Inland Revenue
Te Tari Taake

INTERPRETATION STATEMENT: IS 18/05

INCOME TAX: DONEE ORGANISATIONS — MEANING OF WHOLLY OR MAINLY APPLYING FUNDS TO SPECIFIED PURPOSES WITHIN NEW ZEALAND

All legislative references are to the Income Tax Act 2007 unless otherwise stated. Relevant legislative provisions are reproduced in the appendix to this Interpretation Statement.

Contents

What this statement is about

1. This statement is about organisations having "donee organisation" status under s LD 3(2)(a). Donee organisation status means that, subject to some limits, donors of monetary gifts to the organisation can obtain tax advantages. The tax advantage for natural persons is a refundable tax credit of $33^{1}/_{3}$% of gifts of $5 or more under ss LD 1 and LD 2. Companies and Māori authorities can qualify for a deduction for the amount of the gift under ss DB 41 or DV 12.

2. Generally, organisations can obtain donee organisation status in two main ways. They can meet the requirements of s LD 3(2)(a) or they can be added to the list of overseas donee organisations appearing in sch 32.

3. This statement concerns donee organisations under s LD 3(2)(a). To qualify as a donee organisation under s LD 3(2)(a), an organisation must be:

> 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:

In this statement "charitable, benevolent, philanthropic, or cultural" purposes are collectively referred to as "specified" purposes. Also, gifts eligible for tax advantages, defined in s LD 3(1) as "charitable or other public benefit gifts", are referred to as "gifts" or "donations".

4. This statement seeks to clarify aspects of the interpretation of s LD 3(2)(a) that the Commissioner is aware have given rise to uncertainty. That is, the meaning of "whose funds are applied wholly or mainly to [specified] purposes within New Zealand". In doing so, this statement concludes on approaches to the legislation that donee organisations can feel confident are consistent with the Commissioner's view of the meaning of the legislation.

5. Section LD 3(2) includes paragraphs other than para (a) that also confer donee organisation status in specific cases. For example, s LD 3(2)(bb) can apply to a board of trustees under the Education Act 1989. This statement does not apply to donee organisation status arising under any paragraph of s LD 3(2) other than para (a). This statement also does not apply to overseas donee organisations listed in sch 32.

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

Summary

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

Interpretative conclusion

7. Section LD 3(2)(a) uses the phrase "wholly or mainly" to set the extent to which funds must be applied to specified purposes within New Zealand. The phrase also effectively determines the extent to which an organisation may apply funds to purposes that are not specified purposes within New Zealand and remain a donee organisation under the provision.

8. Before this statement, the Commissioner in recent times, and from time to time, accepted in some cases that the phrase "wholly or mainly" could mean as little as a bare majority (ie, "more than 50%"). This meant it was possible for an organisation to apply up to 49% of its funds to purposes that are not specified purposes within New Zealand and retain donee organisation status. However, the Commissioner's approach was administrative and not necessarily consistently applied.

9. Having now considered the matter in depth, the Commissioner concludes in this statement that the extent to which donee organisations may apply funds to purposes that are not specified purposes within New Zealand is less than what may have been previously accepted in some cases.[1] The Commissioner concludes that "wholly or mainly" in the context of s LD 3(2)(a) requires considerably more than a bare majority of a donee organisation's funds to be applied to specified purposes within New Zealand.

10. The meaning of "wholly or mainly" has been determined after considering the following:

- The ordinary meaning of "wholly" is "entirely" or "fully".
- The ordinary meaning of "mainly" is unclear when expressed numerically in terms of the extent to which a donee organisation needs to apply funds to specified funds within New Zealand. It may mean:
  - no more than a bare majority (ie, "more than 50%"); or
  - something greater than a bare majority.

11. The legislative context and purpose support the view that a meaning for "mainly" of greater than a bare majority better fulfils the purpose of s LD 3(2)(a) in light of:

- the immediate context of s LD 3(2)(a) where "mainly" is used in conjunction with and as an alternative to "wholly";
- the other paragraphs of s LD 3(2) that require purposes to be achieved "exclusively" within New Zealand;
- sch 32 which applies to organisations the purposes of which are achieved principally overseas; and
- the history of the legislation that shows the provision of the tax credit to donors by Parliament was to encourage giving to support community self-help and to help relieve the government of the burden of expenditure that it would otherwise incur to achieve domestic social outcomes.

12. On balance, the Commissioner considers the legislative context and purposes means "mainly" in s LD 3(2)(a) should be read more restrictively, indicating a considerably higher figure than a bare majority. However, "wholly or mainly" is an imprecise term. While something considerably greater than a bare majority is indicated, it is not possible to interpret the expression with any greater certainty.

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[1] For an earlier stage in this process of considering the matters in-depth, see the Public Rulings Unit's 2016 Issues Paper No. 9 "Donee organisations – clarifying when funds are wholly or mainly applied to specified purposes within New Zealand".

Administrative safe harbour for "wholly or mainly" requirement

13. To bring greater certainty, the Commissioner proposes to supplement this interpretative conclusion by administering the "wholly or mainly" requirement of s LD 3(2)(a) on a "safe harbour" basis. The 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, the Commissioner will generally accept without further enquiry that the organisation meets the "wholly or mainly" requirement of s LD 3(2)(a). The Commissioner has set the safe harbour percentage at a minimum of 75%.

14. Accordingly, the safe harbour percentage is relevant only if the organisation applies any of its funds to purposes that are not specified purposes within New Zealand and wants some certainty about its eligibility under s LD 3(2)(a).

15. A figure of 75% was suggested in *R v Radio Authority, ex p Bull* [1997] 2 All ER 561 (CA). In that case, the court adopted a mid-way point between the possible meanings of "mainly" which ranged from 51% to 99%. The Commissioner considers this is a reasonable and pragmatic figure to apply in the context of s LD 3(2)(a).

Interpretative conclusions on other requirements of s LD 3(2)(a)

16. In addition to providing certainty about "wholly or mainly", the Commissioner makes further conclusions on other aspects of s LD 3(2)(a). These are necessary to apply the administrative safe harbour and concern the meanings of:

- "Funds"
- "Applied"
- "Funds are applied"
- "New Zealand".

"Funds"

17. While not free from doubt, the most appropriate meaning of "funds" in the context of s LD 3(2)(a) seems to be a reference to money readily available to an organisation at any point in time (ie, "cash on hand"). This includes cash and other highly liquid assets available to meet commitments. For the purposes of the safe harbour, the term "funds" is accepted as equating to the accounting concepts of "cash" and "cash equivalents".

"Applied"

18. "Applied" means "devoted to" or "put to use" and this includes where funds have been:

- spent on a purpose or purposes;
- invested for a purpose or purposes; or
- set aside to be spent at some future date on a purpose or purposes.

19. While there are no specific limits on the extent to which funds can be accumulated (ie, invested or set aside), organisations that simply accumulate funds still need to show that they are applying funds to specified purposes within New Zealand to the required extent.

"Funds are applied"

20. The expression "funds are applied" suggests:

- The application of funds arises as a result of the organisation either spending money or undertaking some affirmative act to invest or set aside the money for future spending for some purpose or purposes.
- The affirmative act is the decision to accumulate funds that has been made at the appropriate level in the organisation for decisions of that type according to its established management practices. For example, the trustees of a charitable trust resolving to set aside money in the trust's on-call savings account pending a capital purchase.
- The decision to accumulate funds will need sufficient detail to be able to characterise that application of funds as advancing charitable, benevolent, philanthropic, or cultural purposes within New Zealand.

21. The application of funds occurs on a continuing basis over the lifetime of the donee organisation. This is so, even though for administrative purposes to gauge compliance with this on-going lifetime requirement, it is more practicable to look at funds applied over a discrete period of time, such as a year, and then, from year to year.

22. 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. It is the objectively determined purpose sought to be achieved through the application of the funds that is important.

23. Absent the funds being spent or there being an affirmative act to invest or set aside the funds for a purpose, they will not be considered as being applied to any purpose, although these funds still form part of the organisation's total "funds".

"New Zealand"

24. "New Zealand" should commonly be understood as the North, South, Stewart, Chatham and Kermadec Islands and all other territories, islands, and islets in the geographical areas set out in the New Zealand Boundaries Act 1863 (UK) and the preamble of the Kermadec Islands Act 1887.

25. "New Zealand" for the purposes of s LD 3(2)(a) does not include:

- the self-governing states of the Cook Islands and Niue;
- Tokelau; or
- the Ross Dependency.

When funds are applied to specified purposes within New Zealand

26. Unless accumulated or donated to another organisation, funds would usually be applied by being spent on the provision of goods or services in the course of carrying on some activity. 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 activity's results.

27. The enquiry under s LD 3(2)(a) in regard to the application of funds is 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 not necessarily an immediate connection.

28. When assessing the connection:

- A distinction can be made between purposes and results. Some results arise incidentally or as a consequence of the achievement of other results directly relatable to the objects of the organisation as set out in its founding documents. If so, they can be ignored when determining whether the results of activities arising from an application of funds bear a sufficient relationship to specified purposes within New Zealand.
- Results not naturally arising as an incident or consequence of other results that are pursued as a result in their own right may indicate the presence of another independent and additional purpose of the application of funds. If so, the expenditure concerned may need to be apportioned to different purposes. Apportionment is required if the purposes differ as to whether they are specified purposes within New Zealand or other purposes.
- The view taken of the purpose or purposes served by an application of funds may need to have regard to whether it is the immediate or less immediate purposes served that are determinative. One common situation where this may be important is in relation to funds applied in trading activities or fund-raising events. Where trading activities are conducted as a means of raising funds, the Commissioner considers funds applied to such activities as being applied to the same purposes as those to which the net surplus will be applied. In other cases, where the trading directly achieves a certain object or objects of the organisation, then that object or those objects will dictate what the funds applied to the trading activity are applied to.
- In cases where a donee organisation has applied 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.
- Each application of funds needs to be assessed objectively on its own merits as to whether some results are incidental or consequential to other results or whether more than one purpose exists.

Apportionment

29. Apportionment issues in this context can be approached on a similar basis to apportionment arising under s DA 1:

- The circumstances of the particular case will usually determine the most apt way of deciding how to apportion an amount.
- The apportionment must be fair, not arbitrary, and must be done as a matter of fact.
- Where expenditure has distinct and severable components, it may be divided or dissected where the distinct and severable components can be related to differing tax treatments.
- Where a single outlay serves two or more objects without distinction, dissection is impractical and apportionment on a fair and reasonable basis applies.
- In apportionment cases, the onus of proof lies with the taxpayer.

- Just because the apportionment might be difficult is not of itself sufficient reason for failing to find that some apportionment can be made.
- Absolute precision cannot be expected, so a reasonable estimate is sufficient.

Calculating the safe harbour percentage

30. The safe harbour approach comprises determining an organisation's safe harbour percentage for a financial year. Calculating an organisation's safe harbour percentage involves three steps:
    - 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 (ie, all cash outflows whether capital or revenue).
    - 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 entirely for specified purposes within New Zealand and amounts reasonably apportioned to those purposes.
    - Divide the cash spent or set aside for specified purposes within New Zealand (as per the second step) by the organisation's "total funds" (as per the first step) and express this as a percentage.

31. If the figure is below 75% in any year, the cumulative total of its funds applied over the current and preceding two years can be used (including years before the commencement of this statement). This allows some year-on-year variation for exceptional years. However, it would not be expected that under the rolling three-year cumulative safe harbour calculation an organisation would devote 50% or less of its funds to specified purposes within New Zealand in any particular year.

32. If the rolling three-year cumulative safe harbour percentage is below 75% or the figure in any year is 50% or below, the organisation should contact Inland Revenue as soon as possible.

33. 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, organisations may wish to consider whether to establish and maintain a fund exclusively for specified purposes within New Zealand under s 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.

Introduction

34. The Commissioner is aware of a lack of clarity and consistency about aspects of the requirements for "donee organisation" status under s LD 3(2)(a). Unfortunately, there is little judicial guidance on interpreting this provision.

35. A former version of the provision was considered in *Molloy v CIR* [1981] 1 NZLR 688 (CA). The former provision was s 84B of the Land and Income Tax Act 1954 which required organisations to "wholly or principally" apply funds to specified purposes within New Zealand.[2] *Molloy* is the only case to directly consider the legislation. However, while the Court of Appeal noted (at 690) the legislation raised several problems, it was not required to resolve them.

36. The problems noted in *Molloy* included:

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

37. While the court in *Molloy* did not include the meaning of "principally" as a problem (simply stating (at 690 – 691) that it was "sufficient that funds are applied principally to an enumerated purpose"), the Commissioner is aware that the meaning of "wholly or mainly" (as it is now) has been an issue more recently.

38. Accordingly, this statement considers:

- the meaning of "wholly or mainly";
- the meanings of "funds", "applied" and "funds are applied";
- what is required to be "within New Zealand"; and
- when will funds be considered applied wholly or mainly to specified purposes within New Zealand.

39. As most of these issues require interpreting the Act, it is useful first to consider the approach to statutory interpretation in New Zealand.

Text, context and purpose – the approach to interpretation

40. Section 5(1) of the Interpretation Act 1999 sets the approach to statutory interpretation in New Zealand by requiring the meaning of an enactment to be determined by its text and in the light of its purpose. The Supreme Court acknowledged the necessity of applying the s 5(1) approach in *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36 (at [22]):

> It is necessary to bear in mind that s 5 of the Interpretation Act 1999 makes text and purpose the key drivers of statutory interpretation. The meaning of an enactment must be ascertained from its text and in the light of its purpose.

41. The Act acknowledges the role of s 5(1) of the Interpretation Act 1999 in s AA 3(2), which states:

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[2] As part of the 2004 rewrite of the tax legislation, the word "mainly" was used to replace "primarily and principally" and similar expressions in the Act. This was done on the basis that "mainly" bore sufficiently similar connotations to these other expressions. This view was informed by the decision in *Newmans Tours Ltd v CIR* (1989) 11 NZTC 6,027 (HC) (see: "Income Tax Act 2004", *Tax Information Bulletin* Vol 16, No 5 (June 2004) 46 at 71).

(2) The Interpretation Act 1999 also contains definitions of terms, including in particular the term **person**, and other provisions that apply to the interpretation and construction of this Act.

42. The Supreme Court has also confirmed the approach to statutory interpretation in New Zealand (of requiring the meaning of an enactment to be determined by its text and in the light of its purpose) applies without modification to revenue statutes (see *Stiassny v CIR (No 2)* [2012] NZSC 106 at [23] and *Terminals (NZ) Ltd v Comptroller of Customs* [2013] NZSC 139 at [39]).

43. In *Commerce Commission v Fonterra*, the Supreme Court went on to state (at [22]) that the interpretative approach requires determining the meaning of the text and then cross-checking the meaning against the purpose of the legislation. This is so even if the meaning of the text appears clear:

> Even if the meaning of the text may appear plain in isolation of purpose, that meaning should always be cross checked against purpose in order to observe the dual requirements of s 5 [of the Interpretation Act 1999]. In determining purpose the court must obviously have regard to both the immediate and the general legislative context. Of relevance too may be the social, commercial or other objective of the enactment.

44. About the meaning of the text of legislation, the Supreme Court stated (at [23]):

> The concept of a plain and ordinary meaning does not involve the court having recourse to external sources such as expert evidence and textbooks.[12] If the court has to do that there can hardly be a plain meaning. If one has to go outside the immediate text in this way, there is no logical reason to stop there. Any suggestion of a plain meaning must then evaporate.
>
> [12] Reference to recognised dictionaries is, of course, in accordance with the plain meaning approach.

45. Also, when determining the meaning of the text, the Supreme Court has accepted that "there may still be some place for the old canons of construction" (*Terminals (NZ) Ltd* at [74]). This is a reference to guiding principles (or canons) developed from case law that the courts apply to aid in their interpretation of legislation. One canon relevant in the present context is *noscitur a sociis* (ie, words derive colour from those which surround them). It is discussed from [84].

46. Where the ordinary meaning of the text is not clear, the Supreme Court stated in *Commerce Commission v Fonterra* that it would be guided by the legislation's context and purpose (at [24]):

> Where, as here, the meaning is not clear on the face of the legislation, the court will regard context and purpose as essential guides to meaning.

47. In respect of the context and purpose, the practice of the courts, including the Supreme Court, has been to look to the legislative history for assistance. (See, for example *Terminals (NZ) Ltd* from [50] and *Worldwide NZ LLC v NZ Venue and Event Management* [2014] NZSC 108 from [17].) In some cases, the courts will look to parliamentary debates (Hansard) as part of the examination of the legislative history. (See, for example, *Marac Life Assurance Ltd v CIR* [1986] 1 NZLR 694 (CA) at 701 and *Worldwide NZ LLC* at [19].)

48. The Supreme Court has also acknowledged that, in some cases, the only reliable guide as to the purpose of a revenue statute is the legislation itself (*Stiassny* (at 23]):

> The purpose of a taxing provision may be a guide to its meaning and intended application. But, as Burrows and Carter point out, in most cases the only evidence

> of that purpose is the detailed wording of the provision and the safest method is to read the words in their most natural sense.

