Inland Revenue
Te Tari Taake

CHARITABLE ORGANISATIONS AND FRINGE BENEFIT TAX (FBT)

PUBLIC RULING - BR Pub 00/08

Note (not part of ruling): This ruling is essentially the same as public ruling BR Pub 97/6, published in *Tax Information Bulletin* Vol 9, No 5 (May 1997), but its period of application is from 1 July 1999 to 30 June 2004. For clarification purposes, some minor changes have also been made. BR Pub 97/6 applied to FBT periods commencing after 30 June 1997 and ending before 1 July 1999.

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Law

All legislative references are to the Income Tax Act 1994, unless otherwise stated.

This Ruling applies in respect of paragraph (m) of section CI 1 of the Act.

The Arrangement to which this Ruling applies

The Arrangement is the provision of a non-monetary benefit by a charitable organisation to an employee of that organisation.

In this Ruling, the term "charitable organisation" has the meaning that it has in the Act for the purposes of the FBT rules. That is, in relation to any quarter or (where FBT is payable on an income year basis under section ND 4) any income year, any society, institution, association, organisation, trust, or fund (not being a local authority, a public authority, or a university) to which, in the quarter or income year, section KC 5(1) applies.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- For the purposes of the proviso to section CI 1(m), a non-monetary benefit which is provided to an employee of a charitable organisation *is not* received by that employee in relation to the carrying on of a business by the charitable organisation if the employee receives the benefit in the course of an activity of the charitable organisation which involves carrying out any of the organisation's charitable, benevolent, philanthropic or cultural purposes, even if income is received by the organisation in the course of carrying out that activity.

- For the purposes of the proviso to section CI 1(m), a non-monetary benefit which is provided to an employee of a charitable organisation *is* received by that employee in relation to the carrying on of a business by the charitable organisation if the employee receives the benefit in the course of an activity which both:

- cannot be characterised as carrying out any of the organisation's charitable, benevolent, philanthropic or cultural purposes; and

- constitutes a profession, a trade, a manufacture, or an undertaking which is carried on for pecuniary profit (even if that profit is to be applied solely for the purposes of the charitable organisation).

The period for which this Ruling applies

This Ruling will apply for the period from 1 July 1999 to 30 June 2004.

This Ruling is signed by me on the 14th day of August 2000.

Martin Smith
General Manager (Adjudication & Rulings)

Inland Revenue
Te Tari Taake

COMMENTARY ON PUBLIC RULING BR Pub 00/08

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR 00/08 ("the Ruling").

Background

The charitable organisation exemption from fringe benefit tax does not apply to any benefit that is provided by a charitable organisation to an employee in the course of the employee's employment in a business activity of the charitable organisation.

The issue is whether the FBT exemption applies to benefits provided by charitable organisations that carry on their charitable objects in a business-like manner, and which have a record and expectation of making surpluses of income over expenditure.

Legislation

Section CI 1 defines the term "fringe benefit" for the purposes of the FBT rules. The relevant parts of that section, for the purposes of the Ruling, state:

In the FBT rules, "fringe benefit", in relation to an employee and to any quarter or (where fringe benefit tax is payable on an income year basis under section ND 4) income year, means any benefit that consists of -

(a) The private use or enjoyment, in relation to the employee ... of a motor vehicle ...
(b) The availability for the private use or enjoyment of the employee ... of a motor vehicle ...
(c) Any loan that is owing, by the employee,...
(d) Any subsidised transport:
(e) ... any contribution to any sick, accident, or death benefit fund ...
(f) ... any specified insurance premium or any contribution to any insurance fund of a friendly society:
(g) Any contribution in relation to an employer of an employee, to any superannuation scheme:
(h) Any benefit of any other kind whatever,...

being, as the case may be, private use or enjoyment, availability for private use or enjoyment, a loan, subsidised transport, a contribution to a fund referred to in paragraph (e), a specified insurance premium or a contribution to an insurance fund of a friendly society, a contribution to a superannuation scheme, or a benefit that is used, enjoyed, or received, whether directly or indirectly, in relation to, in the course of, or by virtue of the employment of the employee (whether that employment will occur, is occurring, or has occurred) and which is provided or granted by the employer of the employee; but does not include -

...

