the context of cl 7 is, in my view, synonymous with "mainly" which is an expression well understood by ordinary people. Roget's Thesaurus gives the synonyms of the adjective "principal" as "prime, main, chief, foremost, leading". Whilst one must choose synonyms carefully, as there are probably few words with what can be described as identical meanings, the synonyms given in Roget all give a picture of what is meant.
>
> Mr Aspey submitted that "principally" connotes so great a use that a use for any other purpose or purposes must be relatively insignificant. **He went on to suggest that in order to satisfy cl 7, the work related use should be above 85%. I do not agree.**
>
> I have not been referred to any helpful cases other than decisions of the Authority where the meaning of the word "principally" has been considered. However, **there are cases in which the word "mainly", which I regard as the best synonym of "principally", has been considered, but few express its meaning in any quantitative sense.**
>
> **In *Fawcett Properties Ltd v Buckingham County Council* [1961] AC 636, 669, Lord Morton of Henryton expressed the view that the word "mainly" probably means "more than half".** Such is consistent with the definition of "mainly" in the Shorter Oxford English Dictionary – "for the most part, chiefly, principally".
>
> In my view, the Authority did not err in law in applying the wrong meaning to the words "wholly or principally" in cl 7. [Emphasis added]

48. Davison CJ considered "mainly" as synonymous with "principally" and referred to comments by Lord Morton of Henryton in the House of Lords decision in *Fawcett Properties Ltd v Buckingham County Council* [1960] 3 All ER 503 that "mainly" probably means more than half.

Summary of the case law

49. It can be seen from the above case law that "mainly" does not have a set meaning. In *Mason, Imperial Chemical* and *Mitchell*, it was accepted as meaning simply "more than 50%" while in other cases that meaning was rejected and a much higher threshold was expected.

50. In the Commissioner's view, the meaning of "mainly" accepted in a particular case appears to depend on the context in which the word is used and the extent to which "mainly" is read in isolation from words it may be paired with. In other words, it appears that the context can allow the phrase "wholly or mainly" to be read either as a conjunctive or composite phrase or as a disjunctive phrase. Where "wholly or mainly" is interpreted as a conjunctive or composite phrase then the meaning of "mainly" is coloured by its use with "wholly and "mainly" sets a high threshold.

51. Alternatively, where "wholly or mainly" is treated as a disjunctive phrase, "mainly" is read in isolation from "wholly" and simply means more than 50 percent.

52. We note that one factor that may have been influential in determining the approach of the court was whether the facts compelled the court to consider the nature of the phrase. In *Mason* and *Imperial Chemical,* the facts permitted reading "mainly" in isolation from "wholly". In both cases, the taxpayers quite clearly failed to come close to the lowest possible threshold for "mainly" given that the figures involved in those cases were 10 to 15 percent and just over 17 percent respectively.

53. Also, in *Mitchell,* the court did not need to determine the nature of the phrase to reach a decision. The issue was not raised in the court. When the *Mitchell* litigation was heard by the Taxation Review Authority (*Case E102* (1982) 5 NZTC 59,547), the parties' arguments appear to be directed solely at the meaning of "principally". In *Case E102* Judge Barber (at 59,550) agreed with the taxpayer's counsel that the phrase "wholly or principally" was a "disjunctive phrase". The Commissioner's counsel appears not to have taken issue with this.

54. It is also noted that *Fawcett Properties,* cited with approval in *Mitchell,* was not concerned with the use of "mainly" as part of a conjunctive or composite term. *Fawcett Properties* was concerned with the word "mainly" used in isolation in the phrase "an industry mainly dependent on agriculture".

55. Where "mainly" has been paired with "wholly" or "exclusively" and the courts have considered it part of a composite or conjunctive phrase so that it cannot be read in isolation, then they have rejected the proposition that "mainly" means simply more than 50 percent. Where this has occurred the courts have considered that "mainly" means:

- something significantly greater than 50 percent (*Hatschek's patents*);
- more than 75 percent (*Radio Authority*);
- all or substantially all (*British Association of Leisure Parks*);
- 100 percent or a near percentage (*British Association of Leisure Parks*).

56. The distinguishing feature between these two lines of cases appears to be whether "mainly" is read as part of a composite or conjunctive phrase or whether it is read in isolation. In the Commissioner's view, it is the context in which "wholly or mainly" is used that determines whether one approach is to be preferred over the other. Consequently, it is necessary to consider the context of s LD 3(2) and the purpose of the phrase in that context.

Legislative context and purpose

57. Apart from s LD 3(2)(a), the phrase "wholly or mainly" is used in several different places in the Act. For instance, it appears throughout the mining regime (subpart CU) in different contexts such as the use of assets "wholly or mainly" in mining operations. In s CW 59 it is used in relation to income derived "wholly or mainly" from Niue. There are other examples, but none of these references indicates the meaning of "mainly"; nor is it necessarily the case that Parliament intended the same meaning to apply across the Act. Even if the same meaning were intended, it is not clear what that single meaning would be and examining the context and purpose of each provision is still necessary. Consequently, it appears that no assistance can be derived from considering other references to "wholly or mainly" in the Act.