49. The approach to statutory interpretation was summed up in *Mailley v District Court at North Shore* [2015] 2 NZLR 567 (HC) as striking a balance between the text (which is enlarged by considering purpose) and purpose (which is constrained by the text). Keane J stated (at [66]):

> This principle of interpretation, according to Burrows, has stood in New Zealand for over a century.[30] It calls for a balance to be struck between the text and the purpose, in which the latter is decisive. In 1992 Cooke P said that, in principle, "strict grammatical meaning must yield to sufficiently obvious purpose".[31] That is so also where a provision is ambiguous or unclear.[32] But a sensible balance must be struck. As the then chief parliamentary counsel, George Tanner QC, said in 2005, "text is enlarged by purpose, and purpose is constrained by text".[33]
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> [30] JF Burrows and RI Carter *Statute Law in New Zealand* (4th ed, LexisNexis, Wellington, 2009) at 203.
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> [31] *McKenzie v Attorney-General* [1992] 2 NZLR 14 (CA) at 17.
>
> [32] *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767 at [24].
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> [33] Tanner & Carter "Purposive Interpretation of New Zealand Legislation", (paper presented to Australian Drafting Conference, Sydney, August 2005) at [66].

50. Finally, judicial precedent or the doctrine of *stare decisis* acts as a constraint on a court interpreting legislation (see: R Carter, *Burrows and Carter: Statute Law in New Zealand* (5th ed, LexisNexis, Wellington, 2015) at 191–193). *Stare decisis* is the principle that a court is required to follow previous court decisions unless they are inconsistent with a higher court's decision or are wrong in law. While acting as a constraint, judicial precedent provides for greater certainty in interpretation of the law because if an earlier court has given legislation a particular interpretation, then that interpretation is binding on lower courts and very persuasive for courts at the same level.

51. However, there are limits to which the doctrine applies, including those expressed by the House of Lords in *Ogden Industries Pty Ltd v Lucas* [1969] 1 All ER 121 at 126 where Lord Upjohn, delivering the judgment of the court, said:

> It is quite clear that judicial statements as to the construction and intention of an Act must never be allowed to supplant or supersede its proper construction and courts must beware of falling into the error of treating the law to be that laid down by the judge in construing the Act rather than found in the words of the Act itself. No doubt a decision on particular words binds inferior courts on the construction of those words on similar facts, but beyond that the observations of judges on the construction of statutes may be of the greatest help and guidance but are entitled to no more than respect and cannot absolve the court from its duty of exercising an independent judgment.

52. Judicial decisions on other legislation can be helpful, as can decisions of courts in other jurisdictions. However, care must be exercised in both instances. The wording of other provisions may vary slightly, the purpose and context of the Acts may differ, and harmonisation between Acts and jurisdictions is not an absolute requirement.

53. Accordingly, decided cases can be useful in helping to inform questions of the ordinary meaning of words or the context and purpose of legislation where that has been the subject of previous judicial scrutiny.

54. In summary, the legislation is to be interpreted in the following way:

- The statutory text is considered from which the plain and ordinary meaning or meanings of the words used are determined.
- The plain and ordinary meaning or meanings of the text may be determined with reference to recognised dictionaries but should not involve recourse to such things as textbooks or expert evidence.
- The plain and ordinary meaning or meanings must then be cross-checked against the purpose of the legislation.
- In determining purpose, regard must be given to both the immediate and general legislative contexts.
- It may also be relevant when determining purpose to consider the social, commercial or other objective of the legislation.
- Decided cases may be of interpretative assistance in determining the meaning of legislation.

55. Overall, a sensible balance must be struck between text and purpose. In practice, this will mean that if the meaning of the text is consistent with the legislative purpose, the legislative purpose bolsters that conclusion. However, if the meaning of the text is unclear or ambiguous, the legislative purpose is an essential guide to the meaning.

Meaning of "wholly or mainly"

The statutory text: "wholly", "or" and "mainly"

56. The interpretative approach is to first consider the words of the Act. In this case, "wholly", "or" and "mainly". These words are not defined in the Act so they bear their ordinary meanings.

"Wholly"

57. The *Concise Oxford English Dictionary* (12th ed, Oxford University Press, New York, 2011) defines "wholly" as:

> **wholly** … **adv.** entirely; fully.

58. In *FCT v FH Faulding & Co Ltd* [1950] ALR 862 (HCA) the High Court of Australia considered the phrase "wholly or principally". Latham J stated (at 863):

> [T]he word "wholly" necessarily requires the application of a quantitative standard. A quantitative measure is one capable of being measured.

59. Accordingly, it seems reasonably clear that the ordinary meaning of "wholly" would require all of a donee organisation's funds to be applied to specified purposes within New Zealand. It also seems "wholly" requires that the funds are *measurably* applied to those purposes.

"Or"

60. The *Concise Oxford English Dictionary* defines "or" as:

> **or** ▸ **conj. 1** used to link alternatives.

61. Accordingly, "or" means "wholly" and "mainly" are linked as alternatives. As an alternative, "mainly" does not overlap with "wholly". This was confirmed by Aldous LJ in *Radio Authority* where he stated (at 575) that the words "wholly or

mainly" are "not coterminous in meaning" (ie, they do not have the same boundaries).

"Mainly"

62. The *Concise Oxford English Dictionary*, defines "mainly" as:

> **mainly** … **adv.** more than anything else. ▪ for the most part.

63. In the *Collins English Dictionary* (online ed, HarperCollins, New York, accessed 30 August 2018), "mainly" is defined as:

> **mainly** ... (in British) **adv 1**. for the most part; to the greatest extent; principally.

64. The dictionary definitions indicate "mainly" bears meanings that vary as to degree. For instance, "more than anything else" could mean more than anything else considered *singly*. If so, the "main" thing needs to be only greater than any other single thing. Alternatively, it could mean more than anything else considered *collectively*. If this is so, then the "main" thing needs to be greater than all the other things considered together (ie, greater than 50%). "For the most part" could be viewed in the same way, whereas "to the greatest extent" might not. Where the item of interest is but one option of two, this distinction may have no practical effect – the "main" thing will be greater than 50%. However, where the item of interest is one option of many, "mainly" could mean something less than 50%.

65. For instance, in *Franklin v Gramophone Co Ltd* [1948] 1 All ER 353, the United Kingdom Court of Appeal (at 358) considered whether a person spending two hours a day at a task might be considered "mainly" engaged in that task, if during the rest of the day they were involved in, say, eight other tasks for an hour. That is, the person was mainly engaged in a certain task because they spent more time on that task than any other task considered *singly*. In that example, "mainly" could mean something numerically as low as 20%. Somervall LJ did not consider "mainly" had such a meaning in the context of the case. However, he accepted "[t]he word 'mainly' may, in some contexts, have such a meaning".

66. It seems more common for the courts to find that "mainly" has a meaning consistent with the situation where the "main" thing is more than anything else considered *collectively* (ie, more than 50%). However, this may reflect the reality that courts are often called on to consider whether something is or is not the "main" thing (ie, in a context of only two alternatives).

67. In New Zealand, the court accepted "mainly" as meaning "more than half" in *CIR v Mitchell* (1986) 8 NZTC 5,181 (HC). In *Mitchell,* the High Court considered whether a taxpayer's dining room was used "wholly or principally" in connection with employment. The court considered "principally" was synonymous with "mainly". The employment use of the dining room was between 55% and 59% and this use was found to be sufficient. 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 [of the fourth schedule to the Income Tax Act 1976] is, in my view, synonymous with "mainly" which is an expression well understood by ordinary people. ...
>
> Mr Aspey [for the Commissioner] 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.**
>
> ...
>
> 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".**
>
> [Emphasis added]

68. *Mitchell* was cited in *Newmans Tours Ltd v CIR* (1989) 11 NZTC 6,027 (HC) in relation to the phrase "primarily and principally". The court stated (at 6,030):

> As seen, an overriding requirement is that the expenditure be incurred "primarily and principally" for the purpose of attracting tourists to New Zealand from overseas. The term "primarily and principally" does not appear previously to have been the subject of judicial exposition. ***C of IR v Mitchell* (1986) 8 NZTC 5,181, a judgment of Sir Ronald Davison CJ,** was concerned with the provision in cl 7 of the fourth Schedule to the Income Tax Act, concerning expenditure where a room in a dwelling was used "wholly or principally" for the purpose of the taxpayer's employment. **As to the meaning of "principally" the Chief Justice relied on the dictionary meanings of the adjective "principal" — prime, main, chief, foremost, leading. He referred also to *Fawcett Properties Ltd v Buckingham County Council* [1961] AC 636 at p 669 where Lord Morton expressed the view that in the particular context "mainly" probably meant more than half.**
>
> The expression in issue here poses a higher hurdle than that in *Mitchell's* case — the purpose must be not only the main one, in the sense of outweighing all the other purposes, singly or collectively, it must also be the primary purpose, that is the first one.
>
> [Emphasis added]

69. *Mitchell* and *Newmans Tours* referred to the comments of Lord Morton of Henryton in *Fawcett Properties Ltd v Buckingham County Council* [1960] 3 All ER 503 (HL). In *Fawcett Properties*, the House of Lords considered whether a local authority's planning consent for a housing development was invalid because of a condition in the consent requiring the houses' occupation to be "limited to persons whose employment ... was in ... an industry mainly dependent upon agriculture". Lord Morton of Henryton stated (at 512) "mainly" probably meant more than half although the word "at once gives rise to difficulties":

> Other criticisms were directed to other words in the condition, but I shall not detain your Lordships by travelling through them, for, in my opinion, the words "mainly dependent upon agriculture" are of themselves enough to lead your Lordships to declare the condition void. **The word "mainly" at once gives rise to difficulties. Probably it means "more than half"**,...
>
> [Emphasis added]

70. In contrast to the preceding cases, in the Australian Federal Court case of *Davis v FCT; Sirise Pty Ltd v FCT* 2000 ATC 4,201 the court declined to apply a statutorily defined meaning for "mainly" of "to the extent of more than 50%". The court in *Davis v FCT* accepted that while "mainly" usually meant "more than half" as defined, it also accepted the Commissioner's argument that Parliament did not intend for the defined meaning to apply to the relevant use of "mainly" in the legislation. The court considered "mainly" meant something other than "more than half" based on its ordinary meaning of "chief; principal; leading" (per the *Macquarie Dictionary* (2nd ed, Macquarie Dictionary Publishers, Sydney, 1991). In accepting the Commissioner's argument, the court stated (at [62]):

> This suggests that Parliament contemplated that in the present context the word was intended to signify "principal use" or perhaps the "preponderant use" rather than use just greater than 50%.

71. In the context of *Davis v FCT,* the court did not need to decide what percentage of use would be a "principal" or "preponderant" use. However, the case illustrates that, depending on the context, "mainly" could bear an ordinary meaning of greater than a bare majority.

72. Finally, some case law suggests the ordinary meaning of "mainly" may be quantitative in nature. For instance, in *Waugh v British Railways Board* [1979] 2 All ER 1,169 (HL) the court considered the appropriate test for applying legal privilege to documents containing legal advice where the documents were not created solely for that purpose. Courts had used various words to describe the extent to which a legal advice purpose needed to be the purpose of the document before privilege would apply to it. When reviewing these various words, Lord Simon of Gaisdale expressed a preference for the word "dominant" in this context. This is because he considered this word to be "less quantitative than 'mainly'" (at 1,178).

73. From the above case law, applying in contexts other than s LD 3(2)(a), it seems that regardless of the dictionary meaning of "mainly", when the meaning is expressed in quantitative terms by a court, it could indicate something less than half, just greater than half, or something greater again, depending on the context.

74. Accordingly, it is not completely free of doubt what the ordinary meaning of "mainly" means in relation to the degree to which s LD 3(2)(a) requires organisations to apply their funds to specified purposes within New Zealand (ie, what minimum percentage "mainly" translates to). It may mean an organisation simply needs to apply funds to specified purposes within New Zealand to a greater extent than it applies its funds to any other single purpose. It may mean the organisation need only apply more than half of their funds to specified purposes within New Zealand. However, it may mean a figure greater than a bare majority is indicated by "mainly", although how much greater is not clear.

Conclusions on the statutory text: "wholly or mainly"

75. The ordinary meaning of "wholly" seems clear in requiring all of an organisation's funds to be quantifiably applied to specified purposes within New Zealand.

76. However, the addition of "mainly" as an alternative to "wholly" means something less than 100% is also acceptable. That is, the phrase "wholly or mainly" presents a choice between the two alternatives with "wholly" removing any doubt about whether "mainly" includes 100% (*Radio Authority*).

77. "Mainly" (or its synonyms) can mean "for the most part" or "more than anything else" in the sense of "more than anything else considered together" (ie, "more than 50%") (*Mitchell, Newmans Tours, Fawcett Properties* and *Davis v FCT*).

78. However, "mainly" can bear meanings that vary as to degree. These meanings include being simply more than anything else considered singly (ie, something that could be less than 50% (*Franklin v Gramophone*)). Equally, "mainly" could mean something more than a bare majority, even if the boundaries of this meaning are unclear (*Davis v FCT*).

"Wholly or mainly" in light of the context and purpose of the legislation

Introduction

79. In accordance with the approach to statutory interpretation, the next step is to consider the text of the legislation in light of its purpose. This is made more crucial by the conclusion above that the ordinary meaning of "mainly" is unclear. Therefore, the legislative purpose and context are essential guides to the meaning of the legislation.

80. In determining the purpose, regard must be given to the immediate and general legislative context including social, commercial and other objectives of the enactment (*Fonterra* at [22]). Accordingly, considered on their own, no one aspect of the context and purpose of the legislation discussed below may indicate conclusively what the appropriate meaning is for "wholly or mainly". What is required is an overall assessment of these aspects of the legislation.

Immediate context — s LD 3(2)(a) – "wholly" and "mainly" used in conjunction

81. The immediate context of "mainly" in s LD 3(2)(a) is that it is used in conjunction with the word "wholly". "Wholly or mainly" in the context of s LD 3(2)(a) concerns itself with the ratio between funds applied to specified purposes within New Zealand and total funds. Because the legislation is concerned with only two things – funds applied to specified purpose within New Zealand and funds not so applied – only two meanings for "mainly" are relevant:

- as little as a bare majority (ie, "more than 50%"); or
- something greater than a bare majority.

82. The third possible meaning of "mainly" of "more than anything else" considered singly (as suggested in *Franklin v Gramophone*), does not need to be considered further as it is not applicable when there are only two options.

83. As discussed at [67], in *Mitchell,* the synonymous phrase "wholly or principally" was accepted in a New Zealand tax context as meaning "more than 50%". Overseas, the courts have followed a similar approach in other contexts (for example: *Minister of Agriculture, Fisheries and Food v Mason* [1968] 3 All ER 76 (HC), *Imperial Chemical Industries plc v Colmer* [1999] BTC 440 (HL), *On Call Interpreters and Translators Agency Pty Ltd v FCT* 2011 ATC 20-258 (FCA) and *Kenya Aid Programme v Sheffield City Council* [2013] EWHC 54 (Admin)).

84. On the face of it, therefore, the phrase "wholly or mainly" appears to mean anything from over 50% to 100%. However, the meaning of "mainly" can be affected or "coloured" by, its use in conjunction with the word "wholly". This is consistent with the guiding canon of statutory construction of reading words in the legislation in the context of the other words of the section in which they appear. The rule is sometimes referred to by the Latin term *noscitur a sociis* ("words derive colour from those which surround them" per Stamp J in *Bourne v Norwich Crematorium Ltd* [1967] 2 All ER 576 (HC) at 578)). As Stamp J continued to state (at 578):

> Sentences are not mere collections of words to be taken out of the sentence, defined separately by reference to the dictionary or decided cases, and then put back into the sentences with the meaning which you have assigned to them as separate words.

85. The effect of this rule of interpretation can be seen in *Re Hatschek's patents, ex p Zerenner* [1909] 2 Ch 68 (HC). The case concerned a challenge to the Comptroller General's decision to revoke a patent. The legislation at issue provided that any person could apply to the Comptroller for another person's patent to be revoked, if the patented article or process was manufactured or carried on "exclusively or mainly outside the United Kingdom". 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.
>
> ...
>
> **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]

86. Parker J rejected the argument "mainly" meant simply "more than 50 percent". He considered that if this was the word's meaning, then the difference between the activities carried on inside the United Kingdom and the activities carried on outside the United Kingdom could be small in some cases (2% in his example). Parker J concluded that in the context of the relevant legislation, Parliament must have intended an outcome where the difference was greater than a small percentage. That is, "mainly" has a meaning greater than a bare majority. Parker J concluded this because "mainly" was used with "exclusively". Parker J, however, did not indicate what would be considered sufficiently more than a mere small percentage margin to meet his understanding of the phrase.

87. The rule of interpretation was also applied in a New Zealand context by the former Supreme Court (now the High Court) in *Fairmaid v Otago District Land Registrar* [1952] NZLR 782. The case concerned registering a property under the Joint Family Homes Act 1950. The homeowner was a partner in a law firm who had purchased the property because it was close to his law offices. The homeowner also used a small room at the back of the property as an office. To be registered, the property had to be "exclusively or principally" used as a home and the Registrar General argued this requirement was not met. The Registrar General cited the *noscitur a sociis* rule of interpretation arguing this limited the meaning of the word "principally" so it was interpreted more narrowly than if it stood alone.