(m) Any benefit that, in any quarter or (where fringe benefit tax is payable on an income year basis under section ND 4) any income year, is provided or granted by or on behalf of an employer, being a charitable organisation, to an employee of the employer:

Provided that this paragraph shall not apply to any such benefit to the extent that the benefit is used, enjoyed, or received, whether directly or indirectly, primarily and principally in relation to, in the course of, or by virtue of, any employment, in relation to the employee, that consists of any activity or activities performed by the employee in the carrying on, by the employer, of a business: [Emphasis added]

"Business" is defined in section OB 1 as including any profession, trade, manufacture, or undertaking carried on for pecuniary profit.

"Charitable organisation" is defined for the purposes of the FBT rules as:

... any society, institution, association, organisation, trust, or fund (not being a local authority, a public authority, or a university) to which ... section KC 5(1) applies.

Section KC 5(1) applies to certain named institutions (paragraphs (ae) to (bv)), and, more generally, to:

(aa) A society, institution, association, organisation, or trust which is not carried on for the private pecuniary profit of any individual and the funds of which are, in the opinion of the Commissioner, applied wholly or principally to any charitable, benevolent, philanthropic, or cultural purposes within New Zealand:

(ab) A public institution maintained exclusively for any one or more of the purposes within New Zealand specified in paragraph (aa):

(ac) A fund established and maintained exclusively for the purpose of providing money for any one or more of the purposes within New Zealand specified in paragraph (aa), by a society, institution, association, organisation, or trust which is not carried on for the private pecuniary profit of any individual:

(ad) A public fund established and maintained exclusively for the purpose of providing money for any one or more of the purposes within New Zealand specified in paragraph (aa):

"Charitable purpose" is defined in section OB 1 as including:

... every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community:

The Act does not define "benevolent, philanthropic, or cultural purposes".

Application of the legislation

The charitable organisation exemption from FBT contained in paragraph (m) of section CI 1 only applies to the extent that the employee does not receive the benefit in the course of the organisation carrying on a business. The Ruling addresses the issue of when a charitable organisation will and will not be carrying on a business for the purposes of the charitable organisation exemption from FBT.

"Business" is defined in section OB 1 as including "any profession, trade, manufacture, or undertaking **carried on for pecuniary profit**". [Emphasis added]

The Court of Appeal in *Grieve v CIR* (1984) 6 NZTC 61,682 considered that underlying the Act's definition of "business", and the use of the word in the context of a taxation statute, is the fundamental notion of the exercise of an activity in an organised and coherent way that is directed to an end result - the making of pecuniary profits. The Court said that the existence of a business activity is determined on the basis of the nature of the activity and whether the taxpayer has the intention of

making a pecuniary profit in carrying out that activity. The Court stated, at page 61,691:

> Statements by the taxpayer as to his intentions are of course relevant but actions will often speak louder than words. Amongst the matters which may properly be considered in that inquiry are the nature of the activity, the period over which it is engaged in, the scale of operations and the volume of transactions, the commitment of time, money and effort, the pattern of activity, and the financial results.

Many charitable organisations engage in activities on a continuous and ongoing basis, commit time, money and effort to those activities and conduct a large volume of transactions, and so will have these characteristics of a business.

The issue is therefore whether a charitable organisation that budgets for, and has a record of making surpluses of income over expenditure has the intention of making a profit. If it is carried on for profit, it will be a "business" for the purposes of the Income Tax Act.

English cases have held that the fact that a charity makes a profit does not mean that it is carried on "for profit". In *Trustees of the National Deposit Friendly Society v Skegness UDC* [1958] 2 All ER 601, the House of Lords found that a charity's objects are to advance the charitable purposes for which it is established. If profit-making is not one of their purposes but is only a means of achieving those purposes, the charity is not carried on "for profit". In *Customs and Excise Commissioners v Bell Concord Educational Trust Ltd* [1989] 2 All ER 217, the Court held that the question of whether or not an organisation is carried on "for profit" must be answered by reference to the objects for which that organisation is established, as contained in its constitution, and not by reference to the budgeting policy of that organisation.