58. Paragraph (a) of s LD 3(2) is the sole paragraph in the subsection that uses the phrase "wholly or mainly" in relation to a donee organisation. In comparable situations in other paragraphs of the subsection, Parliament has used the word "exclusively" (see paras (b), (c) and (d)). Other than the previously noted change from "wholly or principally" to "wholly or mainly", the wording of s LD 3(2)(a) and its predecessors has been materially unchanged since its enactment in 1962.

59. Section LD 1 is a concessionary provision that gives taxpayers a refundable tax credit or deduction for gifts made to charitable and other public benefit entities without the requirement for any nexus with income. The purpose of allowing a tax credit for gifts is to promote charitable (and other public benefit) giving. Reasons for promoting charitable giving were set out in more detail in the discussion document *Tax Incentives for Giving to Charities and Other Non-profit Organisations: A government discussion document* (Policy Advice Division, Inland Revenue, Wellington, 2006). The discussion document stated at [1.13]:

> Among the reasons that governments seek to promote charitable giving are:
>
> - Charities and other non-profit organisations help governments to further their social objectives, such as increasing support to the disadvantaged members of society and fostering a more caring and cohesive society.

- Many of the activities of charities and other non-profit organisations provide wider benefits to society over and above the value of the benefits received by the recipient or supplier of the activity.
- The activities of charities and other non-profit organisations may be more responsive to the needs of society than government programmes, since donors and charities can often respond more quickly to changing social needs. Also, the donations people make to such organisations provide an effective indicator of the extra goods and services people feel are needed.
- Because charitable activities use donated goods and volunteer labour they may be a more efficient way of providing social assistance than government programmes.

60. The discussion document shows that charitable giving is seen as benefiting government's social objectives. Charities (and other similar entities) are seen as an efficient way to deliver these objectives. Further, people's choices about the entities they support is seen as being an effective way of targeting funds to where society feels that they are most needed.

61. The discussion document also notes (at [1.9]) that government spending on charities (which includes the giving of tax advantages to donors) involves a trade-off with spending in other areas:

> In the government's consideration of the initiatives canvassed in this discussion document, it is necessary to take into account the trade-off between increasing spending on assistance to charities and other non-profit organisations and increasing spending in other areas, such as transport, or other policy priorities, such as initiatives being considered by the Business Tax Review.

62. At [1.21], the discussion document states tax advantages should be given only where the benefits will outweigh the costs for New Zealand:

> A basic principle of the government's revenue strategy is that the use of tax exemptions and concessions will be considered only in the context of the full range of policy options and only if the benefits can be shown to outweigh the costs for New Zealand.

63. This theme in the legislation regarding charitable giving is also reflected in other provisions of the Act dealing with charities. Of particular note is s CW 42 which exempts the business income of a charity but only to the extent that it carries out its charitable purposes in New Zealand (s CW 42(1)(a)). Where the charitable purposes are not limited to New Zealand, then the business income is apportioned reasonably between the purposes in New Zealand and those outside New Zealand (s CW 42(4)). The tax advantage is linked, not to the source of the income, but to where the benefits of the income (and of the exemption) are likely to accrue— New Zealand society.

64. Also, where an entity has mainly overseas purposes, access to donee organisation status and the tax advantages that flow from that are restricted by the requirement for these entities to specifically apply to Parliament for inclusion in Schedule 32 (see further at paragraphs 123 to 125).

65. Finally, s LD 1 refers to gifts that are eligible for a tax credit as "charitable or other public benefit gifts" and to entities receiving such gifts as "recipients of charitable or other public benefit gifts". This suggests a link between the gifts made and application of the resultant funds. However, we acknowledge that this wording was introduced in the Income Tax Act 2007. Previously, the legislation required that a gift be made to "any of the following societies, institutions, associations, organisations, trusts, or funds". The previous wording was not suggestive of how Parliament intended the entities' funds to be applied.

66. From the legislative context it can be seen that:

- There is no universal threshold given for the phrase "wholly or mainly" in the Act.
- The phrase "wholly or mainly" is uniquely used in s LD 3(2)(a) in relation to donee organisations and the more common threshold is set at "exclusively".

- Tax advantages for charities and other public benefit entities are provided to promote charitable giving as a supplement to government's social objectives for New Zealand society. They are biased towards ensuring the benefits to New Zealand outweigh the costs to the country.
- Where it is likely that the benefits will not outweigh the costs, as in the case of overseas-focused entities, Parliament must make a specific policy decision to add a particular entity to Schedule 32.

Meaning of "wholly or mainly" in the context of s LD 3(2)(a)

67. The context of the legislation supports the view that access to tax advantages should generally be restricted as far as possible unless Parliament specifically decides otherwise (as in a Schedule 32 situation). Outside the process for listing in Schedule 32, it seems clear that Parliament intended tax advantages to accrue for gifts to entities that apply their funds to specified purposes within New Zealand that then benefit New Zealand society. Such a conclusion would appear consistent with the policy of the legislation and the goals of promoting charitable giving set out above.