In support, counsel cited *Hatschek's patents.* North J agreed with this view (at 785):

> [Counsel for the Registrar General] very properly, in my opinion, contented himself with submitting that the association of **the three words "exclusively or principally" should cause the Court to interpret the last word rather more narrowly than if it had stood alone**.
>
> [Emphasis added]

88. While North J in *Fairmaid* indicated "principally" should be interpreted more narrowly, he did not indicate what this would mean in percentage terms for the meaning of "exclusively or principally".

89. In *Houston v Poingdestre* [1950] NZLR 966, the former Supreme Court considered a landlord's action for possession brought under the Tenancy Act 1948. No order for possession could be made if the property in question was an "urban property", as defined. The definition of "urban property" excluded properties used "exclusively or principally for agricultural purposes". Findlay J stated (at 973–974):

> [I]t does seem clear that the Legislature intended to leave all land used "exclusively or principally for agricultural purposes" outside the ambit of the Act ... The consequential conclusion seems to follow that the Legislature intended all land not used for agricultural purposes **to the high degree conveyed by the words "exclusively or principally"** to come within the scope of the Act.
>
> ...
>
> For several reasons, but principally for three in particular, I think the Legislature did not intend to exclude premises used primarily as a home from the definition of "urban property." **I think so, first, because the phrase "exclusively or principally" in the definition envisages some, if not some substantial, use for agricultural purposes,** so that it becomes a question of the degree of that use which determines whether a property is urban property or not. That degree has to be determined in relation to the use being made of it for some other purpose.
>
> [Emphasis added]

90. While Findlay J considered that for land to be used "exclusively or principally for agricultural purposes" the use had to be to a "high degree" or "substantially", there is no indication what extent of use in percentage terms would satisfy these terms. This is because, on the facts of the case, Findlay J determined the land was not used for agricultural purposes. Findlay J may have been influenced by the Magistrates' Court decision in *Livingstone v Barker* (1947) MCR 135, which he cited concerning the same legislation where "exclusively" was considered to colour the meaning of "principally".

91. *Livingstone* considered the same question as *Houston* as to whether a property was used "exclusively or principally for agricultural purposes". In considering the meaning of this phrase, the Magistrate stated (at 138):

> The dominating words in the definition are "Exclusively or Principally" and of these words "Exclusively" dominates "Principally". It is the less general term of the two that restricts the meaning of "Principally". In *Maxwell in the Interpretation of Statutes* (8th ed., at p. 284) it says:–
>
> > "When two or more words which are susceptible of analogous meaning are coupled together *noscitur a sociis,* they are understood to be used in their cognate sense. They take as it were, their colour from each other, that is, the more general is restricted to a sense analogous to the less general.
>
> This is precisely how these two words are to be understood. "Principally" which the *New Oxford Dictionary* defines as "in the chief place; as the chief thing concerned

> mainly; above all" has a meaning cognate to and only a few degrees more liberal than "exclusively". Its association with "exclusively" therefore confines its meanings to one more *ejusdem generis* that term.

92. The Magistrate applied the interpretative rule of *noscitur a sociis* to conclude that "principally" is coloured by "exclusively" and is interpreted as setting a high threshold "only a few degrees more liberal than 'exclusively'". He saw the words as specific and general terms of the same class. As such, under the interpretative rule *ejusdem generis* ("of the same kinds, class, or nature") the otherwise wide meaning of the general term "principally" must be restricted to the same class as the more specific term "exclusively". That is, in the context of "wholly or mainly", the view would be that both words are descriptors of a class concerning matters of degree. Then, because "mainly" is a more general descriptor of degree than "wholly", it must be interpreted as meaning something closer to "wholly" than otherwise might be the case.

93. The *noscitur a sociis* rule has also been applied in a New Zealand tax context by the Taxation Review Authority in *Case E79* (1982) 5 NZTC 59,416. *Case E79* concerned whether a panel van was a "motorcar" where that term was defined as a vehicle "designed exclusively or principally" for the carriage of passengers. Judge Barber considered the van was not a "motorcar" because it was designed principally for the carriage of goods. Judge Barber accepted, on authority of *Fairmaid,* the association of the word "exclusively" with the word "principally" should cause the Authority to interpret "principally" more narrowly than if it had been used alone. Again, the Authority did not indicate what this meant in percentage terms for the meaning of the relevant phrase.

94. A meaning for "wholly or mainly" of "100% or a near percentage" was applied in *British Association of Leisure Parks, Piers & Attractions Ltd* [2011] TC 01504 (UKFTT). This case involved the issue of whether an association's membership subscriptions should be exempt from value added tax (VAT). The exemption applied if the association's membership was restricted "wholly or mainly" to individuals or corporate bodies connected to the association's purposes. With 69% of its members connected to its purposes, the association argued it met the relevant test because "mainly" meant more than 50%. In finding against the taxpayer, the First Tier Tribunal (Tax Chamber) 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]

95. Although the Tribunal indicated a meaning for "wholly or mainly" of "100% or a near percentage", the tribunal's conclusions were not supported by authority or analysis. In the context of the VAT legislation, the view that "wholly or mainly" set a high figure limited the application of an exemption from tax and this may have meant the high figure was appropriate. The tribunal's decision was criticised in several areas when the taxpayer unsuccessfully appealed, but not on the meaning of "wholly or mainly" (*British Association of Leisure Parks, Piers and Attractions Ltd v Revenue and Customs Commissioner*s [2013] UKUT 130 (TCC)).

96. Consistent with this rule of interpretation, in *Radio Authority,* a meaning for "wholly or mainly" of greater than a bare majority was applied where the context supported a restrictive interpretation. The United Kingdom Court of Appeal

considered whether Amnesty International (British Section) was a body whose objects were "wholly or mainly" of a political nature. If so, it could not advertise on the radio. Lord Wolf considered the phrase's meaning was not free from ambiguity. He adopted a narrow meaning of "mainly" in light of the legislative context, although he did not directly refer to the word's use with the word "wholly" in terms of the rule of *noscitur a sociis*. Lord Wolf 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 [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. ...
>
> The issue is not whether the restriction ... 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%.**
>
> [Emphasis added]

97. Accordingly, the court in *Radio Authority,* when confronted with the situation where it was appropriate to read "mainly" narrowly opted for the pragmatic solution of translating this in percentage terms to the simple median between the possible range of meanings. That is, it opted for 75% simply because this is half-way between the possible meanings ranging from 51% to 99%.[3]

98. Finally, as mentioned in [58] and [72], the words "wholly" and "mainly" suggest they each set a test that is quantitative in nature and this would carry over to the phrase "wholly or mainly" emphasising the need to settle on some percentage figure for the phrase's use in s LD 3(2)(a) despite its apparent ambiguity. Even if this were not the case, the Commissioner would need to offer some quantifiable measure to provide guidance in administering the provision.

<u>Conclusions on the immediate context – s LD 3(2)(a) – "wholly" and "mainly" used in conjunction</u>

99. The immediate context of "mainly" in s LD 3(2)(a) is that it is used in conjunction with the word "wholly". "Wholly or mainly" in the context of s LD 3(2)(a) concerns the ratio between applying funds to specified purposes within New Zealand and all other possible application of funds. Private pecuniary profit aside, the legislation does not focus on the application of any portion of funds not applied to specified purposes within New Zealand.

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[3] Although, the mid-point between 51% and 99% would seem to more correctly include 75% so translates to "75% or more" rather than "more than 75%", as expressed by the court.

100. Where "mainly" (or its synonyms) is used in conjunction with "wholly" it can retain a meaning of "more than 50%" (*Mitchell, Minister of Agriculture, Fisheries and Food v Mason, Imperial Chemical Industries, On Call Interpreters and Translators* and *Kenya Aid Programme*).

101. Alternatively, if the legislative context and purpose require, "mainly" can be read more narrowly and, in combination with "wholly" (or synonyms of it), bear a meaning of greater than a bare majority (*Hatschek's patents, Fairmaid, Houston, Livingstone, Case E79, British Association of Leisure Parks* (UKFTT) and *Radio Authority*). However, the boundaries of this meaning are unclear. At least one court in the past has simply opted for the mid-point in the range of possible meanings when faced with this situation (ie, 75% per *Radio Authority*).

102. Used together, "wholly or mainly" sets a quantitative test, meaning, in s LD 3(2)(a) the extent to which funds are applied to specified purposes within New Zealand must be measurable in some way (*FH Faulding* and *Waugh*).

Immediate context — other paragraphs of s LD 3(2) – "exclusively"

103. The language used in other paragraphs of s LD 3(2) is also relevant. These other paragraphs form part of the context in which para (a) must be interpreted and may have some influence on the interpretation of para (a). The relevant paragraphs are (b), (c) and (d):

> (b) a public institution **maintained exclusively** for any 1 or more of the purposes within New Zealand set out in paragraph (a):
>
> ...
>
> (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).
>
> [Emphasis added]

104. These other paragraphs require funds to be applied exclusively or *wholly* within New Zealand. This may indicate Parliament intended only some minor relaxation of this standard when it used "wholly or mainly" in s LD 3(2)(a) (ie, "mainly" means something greater than a bare majority). Or, it may indicate no more than a different test was intended to apply for these other paragraphs.

105. Additionally, under s LD 3(2)(a), funds not applied by a donee organisation to specified purposes within New Zealand are not focused on by the provision. These other purposes may not necessarily be ones Parliament would wish to support through the tax system.

106. On balance, the Commissioner considers the use of "exclusively" and "wholly or mainly" shows Parliament was concerned with what purposes organisations achieved and where. Except for sch 32 (where Parliament retains case-by-case control on donee organisation status), Parliament intended purposes to be generally achieved within New Zealand rather than overseas. That is, the context of s LD 3(2) shows some bias toward purposes being achieved within New Zealand.

Wider context — Part L of the Act

107. As mentioned, the tax credits for charitable gifts are part of calculating a taxpayer's tax liability. This is the context of part L of the Act, which collates various credits affecting the calculation.

108. Tax credits are significant because they can be used to satisfy a taxpayer's tax liability or refunded to them in cash. Credits usually recognise tax already paid elsewhere or are used to promote social objectives, (such as in this case, the object of encouraging charitable and public-benefit giving). This suggests s LD 3(2)(a) is concessionary in nature in its application to donee organisations because it encourages giving to organisations that include charities. This is consistent with the Act's treatment of charities generally, such as providing income exemptions for the income of charities.

109. However, the tax credits in this case accrue to donors and not to the organisations receiving the gifts. Despite this, it could be argued a lower figure for "wholly or mainly" is consistent with a concessionary approach to charities. This is because it could permit more organisations to be eligible for donee organisation status, (ie, those that undertake activities outside New Zealand but not extensively enough to meet sch 32 listing requirements). A lower figure could have a positive effect for donors by widening their choice of eligible organisations.

110. The Commissioner does not consider such an argument to be sustainable. The linkages between cause and effect in this argument are weak. It may not necessarily follow that more donee organisations would exist if the figure was lower rather than higher. Even if donors had more choice, this may not encourage more giving as opposed to simply causing the redirection of existing donations.

111. Also, the presence of sch 32 in the Act (discussed from [112]) and the history of the legislation (discussed from [125]) would weigh against such an argument.

Wider context — other parts of the Act

<u>Schedule 32</u>

112. As mentioned in [2], organisations can obtain donee organisation status in two main ways. They can meet the requirements of s LD 3(2) or they can be added to the list of overseas donee organisations appearing in sch 32. The history of sch 32 is that individually named organisations approved as "overseas" donee organisations were not originally listed in a schedule. Instead, they were listed in the body of the Act in what is now s LD 3(2). A separate schedule did not exist until the enactment of the Income Tax Act 2007. In either case, listing in the body of the legislation or in the schedule relies on the scrutiny and approval of Cabinet. The current listing criteria have existed since 1978 as follows:

> The basic criteria for adding an organisation to the list of approved "overseas" charities:
>
> (i) the funds of the charity should be principally applied towards:
>
> the relief of poverty, hunger, sickness or the ravages of war or natural disaster; or the economy of developing countries*; or
>
> raising educational standards of a developing country*;
>
> (ii) charities formed for the principal purpose of fostering or administering any religion, cult or political creed should not qualify;

* developing countries recognised by the United Nations.

[CM 78/14/7 refers]

113. The eligible purposes set out in the criteria are narrower than the common law meaning of "charity", the meaning of "charitable purpose" in s 5 of the Charities Act 2005 and the purposes in s LD 3(2)(a). Accordingly, s LD 3(2)(a) and sch 32 are not concerned with identical purposes. They do not simply sit at opposite ends of a spectrum, depending on where an organisation's purposes are achieved geographically. Schedule 32 criteria are limited to charitable purposes, whereas purposes for s LD 3(2)(a) include, but are not limited to, charitable purposes. Further, sch 32 charitable criteria are limited to a subset of charitable purposes and include only certain charitable purposes achieved in certain foreign countries.

114. This limits the extent to which inferences can be drawn on the meaning of "wholly or mainly" in s LD 3(2)(a). Also, the criteria determining how organisations may be added to sch 32 are not interpretatively relevant as they are not part of the Act.

115. Despite this, sch 32 is part of the Act. It is possible to look at the listed organisations and discern a common characteristic. This characteristic is that they all focus on achieving purposes outside New Zealand (although, a narrower range of purposes than s LD 3(2)(a)). The overseas focus of those organisations listed in sch 32 further reinforces the finding that Parliament is concerned with where purposes are being achieved.

116. The Commissioner considers it shows Parliament intended different rules to apply depending on whether purposes were being achieved to some degree within or outside New Zealand. Where purposes are being achieved outside New Zealand, Parliament controls donee organisation status through the Cabinet criteria and the need for legislative amendment to sch 32 to add further organisations. Where purposes are being achieved within New Zealand, s LD 3(2)(a) (in particular, the "wholly or mainly" requirement) exerts control on where such purposes are achieved.

117. However, as mentioned, this does not immediately suggest an appropriate numeric meaning for "wholly or mainly". Arguably, a high figure for "wholly or mainly" would be more consistent with a view that this phrase in s LD 3(2)(a) expresses Parliament's concern with, in this case, purposes being achieved within New Zealand. A lower figure for "wholly or mainly" would seem to undermine Parliament's concern. This is because it would result in the domestic rules applying to situations where more funds (potentially, up to 49%) were being applied outside New Zealand without the degree of scrutiny required for sch 32 listing applying.

Other uses of "wholly or mainly"

118. "Wholly or mainly" appears in other provisions of the Act. For example, s DC 3(2) refers to "a partnership that is engaged wholly or mainly in investing money" and an exemption in s CW 59 applies to a New Zealand company deriving income "wholly or mainly from Niue".

119. For one recently enacted example, some extrinsic material suggests what was contemplated for "wholly or mainly". Section CE 1B(4)(c) was inserted into the Act by s 15 of the *Taxation (Annual Rates, Employee Allowances and Remedial Matters)* Act 2014 which followed *Employee Allowances* (special report, Policy and

Strategy, Inland Revenue, Wellington, 2014). The special report commented on the meaning of "wholly or mainly" as follows:

> Work use of accommodation
>
> The deduction from the taxable amount when part of the accommodation is used for work purposes reflects current practice and the amendment is merely intended to clarify and confirm that approach. To qualify, a clearly identifiable part of the accommodation needs to be used "wholly or mainly" for work purposes related to the employee's employment or service. **The accommodation does not need to be used solely for work purposes to meet the "wholly or mainly" test, but it must at least be used predominantly for work purposes, and its primary purpose must be work-related. Any non-work-related use must be temporary or sporadic, or otherwise minor (such as using an office for checking personal emails or a family member occasionally using it for personal projects).** The deduction is determined by apportioning between the business and private use.
>
> [Emphasis added]

120. While not expressed in percentage terms, references to predominate or primary use in contrast to temporary, sporadic or minor use show "wholly or mainly" in the context of s CE 1B(4)(c) was intended to mean more than a bare majority.

121. However, the same meaning of "mainly" may not necessarily apply throughout the Act. This is especially so, in the absence of a definition applicable for all uses of "wholly or mainly" or "mainly" in s YA 1. This is despite the word "mainly" being adopted in the 2004 rewrite of the Act with the intention of making the tax legislation clearer and structurally consistent through greater use of plain language. As explained in the approach to interpretation from [40], the required approach cannot disregard the context and purpose of the provisions, which could differ with different uses of the same word or phrase in the Act.

122. Even if the same meaning were intended, it is not clear what single meaning would be applied, so examining the context and purpose of each provision is still necessary. Consequently, it appears little assistance in determining the meaning of "wholly or mainly" in s LD 3(2)(a) can be derived from considering other references to "wholly or mainly" or "mainly" in the Act.

Purpose

123. The purpose of the Act is provided in s AA 1 as being to:

- define, and impose tax on, net income;
- impose obligations concerning tax; and
- set out rules for calculating tax and for satisfying the obligations imposed.