Thus, a charitable organisation that carries on its activities in a business-like manner and which has the intention and record of making surpluses is not carried on "for profit", unless the organisation's constitution states that one of its purposes is to make a profit. As such organisations are not carried on "for pecuniary profit", they are not carrying on a "business" for the purposes of the Income Tax Act and the FBT exemption.

The Commissioner considers that Parliament did not intend the word "business" in the proviso to paragraph (m) of section CI 1 to include any charitable organisation which operates in a business-like manner and which intends to make surpluses. Such an interpretation would mean that most successful charitable organisations, in carrying on their charitable, benevolent, philanthropic, or cultural purposes, would be carrying on businesses for the purposes of the Income Tax Act and so would be subject to FBT in respect of benefits they provide to their employees. The proviso to the exemption contained in paragraph (m) would apply to most charitable organisations, making them subject to FBT, and the exemption from FBT contained in paragraph (m) would generally not apply. Only those charitable organisations that could show that they did not operate in a business-like manner or did not intend to make surpluses, either in the short or long term, would not be carrying on a business and would be exempt from FBT. The Commissioner considers that this wide

interpretation of the word "business" in the proviso to paragraph (m) of section CI 1 is not correct.

Instead, the Commissioner considers that the proviso to paragraph (m) of section CI 1 only applies to business activities which are carried on by charitable organisations but which are not, themselves, charitable, benevolent, philanthropic, or cultural activities. Such business activities may be conducted to assist the achievement of charitable purposes, and the income produced by them may be applied to the charitable purpose. However, the business activities that the proviso applies to are not the intrinsically charitable, benevolent, philanthropic, or cultural activities of the organisation.

A distinction between the charitable (i.e. running and administering a charity, and providing charitable services) and the non-charitable purposes of a charity was drawn in *Oxfam v City of Birmingham District Council* [1975] 2 All ER 289.

That case concerned section 40 of the United Kingdom General Rate Act 1967 that applied to premises or hereditaments that were occupied by a charity and **wholly or mainly used for charitable purposes**. The House of Lords considered whether Oxfam's gift shops were on premises wholly or mainly used for charitable purposes. The House of Lords found that, although the gift shops were used for purposes that indirectly related to the achievement of the objects of the charity (i.e. selling donated goods to raise money for the charity), the premises were not wholly or mainly used for charitable purposes.

In reaching this conclusion, the House of Lords drew a line between the use of premises for purposes which are the charitable purposes of the charity, and the use of premises for purposes which, though purposes of the charity, are not charitable purposes. Lord Cross said (at page 293):

> The wording of s 40(1) of the 1967 Act shows that the Legislature did not consider that the mere fact that a hereditament in question is occupied by a charity justifies any relief from rates. That is only justified if the hereditament is being used for the 'charitable purposes' of the charity. So the first question which arises is: what are the 'charitable purposes' of a charity as distinct from its other purposes? The answer must be, I think, those purposes or objects the pursuit of which make it a charity - that is to say in this case the relief of poverty, suffering and distress.

Oxfam identifies the fact that a charitable organisation can carry out both charitable and non-charitable activities. However, not all of the "non-charitable" activities carried on by a charitable organisation will constitute business activities. Only benefits provided to employees of a charitable organisation in relation to the carrying on of a business by or on behalf of the organisation will be subject to FBT.

The distinction between an organisation carrying out the functions for which the organisation was established and an organisation carrying on a business was examined in *Port Chalmers Waterfront Workers Union v CIR; New Zealand Waterfront Workers Union v CIR* (1995) 17 NZTC 12,059 (High Court); *CIR v Port Chalmers Waterfront Workers Union* (1996) 17 NZTC 12,523 (Court of Appeal). That case concerned section 61(23) of the Income Tax Act 1976. Section 61(23) (section CB 4(1)(a) of the Income Tax Act 1994) provides an exemption from income

tax for the income of a friendly society, except so far as that income is derived from **business** carried on beyond the circle of its membership.