68. It also appears that Parliament has made an exception in the case of s LD 3(2)(a) in that it has used the word "mainly" in addition to "wholly". This may have been to prevent minor or inconsequential applications of funds to non-qualifying purposes being a barrier to achieving donee organisation status. If the legislation were limited to "wholly", entities that would otherwise bring substantial benefits to New Zealand society by applying almost all of their funds to specified purposes within New Zealand would be denied donee organisation status.

69. This leads the Commissioner to the preliminary view that the context of the legislation supports a conclusion that "wholly or mainly" should be read as a conjunctive or composite phrase. That is, the meaning of "mainly" is coloured by its use in conjunction with "wholly" and sets a high threshold.

70. Based on the above case law where "mainly" has been read in this way, it means that "wholly or mainly" as used in s LD 3(2)(a) means "something close to 100%" or "substantially all" of what is being considered.

"Wholly or mainly" and percentages of funds applied

71. While it seems that "wholly or mainly" should be interpreted as meaning something close to 100 percent, it is not clear how close to 100 percent this is. Also, when it comes to assigning percentages to the meaning of a term such as "wholly or mainly" it is important not to give the term a false impression of precision. This danger was highlighted in *Radio Authority* (at 569) where the court cited from the House of Lord's decision in *South Yorkshire Transport Ltd v Monopolies and Mergers Commission* [1993] 1 All ER 289. In South Yorkshire, Lord Mustill stated in relation to the meaning of the word "substantial" (at 294–295):

> The courts have repeatedly warned against the dangers of taking an inherently imprecise word, and by redefining it thrusting on it a spurious degree of precision.

72. In a similar way, the case law discussed above shows that the threshold for "wholly or mainly" has imprecise boundaries. However, in the interest of providing entities with greater certainty about the practical application of s LD 3(2)(a), the Commissioner considers it desirable that some attempt is made to affix some percentage figure to the meaning of "wholly or mainly" and to formulate a suitable practical measure that would be indicative of compliance with this percentage.

73. The Commissioner suggests that in the context of s LD 3(2)(a), "substantially all" or "close to 100 percent" could mean 90 percent or more. That would mean that

entities could apply 10 percent or less of their funds to non-qualifying purposes and qualify for donee organisation status under s LD 3(2)(a).

74. This in turn suggests the need for some suitable calculation method that could indicate whether an entity was, on the face of it, applying 10 percent or less of its funds to non-qualifying purposes. This method could provide some assurance and greater certainty to the Commissioner and to individual entities about whether the entity was meeting this aspect of being a donee organisation.

75. This calculation could effectively provide a "safe harbour". What this means is that where the calculation confirms that an entity has applied 10 percent or less of its funds to non-qualifying purposes, the Commissioner would not, in most cases, need to make further enquiries. It would allow the Commissioner to generally accept, on the basis of the calculation, that the entity was complying with the requirement for a donee organisation to apply its funds "wholly or mainly" to specified purposes within New Zealand.

76. To the extent that some form of safe harbour calculation became the Commissioner's decided approach, the result of the calculation would be indicative only. Compliance with the "wholly or mainly" requirement for those entities falling outside of the safe harbour calculation would be considered on a case-by-case basis. In some instances, failure to meet the safe harbour in a particular year might be explicable in terms of a short-term variation in the pattern of an entity's activities. One specific situation where the Commissioner would make further enquiries is where part-way through an income year the nature of an entity's activities underwent a fundamental change such that from the date of change it might no longer be meeting the "wholly or mainly" requirement. This would remain the case even if the safe harbour calculation for that income year was within the 10 percent threshold.

77. Accordingly, any decisions as to an entity's status as a donee organisation would not be based solely on the calculation without taking into account all the circumstances. It is unlikely that donee status would be withdrawn retrospectively but full transitional arrangements would need to be established as part of the Commissioner deciding on any final approach.

How the "wholly or mainly" requirement is measured

78. It is acknowledged that the legislation neither provides a calculation method nor indicates what quantities should be used. The legislation also appears to set the "wholly or mainly" requirement as one that must be met at all times rather than one that must be met at a particular time or over some particular period. Any quantities chosen as a basis for measuring compliance with the "wholly or mainly" requirement would affect the accuracy of any measurement. Unless the quantities captured all relevant aspects of how an entity applied its funds, a danger exists that determining the boundary of "wholly or mainly" solely from a percentage calculation might not be correct. Despite this, Parliament would have intended the requirement to be met, so there must be some practical way of measuring compliance with the requirement to give effect to this intention.

79. It seems that any calculation of whether an entity has "wholly or mainly" applied its funds to specified purposes within New Zealand will, of necessity, require quantifying an entity's funds and quantifying the extent to which they have been applied to different purposes. It will also require this exercise to be undertaken at a specific time or for a specific period.

How should "funds" be measured?