124. Donee organisations and the tax benefits accruing to donors are part of the rules for calculating tax. This connection was more obvious when the donee organisation rules were first enacted as part of the Land and Income Tax Act 1954. When first enacted, the tax benefit was in the form of a deduction from income up to a limit of £25. Aside from this, the purpose of the Act as a whole provides little guidance on how to interpret "wholly or mainly" in s LD 3(2)(a) in the context of the Act.

Legislative history

125. The history of s LD 3(2)(a) dates from the 1960s. Because of the age of the legislation there is little historical material available. None of the following material (identified in *Burrows and Carter: Statute Law in New Zealand* (at 278) as possible aids to interpretation) is available to draw on:

- reports of committees, commissions or other bodies;
- regulatory impact statements;
- the explanatory note accompanying a Bill's introduction;
- disclosure statements identifying the Bill's policy objective;
- any report by the Attorney-General concerning implications under the New Zealand Bill of Rights Act 1990;
- any changes made during the Bill's passage through the House;
- select committee commentary and reports;
- explanations of any Supplementary Order Paper.

126. Dr Michael Gousmett traces the precedents for and history of the donee organisation legislation that now appears in the Act in "The history of charitable purpose tax concessions in New Zealand: Part 1 *New Zealand Journal of Taxation Law and Policy* Vol 19 (June 2013):139. As for the rationale for the legislation, the author concludes (at 155):

> There can be no doubt that the donations concession was intended to encourage philanthropy, as can be seen in [the Prime Minister, the Rt Hon Keith Holyoake's] words, that "[t]he Government is now giving an incentive to people to think of what they can give, not what they can get. *This is an incentive to our people to give."*[133] But what was behind the incentive?
>
> When Mr Holyoake says that the incentive "will encourage self-help, community help, and community welfare activity,"[134] was National's underlying rationale that if we encourage greater community activity, then there will be less of a call on government funds? Was this Government abdicating its responsibility for those less fortunate based on its philosophy of individual responsibility, or a genuine desire to assist the community in helping itself? Can the answer be found in National's 1960 Election Manifesto? The author pondered on this thesis during the research phase, and eventually found an answer provided by [Hon John Rae MP], who said that:[135]
>
> > The exemption of the donation is £25, which can be deducted for income tax purposes. ... I believe that this sum, which starts off quite modestly, can grow. At the moment it is limited to individuals. It is denied to companies. We will see how it goes and what it costs the country. I believe if people are given a little incentive great things will be done privately, *and fewer demands will fall on the Government's plate*. *I look forward to this concession growing with time*. I believe that a great deal of good will be done by private donations for all these worthy objectives.
>
> In other words, community activity will relieve the government of burden, by transferring the cost to charitable entities which, in turn, would benefit from being exempt from income tax and donors would receive concessions. The unasked and answered question, however, is whether the cost to the government would be at least equal to or less than the tangible benefits provided by charitable entities to the community.
>
> [133] (3 July 1962) 330 NZPD 591 (emphasis added).
>
> [134] (3 July 1962) 330 NZPD 591.
>
> [135] (11 July 1962) 330 NZPD 840 (emphasis added).

127. From the limited internal tax policy records available from when the legislation was enacted, the Commissioner is aware that the question of whether "principally" should be defined was considered and discounted. It was considered that by not expressly defining the term a more "elastic arrangement" would result.[4]

128. In 1962, during the second reading of the Land and Income Tax Amendment Bill (No 2) the Hon H R Lake (Minister of Finance), said ((23 November 1962) 333 NZPD 2,893, at 2,894):

> The first main feature of the donation scheme is that, apart from the four organisations listed in the Bill—CORSO, the Red Cross Society Incorporated, the Lepers Trust Board Incorporated, and the Mission to Lepers (New Zealand)—the society, institution, organisation or trust to which the donation is made must be one in which there is no private profit for any individual. Furthermore, apart from the four exemptions mentioned in the Bill, it must be in New Zealand and its funds must be applied wholly or principally to charitable, benevolent, philanthropic, or cultural purposes within New Zealand; or alternatively, it must be a New Zealand public institution maintained exclusively for one or more of these purposes, or a public fund so applied. Secondly—and this is important—if the society or other body does not qualify because of its purposes being partly but not principally charitable, benevolent, philanthropic or cultural, it may set up a separate fund to be applied exclusively for those purposes, and in that case donations to the separate fund would qualify.

129. Also, the National (Government) member for Wellington Central, David Riddiford, after noting the credit's extension beyond charitable purposes to benevolent, philanthropic and cultural purposes, stated (at 3,056):

> This provision extends the word "charitable" beyond its purely legal definition. Lawyers who have had to try to interpret the word "charity" in its legal definition will realise how many pitfalls are involved. .... However, this particular provision goes further by uniting the word "charitable" with the words "benevolent, philanthropic, or cultural purposes", and overcomes a difficulty which existed in regard to donations for charitable purposes, in that the donation had to be wholly for that purposes. Now it is sufficient if it be principally for that object.
>
> ...
>
> This Bill is in line with the National Government's policy of reduction in taxation; ... to give encouragement and help to the charitable institutions which are in a position to assume such a large part of the burden which would otherwise fall on the shoulders of Government.

130. Mr Riddiford's comments echo those cited by Dr Gousmett as attributable to the Rt Hon Keith Holyoake concerning the underlying rationale for the legislation was to encourage self-help and community help (ie, purposes being achieved within New Zealand). The history of the legislation appears to reinforce the view gained above that Parliament has a concern with where the purposes were being achieved. The object of relieving the government of the burden of expenditure that would otherwise be incurred domestically to achieve social outcomes would not be achieved if purposes were not being achieved within New Zealand.

131. More recently, the purpose of allowing a tax credit for gifts was set out in more detail in *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:

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[4] The Commissioner acknowledges this material is not interpretatively relevant and is mentioned only to highlight that no clear intended meaning by the original drafters has been located.

> 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.

132. The discussion document shows that charitable giving is seen as benefiting a government's social objectives. Charities (and other similar organisations) are seen as an efficient way to deliver these objectives. Further, people's choices about the organisations they support are seen as being an effective way of targeting funds to where society feels they are most needed. The discussion document led to the Taxation (Business Taxation and Remedial Matters) Act 2007, which enhanced the tax incentives available for donations. The enhancement of tax incentives for charitable giving serves to reinforce the imperative for the incentives to advance the government's social objectives.

133. This tends to support a higher numeric meaning for "wholly or mainly" than a bare majority. A higher figure is consistent with more social outcomes being achieved within New Zealand and with maximising the burden that the government is relieved of.

Conclusions on the context and purpose

134. At a general level, the purposes of the donee organisation legislation are to encourage giving in society and encouraging community self-help. More specifically, a discernible concern exists in the legislation as to where the benefits of the giving are achieved.

135. For s LD 3(2)(a) that concern would indicate an interpretation of the text that ensures, as far as possible, benefits accrue to New Zealand society as this best achieves self-help in the community. In this way, the government is relieved of some of the burden of providing the goods and services that donee organisations provide to New Zealand society.

Conclusions on the meaning of "wholly or mainly"

136. Generally, the ordinary meaning of "mainly" is not without its "difficulties" (see *Fawcett Properties* (at 512) or *Hatschek's patents* (at 83)). The phrase "wholly or mainly" has been thought "ambiguous" (see *Radio Authority* (at 570)).

137. The examination of the text of s LD 3(2)(a) has shown that "mainly" can bear meanings that vary as to degree and is, therefore, unclear as to the figure it would set for the extent to which donee organisations must apply their funds to specified purposes within New Zealand.

138. In this situation, a court would regard the context and purpose of the legislation "as essential guides to meaning" (*Commerce Commission v Fonterra*).

139. On balance, the Commissioner considers a meaning for "wholly or mainly" of something greater than a bare majority better fulfils the purposes of the legislation in ensuring benefits accrue to New Zealand society as a result of s LD 3(2)(a). That is, in the Commissioner's view, "mainly" is "coloured" by its use in conjunction with the word "wholly" and as a result means something considerably closer to 100% than a bare majority.

140. This view is due to:

- The immediate context of s LD 3(2)(a) where "mainly" is used in conjunction with "wholly" and the focus is only on the portion of funds applied to specified purposes within New Zealand.
- The other paragraphs of s LD 3(2) that require purposes to be achieved "exclusively" within New Zealand.
- Schedule 32 of the Act which applies to organisations whose purposes are achieved principally overseas.
- The history of the legislation that shows the provision of the tax credit to donors by Parliament was to encourage community self-help and help relieve the government of the burden of expenditure that it would otherwise incur to achieve domestic social outcomes.

141. However, the words "wholly or mainly" are ones of degree, and it is easier to point to certain figures and say with some certainty they are not included than it is to say what figure or range of figures are included. For instance, looking again at the cases where a figure greater than a bare majority was adopted for "mainly", the decision in *British Association of Leisure Parks* (UKFTT) (which set the highest figure) is something of an outlier. Given the stature of the court involved and the lack of analysis in support of the court's reasoning for the threshold, the Commissioner does not consider the case as authoritative in the context of s LD 3(2)(a). However, *Hatschek's patents*, *Fairmaid* and *Case E79* offer no assistance as to how much more than a bare majority is sufficient. In *Radio Authority,* the court simply adopted 75% as a mid-way point between the possible meanings of "mainly" ranging from 51% to 99%.

142. 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 delivering the judgment of the court 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.

143. On balance, the Commissioner's view is that "wholly or mainly" is an imprecise term. While something considerably greater than a bare majority is indicated, it is not possible to interpret the expression with any greater certainty.

144. Despite this lack of interpretative certainty, the Commissioner will adopt an "administrative safe harbour" approach to administering s LD 3(2)(a). The 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, the Commissioner will generally accept without further enquiry that the organisation meets the "wholly or mainly" requirement in

s LD 3(2)(a). The Commissioner has set the safe harbour figure at a minimum of 75%. In other words, the Commissioner will adopt a "75% or more" safe harbour approach from the application date of this statement.

145. A figure of 75% was suggested in *R v Radio Authority, ex p Bull* [1997] 2 All ER 561 (CA). In that case, the court adopted a mid-way point between the possible meanings of "mainly" which ranged from 51% to 99%. The Commissioner considers this is a reasonable and pragmatic figure to apply in the context of s LD 3(2)(a).

146. This approach includes an allowance for flexibility year-on-year including an ability to look at an organisation's history. In an exceptional year an organisation may be able to fall below the 75% lower boundary. However, it will not be acceptable to fall below a bare majority in any year as this is the lower bound of "mainly" in the context of s LD 3(2)(a) under any view of the meaning of the word. Further details on how the safe harbour approach is to apply are set out from [281].

Meaning of "funds are applied"

147. Section LD 3(2)(a) refers to organisations "whose **funds are applied** wholly or mainly to [specified] purposes within New Zealand" (emphasis added). The key words yet to be considered in this phrase are "funds are applied". "Funds" and "applied" are not defined in the Act, so both terms bear their ordinary meanings.

The statutory text: "funds"

148. The *Concise Oxford English Dictionary* defines "funds" as:

> **fund** ▪ n. ... 2 (funds) financial resources.

149. It is not immediately apparent what the "financial resources" of an organisation would comprise. At its widest, it may include all actual and potential resources of a financial nature that might be available to an organisation. If so, it may include financial resources from a particular source (such as, income or capital receipts or both) or a financial resource of a particular form (such, as fixed, current or non-current assets or all of these). Alternatively, "financial resources" might comprise only some subset of these resources.

150. The *Concise Oxford English Dictionary* further defines the adjective "financial" as relating to "finance" which, in turn, is defined as "the management of large amounts of money". This suggests "financial resources" might be limited to resources in money. This would be consistent with the *Collins English Dictionary,* which refers to "funds" in terms of "money" as follows:

> **Funds** (in British) plural noun **1**. money that is readily available.

151. It would also be consistent with the *Macquarie Dictionary* (7th ed, Macquarie Dictionary Publishers, Sydney, 2017) that defines the plural of "fund" as:

> **Fund** ... **4** (plural) money in hand; pecuniary resources.

152. "Money that is readily available" or "money in hand" suggests a meaning of "funds" that is referring to the financial resources that a person or an organisation has immediately available to meet commitments. Viewed narrowly, this could be simply cash or, more broadly, it may extend to such things as marketable securities and other highly liquid investments (ie, "near cash" financial resources).

153. As such, "funds" as "money in hand" might then be likened to the accounting concepts of "cash" or a combination of "cash" and "cash equivalents". "Cash equivalents" include short-term, highly liquid investments that are readily convertible to known amounts of cash, are subject to an insignificant risk of changes in value and are held for the purpose of meeting short-term cash commitments, rather than for investment or other purposes.

154. "Funds" may also be likened to the accounting concept of "working capital" (which is the funds an entity has on hand to use in day-to-day operations calculated as current assets minus current liabilities). However, this appears to be a net concept so may not be as synonymous with "funds".

155. While these other terms may have a technical meaning in law or the field of accounting practice, there is no indication that "funds" itself has a particular technical meaning (or, for that matter, that Parliament intended for "funds" to bear a technical meaning in the context of s LD 3(2)(a)).

156. Accordingly, the ordinary meaning of "funds" is not free from doubt. It may mean all the assets of an organisation, certain sources of financial resources (such as, income or capital receipts or both) or certain assets, such as cash or cash and near cash. Its meaning in s LD 3(2)(a) needs to be determined in light of the context and purpose of the legislation.

The statutory text: "applied"

157. Dictionary definitions of "applied" give several meanings to the verb "apply". The *Collins English Dictionary* relevantly defines "apply", when used as a transitive verb (ie, with an object), as:

> **apply** (in British) verb –plies, -plying *or* –plied
>
> **1** *(transitive)* to put to practical use; utilize; employ ... **6.** (*transitive*) to bring into operation or use ...

158. The *Concise Oxford English Dictionary* relevantly defines "apply" as:

> **apply** ▸ v. (**applies, applying, applied**) ... **2** ... ▪ bring into operation or use. ...

159. Consistent with these definitions, in *Williams v Papworth* [1900] AC 563 (PC), Lord Macnaghten stated (at 567):

> ... the word 'applied' ... simply means 'devoted to' or 'employed for the special purpose thereof'.

160. Accordingly, it seems reasonably clear that "applied" refers to the situation where something (ie, "funds") is "devoted to" or "put to use", in this case, toward the object of specified purposes within New Zealand.

Funds accumulated in investments or set aside rather than spent

161. Where funds have been spent it seems reasonably clear that the funds have been "applied" by being devoted to the object of the spending and the purposes that flow from the results of the spending. However, when funds are accumulated in investments or set aside in cash or short-term deposits rather than spent, the question arises as to whether the funds held have been "devoted to" or "put to use" to a purpose.

162. No New Zealand case law appears to help with deciding this question. There are, however, overseas authorities on the question of whether accumulating income of a charity is to "apply" them. While care must be exercised in accepting the comments of courts in other jurisdictions, the Commissioner considers the United Kingdom and Australian authorities cited in this context relate to legislation sufficiently similar to s LD 3(2)(a) as to be relevant.

163. In each jurisdiction, the question was similar – whether the income of a charity or charitable fund had been "applied" either to charitable purposes or the purposes for which the fund was established. Similarities exist between s LD 3(2)(a) and the relevant overseas legislation in the way they both set a twofold test. First, the test concerns the nature of the organisation or fund. Second, the test concerns the application of the relevant funds to certain purposes. That is, s LD 3(2)(a) qualifies the types of organisations that it applies to in the first instance and, secondly, limits what qualifying organisations may apply their funds to.

164. This question arose in *General Nursing Council for Scotland v Commissioners of Inland Revenue* (1929) 14 TC 645 (CSIH) in relation to an income tax exemption that, among other things, required the exempt income to be "applied to charitable purposes". For some years the Nursing Council had accumulated surpluses of income over expenditure in cash, bank deposits and investments. The Council claimed the tax exemption for amounts of interest and dividends received from the accumulated funds. On the question of whether the interest and dividends needed to be spent to be "applied to charitable purposes", Lord Sands stated (at 653):

> **It does not import that the exemption is to be allowed only when the income has been spent, or falls immediately to be spent,** for some charitable purposes. 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.
>
> [Emphasis added]

165. Accordingly, Lord Sands considered income could be "applied" when being accumulated for the general purposes of an organisation, rather than spent.

166. The issue of whether accumulating funds amounts to applying them did not arise in *Molloy.* However, the Court of Appeal in *Molloy* referred (at 690) to *General Nursing Council for Scotland.* In doing so, the court seemingly considered the case relevant to the issue of applying 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)).

167. Lord Sands' view expressed in *General Nursing Council for Scotland* was accepted by the United Kingdom Court of Appeal in *IRC v Helen Slater Charitable Trust Ltd* [1982] 1 Ch 49. In this case, the court considered that, where an organisation invested surplus funds, it was applying those funds to the purposes of the organisation. The case involved a similarly worded income tax exemption as considered in *General Nursing Council for Scotland*. The issue was whether donations by one charity to another charity were an application of the first charity's income to charitable purposes, even though the second charity simply accumulated the funds. Among other things, the Commissioner argued that funds simply being invested as an accumulation to the second charity's general funds was not an application of those funds to charitable purposes. The court rejected the Commissioner's argument with Oliver LJ stating (at 59F):

> Charitable trustees who simply leave surplus income uninvested cannot, I think, be said to have "applied" it at all and, indeed, would be in breach of trust. But if the income is reinvested by them and held, as invested, as part of the funds of the charity, I would be disposed to say that it is no less being applied for charitable purposes than it is if it is paid out in wages to the secretary.