In *Port Chalmers,* the High Court drew a distinction between a friendly society carrying on a business as a trading organisation and a friendly society discharging its functions as a friendly society. It said that where the friendly society is discharging its functions as a friendly society, it is not carrying on a business even though it may conduct transactions that have a commercial flavour. This distinction was accepted by the Court of Appeal.

The Ruling interprets paragraph (m) of section CI 1 as drawing a similar distinction as that drawn in *Port Chalmers* between the activities of a charitable organisation which discharge the purposes for which the organisation was established (i.e. the discharging of its charitable, benevolent, or philanthropic objects) and the charitable organisation carrying on a business as a trading organisation. A charitable organisation is not carrying on a business for the purposes of paragraph (m) when it discharges its charitable objects, even though it may discharge those purposes in a business-like manner.

The effect of the Ruling is that the activities involved in carrying out the charitable objects of a charitable organisation, or directly facilitating the carrying out of the charitable objects (such as fundraising or administrative or clerical activities) will not be treated as being business activities for the purposes of paragraph (m). However, trading activities carried on to raise funds for the charity, which are not themselves the charitable purposes of the charity, will be treated as business activities of the charitable organisation if they satisfy the "business" test set out in the Income Tax Act (i.e. if those activities are carried on for the purpose of making a pecuniary profit).

Thus, when a charitable organisation's employees are engaged in carrying out the charitable purposes of the organisation, any benefits provided to them are not provided in the course of employment in a business activity of the organisation. The benefits will therefore be exempt from FBT under paragraph (m) of section CI 1. However, when a charitable organisation's employees are engaged in activities of the organisation which are not in themselves charitable, **and** which constitute business activities of the organisation, any benefits provided to them will be provided in the course of employment in a business activity of the organisation. These benefits will not be exempt from FBT under paragraph (m).

An employee may be employed by a charitable organisation in a range of activities, some of which relate to the carrying out of the organisation's charitable purposes or other non-business activities of the organisation, and some of which are non-charitable business activities. Such an employee may receive benefits from the organisation in connection with both the business and non-business types of activities. Section CI 1(m) exempts benefits provided to employees of charitable organisations from FBT except **to the extent that** the benefit is received **principally or primarily** in relation to the employee's employment in a business carried on by the charitable organisation.

The phrase "to the extent that" does not, in this instance, mean that the benefit should be apportioned. In other contexts, it has been held that the words provide for the possibility of apportionment. However, in section CI 1(m) Parliament has also used the phrase "primarily and principally". This use of "primarily and principally" is inconsistent with the concept of apportionment: rather the phrase means that where the requirement is for the most part true for that element, the section is satisfied completely. There is no need for an apportionment and, consequently, in the context of section CI 1(m), the phrase "to the extent that" is to be interpreted as meaning "where".

Thus, a benefit provided to an employee who engages in both the business and non-business activities of a charitable organisation will only be subject to FBT if the employee receives that benefit principally and primarily in relation to the carrying out of the organisation's business activities. In other cases the benefit will remain exempt from FBT. As a guide, the Commissioner considers that an employee will receive a benefit principally and primarily in relation to his or her employment in a business activity of the organisation where the benefit arises primarily in connection with such a business activity, rather than in connection with a non-business activity, or where the benefit arises equally in connection with both the business and non-business activities carried out by the employee, but the employee is predominantly employed in the business activities of the employer.

Note that the Ruling does not apply to employers that are local authorities, public authorities, or universities. These organisations are excluded from the definition of "charitable organisation" for the purposes of the FBT rules, so the charitable organisation exemption contained in paragraph (m) of section CI 1 does not apply to them. Fringe benefits provided by these organisations will be subject to FBT unless some other exemption applies to them.

Examples

It will be a question of fact in each case whether the particular activities of a charitable organisation are activities that are not the inherently charitable activities which the organisation was established to carry out, and are also activities which constitute a business for the purposes of the Income Tax Act. The following activities are examples of activities likely to be characterised as not being business activities of the charitable organisation (and, hence, any benefits provided to employees of the organisation in connection with these activities will be exempt from FBT). Note that this is not intended to be an exhaustive list of such activities:

- Activities **directly** related to carrying out the objects of the charity, but which also have an income component. For example:

    - A school or polytechnic established to provide education that charges fees for the provision of the educational services.