80. The first matter for consideration relates to "funds". Section LD 3(2)(a) refers to entities "whose **funds** are applied wholly or mainly to [specified] purposes within

New Zealand" [emphasis added]. Before the application of an entity's funds can be measured, we need to understand what the term "funds" encompasses.

81. In the context of s LD3(2)(a), "funds" appears capable of being viewed widely or narrowly. Ranging from the widest to the narrowest, these views would be to consider "funds" as including all of an entity's:

- financial resources;
- receipts; or
- receipts of a certain nature (ie, gifts).

82. A wide view of the meaning of "funds" can be supported by dictionary definitions of the term. For instance, the *Concise Oxford English Dictionary* (12th ed, Oxford University Press, New York, 2011) defines "fund" and "funds" as:

> **fund ▪ n. 1** a sum of money saved or made available for a particular purpose. **2 (funds**) financial resources.

83. No case law has been identified that assists further with determining the extent of "funds" in this context. The dictionary definition shows that a "fund" is a discrete sum of money whereas "funds" can be a more general reference to financial resources. A comparison between para (a) of s LD 3(2) (which refers to an entity's "funds") and paras (c) and (d) (which refer to a "fund" established and maintained exclusively for specified purposes within New Zealand), also suggests this difference between the two terms.

84. Viewed at its widest, "funds" would seem capable of encompassing all ways in which financial resources are available to an entity. It does not appear to distinguish between their character (ie, income or capital) or between their forms (ie, current or non-current asset). The financial resources of an entity could arise from a variety of sources. These sources could include funding from central or local government, sponsorships, fundraising, self-generated income (eg, sales of goods and services), investment income or the sale of assets. Also, the financial resources of an entity could include the investments, property and assets themselves. Financial resources could also extend as far as including available lines of credit.

85. However, narrower views of "funds" are possible. One view would be to treat "funds" as including all receipts of an entity, regardless of their character or source. This view is based on the notion that all the financial resources of an entity must have originated at some point in a receipt (with the possible exception of lines of credit). The receipt would have arisen from gifts or other sources or from the conversion of one financial resource into another (eg, capital receipts from the sale of an asset that itself was acquired from some earlier receipt).

86. An even narrower view of "funds" would be to treat the term as just referring to gifts received by an entity. This view is based on the fact it is the gifts received that generate the tax advantages for donors.

87. The difference in adopting a wide or narrow view of "funds" can be illustrated in a simple example. Consider an entity that receives few receipts but is asset rich. It holds substantial amounts of real property overseas that it applies to purposes it conducts overseas. Concurrently, it applies to specified purposes within New Zealand all of its modest annual receipts, which arise largely from gifts. If compliance with the "wholly or mainly" requirement were gauged from a figure calculated as a result of adopting a wide view of "funds", then the entity might be thought to have failed the requirement because of the substantial amount of funds in the form of assets applied to non-qualifying purposes overseas. If "funds" just included total receipts or just total gifts then the entity has applied

these funds wholly to specified purposes within New Zealand and would meet the "wholly or mainly" requirement.

88. The narrower views of "funds" offer practical advantages. They appear to avoid the full extent of the difficulties that the widest view would entail as will be seen when how funds are "applied" is considered.

How should "applying" funds be measured?

89. Another aspect of formulating a measure of an entity's application of funds is to consider how to ascertain the extent to which funds have been "applied" to different purposes. There seems no difficulty in considering funds as being "applied" once they have been spent on goods or services. In many cases, whether the funds have been spent on specified purposes within New Zealand will be readily ascertainable from the amounts incurred and payments made. As mentioned in paragraphs 17 to 24, this would not turn on whether the funds had been spent within New Zealand or overseas, but whether the purposes on which the funds were spent were specified purposes carried out or achieved within New Zealand.

90. However, in many cases, even though the funds have been spent, it may be difficult to categorise how the funds have been "applied". For instance, a question might arise as to how to categorise spending on the entity's own administration where it is known that not all of the entity's funds have been applied to specified purposes within New Zealand. If so, administration costs should be apportioned between specified purposes within New Zealand and non-qualifying purposes.

91. The apportionment of funds spent on mixed purposes (both specified purposes within New Zealand and non-qualifying purposes) would have to be undertaken on some reasonable basis. The exact basis would depend on the nature of the expenditure. For instance, general administration expenditure could be apportioned on the basis of the ratio of spending in other areas. Some costs would be apportioned more reasonably on some other basis. For instance, staff costs might be apportioned on the basis of time spent by staff on different tasks. Similarly, lease or rental costs could be apportioned on an area basis.

92. However, there is an added complication to consider in relation to this aspect of the application of funds. As noted in paragraphs 25 to 29, applying funds might not be limited to just spending funds. Funds held for application in the future appear to meet the requirement of being "applied". If funds held at the end of a period were clearly being held for exclusive use on a particular purpose, then their allocation to specified purposes within New Zealand or to non-qualifying purposes could be possible. There may be some entities that only hold funds and do so for an extended period before spending them.