168. Oliver LJ also affirmed the view of Slade J in the High Court (*IRC v Helen Slater Charitable Trust Ltd* [1980] 1 All ER 785) that to apply income to a particular purpose where it has been accumulated rather than spent required some affirmative act on the part of the organisation. That is, the organisation needed to have turned its mind to why the funds are being held. After reviewing several authorities referred to in the context of trust settlements, Oliver LJ stated (at 59E):

> I find these cases of little assistance in determining the meaning of the word "applied" in the context of the relevant subsections. Manifestly the legislature, in enacting them in the form in which they are, intended to impose some additional qualification for the exemption of income beyond that of merely being applicable for charitable purposes. ... **I agree with Slade J. that it imports more than that—some affirmative requirement that the income should have been dealt with in some way or other.**
>
> [Emphasis added]

169. Oliver LJ affirmed the High Court decision and, as above, Slade J's comments in respect of "applied". Oliver LJ also stated (at 794):

> Counsel submitted on behalf of the Crown, and counsel for the trust I think accepted, that the legislature, in using the affirmative phrase 'so far as applied' etc, must have intended to impose an affirmative requirement that the income should have been dealt with in some way or other. **It was, I think, common ground that merely to receive income and do nothing with it would not amount to an 'application' thereof.**
>
> [Emphasis added]

170. Accordingly, on these authorities, applying funds can include accumulating or setting aside funds. A conclusion that setting aside funds for a purpose is to apply those funds is also consistent with a meaning for "applied" of "devoted to" as noted at [160].

171. However, the authorities above indicate there is an affirmative requirement to the investing or setting aside of funds. That is, funds will be "applied" by being invested or set aside only provided there has been an affirmative act on the part of the organisation to deal with them in some way so as to devote them to some purpose. Otherwise, the organisation is at risk of being considered to have done nothing with the funds.

172. The Commissioner expects this affirmative act of applying the funds by setting them aside would be the result of a decision as to the purpose to which the funds are to be applied. Some evidence of a decision to invest or set aside the funds would then be required. The decision may also be accompanied by certain acts such as opening bank accounts, depositing or transferring money, or making appropriate accounting entries. The decision needs to have been made at the appropriate level in the organisation for decisions of that type according to its established management practices (eg, the trustees of a charitable trust resolving to set aside money in the trust's on-call savings account pending a capital purchase).

173. For the purposes of s LD 3(2)(a) the relevant purpose is whether the funds invested or set aside are being devoted to specified purposes within New Zealand. Accordingly, it is necessary for the decision to accumulate funds to identify that the funds are to be applied to a purpose in sufficient detail to be able to characterise that application of funds as advancing charitable, benevolent, philanthropic, or cultural purposes within New Zealand. In all cases, where funds are "applied" by being accumulated, the application of the funds is considered again when the funds are spent.

174. Also, there may be instances where the decision to devote funds to a purpose is made in the first instance and not overtly revisited subsequently. For example, the decision to devote funds held in a particular bank current account to all the purposes of the organisation as general operating funds would usually be made at the time the account was opened and would not be expected to be formally revisited thereafter. Similarly, a decision to accumulate funds in investments over an extended period to fund a future major asset purchase would not necessarily be formally revisited each time income from the investments accrued to the capital or further investments were accumulated for the same purpose.

175. As mentioned, failing any affirmative act to apply the funds, the funds would not be considered "applied" in any way. This would mean they could not be treated as funds applied to specified purposes within New Zealand, despite remaining part of the total "funds" of the organisation.

<u>"Excessive" accumulation of funds</u>

176. An issue that arises in this context is whether funds can be accumulated "excessively". This issue arose in the Australian Administrative Appeals Tribunal (AAT) case of *TACT v FCT* (2008) AATA 275. In *TACT,* the Federal Commissioner argued that the trustee's decision to accumulate income until the trust fund had net assets of $1 million was "excessive". With no particular purpose for the accumulation, no assessment of the appropriateness of the figure and no time frame in which to raise the sum, the Commissioner argued the income was not being "applied for the purposes for which [the trust fund] was established". At the same time, however, the Federal Commissioner accepted some accumulation of income for specific and justifiable good reasons was acceptable.

177. The AAT considered there was an inherent difficulty with the Federal Commissioner's argument (at [45]):

> On the one hand it implicitly concedes that some accumulation of income is permissible. On the other it relies on either the concept of accumulation for a specific purpose, or an impressionistic characterisation of the accumulation as "excessive", as marking the limits of permissible accumulation.

178. The AAT considered that the concepts of acceptable accumulations for specific purposes or the arbitrary characterisation of some accumulations as "excessive" were not found in the legislation's requirement for the income of the fund to be applied for the purposes for which the fund was established. The AAT also referred to *Helen Slater Charitable Trust* (CA) as authority for rejecting the proposition that accumulation for general purposes does not evidence the required application of the fund. This argument was not renewed on subsequent appeals. (The litigation was concluded in *FCT v Bargwanna* [2012] HCA 11.)

179. As noted above, funds may not be considered "applied" if an organisation does nothing with them. The AAT decision in *TACT v FCT* raises the issue of whether a

question about an organisation's eligibility under s LD 3(2)(a) could arise if it applied its funds by accumulating them to such an extent over such a period of time that it was doubtful that it was applying its funds to specified purposes within New Zealand to the required degree. *TACT v FCT,* however, illustrates that it is not possible to provide hard and fast rules in this respect.

180. For instance, in *Bargwanna* the full High Court of Australia also noted where the issue of accumulating funds had arisen in earlier Australian cases. In particular, the issue arose in *Trustees, Executors and Agency Co Ltd v Acting FCT* (1917) 23 CLR 576 (HCA). This case was not decided on the issue of accumulating funds. However, in the course of argument, the Acting Federal Commissioner submitted that it was not possible to determine if a fund was being applied to charitable purposes until the fund or the income of the fund was spent on charitable purposes. The court did not accept this submission, with Isaacs J stating (at 586–587):

> **Argument was addressed to us on the meaning of "applied," though it does not directly fall within the question asked.** It must be observed, as pointed out by [counsel for the appellant], that a distinction is made between the "income" and the "fund," and "applied" is attached to the "fund" and not the "income." Further, the words are "the fund is being applied" – not simply "applied." I agree that some elasticity must be given to the phrase. **For instance, if a fund were established to purchase radium for free curative purposes, and if it were found that (say) £20,000 were required as a minimum, but the fund could accumulate only at the rate of £5,000 a year, and the Commissioner were satisfied that each year's income was deposited in a bank for the special purpose of getting together £20,000, and buying the radium, he could well say he was satisfied the fund was "being applied" to the charitable purpose.**
>
> [Emphasis added]

181. Not only does this decision reinforce the view that accumulating funds can mean the funds are applied, it illustrates by way of example the difficulty with setting limits around what might be considered "excessive" accumulations. In *Trustees, Executors and Agency Co Ltd v Acting FCT,* Isaacs J notes that an organisation might well accumulate all of its income over a period for a specific purpose and that this might well mean the income was being "applied" in an acceptable manner.

182. As noted from [125], the history of s LD 3(2)(a) supports the view that Parliament intended benefits to accrue to New Zealand society and, as a result, government would be relieved of some of the burden of providing the goods and services that donee organisations provide to New Zealand society. Organisations that simply accumulate funds, either by setting them aside or investing them over a period, may have difficulty in showing this purpose of the provision was being achieved. In the Commissioner's view, an organisation that accumulates funds in this way will need to show that it has applied those funds to specified purposes within New Zealand to the required degree.

"Funds are applied" in light of the context and purpose of the legislation

183. In accordance with the approach to statutory interpretation, set out from [40], the next step is to consider the ordinary meanings of "funds" and "applied" in light of the context and purpose of the legislation.

184. As discussed, the word "funds" may be capable of a variety of meanings, such as the income or receipts of an organisation, or all or some of its assets. The

question is which meaning is most consistent with the context and purpose of the legislation. In contrast, it appeared reasonably clear that "applied" meant "to devote to" or "put to use" and that this included accumulating funds by investing them or setting them aside. If so, what is required next is to cross-check this meaning of "applied" in the context of s LD 3(2)(a).

Immediate context – s LD 3(2)(a)

185. Section LD 3(2)(a) is concerned with the achievement of certain purposes within New Zealand. Clearly, to achieve certain purposes as a set of desired results or some future state, resources of some sort need to be deployed in some way to bring about those results or that future state. In this case, Parliament used the word "funds" to describe the resources being considered, and it expects those resources to be deployed by way of being "applied".

"Funds"

186. The immediate context includes the need for "funds" to be "applied" to specified purposes within New Zealand to the extent required of the quantitative measure provided by the phrase "wholly or mainly". This means "funds" and the extent of their application must be measurable. Another relevant factor is, as discussed above, funds can be applied where they have been accumulated for a purpose, in addition to being spent.

187. Another consideration, especially relevant when considering a quantitative test, is that a meaning that gives the most practical and sensible result is to be preferred. *Burrows and Carter: Statute Law in New Zealand* notes this is a relevant interpretative consideration (at 329):

> If a provision is susceptible of several meanings, it is obvious that a court is likely to choose the one that leads to the most practical and sensible result. In many cases, courts have said that they are seeking the "most practical" interpretation. Finnemore J once said "[If] there are two different interpretations of the words in an Act, the Court will adopt that which is just, reasonable and sensible rather than that which is none of those things".
>
> [Footnotes omitted]

188. As discussed from [148], the ordinary meaning of "funds" suggests a variety of possible meanings. To determine the meaning most appropriate in the context of s LD 3(2)(a), these possible meanings can be evaluated in light of the factors of measurability, practicality and the implications (if any) of how funds can be "applied".

189. On the basis of the dictionary definitions of "funds", the most consistent meaning appears to be "money in hand" or "money available to be spent". A meaning of "financial resources" including fixed assets is less so, and meanings such as "receipts" or "income" do not feature in the definitions and would require a particular reading of "financial resources".

190. Also, in the case of meanings such as "receipts" or "income", it would have been open for Parliament to use more specific words than "funds", such as "receipts" or "income", had it intended those meanings. For that matter, it is also clear that "funds" does not mean "gifts". This meaning was discounted by the court in *Molloy* in the context of a predecessor of s LD 3(2)(a). The court stated (at 691):

> What s 84B(2)(a) refers to is not the intended or actual fate of the donation itself but the manner of the application of the whole or the principal part of the funds of the donee.

191. In any event, all of the meanings of "funds" discussed above could, arguably, include the gifts for which donors receive tax benefits. Most obviously, receipts would include gifts. Gifts could also be the source of cash or other assets (if the gifts had been spent on acquiring assets). Equally, all the meanings discussed above include more than just gifts. Accordingly, whether or not "funds" includes the gifts on which tax benefits accrue does not seem to provide a basis on which to distinguish the meaning for "funds" in the context of s LD 3(2)(a).

192. On the basis of measurability and practicality, "receipts" or "income" could, and are, easily quantified in the usual course of preparing an organisation's financial statements. However, "income", which excludes capital receipts, may not capture all amounts that then can be "applied" by being accumulated or spent. The receipts of an organisation over a particular period would include capital receipts. However, the funds "applied" would not necessarily correlate with the receipts for the period. This is because funds accumulated from a prior period may be spent in a later period. Overall, the terms "receipts" and "income" seem to be more descriptions of the sources of "funds" rather than a possible meaning of "funds".

193. "Funds" as "money in hand" (being cash and highly liquid assets) are also measurable and can be practicably determined from accounting statements such as cash flow statements. Such a meaning would, over time, include all sources of money in hand as would be included in a meaning of "receipts". It would also include money on hand at any point that has been applied by being accumulated. Cash on hand is readily quantifiable when held as physical currency. Cash on hand held in current accounts or other short-term deposits with financial institutions are similarly easily quantified.

194. The least quantifiable and most complicated meaning would seem to be the meaning of "financial resources" where this includes assets of all types. In this case, the amounts needed to be taken into account in terms of determining the application of funds would include not only closing values of cash and highly liquid assets but all other current and fixed assets as well. This includes assets that may have a significant risk of changes in value.

195. Accordingly, the "all assets" meaning of "financial resources" introduces difficult valuation issues and possible inequities in terms of quantifying the amount of an organisation's "funds", particularly, fixed assets. For instance, are the assets quantified for s LD 3(2)(a) purposes at original cost, written down book value or current market value. Market value would result in additional costs for organisations having to annually revalue all their assets. Cost or book values are easier to calculate but suffer from the fact that, over time, they may increasingly fail to provide a true reflection of the extent the resources of an organisation are devoted to different purposes.

196. While not free from doubt, in the Commissioner's view the immediate context of s LD 3(2)(a) suggests that the most appropriate meaning of "funds" seems to be "money in hand" where this contemplates both cash and highly liquid investments available for meeting commitments. In this sense, it most closely resembles a combination of the accounting concepts of "cash" and "cash equivalents".

Continuous application of funds over time

197. The phrase "funds are applied" suggests the putting to use of funds occurs on a continuing basis over the lifetime of the donee organisation. As noted at [34], the court in *Molloy* noted in relation to a predecessor of s LD 3(2)(a), that the legislation raised a number of problems, including (at 690):

> (4) whether the words "the funds are applied" relate to an income year or import a history of consistent qualifying application".

198. In the Commissioner's view, it is the latter (ie, a history of consistent qualifying application) that is required by the tenor of words "funds are applied". This is so, even though administrative measures of compliance with this on-going lifetime requirement may be confined to looking at funds applied over a discrete period, such as a year, and then from year to year. This is not only a practical approach but is consistent with income tax being an annual tax, the administration of which 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).

199. Although the Commissioner considers that the legislation requires an on-going application of funds approach, quantifying how funds have been "applied" requires considering what the funds on hand have been invested or set aside for, or spent on. Spending, as the application of funds, is quantifiable with reference to the transaction values for funds spent over a period. Quantifying the funds invested or set aside for different purposes, however, can be done only for a point in time (eg, at the time the investment is made or at balance date). In either case, difficulties may arise with determining the purpose or purposes to which these "funds" have been "applied". However, those difficulties arise regardless of which meaning is adopted for "funds are applied".

Wider context – the Act and other legislation

200. The only other instance of the phrase "funds are applied" in the Act appears in the group investment rules concerning "designated sources" (s HR 3(5)(b)). Historically, this provision can be traced back to 1968 when it was introduced to exempt charity-related trusts from a new trust tax regime. Due to the age of the provision, there is little material to suggest the intended meaning of "wholly or mainly" in this context. At the time it was introduced, it more closely resembled s 84B which was the predecessor of s LD 3(2)(a). This resemblance suggests it was simply modelled on s 84B which had been inserted in the Act only five years prior.

201. Section 58 of the Tax Administration Act 1994 permits the Commissioner to request a gift-exempt organisation to furnish a return of its "funds derived or received in any tax year and showing the source and application of those funds". A gift exempt body comprises sch 32 donee organisations and could include s LD 3(2)(a) donee organisations that have RWT-exempt status. On the face of it, the use of "funds" in s 58 appears to contemplate funds as including "income" (ie, amounts either "derived" or "received"). As such, it does not appear entirely consistent with a view that the "funds" of an organisation in s LD 3(2)(a) means "money in hand", although income received would be included in that meaning. However, as an administrative provision concerned with annual returns, it may be directed at different purposes.

202. In a wider context, it can be seen that in other legislative contexts where a far-reaching definition of "funds" was seen as important, drafters did not rely on ordinary meanings of "funds". Instead, the drafters provided an expansive statutory definition where the word "funds" includes, among other things, "assets of every kind, whether tangible or intangible, moveable or immoveable" (see s 4(1) of the Terrorism Suppression Act 2002, s 5(1) of the Cluster Munitions Act 2009 and s 9(2) of the Mercenary Activities (Prohibition) Act 2004).

203. On balance, the wider legislative context does not suggest a need to reach a different conclusion on the meaning of "funds are applied" to that arrived from examining the immediate context of s LD 3(2)(a).

Purpose

204. Following the approach to statutory interpretation previously outlined, the next step is to examine the meaning of "funds are applied" in light of the purpose of the legislation. The purpose of the legislation has been considered in [123] to [133] when looking at the meaning of "wholly or mainly". It was concluded that the legislation was intended by Parliament to encourage giving to support community self-help and help relieve government of the burden of social expenditure that it would otherwise incur to achieve domestic social outcomes.

205. This purpose for the provision would tend to suggest an emphasis is on funds being spent on specified purposes within New Zealand. This reinforces the comments made at [182] that, while funds can be "applied" by being invested or set aside, organisations that simply accumulate funds in this way over a period may have difficulty in showing this purpose of the legislation was being achieved.