  - An organisation established to provide assistance to a disabled or disadvantaged group that provides services to those people for payment (e.g. residential accommodation services in return for board).

  - An organisation established to provide relief and assistance to the poor that runs a secondhand shop in order to provide affordable goods to that group.

- Appeals for funds for the charity's purposes.

- Passive investment and management of the funds of the charity, as long as the charitable organisation does not carry on a business of fund investment.

- Administration of the above activities.

An activity that is carried on by the charitable organisation that does not involve the organisation carrying out its charitable objects, but which involves the sale of goods or services for valuable and adequate consideration on a similar basis to business enterprises carried out by private individuals, and with a view to making a profit, is likely to constitute the organisation carrying on a business. Any benefits provided to employees in connection with such an activity will be subject to FBT under the proviso to paragraph (m).

Example 1

A charitable trust has the principal purpose of providing education through a private school. The trust is a charitable organisation for the purposes of the FBT rules, as it is not carried on for the private pecuniary profit of any individual and its funds are applied wholly or principally for charitable purposes (the advancement of education) within New Zealand. The trust charges tuition fees and has had surpluses of income over expenditure for the last three income years. It provides a car to its school principal for work and private use.

The trust is not liable for FBT on the benefit arising from the private use or availability for private use of the car provided to the principal. This is because the benefit is provided by a charitable organisation to an employee who is employed in respect of the charitable organisation carrying out its charitable objects. The employee is not employed in a separate business activity carried on by the school.

Example 2

A company conducts a farming business on land adjacent to the school. All the shares in the company are held for the benefit of the school charitable trust referred to in Example 1, and the company's constitution provides that the assets and profits of the farming business must be applied exclusively to the promotion of the objects of the school charitable trust.

The company provides a car to its farm manager for his work and personal use. The company is liable for FBT on the benefit arising from the provision of the car to the

farm manager, because the farm manager receives the benefit in relation to his employment in a business (the farm) carried on by the company.

Example 3

The same facts exist as in Example 2, except in this case the farming operation is carried out by the company, in a business-like manner, for the purpose of the practical component of the school's agricultural courses. In this situation the farming operation relates to the carrying on of the educational charitable objects of the school, and the availability of the car for private use by the farm manager is not subject to FBT.

Example 4

A polytechnic charitable organisation offers a course on working in the hospitality industry. As part of that course the polytechnic operates a restaurant where the students gain experience in preparing food and waiting on tables. The restaurant is open to the public and patrons pay for their meals.

The polytechnic provides the hospitality course supervisor with a van for restaurant use. The van is also available for the supervisor's private use. The supervisor is employed in carrying out the polytechnic's charitable purpose of providing education to the students in the hospitality course. Because of this, the van is not provided in relation to the supervisor's employment in a business carried on by the polytechnic and its availability for private use is not a benefit that is subject to FBT.

Example 5

A polytechnic runs a cafeteria that is open to students and the general public. The cafeteria is not operated as part of any polytechnic course. The cafeteria is an activity of the polytechnic that cannot be characterised as carrying out the polytechnic's charitable purposes of providing education. Further, it is a commercial trading activity carried on with the intention of making a profit. The cafeteria is therefore a business run by the polytechnic.

The polytechnic employs a person to prepare food for the cafeteria. Once a week, this employee is also employed by the polytechnic to provide instruction in the hospitality course run by the polytechnic. The employee therefore is employed in both the business operations (the cafeteria) and the charitable activities (providing education in the hospitality course) of the polytechnic.

The polytechnic pays for the employee's membership to an off-campus fitness centre. This benefit arises because of the employee's employment with the polytechnic, and does not specifically arise in relation to either her employment in the cafeteria or her employment in the hospitality course. However, because the employee's employment in the cafeteria takes up 80% of her time, the benefit arises principally and primarily in relation to her employment in a business activity of the polytechnic. The benefit is

therefore not exempt from FBT under paragraph (m) of section CI 1 and will be subject to FBT.