93. On the other hand, if any funds held were being held for general use and were not being held for exclusive use on a particular purpose, then they would have to be apportioned using some appropriate basis. The most appropriate basis to use would appear to be to apportion the general funds held using the same ratio as the funds actually spent. If so, including the general funds held in the calculation would not alter the overall outcome obtained, if the application of funds were limited to funds spent. In other words, treating funds held as "applied" would alter the outcome of any calculations only if funds were being held exclusively for clearly defined purposes.

94. However, treating funds held as "applied" would raise compliance costs and issues around tracking the funds held at the end of each and every period until they were ultimately spent. Further complications would arise if these purposes were found to have changed. It would raise questions about whether any subsequent spending of the funds on different purposes should negate earlier conclusions as

to the entity's status, and whether any tax advantages for earlier periods should be reversed retrospectively. Accordingly, a conclusion that applying funds includes holding funds has practical disadvantages for determining how an entity's funds have been "applied".

95. As mentioned, considering aspects of what it means to "apply" funds may also help with determining the view that should be taken of "funds". It is extremely difficult to determine how "funds", in the widest sense of being all financial resources, are "applied" in the present or how their application might change over time. Not all investments will necessarily be held for designated future uses and funds held as general working capital could be used for any purpose. Issues as to how to determine the value and application of physical assets also arise.

96. Taking a narrower view of "funds" and looking at receipts and their immediate application could, over time, broadly capture most things that could be included in the widest view of the term "funds". A possible exception would be any subsequent changes in the actual use or "application" of fixed assets from one purpose to another in periods following their initial purchase. Even then, changes in the use or application of assets after purchase could be another situation causing the Commissioner to make further enquiries in addition to that mentioned in paragraph 76. Despite this, such a view of "funds" would have the advantage of being relatively easy to ascertain and would avoid some of the practical difficulties a wider view of funds would entail, such as valuing fixed assets.

97. As mentioned, taking the narrowest view of "funds" as meaning just gifts received and then considering how those gifts are then "applied" would appear to be consistent with the legislation, because it is the gifts that qualify for tax advantages. However, Parliament has not overtly linked the receipt of funds in the form of gifts that have attracted tax advantages to their subsequent application. It has been content to frame the legislation more at the level of the entities themselves by using the term "funds" instead of "gifts" or some other more specific term.

98. Also, limiting "funds" to a particular type of receipt creates other practical difficulties in tracing how those receipts have been "applied". An entity is likely to have multiple sources of receipts over a particular period, and it is equally likely to apply those receipts in multiple ways. It would be difficult to ascertain which application of funds was funded from which receipts.

99. Bearing all the foregoing matters in mind, the Commissioner considers that the most practicable approach is to treat an entity's receipts from all sources (both income and capital) as the "funds" that must then be "applied" to specified purposes within New Zealand. This means that, for calculation purposes, the entity's "funds" that are "applied" are the entity's payments, as shown in its statement of financial performance or statement of receipts and payments.

100. Such an approach would seem to avoid most of the practical difficulties. Using this approach the source of the funds used to make the payments would not need to be traced, and funds held at the end of a period could be ignored. Also, an entity would need to consider apportionment issues only if it had incurred expenditure or made payments towards non-qualifying purposes in the period.

101. Accordingly, the Commissioner suggests this is a preferable approach. It would seem to offer the most practical, certain and readily ascertainable approach to determining how "funds" have been "applied", although apportionment issues remain.

102. It is important to note that in this preferred approach to "applying funds", the extent of the application of funds to different purposes would be calculated with reference to the **total expenses incurred or payments made** for the period and **not total amounts received or receivable**. For example, if an entity only

paid out $10,000 of its receipts of $15,000 for a period, of which $1,500 was on non-qualifying purposes, the entity would be considered to have applied 15 percent of its funds to non-qualifying purposes. This is the percentage obtained by comparing the payments on non-qualifying purposes to total payments: ($1,500 ÷ $10,000 X 100). The entity would not be considered to have applied 10 percent of its funds to non-qualifying purposes, as arrived at by comparing the non-qualifying payments with total receipts: ($1,500 ÷ $15,000 X 100). To do so, would be to include the funds held at the end of the period in one part of the calculation without also taking into account how those funds were applied. It would be inappropriate to include the funds held at the end of the period of $5,000 in this way when using the preferred approach. The application of the $5,000 would be measured in the later period or periods in which those funds were spent.

103. In summary, the Commissioner suggests that the most practicable approach to ascertaining the purposes to which an entity has applied its funds in a particular period is to consider its spending in that period.

What period should the measurements cover?

104. The legislation refers to entities whose "funds are applied" wholly or mainly to specified purposes within New Zealand. This wording suggests some continuous action, so that the "wholly or mainly" requirement is an ongoing test and must be met at all times. However, any calculation undertaken to ascertain compliance with this requirement must, of necessity, include some temporal element. This tension was noted by the court in *Molloy* in relation to a predecessor of s LD 3(2)(a). In *Molloy,* the court noted (at 690) that the legislation raised several problems that the case did not call for determination, including:

> whether the words "the funds are applied" relate to an income year or import a history of consistent qualification.