Conclusions on the meaning of "funds are applied"

206. While not free from doubt, the Commissioner considers that, out of the range of possible meanings, the most appropriate meaning of "funds" is that it refers to the money readily available to an organisation at any point (ie, "money in hand"). This includes cash and other highly liquid assets available to meet commitments.

207. "Applied" means "devoted to" or "put to use" and includes where funds have been:

- spent on a purpose or purposes;
- invested for a purpose or purposes; or
- set aside to be spent at some future date on a purpose or purposes.

208. While there are no specific limits on the extent to which funds can be accumulated, organisations that simply accumulate funds will still need to show that they are applying funds in this way to specified purposes within New Zealand to the required extent.

209. In the Commissioner's view, "funds are applied" suggests:

- Money can be applied to a purpose as a result of an affirmative act by the organisation to invest or set aside the money for future spending for some purpose or purposes.
- The affirmative act is the decision to accumulate the funds that was made at the appropriate level in the organisation for decisions of that type, according to the organisation's established management practices (eg, the trustees of

a charitable trust resolving to set aside money in the trust's on-call savings account pending a capital purchase).

- The decision to accumulate funds will need sufficient detail to be able to characterise that application of funds as advancing charitable, benevolent, philanthropic, or cultural purposes within New Zealand.

210. Absent an affirmative act to apply funds, the funds are not applied to any purpose, although still form part of the organisation's total "funds".

211. The application of funds occurs on a continuing basis over the lifetime of the donee organisation. This is so, even though to gauge compliance with this on-going lifetime requirement on an administrative basis it is more practicable to look at funds applied over a discrete period, such as a year, and then from year to year.

Meaning of "within New Zealand"

212. Section LD 3(2)(a) requires funds to be applied to specified purposes "within New Zealand". The preposition "within" is defined in the *Concise Oxford English Dictionary* as meaning "inside the range of" or "inside the bounds set by" something, in this case, "New Zealand". In most cases it does not seem to present any particular interpretative difficulties. However, there can be situations where what made up the boundaries of this country may be in issue. It is, therefore, useful to explain in more detail the meaning of "New Zealand" in this context.

"New Zealand"

213. The Act defines "New Zealand" inclusively (but not exhaustively) in s YA 1 as including certain things – the continental shelf and the water and air space above the continental shelf that is beyond New Zealand's territorial sea (subject to some limitations).

214. To find a definition of "New Zealand" in terms of what it would commonly be thought of as including, resort must be made to s 29 of the Interpretation Act 1999, which provides:

> **New Zealand** or similar words referring to New Zealand, when used as a territorial description, mean the islands and territories within the Realm of New Zealand; but do not include the self-governing State of the Cook Islands, the self-governing State of Niue, Tokelau, or the Ross Dependency

215. The Interpretation Act 1999 applies to the Income Tax Act 2007 unless the latter provides otherwise or the context of the legislation requires a different interpretation (s 4 of the Interpretation Act 1999). In the Commissioner's view, the Income Tax Act 2007 does not apply otherwise or for the purposes of s LD 3(2)(a) indicate a different context in terms of overriding the effect of s 4 of the Interpretation Act 1999. Therefore, the Interpretation Act 1999 definition of "New Zealand" applies to s LD 3(2)(a).

216. Importantly, the definition in s 29 of the Interpretation Act 1999 does not include the Cook Islands, Niue, Tokelau or the Ross Dependency in the meaning of "New Zealand".

217. This means "New Zealand" in s LD 3(2)(a) includes what is commonly understood to be included in this geographical term. That is, the North, South, Stewart,

Chatham and Kermadec Islands and all other territories, islands, and islets in the geographical areas set out in the New Zealand Boundaries Act 1863 (UK) and the preamble of the Kermadec Islands Act 1887.

"Within New Zealand"

218. Where it refers to an organisation "whose funds are applied wholly or mainly to [specified] purposes within New Zealand", s LD 3(2)(a) may leave some doubt about what the "within New Zealand" requirement relates to. In the Commissioner's opinion, the phrase "within New Zealand" relates to where the purposes are carried out or achieved, rather than to where the funds are applied or spent. This means the geographic location of where the funds are spent is not relevant.

219. This issue arose in *Case T50* (1998) 18 NZTC 8,346 (TRA). *Case T50* concerned whether the taxpayer was a charitable trust where a payment of trust money was made as a donation to an organisation 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]

220. Judge Willy looked past where the funds were spent to the purpose for which the money was outlaid. The purpose of the expenditure in Australia was seen to provide a benefit arising in New Zealand (the right to use video material). As a result, Judge Willy considered the funds had not been applied outside New Zealand. *Case T50* was appealed to the High Court (*CIR v Dick* [2002] 2 NZLR 560 (HC)). 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 ... 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]

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

222. Accordingly, the geographical location of where funds are applied in terms of where they are spent or paid is not determinative. What is determinative is for an organisation's funds to be applied to specified purposes within New Zealand. This may occur even if it results in money being paid outside New Zealand to achieve specified purposes within New Zealand. That is, there is no separate requirement in s LD 3(2)(a) for funds to be spent within New Zealand.

223. Conversely, spending money in New Zealand to achieve purposes overseas would not be sufficient for the funds involved to be considered as applied to specified purposes within New Zealand. For example, if the facts of *Case T50* were reversed and altered slightly so that the payments were made to produce the video educational material in New Zealand for the Australian League of Rights to use, then this would not be an application of funds to specified purposes within New Zealand. This would be so, despite the funds being spent in New Zealand.

When funds will be applied to specified purposes within New Zealand

224. The Commissioner concluded at [209] that to apply funds requires some affirmative act on the part of the organisation to apply the funds to a purpose or purposes. In the context of s LD 3(2)(a), the relevant purposes are specified purposes within New Zealand. The question then arises as to when a particular application of funds are considered as an application of funds to specified purposes within New Zealand.

"Purposes"

225. The *Concise Oxford English Dictionary* defines "purpose" (as the singular of "purposes"):

- n. 1 the reason for which something is done or for which something exists

226. This definition suggests that the ordinary meaning of "purpose" is either the reason for which something is done or the reason for which something exists. In the context of s LD 3(2)(a), "purposes" is used as part of the phrase "charitable, benevolent, philanthropic, or cultural purposes within New Zealand". These "purposes" are linked to the application of the funds with the word "to" so it is the organisation's funds that must be applied to these purposes. This suggests a meaning of "purposes" of the reason or reasons for which something is done. In this case, the reason or reasons the funds were applied must be to serve specified purposes within New Zealand.

Connection to specified purposes within New Zealand

227. As a matter of practice, funds cannot be applied directly to purposes. Funds will usually be applied by being spent on the provision of goods or services in the course of carrying on some activity (unless they are accumulated for spending on future activities or donated to another organisation). The character of an activity is, however, ambiguous and is determined by the reason for which the activity is carried out. This was the view of Iacobucci J in *Vancouver Society of Immigrant and Visible Minority Women v MNR* [1999] 1 SCR 10 (SCC):

> 152. While the definition of "charitable" is one major problem with the standard in s 149.1(1), it is not the only one. Another is its focus on "charitable activities" rather than purposes. **The difficulty is that the character of an activity is at best ambiguous;** for example, writing a letter to solicit donations for a dance school might well be considered charitable, but the very same activity might lose its charitable character if the donations were

> to go to a group disseminating hate literature. **In other words, it is really the purpose in furtherance of which an activity is carried out, and not the character of the activity itself, that determines whether or not it is of a charitable nature.**
>
> [Emphasis added]

228. In the same case, Gonthier J considered that it would then be a matter of whether a sufficient connection exists between the activity and the purpose the activity is meant to serve:

> 62 **Some question may also arise as to the degree of "sufficient connection" between the activity under scrutiny and the purpose it is meant to serve.** In *Toronto Volgograd Committee,* supra, at p. 259, Marceau J.A. held that **activities must "be considered with respect to their immediate result and effect, not their possible eventual consequence". That is, there must be a direct, rather than an indirect, relationship between the activity and the purpose it serves.** That is the position taken by Iacobucci J. in the present appeal. I agree. **However, I would be reluctant to interpret "direct" as "immediate"**. All that is required is that there be a coherent relationship between the activity and the purpose, such that the activity can be said to be furthering the purpose.
>
> [Emphasis added]

229. This connection or nexus requirement is one that is similar to and consistent with the approach taken in other areas of tax, particularly, in respect of the principles of deductibility under the general permission of s DA 1. Section DA 1 allows deductions against income for expenditure or loss to the extent the expenditure is incurred in deriving assessable income or in the course of carrying on a business for the purpose of deriving assessable income.

230. One of the leading cases on the principles of deductibility is *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 (CA) in which Richardson J stated (at 61,274):

> The heart of the inquiry is the identification of the relationship between the advantage gained or sought to be gained by the expenditure and the income earning process. That in turn requires determining the true character of the payment. It then becomes a matter of degree and so a question of fact to determine whether there is a sufficient relationship between the expenditure and what it provided or sought to provide on the one hand, and the income earning process on the other, to fall within the words of the section (*C. of I.R. v Banks* (1978) 3 NZTC 61,236, 61,242).

231. Applied to s LD 3(2)(a), this test would suggest that the "heart of the enquiry" over the application of funds would be to identify the relationship between the advantage gained or sought by the application of funds to an activity and the purposes served by that activity.

232. Under the general permission nexus test, the relationship between the expenditure and what it sought to provide does not hinge on the subjective motives of the taxpayer. For instance, in *Magna Alloys & Research Pty Ltd v FCT* 80 ATC 4,543 the full Federal Court of Australia considered that, under the Australian equivalent of the general permission, the relationship between expenditure and its purpose needed to be determined objectively (at 4,551):

> Given a sufficient identification of what the expenditure is for and the character and scope of the taxpayer's income-earning undertaking or business, **the question whether expenditure is incurred for the purpose of carrying on a business or for the purpose of gaining or producing assessable income does not depend upon the taxpayer's state of mind. The relationship between what the expenditure is for and the**

> **taxpayer's undertaking or business determines objectively the purpose of the expenditure. In cases to which a reference to purpose is required or appropriate, objective purpose will be found to be an element in determining whether expenditure is incurred in gaining or producing assessable income or in carrying on business.** If the purpose of incurring expenditure is not the gaining or producing of assessable income or the carrying on of a business, the expenditure cannot be said to be 'incidental and relevant' to gaining or producing assessable income or carrying on business; or to be incurred 'in the course of gaining or producing' assessable income or of carrying on a business; nor can the undertaking or business be seen to be 'the occasion of' the expenditure.
>
> [Emphasis added]

233. The Commissioner considers these comments have relevance to the evaluation of funds applied, or to be applied on activities and whether those activities serve particular purposes. In the Commissioner's view, applied to s LD 3(2)(a), they mean that the question of whether funds have been applied to specified purposes within New Zealand must be determined objectively. They also mean that there must be a sufficient direct (although not necessarily an immediate) connection between the application or future application of funds to an activity and the advancement of specified purposes within New Zealand.

234. In relation to determining whether a sufficient relationship exists between the application of funds and specified purposes within New Zealand the issues that must be considered are:

- the distinction between results and purposes;
- whether funds are applied to more than one purpose and need apportioning to different purposes;
- whether it is the immediate or less immediate purpose that is determinative; and
- the situation where funds are applied by being donated to another organisation.

Distinction between results and purposes

235. A distinction can be made between results of an activity and the purposes the activity serves in terms of ends, means and consequences. The Privy Council made this distinction in an analogous context of whether a trust was established for charitable purposes in *Latimer v CIR* [2004] UKPC 13:

> [32] A trust may, however, authorize the trustees to apply the trust income for a number of different purposes. In such case the trust is not a valid charitable trust unless every purpose is wholly charitable.
>
> ...
>
> [36] **The distinction is between ends, means and consequences. The ends must be exclusively charitable. But if the non-charitable benefits are merely the means or the incidental consequences of carrying out the charitable purposes and are not ends in themselves, charitable status is not lost.**
>
> [Emphasis added]

236. The Privy Council equated "ends" with "purposes". It noted that the means by which purposes are achieved or the incidental consequences of pursuing purposes may sometimes result in non-charitable results. However, this does not mean the organisation concerned has been established for the purpose of bringing about those non-charitable results, unless they were pursued as an end in themselves.

237. A similar distinction was made in a charitable context by the United Kingdom Court of Appeal in *Incorporated Council of Law Reporting for England and Wales v Attorney-General* [1971] 3 All ER 1,029. In this case the issue arose of whether the council, which was incorporated for the purpose of preparing and publishing law reports, was charitable. The court held that the council was established exclusively for the charitable purpose of disseminating law reports that were beneficial to the development, administration and knowledge of the law. The fact that one result flowing from the council's activities directed at this purpose was that the law reports were used by members of the legal profession in the earning of their fees did not detract from this finding. The court emphasised that the results flowing from the achievement of a purpose should not be confused with the purpose itself. Sachs LJ stated (at 1040):

> Where the purpose of producing a book is to enable a specified subject, and a learned subject at that, to be studied, it is, in my judgment, published for the advancement of education, as this, of course, includes as regards the Statute of Elizabeth I the advancement of learning. That remains its purpose despite the fact that professional men--be they lawyers, doctors or chemists--use the knowledge acquired to earn their living. **One must not confuse the results flowing from the achievement of a purpose with the purpose itself, any more than one should have regard to the motives of those who set that purpose in motion.**
>
> [Emphasis added]

238. In this case, the result of benefiting the legal profession arose as a consequence of, or incidental to, the result of benefiting the public. As such, the court felt it could ignore these results when characterising the Council's activities as exclusively charitable. In a New Zealand context, a similar outcome arose in *CIR v New Zealand Council of Law Reporting* (1981) 5 NZTC 61,053 (CA).

239. In these cases, the court could arrive at its conclusion only if the benefit to the public was seen as the overriding purpose or object of the Council. To arrive at this view of the relationship between these different results, the court saw the objects clause in the founding memorandum of the Council as playing a leading role. Those objects established, in the eyes of the court, the leading role of the purpose of benefiting the public to which other results could then be seen as an incidence or consequence of.

240. While these cases relate to whether a particular entity is charitable, the Commissioner considers the approach adopted by the courts in these cases has some relevance to s LD 3(2)(a). In particular, they have relevance to the question of whether funds have been applied to specified purposes within New Zealand. The approach of the courts in these cases may assist in deciding if all the results that arise from a particular application of funds are relevant to this question. For instance, a particular application of funds may result in a variety of results some of which may be possibly seen as advancing specified purposes within New Zealand. Conversely, some results may be able to be seen as advancing purposes other than specified purposes within New Zealand.

241. If the approach taken in these types of cases is applied in the context of s LD 3(2)(a) it requires considering all the results that arise from a particular application of funds and determining the relationship the results have to each other and to the organisation's objects as set out in its founding documents. From this, it may be possible to discern which results arose directly from pursuing the organisation's objects and which were incidental, ancillary or consequential to other results. Only the results directly relatable to the objects of the organisation

would then characterise the purposes served by the application of funds. Incidental or consequential results could be ignored for this exercise. Put another way, these cases provide another way of viewing whether the results from a particular application of funds are sufficiently related to the advancing of specified purposes within New Zealand.

242. Viewing the results of an application of funds in terms of whether they are incidental to other results and in terms of their relationship to the organisation's objects provides a way of narrowing the range of results that are relevant to the enquiry into whether the results bear a sufficient relationship to specified purposes within New Zealand. In other words, just because an application of funds gives rise to certain results, these results may not be determinative of the purpose or purposes to which the funds have been applied. The examples 2, 7 to 9 and 15 appearing from [280] illustrate this concept.

243. On the other hand, if certain results do not naturally arise incidentally or consequentially to other results such that they appear to have been pursued as an additional result or end in their own right, this may indicate the presence of another independent and additional purpose for the application of funds. If so, there may be a need to apportion the expenditure concerned to different purposes when determining if an organisation has applied funds to specified purposes within New Zealand to the required extent. Apportionment is required if the purposes differ as to whether they are specified purposes within New Zealand or other purposes. The examples 3 and 4 appearing from [280] illustrate situations where apportionment is necessary because funds have been applied to different purposes.

244. It will be a matter of fact and degree as to whether particular results are of sufficient importance to indicate that they are an additional purpose of the application of funds. Similarly, it is not possible to provide rules as to when some results are independent results and, therefore, fulfilling an additional purpose or when they are incidental to other results. Each application of funds will need to be assessed objectively on its own merits. The examples appearing after [280] may assist an organisation with this issue.

Apportionment of funds applied to more than one purpose

245. As discussed above, there may be instances of where funds have been applied to more than one purpose and a need to apportion the expenditure to these different purposes may arise if the purposes differ as to whether they are specified purposes within New Zealand or other purposes.

246. As mentioned at [229], the need for a connection between the activity to which funds have been applied and specified purposes within New Zealand is similar to and consistent with the approach to the deductibility of expenditure under the general permission of s DA 1. Apportionment issues also arise under the general permission because s DA 1 permits a deduction for expenditure or loss "to the extent" it is incurred in deriving assessable income or carrying on a business for the derivation of income. Case authorities on this issue in that context include *CIR v Banks* (1978) 3 NZTC 61,236 (CA), *Ronpibon Tin NL v FCT* (1949) 78 CLR 47 (HCA), *Buckley & Young* and *Omihi Lime Co Ltd v CIR* [1964] NZLR 731 (HC)).