105. Over time, the application of an entity's funds is likely to fluctuate. The specific time or period chosen could markedly affect any calculations of the extent of an entity's compliance with the "wholly or mainly" requirement. The Commissioner suggests that, for calculation purposes, it would be appropriate to use a period over which to gauge compliance with the "wholly or mainly" requirement and that this period should be an income year. This is because income tax is an annual tax and its administration follows an annual cycle (see *Golden Bay Cement Company Ltd v CIR* [1999] 1 NZLR 385 (PC) at 392 and *CIR v Lemmington Holdings Ltd* [1982] 1 NZLR 517 (CA) at 523).

106. Where the calculation based on an income year indicated an entity might not be applying funds "wholly or mainly" to specified purposes, then all of the entity's circumstances would be relevant to making a final determination of the entity's tax status. This would include whether the entity had a history of consistent qualification (as mentioned in *Molloy*).

Example of the suggested calculation method

107. The following example illustrates some of the practical conclusions reached in paragraphs 71 to 106 concerning "wholly or mainly" and calculating percentages of funds applied to different purposes.

108. An analysis of Entity A's statement of receipts and payments for the income year ended 31 March 2015 shows it made the following payments:

Operating payments directly related to specified purposes within New Zealand	$22,125
Rent	$26,000
Staff costs: administration	$18,000
Staff costs: fund-raising	$11,000
Operating payments directly related to non-qualifying purposes	$13,375
Capital payments directly related to non-qualifying purposes	$4,000
General office costs relating to administration	$5,500
	$100,000

109. Because the entity does not wholly apply its funds to specified purposes within New Zealand, it is necessary to allocate the payments between the specified purposes and non-qualifying purposes to gauge whether the entity is applying 10 percent or less of its funds to non-qualifying purposes.

110. The payments directly relating to a particular purpose can readily be categorised on the basis of the purposes to which they relate. However, other payments will have to be apportioned to the different purposes on some reasonable basis. In this example, the rent relates to a building that is primarily used for specified purposes within New Zealand. However, the building includes office space used exclusively for the entity's administration. The office space comprises 10 percent of the building on an area basis. Also, the fund-raising staff costs represent the costs of employing one part-time staff member. It is estimated this staff member spends 10 percent of their time on tasks relating to non-qualifying purposes. The other part-time staff member is fully engaged in administration duties.

111. Using this information, the above payments for the income year can be allocated to different purposes:

Payments	Specified purposes ($)	Non-qualifying purposes ($)	Total ($)
Operating payments directly related to specified purposes within New Zealand	22,125	–	22,125
Rent – directly related to specified purposes within New Zealand[1]	23,400	–	23,400
Staff costs: fund-raising[2]	9,900	1,100	11,000
Operating payments directly related to non-qualifying purposes	–	13,375	13,375
Capital payments directly related to non-qualifying purposes	–	4,000	4,000
Subtotal	**55,425**	**18,475**	**73,900**
Percentage "other spending"	*75%*	*25%*	*100%*
Administration: staff costs[3]	13,500	4,500	18,000
Administration: office general costs[4]	4,125	1,375	5,500
Administration: rent[5]	1,950	650	2,600
Total	**75,000**	**25,000**	**100,000**

Note: Apportionment calculations

1 Initial apportionment of rent on an area basis (as per paragraph 110):

Specified purposes: $26,000 x 90% = $23,400

Administration: $26,000 x 10% = $2,600 (see below for further apportionment of this amount)

2 Apportionment of fund-raising staff costs on a time basis (as per paragraph 110):

Specified purposes: $11,000 x 90% = $9,900

Non-qualifying purposes: $11,000 x 10% = $1,100

3 Apportionment of administration staff costs on the basis of the "other spending" percentage (see subtotals in the table):

Specified purposes: $18,000 x 75% = $13,500

Non-qualifying purposes: $18,000 x 25% = $4,500

4 Apportionment of general office costs relating to administration on the basis of the "other spending" percentage:

Specified purposes: $5,500 x 75% = $4,125

Non-qualifying purposes: $5,500 x 25% = $1,375

5 Subsequent apportionment of rent relating to the administration office on the basis of the "other spending" percentage:

Specified purposes: $2,600 x 75% = $1,950

Non-qualifying purposes: $2,600 x 25% = $650

112. As can be seen from the table above, last to be apportioned are administration payments (office overheads, office rent and administration staff costs) that have no specific apportionment basis. They have been apportioned on the basis of the ratio of the spending on different purposes obtained from the subtotals of all other costs that have been allocated or apportioned.

113. Adopting a measure such as this for this example gives the following outcome:

Percentage of funds applied to:	**%**
Specified purposes within New Zealand: (75,000 ÷ 100,000) x (100 ÷ 1)	75
Non-qualifying purposes: (25,000 ÷ 100,000) x (100 ÷ 1)	25
Total	**100**

Note: The outcome revealed by the subtotals of the other spending is unaltered by the apportionment of the administration costs when that apportionment is made on the same basis as the other spending.

114. On the face of it, Entity A does not meet the requirements of being a donee organisation in the income year ended 31 March 2015. This is because this calculation confirms it is applying more than 10 percent of its funds to non-qualifying purposes. The Commissioner would need to make further enquiries into Entity A's circumstances to reach a conclusion about whether it can be considered to be an entity "whose funds are wholly or mainly applied to [specified] purposes within New Zealand".

Initial conclusions on the meaning of "wholly or mainly"

115. In the context of s LD 3(2)(a), it appears "wholly or mainly" means all or substantially all of an entity's funds must be applied to specified purposes within New Zealand.

116. For practical purposes and for greater certainty about the application of the legislation, "wholly or mainly" should be treated as meaning something in the order of 90 percent or more. This means an entity could apply 10 percent or less of its funds to non-qualifying purposes and meet the "wholly or mainly" requirement. The 10 percent figure should be treated as marking the boundary of a "safe harbour". Generally, entities within the safe harbour would be presumed to be meeting the "wholly or mainly" requirement; entities outside the boundary would need to be considered further on a case-by-case basis.

117. This interpretation of "wholly or mainly" ensures tax advantages mainly accrue for gifts to entities that apply their funds to specified purposes within New Zealand and that benefit New Zealand society.

118. This also means we should formulate a method by which an individual entity's position in relation to the safe harbour can be calculated. The Commissioner suggests that one method could be to calculate the proportion of an entity's total expenses incurred or payments made to non-qualifying purposes in an income year. This could be derived from information summarised in the entity's statement of financial performance or statement of receipts and payments for the income year.

119. The following apply for the purposes of the safe harbour calculation:

- "Funds" as used in s LD 3(2)(a) should be viewed as the amounts receivable or received for an entity from all sources (both income and capital).

- How funds are "applied" should be determined from the expenditure incurred or payments made in a period ignoring funds held or on hand at the end of a period.
- Amounts incurred or payments made towards both specified purposes within New Zealand and non-qualifying purposes should be apportioned on some reasonable basis. This will include administration and overhead costs incurred by entities that do not apply their funds 100 percent to specified purposes within New Zealand.
- Measuring compliance should occur annually based on an entity's payments made for an income year.

What are the alternatives to s LD 3(2)(a)?

120. The Commissioner's view is that "wholly or mainly" sets a high threshold. This may mean some entities who apply their funds to specified purposes within New Zealand may not meet the requirements of s LD 3(2)(a). However, such entities might have two alternatives, if they wish donors to receive tax advantages.

121. First, s LD 3(2)(c) allows entities to set up and maintain a separate fund **exclusively** for specified purposes (being charitable, benevolent, philanthropic, or cultural purposes) within New Zealand. Gifts to such a fund would be eligible for tax advantages. This allows an entity to effectively carve off from any non-qualifying purposes the part of the entity's operations that relates exclusively to specified purposes within New Zealand.

122. However, the requirement to apply the fund exclusively to specified purposes within New Zealand must be maintained at all times and adequate records substantiating this would be needed. The exclusivity requirement would mean the entity would not be able to draw money from the fund to apply to anything that was not a specified purpose within New Zealand. This would include using the fund to support the entity's operating expenditure. This is because the entity's operations would entail the application of funds to all the entity's purposes, including non-qualifying purposes.

123. Second, an entity can apply to be included in Schedule 32. If the entity were included in Schedule 32, a tax advantage could be allowed for all gifts of money it receives. There are government guidelines for New Zealand charitable entities with mainly overseas purposes seeking donee organisation status. For information on the guidelines for Schedule 32 inclusion go to the:

- main Inland Revenue website – www.ird.govt.nz (keywords: charitable bodies requesting overseas donee status)
- Inland Revenue's Policy and Strategy website – www.taxpolicy.ird.govt.nz (keywords: overseas donee status).

124. Parliament will consider for inclusion within Schedule 32 only entities whose funds are principally applied towards:

- the relief of poverty, hunger, sickness or the ravages of war or natural disaster;
- the economy of developing countries (recognised as such by the United Nations);
- raising the educational standards of a developing country.

125. Specifically excluded from consideration are charities formed for the principal purpose of fostering or administering any religion, cult or political creed.

Conclusions on alternatives to s LD 3(2)(a)

126. Entities unable to satisfy the "wholly or mainly" requirement may take alternative approaches if they wish donors of gifts to them to be eligible for tax advantages:

- Entities could establish and maintain a separate fund exclusively for specified purposes within New Zealand (in which case only gifts to that fund would be eligible for tax advantages).
- Entities could seek to be listed in Schedule 32 (in which case all gifts to the entity could be eligible for tax advantages).

Closing comments

127. Tax advantages accrue to donors for gifts made to donee organisations where there is a benefit to New Zealand society. The interpretation of s LD 3(2)(a) raises several uncertainties as to whether this is being consistently achieved. The Court of Appeal acknowledged some of these uncertainties in *Molloy* (at 690). How the legislation is to apply in practice raises further uncertainty.