247. Case law in the context of s DA 1 establishes general principles that the Commissioner considers would be applicable to apportionment issues under s LD 3(2)(a), being:

- It is impossible to prescribe any precise formula applicable to all cases because the circumstances of the particular case will usually determine the most apt way of deciding how to apportion an amount (*Buckley & Young*).
- The apportionment must be fair, not arbitrary, and must be done as a matter of fact (*Buckley & Young*).
- Where expenditure has distinct and severable components it can be divided or dissected where the distinct and severable components can be related to differing tax treatments (*Banks, Ronpibon Tin*).
- Where a single outlay serves two or more objects indifferently, dissection is impractical and apportionment on a fair and reasonable basis applies (*Buckley & Young*).
- Some fair and reasonable bases for apportionment may include (*Buckley & Young*):
    - the actual use or availability for use, of an asset used for more than one purpose;
    - the respective values of the advantages arising from the expenditure; or
    - where the advantages do not lend themselves to measurement, some particular part or fractional share of the total expenditure if the part or share can be established on the basis of sufficient evidence.
- In apportionment cases, the onus of proof lies with the taxpayer (*Buckley & Young*).
- Just because the apportionment might be difficult is not of itself sufficient reason for failing to find that some apportionment can be made (*Buckley & Young*).
- Absolute precision cannot be expected and a reasonable estimate is sufficient (*Omihi Lime Co*).

Immediate and less immediate purposes

248. As mentioned, the reasons for funds being applied in a particular way need to be assessed objectively alongside the objects of the organisation and an assessment made of the degree of connection between the application of funds, the related activities and the actual or likely results and consequences of those activities. The aim is to reach an overall determination of what purposes are being served.

249. The need for a sufficient connection between the application of funds and purposes might suggest the connection must be the immediate purpose served by the application of funds. However, as noted at [228], in *Vancouver Society of Immigrant and Visible Minority Women,* Gonthier J was reluctant to relate the need for a direct relationship between an activity and the purpose it serves as an "immediate" need.

250. Accordingly, the determination of the purpose or purposes served by an application of funds may need to have regard to whether it is the immediate or less immediate purposes served that are determinative

251. One common situation where this may be important is in relation to funds applied in trading activities or to fund-raising events. On one view, these funds are immediately applied to those activities or events. This may lead to a view that

these funds are not applied to specified purposes within New Zealand. However, the less immediate, but more relevant purpose to which they are applied, may be the purpose to which the surplus funds generated by the activities or events are to be applied.

252. The situation where a charitable organisation has been carrying on a trading activity and its relationship to its charitable ends has arisen many times in the courts in various contexts. For example, in *CIR v Carey's (Petone and Miramar) Ltd* [1963] NZLR 450, the Court of Appeal considered the issue of whether a stamp duty exemption for property held on charitable trust applied to certain property assigned to a company on trust. The Commissioner argued that, as the company was empowered to use the property assigned in the furtherance of its trading activities, the property could not be said to be held on charitable trust. However, the Court of Appeal rejected the Commissioner's argument with Glesson P stating (at 455):

> The conduct of the business is subjected to the dominating consideration that the income, when ascertained, shall be paid to the Board to be apportioned exclusively amongst charities. All the wide powers given to the respondent are for the purpose of developing the business and increasing the income yield. It is indeed not uncommon for trustees to be given such powers as to carry on farming or other business for the benefit of the widow or children of a testator; in such a case the whole net income from the investment is held in trust for the nominated beneficiaries**. It cannot be doubted that a trust is thus constituted, and if the objects of such a trust are indubitably charitable, can it be contended that it is not a charitable trust? Such trustees, in carrying on the business of the farm would have to buy and sell stock and engage in sundry other commercial operations; but these incidental and intermediate operations, involving no diversion of ultimate income into non-charitable channels cannot, in our opinion, change the essential charitable nature of the original trust** if that nature be found to be originally charitable.
>
> [Emphasis added]

253. Accordingly, the court saw the trading activities of a charitable trust as "incidental and intermediate operations" that would not detract from the charitable nature of the trust. While some income may be applied immediately to non-charitable business operations, the court appeared to take a less immediate view in concluding that there was "no diversion of ultimate income" to non-charitable purposes.

254. In *FCT v Word Investments Ltd* [2007] FCAFC 171 the full Federal Court of Australia considered the charitable status of a company that carried out investment activities and operated a funeral business where its profits were applied to another charitable entity. The court considered the trading activities did not mean the company was not charitable in nature. Allsop J stated:

> 32. To the contrary of the Commissioner's proposition that the predominance of non-charitable activities by an entity can deny the possibility of its characterisation as a charitable institution, there is authority to the effect that a company that is incorporated for the object of charitable purposes that conducts activities of a so-call commercial (or relevantly non-inherently charitable kind) for the clear and exclusive purposes (as here) of raising funds to deploy in ways that are charitable is or can be characterised as a charitable institution.
>
> ...
>
> 48. Here, on the proper understanding of the memorandum of association, the purpose of all activities was, and could only be, the religious (and charitable) purposes of Word. ... **On the basis of the authorities to which I have referred, the commercial nature of the activities did**

not necessarily destroy the capacity of Word to be characterised as a charitable institution.

[Emphasis added]

255. The authorities Allsop J referred to included *CIR v Carey's (Petone and Miramar) Ltd* and *Vancouver Society of Immigrant and Visible Minority Women*. This focus by the courts on the way in which the net surplus is applied to charitable purposes seems to involve characterising the non-charitable activities as either "incidental" (and thus ignored as a purpose of the application of the funds) or charitable in themselves. The latter would be consistent with the view of Iacobucci J in *Vancouver Society of Immigrant and Visible Minority Women*. That is, that activities (including trading activities) are "at best ambiguous" and that it is "really the purpose in furtherance of which an activity is carried out, and not the character of the activity itself, that determines whether or not it is of a charitable nature" (at 152 as shown at [227]).

256. In other cases, it has been recognised that the commercial activities may be the way the entity directly realises its charitable purposes. If so, it would seem that the trading activities themselves are seen as charitable in nature. See, for example, *Scottish Burial Reform and Cremation Society Ltd v Glasgow Corporation* [1967] SC (HL) 116, *Incorporated Council of Law Reporting (Qld) v FCT* [1971] HCA 44 and *Incorporated Council of Law Reporting for England and Wales v Attorney-General*. In these cases the activities carried out (cremation services and law reporting, respectively) were the means of carrying out the charitable purposes of the organisation.

257. Accordingly, as the authorities show, the mere operation of trading activities does not preclude the organisation conducting the activities from being considered charitable. The application of funds to non-charitable purposes in those examples is not seen as detracting from the organisation's overall charitable nature. This is because either the application of funds to the trading activity is an application for charitable purposes or the trading purposes are incidental to charitable purposes.

258. In light of these authorities, the Commissioner considers that a court faced with a similar situation in the context of s LD 3(2)(a) is likely to view the funds applied to trading activities as being applied to the same purposes as the net surplus from such activities are applied where trading activities are conducted as a means of raising funds. Alternatively, where the trading directly achieves a certain object or objects of the organisation, the funds applied immediately to trading activities are accepted as being applied to those objects.

Applying funds by donating them to another organisation

259. As mentioned at [227], funds cannot be applied directly to purposes and would usually be applied by being spent on activities that then serve certain purposes. Unless, that is, the funds were either accumulated for future spending or passed on to another organisation to fund the activities and purposes of the other organisation.

260. In the latter case, the question arises as to what purposes the donated funds would be considered as applied to where the donation is made by an organisation to which s LD 3(2)(a) applies.

261. In *FCT v Word Investments Ltd* [2006] FCA 1414 the Federal Court of Australia stated it was what the donor understood was to be the purposes advanced by the

donated funds that was relevant to whether funds had been applied to a charitable purpose. This case involved the application of the Australian income tax exemption available to charities. As part of the decision, Sundberg J considered the purposes to which funds had been applied by one organisation (Word) when it had passed money to another organisation (Wycliffe):

> 31 **This evidentiary submission invites consideration of the wrong question. It is not relevant whether Wycliffe and the other recipients of Word's funds used those funds for religious purposes;** that question is only relevant to the charitable purposes of those organisations. **In determining Word's purposes, the question is what Word understood was being done with its funds.** On this question, there was ample evidence. Three directors of Word gave evidence before the Tribunal. Two of them were also directors of Wycliffe. All three gave evidence of Wycliffe's activities and the reasons why Word supported those activities. All three were cross-examined by counsel for the Commissioner. Also in evidence was the fact that Wycliffe has itself been endorsed by the Commissioner as an exempt charity and that the directors of Word were aware of this. **Finally, in considering the evidence, the Tribunal was required to give Word the benefit of the presumption referred to by Higgins J in *Hardey v Tory* [1923] HCA 35; (1923) 32 CLR 592 at 595: "where a gift is made to a society having a distinctive charitable purpose, prima facie the gift is for that purpose."**
>
> 32. ... **Clearly, in this case there was evidence that Wycliffe and the other organisations used the money received from Word for charitable purposes.** More importantly, there was also evidence that Word intended and believed Wycliffe and the other organisations would use the money for charitable purposes. ...
>
> [Emphasis added]

262. Sundberg J suggests (at [31]), it may not be relevant what the recipient organisation (Wycliffe) did with the funds that it received from Word. He suggests what was more relevant was what Word understood was to be done with the funds. However, the two organisations had close associations, and Sundberg J notes (at [32]) that the funds passed from Word to Wycliffe were actually used for charitable purposes.

263. Sundberg J also relied on authority arising in a *cy-près* context. This is a reference to the situation where the original objective of a settlor or testator in making a charitable settlement or donation has become impossible, impractical or illegal to perform. If so, the court can amend the terms of the charitable trust as closely as possible to that as originally intended by the settlor or testator. This arose, for instance, in *Hardey v Tory* (1923) 32 CLR 592 where Higgins J stated (at 595):

> **... where a gift is made to a society having a distinctive charitable purpose, prima facie the gift is for that purpose.** ... The gift to the Wesleyan Missionary Society is prima facie to the objects of that Society, and there is nothing in the will to contradict or qualify that prima facie meaning.
>
> [Emphasis added]

264. For other examples of this approach from the courts in a testamentary gift context see: *Smith v West Australian Trustee Executor & Agency Co Ltd* (1950) 81 CLR 320 (HCA) (at 322) and *Stratton v Simpson* (1970) 125 CLR 138 (HCA) (at 142).

265. *Helen Slater Charitable Trust* (CA) similarly suggests the use of donated funds by the recipient may not be relevant to determining if the donee organisation has

made charitable use of its funds where it has passed its funds on to another organisation. In *Helen Slater Charitable Trust* (CA), Oliver LJ stated (at 56):

> **The Crown's proposition is a startling one; it involves this, that the trustees of a grant-making charity,** although they may discharge themselves as a matter of law by making a grant to another properly constituted charity, **are obliged if they wish to claim exemption under the subsections to inquire into the application of the funds given and to demonstrate to the revenue how those funds have been dealt with** by other trustees over whom they have no control and for whose actions they are not answerable. Anything more inconvenient would be difficult to imagine, and **I find myself quite unable to accept that the legislature, in enacting these sections, can possibly have intended such a result. For my part, I entertain no doubt whatever that, as a general proposition, funds which are donated by a charity "A", pursuant to its trust deed or constitution, to charity "B" are funds which are "applied" by charity "A" for charitable purposes.**
>
> [Emphasis added]

266. Accordingly, there is authority in such cases as *Word* and *Helen Slater Charitable Trust* (CA) that, in deciding whether funds are applied to charitable purposes when they are passed from one organisation to another, it may not be necessary to trace what the recipient organisation did with the funds. However, in both cases there was a close relationship between the two organisations involved. Also, all that the court needed to establish in these cases was whether funds were applied to charitable purposes. The courts did not need to decide *where* those charitable purposes were being advanced geographically, as is the nature of the enquiry in s LD 3(2)(a).

267. In the situation where the recipient organisation is clearly charitable, case authorities suggest that reliance can be placed on the proposition that a donation to a charitable organisation is, on the face of it, a donation to the distinct charitable purposes of that organisation (see *Hardey v Tory, Smith v West Australian Trustee Executor & Agency Co* and *Stratton v Simpson*).

268. In some instances, the distinctive objects of the other organisation will indicate that the donated funds have been applied wholly to specified purposes within New Zealand and can be counted as such. For example, a donation to a public institution or fund that has donee status under ss 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. Sometimes, the other organisation will have objects such that it is obvious any donations received by it are applied to specified purposes within New Zealand.

269. In other cases, such as an overseas donee organisation listed in sch 32 of the Act, 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. Those funds need to be counted as not applied to specified purposes within New Zealand.

270. In all cases where a donee organisation has applied funds by donating them to another organisation, the donee organisation may need to establish it has applied funds to specified purposes within New Zealand and, depending on the circumstances, to what extent to ensure it meets the safe harbour.

Conclusions on when funds are applied to specified purposes within New Zealand

271. "Purposes" in relation to s LD 3(2)(a) means the reason or reasons funds were applied and these reasons must be to serve specified purposes within New Zealand.

272. Unless accumulated or donated to another organisation, funds would usually be applied by being spent on the provision of goods or services in the course of carrying on some activity. The character of an activity is, however, ambiguous and is determined by the reason for which the activity is carried out as assessed objectively from the activity's results.

273. The heart of the enquiry under s LD 3(2)(a) over the application of funds is to identify objectively if a sufficient relationship (a connection or nexus) exists between the purposes served by the activity (or, the future activity) and specified purposes within New Zealand. This is similar to the approach taken in respect of the principles of deductibility under the general permission of s DA 1. The connection needs to be sufficiently direct, although this is not necessarily an immediate connection.

274. In assessing the connection, the following must be considered:

- A distinction can be made between purposes and results. Some results arise incidentally or consequentially to the achievement of other results directly relatable to the objects of the organisation as set out in its founding documents. If so, they can be ignored for the exercise of determining whether the results of activities arising from an application of funds bear a sufficient relationship to specified purposes within New Zealand.
- Results not naturally arising as an incident or consequence to other results pursued as an additional result or end in their own right may indicate the presence of another independent and additional purpose of the application of funds. If so, the expenditure concerned may need to be apportioned to different purposes. Apportionment is required if the purposes differ as to whether they are specified purposes within New Zealand or other purposes.
- Each application of funds will need to be assessed objectively on its own merits as to whether some results are incidental or consequential to other results or whether there was more than one purpose.

275. Where an application of funds serves both specified purposes within New Zealand and other purposes there may be a need to apportion the funds to these different purposes. Apportionment issues in this context can be approached on a similar basis to apportionment arising under s DA 1.

276. The view taken of the purpose or purposes served by an application of funds may need to have regard to whether it is the immediate or less immediate purposes served that are determinative.

277. Where trading activities are conducted as a means of raising funds, the Commissioner considers funds applied to such activities as being applied to the same purposes as those to which the net surplus are applied.

278. In other cases, where the trading directly achieves certain objects of the organisation, then those objects will dictate what the funds applied to the trading activity are applied to.

279. In all cases where a donee organisation has applied funds by donating them to another organisation, the donee organisation may need to establish it has applied funds to specified purposes within New Zealand, and, depending on the circumstances to what extent, to ensure it meets the safe harbour.

280. The examples appearing below will help an organisation decide how much of its total funds are accumulated or spent for specified purposes within New Zealand.

Examples – how to determine when 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 (eg, 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.[5] This means the electricity bill is apportioned to specified purposes within New Zealand to the extent of $240 ($8,000 / $10,000 x $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.

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[5] This apportionment approach is described in more detail following these examples under the heading "apportionment of 'overheads'" in the explanation of the safe harbour calculation (at [299]).

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.

The administrative safe harbour

Introduction

281. As mentioned at [144], the Commissioner will, to provide greater certainty, administer the requirement that donee organisations under s LD 3(2)(a) must "wholly or mainly" apply their funds to specified purposes within New Zealand by adopting a "75% or more administrative safe harbour". The following portion of this statement details how the safe harbour percentage is calculated and applied.

282. Broadly, the administrative safe harbour approach will give organisations certainty that the Commissioner will generally accept without further enquiry they have donee organisation status under s LD 3(2)(a) because they are sufficiently oriented towards achieving specified purposes within New Zealand. The "wholly or mainly" requirement of the legislation is considered a "whole-of-life" test, but the administrative safe harbour approach can be made part of an organisation's annual financial reporting cycle. The safe harbour calculation below adopts the financial information prepared by organisations as part of their annual financial reporting as a starting point for the calculation.

283. If an organisation falls below the safe harbour minimum of 75% in an exceptional year, they can recalculate their safe harbour percentage by aggregating amounts for the current and previous two years (including periods before the application date of this statement).