128. This paper discusses some of the uncertainties with a view to focusing attention on them and offering possible approaches to reduce the level of doubt and confusion. As mentioned at the beginning, although this paper represents the Commissioner's initial views, the purpose of an issues paper is to stimulate discussion and invite submissions from interested parties.

Appendix – Legislation

Income Tax Act 2007

1. Section DB 41 provides a tax deduction for gifts made by a company:

DB 41 Charitable or other public benefit gifts by company

(1) *(repealed)*

(2) A company is allowed a deduction for a charitable or other public benefit gift that it makes to a donee organisation

(3) The deduction for the total of all gifts made in an income year is limited to the amount that would be the company's net income in the corresponding tax year in the absence of this section.

(4) This section supplements the general permission. The general limitations shall still apply.

2. Section DV 12 provides a tax deduction for gifts made by a Māori authority:

DV 12 Maori authorities: donations

(1) A Maori authority is allowed a deduction for—

...

(b) a charitable or other public benefit gift that it makes to a donee organisation.

3. Section LD 1 provides a refundable tax credit for gifts by a person:

LD 1 Tax credits for charitable or other public benefit gifts

Amount of credit

(1) A person who makes a charitable or other public benefit gift in a tax year and who meets the requirements of section 41A of the Tax Administration Act 1994 has a tax credit for the tax year equal to the amount calculated using the formula in subsection (2).

Formula

(2) The formula referred to in subsection (1) is—

total gifts × $33^1/_3$%.

Definition of item in formula

(3) In the formula, total gifts means the total amount of all charitable or other public benefit gifts made by the person in the tax year.

Administrative requirements

(4) Despite subsection (1), the requirements of section 41A are modified if a tax agent applies for a refund under that section on behalf of a person, and—

(a) the tax agent sees the receipt for the person's charitable or other public benefit gift; and

(b) the person retains the receipt for 4 tax years after the tax year to which the claim relates.

Refundable credits

(5) A credit under this section is a refundable tax credit under section LA 7 (Remaining refundable credits: tax credits under social policy schemes) and is excluded from the application of sections LA 2 to LA 6 (which relate to a person's income tax liability).

4. Section LD 2 states when s LD 1 does not apply:

LD 2 Exclusions

Section LD 1 does not apply to—

(a) an absentee:

(b) a company:

(c) a public authority:

(d) a Maori authority:

(e) an unincorporated body:

(f) a trustee liable for income tax under subpart HC, and section HZ 2 (which relate to trusts and distributions from trusts):

(g) in relation to the credit, a person who has a tax credit for a payroll donation.

5. Section LD 3 provides what is a charitable or other public benefit gift:

LD 3 Meaning of charitable or other public benefit gift

Meaning

(1) For the purposes of this subpart, a **charitable or other public benefit gift**—

(a) means a monetary gift of $5 or more that is paid to a society, institution, association, organisation, trust, or fund, described in subsection (2) or listed in schedule 32 (Recipients of charitable or other public benefit gifts):

(b) includes a subscription paid to a society, institution, association, organisation, trust, or fund, only if the subscription does not confer any rights arising from membership in that or any other society, institution, association, organisation, trust, or fund:

(c) does not include a testamentary gift.

Description of organisations

(2) The following are the entities referred to in subsection (1)(a):

(a) a society, institution, association, organisation, or trust that is not carried on for the private pecuniary profit of an individual, and whose funds are applied wholly or mainly to charitable, benevolent, philanthropic, or cultural purposes within New Zealand:

(ab) an entity that, but for this paragraph, no longer meets the requirements of this subsection, but only for the period starting on the day it fails to meet those requirements and ending on the later of—

(i) the day the entity is removed from the register of charitable entities under the Charities Act 2005;

(ii) the day on which all reasonably contemplated administrative appeals and Court proceedings, including appeal rights, are finalised or exhausted in relation to the person's charitable status.

(ac) a community housing entity, if the gift is made in a tax year that the entity meets the requirements to derive exempt income under section CW 42B (Community housing trusts and companies):

(b) a public institution maintained exclusively for any 1 or more of the purposes within New Zealand set out in paragraph (a):

(bb) a Board of Trustees that is constituted under Part 9 of the Education Act 1989 and is not carried on for the private pecuniary profit of any individual:

(bc) a tertiary education institution that is established under Part 14 of the Education Act 1989 and is not carried on for the private pecuniary profit of any individual:

(c) a fund established and maintained exclusively for the purpose of providing money for any 1 or more of the purposes within New Zealand set out in paragraph (a), by a society, institution, association, organisation, or trust that is not carried on for the private pecuniary profit of an individual:

(d) a public fund established and maintained exclusively for the purpose of providing money for any 1 or more of the purposes within New Zealand set out in paragraph (a).

6. Section YA 1 defines a donee organisation:

YA 1 Definitions

In this Act, unless the context requires otherwise,—

...

donee organisation means an entity described in section LD 3(2) (Meaning of charitable or other public benefit gift) or listed in schedule 32 (Recipients of charitable or other public benefit gifts)