284. The calculation method takes into account money spent (on capital and revenue items) and money on hand that has been accumulated in investments or set aside during the year in cash or short-term deposits. It requires identifying amounts that may have been spent or accumulated *entirely* for charitable, benevolent, philanthropic, or cultural purposes within New Zealand or entirely for other purposes. Other amounts may have been spent or accumulated *partly* for charitable, benevolent, philanthropic, or cultural purposes within New Zealand and partly for other purposes. For example, office overhead costs and general operating funds on hand at year-end may have been spent or set aside for a combination of these purposes. Funds may also have been accumulated in investments for a combination of purposes. If so, these funds need to be apportioned on a reasonable basis as described from [245].

The safe harbour calculation

Using the organisation's financial statements or performance report

285. For a registered charity, the starting point for the safe harbour calculation will be its:

- Statement of cash flows or
- Statement of receipts and payments.

286. These reports should be prepared as a matter of course in the organisation's financial statements or performance report required annually by Charities Services. Organisations that are not registered charities could use the equivalent reports from their financial reports.

287. The financial statements or performance report for the organisation should be used rather than any consolidated accounts that include financial information for other entities. This is because s LD 3(2)(a) refers to "a society, institution, association, organisation, or trust" and not to a consolidated group that may include an entity of that type.

288. Financial reporting for registered charities fall into different "tiers" numbered from 1 to 4. A charity's tier generally depends on the amount of its annual expenses or operating payments. Tier 1 to 3 charities will prepare a statement of cash flows as part of their financial statements. Organisations reporting under tier 4 prepare their performance report on a cash basis and have a statement of receipts and payments rather than a statement of cash flows. The statement of receipts and payments is equivalent in most respects to the statement of cash flows for tier 1 to 3 organisations, and can be used as the starting point to determine how an organisation's funds have been applied.

The steps in the calculation

<u>Step one – determine the organisation's "total funds" for the year</u>

289. The first step in the calculation is to find the organisation's "total funds" for the year. As mentioned at [153], the term "funds" might be likened to the accounting concepts of "cash" and "cash equivalents" (ie, cash on hand and demand deposits plus short-term deposits and other amounts held for the purpose of meeting cash commitments, rather than for investment). For the purposes of the safe harbour calculation, all "cash and "cash equivalents" are accepted as a proxy for "funds".

290. An organisation's total funds for a year is the amount of cash and cash equivalents the organisation had on hand at the beginning of the year plus all cash received in the year from all sources (ie, capital and revenue receipts).

291. Total funds will also equate to all the cash that an organisation has spent or invested in the year (ie, all cash outflows) and the cash and cash equivalents it has remaining on hand at the end of the year.[6] Given the focus on applying funds by way of accumulating or spending it, this view of "total funds" provides a more convenient starting point for the safe harbour calculation.

292. Regardless of how viewed, the "total funds" figure is intended to capture the total amount of cash and cash equivalents (ie, "funds") that was available to the organisation in the year for it to apply in some way, either by spending or by accumulating it for future spending.

Step two – determine the portion of total funds applied in the year to specified purposes within New Zealand

293. The second step is for the organisation to find the portion of the total funds that have been applied in the year to specified purposes within New Zealand. This step involves looking at all the cash spent or invested in the year and the cash (and cash equivalents) on hand at the end of the year (ie, amounts on hand excluding investments) and deciding whether it was applied:

(a) entirely for charitable, benevolent, philanthropic, or cultural purposes within New Zealand;

(b) entirely for purposes other than charitable, benevolent, philanthropic, or cultural purposes within New Zealand; or

(c) for a combination of charitable, benevolent, philanthropic, or cultural purposes within New Zealand and other purposes.

294. Some reasonable apportionment must be made between the different purposes advanced by the relevant application of funds for the amounts in (c) above (see the discussion of apportionment from [245]). The total of the amounts in (c) apportioned to charitable, benevolent, philanthropic, or cultural purposes within New Zealand plus the total of the amounts in (a) gives the total amount of funds the organisation has applied to charitable, benevolent, philanthropic, or cultural purposes within New Zealand for the year.

Step three – calculate the safe harbour percentage

295. The third step in the safe harbour calculation is to work out the "safe harbour percentage" by dividing the total amount of funds applied to charitable, benevolent, philanthropic, or cultural purposes within New Zealand (per step two) by the organisation's "total funds" (per step one). This figure, expressed as a percentage, is the organisation's safe harbour percentage for the year. The Commissioner would expect that this figure is usually 75% or greater (but see

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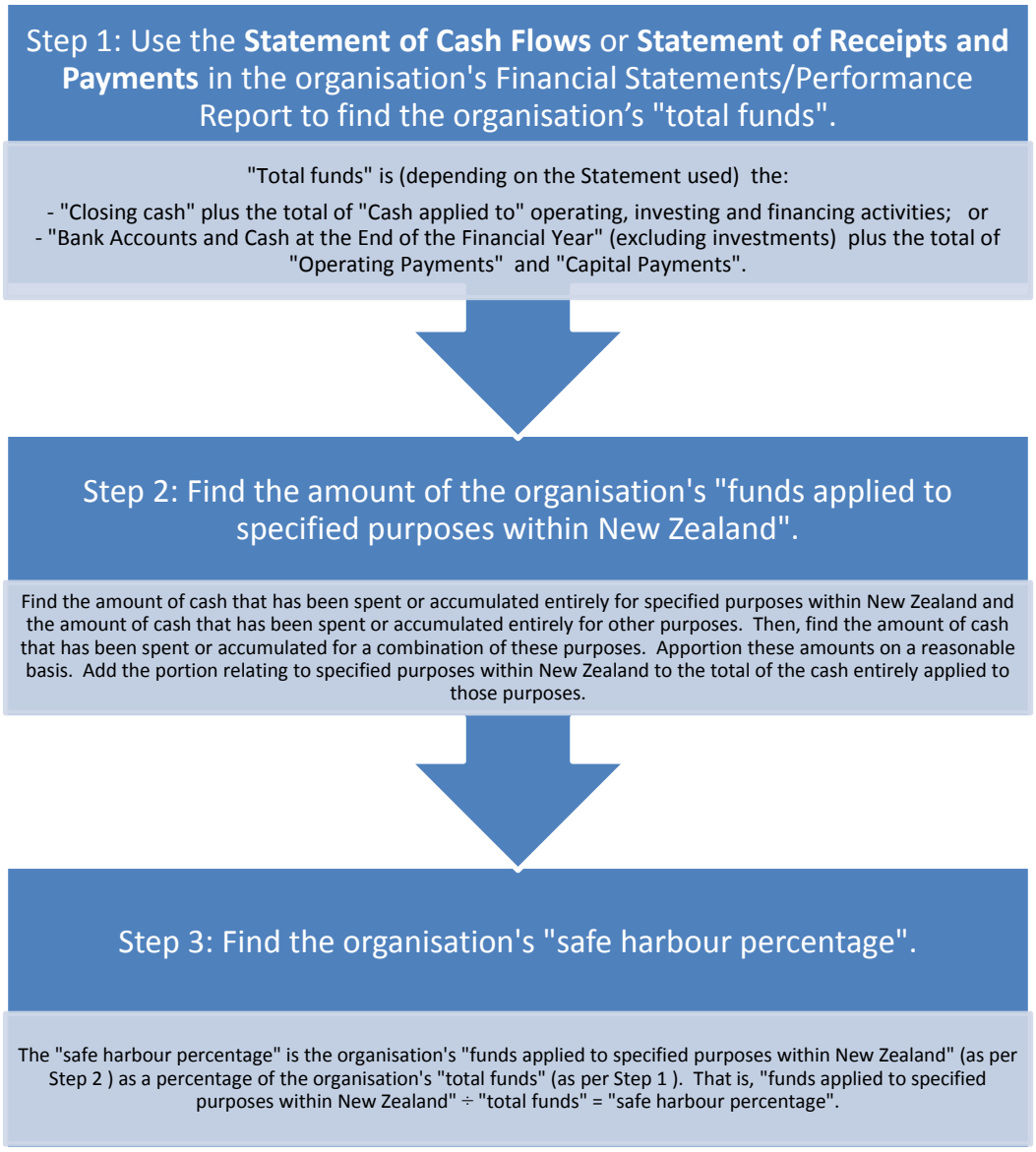
6 Cash and cash equivalents on hand will not include investments made in prior years. Investments made in the current year are treated as an application of funds at the time the investment is acquired (see [297] and [298]).

further from [309] concerning organisations not meeting this requirement in an exceptional year).

296. The flow chart in Figure 1 describes how an organisation should go about using its Financial Statements or Performance Report to find its percentage of funds applied to charitable, benevolent, philanthropic, or cultural purposes within New Zealand using the steps in the calculation mentioned above:

Figure 1: The three steps of the safe harbour calculation[7]



[7] Step 1 assumes that the statement of cash flows has been prepared using the direct method.

Additional comments about finding the amount an organisation has applied to specified purposes within New Zealand

Investing and setting aside funds

297. 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 until and in the year they are spent. However, funds invested will be considered only in the year they are invested and again when spent.

298. 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.

Apportionment of "overheads"

299. Step 2 in the safe harbour calculation (in Figure 1) requires finding the amount of cash an organisation has spent or accumulated (ie, set aside or invested) for specified purposes within New Zealand. This includes apportioning amounts where they have been spent or accumulated for both specified purposes within New Zealand and other purposes.

300. As mentioned in the earlier discussion on apportionment, 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 commonly arise for "overhead" type costs (eg, sundry office expenses). It may also arise for investments where funds have been accumulated for the general purposes of the organisation (see [284]). It may also be true of 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 of the funds (cash and cash equivalents) an organisation set aside at year-end.

301. In such cases, some basis of apportionment is still required. The Commissioner 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.

302. 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)).

303. 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, the Commissioner 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 (ie, 80% to specified purposes within New Zealand).

304. In that case, the $800 of remaining funds is apportioned to specified purposes within New Zealand to the extent of $640 (800 x 0.80). 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).

305. Including these remaining funds in the calculation does not affect the safe harbour percentage already determined from the analysis of the other funds spent or accumulated because the $800 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.

Funds not accumulated for a purpose

306. 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 either 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 – see discussion from [172]).

307. 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.

308. 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 occurring in any year is that it will tend to reduce the percentage of funds applied to New Zealand specified purposes for that year.

Organisations not meeting the 75% figure

309. The 75% figure is an administrative safe harbour rather than a figure set out in the legislation. However, the Commissioner is satisfied that meeting this percentage is indicative of an organisation meeting the "wholly or mainly" requirement in s LD 3(2)(a).

310. Broadly, the requirement that organisations apply their funds wholly or mainly to specified purposes within New Zealand means that to qualify for donee organisation status under the legislation an organisation needs to be oriented towards advancing specified purposes within New Zealand over its lifetime. The Commissioner accepts that in an exceptional year an organisation could find that its safe harbour percentage is less than 75%. This is where the rolling three-year cumulative approach described below may assist the organisation.

311. However, in the Commissioner's view, an exceptional year would not include the situation where the safe harbour percentage fell below a bare majority (ie, 50% or less). This is because, on any view of the meaning of the words "wholly or mainly", at least a bare majority must be applied to specified purposes within New Zealand on a consistent and continuous basis.

312. Where organisations are not within the administrative safe harbour in an exceptional year they may consider the organisation's safe harbour percentage derived by aggregating amounts for the current year and the two previous years (including years before the commencement of this statement). If that percentage is 75% or more, the Commissioner will generally accept that the organisation is within the administrative safe harbour.

313. This approach is intended to provide organisations with some flexibility in the event that their percentage of funds applied to specified purposes within New Zealand falls below 75% in an exceptional year. However, as mentioned, the Commissioner would expect an organisation to apply more than a bare majority of its funds to specified purposes within New Zealand every year.

314. For new organisations, the approach above means the organisation's safe harbour percentage should be at least to the extent of 75% in the first year of its operation.

315. The table below shows an example of how the organisation should approach this calculation:

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%	**60%**
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%	**80%**

316. If the rolling three-year cumulative safe harbour percentage of funds applied to specified purposes within New Zealand in a year is below the 75% administrative safe harbour or the figure in any year is 50% or below, then the organisation should contact Inland Revenue as soon as possible.

317. 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 s 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. Organisations can discuss their situation with Inland Revenue.

318. The following example is included to illustrate the approach to the safe harbour percentage calculation.

Worked example of the safe harbour calculation

319. 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.

320. 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.

321. 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.

322. 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.

323. 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.

324. 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.

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

326. 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

EduParcel Statement of Receipts and Payments "How was it funded?" and "What did it cost?" For the year ended: 31 March 2020	Notes	Actual This Year $	Actual Last Year $
Operating Receipts			
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		-	
Total Operating Receipts		**22,020**	-
Operating Payments			
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		-	
Total Operating Payments		**10,500**	-
Operating Surplus or (Deficit)		**11,520**	
Capital receipts			
Receipts from sale of resources			
Receipts from borrowings		2,000	
Capital payments			
Purchase of resources	3	800	
Repayment of borrowings		2,000	
Increase /(Decrease) in Bank Account and Cash		**10,720**	-
Bank accounts and cash at beginning of the financial year		-	
Bank accounts and Cash at the End of the Financial Year		**10,720**	-
Represented by:			
Cheque account(s)		300	
Savings accounts(s)		420	
Term Deposit account(s)		10,000	
Cash Floats		-	
Petty Cash		-	
Total Bank Accounts and Cash at the End of the Financial Year		**10,720**	-

327. 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).

328. 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.

329. "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).

330. 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.

331. 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 March2020

EduParcel Notes to the Performance Report For the year ended: 31 March 2020			
Note 3: Analysis of Payments "What did it cost?"			
		This Year	Last Year
Payment item	**Analysis**	$	$
Payments relating to public fundraising		-	
	Total	-	-
Payment item	**Analysis**		
Volunteer and employee-related payments		-	
	Total	**-**	-
Payment item	**Analysis**		
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	
	Total	**9,300**	-
Payment item	**Analysis**		
Grants and donations paid	NZ scholarship grant	1,150	
	Overseas food parcel programme	50	
	Total	**1,200**	-
Payment item	**Analysis**		
Other operating payments		-	
	Total	**-**	-
Payment item	**Analysis**		
Capital payments	Property, plant and equipment	800	
	Repayment of borrowings	2,000	
	Total	**2,800**	**-**

332. 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.

333. 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.

334. 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.

335. 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.

336. 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.

337. 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.

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

Table 4: Example – EduParcel safe harbour calculation

EduParcel – Safe harbour calculation			
Item	**Specified purposes within NZ $**	**Other purposes $**	**Total $**
Funds applied entirely for a purpose:			
NZ scholarship grant	1,150		1,150
Overseas food parcel programme		50	50
Storage unit rent		300	300
Funds applied for both purposes – apportioned on some reasonable basis			
Contents insurance	400	100	500
Total	**1,550**	**450**	**2,000**
Percentage of funds applied	78%	22%	100%
Funds applied for a combination of purposes apportioned on above percentage:			
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
Total	**17,176**	**4,844**	**22,020**
Funds applied to no purpose	**-**	**-**	**-**
Total funds applied	**$18,726**	**$5,294**	**$24,020**

339. 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.

340. 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%).

341. 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 from [245]). 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.

342. 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)

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

Inland Revenue
Te Tari Taake

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Subject references

Applied
Donee organisation
Funds
New Zealand
Wholly or mainly

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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

Who this section applied to [Repealed]

(1) *[repealed]*

Deduction

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

Amount of deduction

(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.

Link with subpart DA

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

2. Section DV 12(1)(b) provides a tax deduction for gifts made by a Māori authority:

DV 12 Maori authorities: donations

Deductions

(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—

$$\text{total gifts} \times 33^{1}/_{3}\%.$$

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) (the **entity**):

(b) includes a subscription of $5 or more paid to an entity only if the subscription does not confer any rights arising from membership in that entity 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) and (b):

(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 at a time the entity is eligible 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:

(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 provides the following definitions:

YA 1 Definitions

In this Act, unless the context requires otherwise,—

...

continental shelf is defined in the Continental Shelf Act 1964

...

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)

...

New Zealand includes—

(a) the continental shelf:

(b) the water and the air space above any part of the continental shelf that is beyond New Zealand's territorial sea, as defined in section 3 of the Territorial Sea, Contiguous Zone, and Exclusive Economic Zone Act 1977, if and to the extent to which—

(i) any exploration or exploitation in relation to the part, or any natural resource of the part, is or may be undertaken; and

(ii) the exploration or exploitation, or any related matter, involves, or would involve any activity on, in, or in relation to the water or air space

...

Interpretation Act 1999

7. Section 4(1) provides:

4 Application

(1) This Act applies to an enactment that is part of the law of New Zealand and that is passed either before or after the commencement of this Act unless—

(a) the enactment provides otherwise; or

(b) the context of the enactment requires a different interpretation.

8. Section 5(1) provides:

5 Ascertaining meaning of legislation

(1) The meaning of an enactment must be ascertained from its text and in the light of its purpose.

...

9. Section 29 defines "New Zealand" as:

> **New Zealand** or similar words referring to New Zealand, when used as a territorial description, mean the islands and territories within the Realm of New Zealand; but do not include the self-governing State of the Cook Islands, the self-governing State of Niue, Tokelau, or the Ross Dependency